



AN INDEPENDENT FIRM

# ECONOMIC UPDATE

*Individual Solutions  
From Independent Advisors*

October 2011

## NEWS AT EWS

Steffanie and her husband Mike will be welcoming their first child this fall with a due date in late November. She will be working in the office until mid-November and will then be on maternity leave until early next year. We are all very excited for the new arrival to the EWS family.

Chris, a new board member of the Boys and Girls Club of Gloucester County as of this past June, will be assisting in the organization of a 5k Fun Run/Walk to take place on Saturday, December 3<sup>rd</sup> at Rowan University. Currently there are clubhouses in Glassboro and Paulsboro, with a third planned for Woodbury. A website will be available shortly which will allow for donations to the club in Chris's name. The proceeds will benefit the growing chapter.

## ECONOMY AND INVESTMENT MARKETS

In terms of stock market performance, the 3<sup>rd</sup> quarter was the worst quarter we have experienced in the past three years and the worst 3<sup>rd</sup> quarter in over 80 years (Wall Street Journal). The S&P 500 Index, a broad measure of the US stock market, declined 7.0% in September and 13.9% for the quarter. Most of this quarterly decline actually occurred between July 22<sup>nd</sup> and August 10<sup>th</sup>, but after a brief rally from mid to late August, the market declined once again in September (as of October 10<sup>th</sup>, the market is actually above where it was on August 10<sup>th</sup>).

If there is something good to take from this general investment shellacking, it would be the noteworthy trend that the 4<sup>th</sup> quarter is generally better than the 3<sup>rd</sup> (which in turn has historically been the worst quarter) and that October has been termed the "Bear Killer" since, according to Barron's, eleven post-World War II bear markets have been reversed this month. Also, the market's best six months have historically been November through May, while the worst six have been June through October.



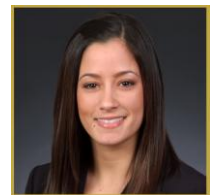
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In terms of the economy, there has been plenty of negativity – particularly outside of the US (more on this later) – but we do see signs that the US economy could be poised to strengthen.

First, there were several recent revisions to various economic data that suggest things are not as bad as initially reported, which is always an encouraging sign. For example, 2<sup>nd</sup> quarter growth was raised from the previously announced 1.0% to 1.3%. Not much of an improvement, but nevertheless, it was revised upwards. On Friday, October 7<sup>th</sup>, the hiring numbers for September were released, exceeding expectations with 103,000 new private sector jobs being created. Also, there were positive revisions made to the employment figures for both July and August (July was revised from 85,000 new jobs to 127,000 while August was revised from 0 to 57,000). The original August announcement of 0 jobs created, which was released in early September, seemed to create a significant drop in confidence. It received considerable negative media coverage as well, and between the day before the announcement and October 7<sup>th</sup>, the Dow Jones Industrial Average topped the September 1<sup>st</sup> close only one time.

At our economic dinner on October 4<sup>th</sup>, Raymond James chief investment strategist Jeffrey Saut felt that we would not experience a recession. He also stated – which he repeated on CNBC the morning of October 7<sup>th</sup> – that he felt the stock market had reached its 2011 low point on October 4<sup>th</sup> (a day that also saw the Dow Jones Industrial Average recover from a negative 250 points to a positive 150 in a matter of a few hours). His analysis indicates that stocks were as oversold in August of this year as they were in March of 2009 (the “bottom” of the 2008-2009 bear market). While this is not a guarantee or even a projection of the future, Mr. Saut is a well-respected market strategist who is widely followed in the financial field.

His positive outlook is based on a number of factors including the following:

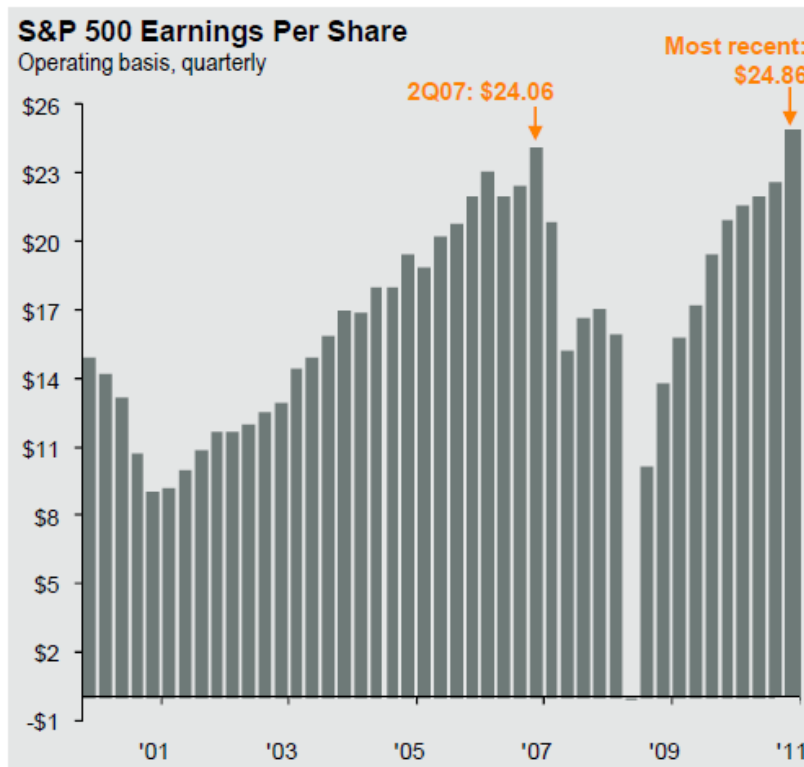
- ✧ the current cycle we are in is beating the average of prior “profit recoveries”
- ✧ taxes collected by the states are growing at the fastest rate in six years, indicating increases in consumer spending, consumer income, and business growth
- ✧ inventories are extremely low (similar to levels last seen in 2008), signifying that they will need to be rebuilt at some point in the near future which should increase manufacturing
- ✧ increases to several key “discretionary spending” indicators:
  - an announcement by the National Restaurant Association that sales were expected to create an annual record of over \$604 billion after three straight years of revenue declines
  - hotels reported double-digit increases in per-room revenue
- ✧ increased container shipping from the Port of Los Angeles, one of the world’s largest ports
- ✧ the leading manufacturing index, the ISM, was up in September over August for the second straight month after two months of declines (Philadelphia Inquirer)

✧ auto sales were up in September and remain strong for the year

With that being said, in the media there has been a growing prediction of a new US recession and we may – as uncertainty continues over a variety of issues – talk ourselves into one. Many economists still believe we will avoid a recession and that it would not be the end of the world if we have one, but from our conversations with clients and their accountants and attorneys, there is an “economic exhaustion” that seems pervasive. The crisis seems to be one more of confidence and perception than economics, though today they are closely linked.

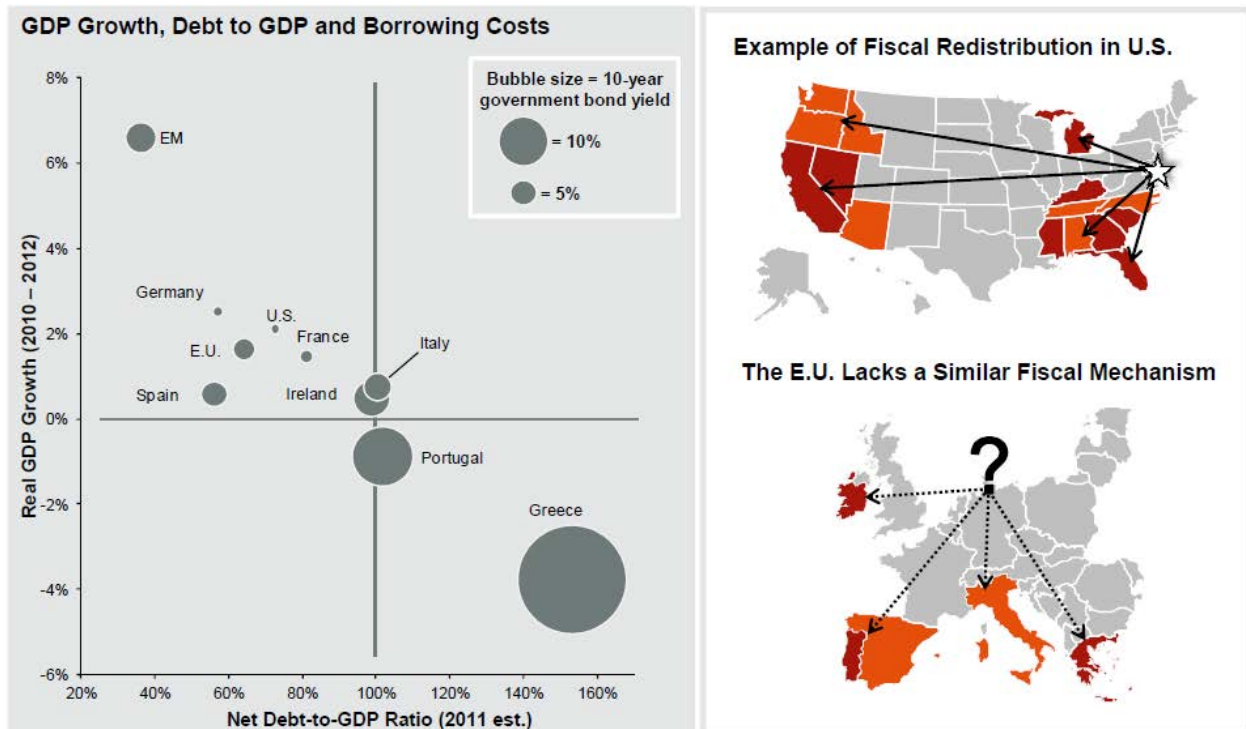
While it is both frustrating and frightening to go through what seems to be an almost unending series of financial woes, these are often the times policymakers (who would like to retain their jobs) take decisive action. It can also be a time when investment opportunities are plentiful. We know it does not feel like that at the moment, but if history is any guide, things are often not nearly as bad as they seem.

The chart below, courtesy of J.P. Morgan, illustrates the earnings per share figures for the S&P 500 companies. The profitability of US companies (as represented by corporate earnings) continues to strengthen with the 2<sup>nd</sup> quarter of this year eclipsing the previous record set in the 2<sup>nd</sup> quarter of 2007. Companies are much less leveraged than several years ago and have plenty of cash on their balance sheets. As the uncertainty in tax, entitlement, health care, and regulatory reforms is settled, we believe that we could see an increase in corporate spending and consequently, hiring.



Currently, the biggest threat to our investment markets is not even within our borders, but rather is the ongoing debt issues in Europe. The problem countries – Portugal, Italy, Ireland, Greece, and Spain – have enjoyed years of overspending, which is now finally catching up with them. Greece, though only the eleventh largest economy within the European Union (27 countries in total), is nevertheless the epicenter of the area’s problems.

The chart (below left) illustrates the current economic state of the US, many European countries, and the emerging market countries (labeled as “EM”). Ideally, a country would like to be in the upper left hand quadrant where Gross Domestic Product (GDP) is positive and the debt-to-GDP ratio is lower. The size of the “bubble” represents the country’s current 10-year government bond yield (the higher the rate, the higher the perceived risk). The European “problem countries” have, for the most part, shrinking economies and higher levels of debt. As Mr. Saut had mentioned at our economic dinner, a structured default of Greece (or even Portugal or Ireland) would not be the significant issue. Instead, the larger, looming issue is how exactly Italy and Spain would be affected (as they are the fourth and fifth largest economies in Europe) and whether or not substantial spillover would affect Germany, the United Kingdom, and France (the three largest economies in Europe).



The top right chart above demonstrates how money can be easily redistributed in the US from states where unemployment is generally lower (the northeast and Midwest) to states where the unemployment is much worse (the west and southeast). The politics within Europe (lower right chart), however, are much more complex. In order to prevent the debt problems from spreading to the rest of Europe, the healthiest countries, such as Germany and France, would have to redistribute their wealth to the

countries that have been fiscally irresponsible. This would be comparable to New Jersey taxes being used to shore up the economy of Mexico. Though this is not politically appealing, France and Germany will be forced to accept this position or face more debilitating repercussions if this situation were to continue unaided. We believe, as evidenced by their October 9<sup>th</sup> agreement on protecting European banks, that Germany and France will eventually put forth measures to quell their continent's debt crisis.

Per Mr. Saut, and courtesy of research done by Bespoke Investment Group, the following are results from an interesting study on the psychological impact of the European issues on our country's stock market:

Because of the time difference, many European stock markets close at 11:30 am eastern time. The study focused on performance differences of the US market when the US and European markets are open at the same time (9:30 am to 11:30 am) and after the European markets are closed for the day. Between July 7<sup>th</sup> and October 3<sup>rd</sup>, when the markets were open at the same time, the average daily return of the US market was -0.25%. However, after 11:30 am, the US market's daily average was only -0.05%. The US market's return was 5 times worse when the European markets were open!

We believe that as the European issues are dealt with, the US economy continues to grow, and US political uncertainties are resolved, we will experience an investment market recovery. We have a number of conference calls and meetings in the next few weeks with asset management firms and will likely be sending a second letter later this month with some input from those sources. If market volatility remains, we will continue to provide you with insights and analysis as to what is transpiring.

Lastly, we have enclosed another great essay from noted financial author Nick Murray titled, ***"Have You Ever Known Everyone To Be Right?"*** Although it is often difficult to see the light at the end of the tunnel with the constant barrage of negativity, after reading Mr. Murray's thoughts you may begin to see the current state of affairs in a different light. We hope you enjoy the article as we did.

As always, we thank you for your continued trust, confidence and friendship.

Best regards,

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CERTIFIED FINANCIAL PLANNER™

*Steffanie A. Lerch*  
CERTIFIED FINANCIAL PLANNER™

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*Inclusion of these is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results.*

*The S&P 500 is an unmanaged index of 500 widely held stocks that's generally considered representative of the US stock market. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow", is an index representing 30 companies maintained and reviewed by the editors of the Wall Street Journal.*

*Chart#1: Sources – Standard & Poor's, JP Morgan Asset Management. EPS levels are based on operating earnings per share. Most recently available is a 2Q11 99% estimate. Data reflect most recently available as of 9/30/2011*

*Chart#2: Sources – IMF, BLS, JP Morgan Asset Management. Maps are for illustrative purposes only and are intended to show the current sources of stress in each region. The US state colors are based on level of unemployment rate. European country colors are based on levels of sovereign stress, including but not exclusively the measure shown in the above chart on the left (data as of 9/30/2011)*

*Chart#3: Sources – Barclays Capital, FactSet, Robert Shiller, Strategas/Ibbotson, Federal Reserve, JP Morgan Asset Management (data as of 9/30/2011)*

*Opinions expressed in the attached article are those of the author and are not necessarily those of Raymond James.*

# Have You Ever Known Everybody To Be Right?

*"I buy when blood is running in the streets of Paris" —an early Rothschild*

On the day of my birth—Monday, October 11th, 1943—General Eisenhower and Field Marshall Montgomery, meeting in Carthage, made a bet. Ike offered to bet Monty five pounds sterling that the war in Europe would be over by Christmas 1944; the skeptical Englishman took the wager. (Ike loathed Monty to such a degree that, even though it had long been clear that he had lost, he didn't pay Monty the five pounds until that Christmas Eve. But I digress).

Also on that day, the broad equity market in the United States, as denominated in the Standard & Poor's stock index, closed at 11.7. As I write, less than a month before my 68th birthday, it's around 1170.

There's a certain lovely symmetry in that juxtaposition—stock values, in the aggregate, up a hundred times in my lifetime (while consumer prices are only up about fifteen times)—and I impart this information to you not so much as ancient history as a confession of my bias: all my life experience instructs me to be bullish on the earnings, cash flows, dividends and market values of the great companies in America (and, increasingly, the world) *in the long run*.

This rise of equity values by a factor of a hundred in my lifetime has been punctuated by thirteen "bear markets"—declines in stock prices averaging about 30%. (Ask your financial advisor for a table of them. I think you'll find it highly instructive.) For what it may be worth, I've been an investment professional

through nine of those thirteen episodes, and I can testify from vivid memory that they were all presented to the public by apocalyptic headlines in the financial media as the incipient end of the world. I note as a matter of historical record that the world did not end on any of those thirteen occasions, and that after each of them the long-term uptrend resumed.

This experience—which I hasten to add is not predictive in any scientific or mathematical way—may bring some perspective to the current situation, in which the media are once again trumpeting the end of economic life on the planet as we have known it, due to the stagnation of the U.S. economy and the financial unraveling of the eurozone. And it's clear that many if not most investors have taken this doomsday scenario to heart, as the flight out of equities and into havens like Treasury bills and gold attests.

Again, though, there is implicit in the paragraph above a fact which always sets off an alarm in my grizzled head. More accurately, it's a juxtaposition of two facts, one of which is just a statement of my experience. (1) Most people seem to be quite terrified by current events, and are fleeing equities in droves. (2) I have never—not once, not ever in my 45 years as an investment professional—known most people to be right for very long. To the contrary, all my experience indicates that huge and very emotional public consensus—bullish and bearish—turns out relatively soon to be wrong.

But my experience, I hasten to repeat, is not predictive. It does, however, tend to bear out the wisdom of something that the late Sir John Templeton, the father of in-

ternational investing, was fond of saying: *"Among the four most dangerous words in investing are 'It's different this time'."*

In closing, even I can respect that my own experiences, based on nearly seven decades on the planet, may be just a bit more information than my reader finds practical or useful. Perhaps, then, we might just look back thirty years, if for no other reason than that that's probably going to be the average length of a two-person baby-boomer retirement.

In October 1981, we were right in the middle of one of those bear markets. The country was still in the grip of stagflation: unemployment was about eight percent, and inflation was still ten percent, if you can even believe that. And I daresay the bearishness of the mainstream media was every bit as hysterical then as it is now.

That bear market ended, as they all have. But in the intervening thirty years there would be five more, including the deepest (2007–2009) of the postwar era. Now, my birthday in 1981 was a Sunday, so we have to look at the next day to see where we were then, and how far we've come.

On Monday, October 12, 1981—thirty years and six bear markets ago—the S&P 500 closed at 121.21. That's right: it's about ten times higher today. No, that doesn't prove anything about the future. (For the record, nothing proves anything about the future.) But it may very well suggest a useful perspective. And you may want to give this some thought before your next conversation with your financial advisor.

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