



Paul R. Ried Financial Group, LLC
Security for your future

A MESSAGE FROM YOUR FINANCIAL TEAM
Third Quarter 2011

September 16, 2011

Dear Clients,

In our last quarterly letter we mentioned that “anxious complacency” was a fitting description for current investor attitudes. Since August a more fitting description has been “bipolar”.

With the dramatic moves from one day to the next, the market has definitely displayed a lot of the symptoms. Extreme mood swings between mania and depression? Check. Hyperactivity? Check. Easily distracted? Check. Impulsiveness? Check. Sleepless nights? For many investors, possibly!

Delayed Reactions

What is most interesting about the wild market movements over the last month or so is that it seems to be a response to issues that are either (1) not new, or (2) not surprising. It is as if the markets were suddenly awoken from a deep sleep and had just become aware of issues that have been growing for some time. While the news events may have provided details, the big picture remained the same.

One such event was the downgrade of US debt from “AAA” to AA+” by the credit-rating agency, Standard and Poors. Along with the debt ceiling debate, this brought more attention to the US debt problem, but it was only a detail. The reality is the big picture remained unchanged: The United States has a serious debt issue that must be addressed. Nobody needs a rating agency to figure that out.

Similarly, the daily “breaking news” events out of Europe are the predictable result of trying to bailout countries that have too much debt by lending them more money. It will only make the eventual default bigger. It is interesting that this tactic is only used by governments. No one who is falling behind on their credit card payments is likely to be given a credit limit increase by their credit card companies. The credit card companies know the likely end result of that maneuver.

The final issue drawing a lot of attention doesn’t fall in the “not new” category, but it should fall in the “not surprising” category. These are the recent reports that show slowing economic growth, bordering on recessionary levels. This has been the slowest post-WW-II jobs recovery on record even with the constant stimulus measures. It is no wonder that many indicators have slowed even further as many of those stimulus measures have been winding down.

Flashback to the Future

Since the issues of the day are essentially the same as those we have been touching on in past letters, it seems to be a good time to revisit the big picture.

-January 25th, 2010-

"The decade ahead is sure to provide its own set of risks, as well as opportunities. It is also likely true that the decisions of this last decade will have a lasting impact on the next.

A recent yearly report by the World Economic Forum titled 'Global Risks 2010' touches very well on possible risks caused by those decisions. The amount of money that governments around the world have spent on bailouts and stimulus, with mostly borrowed money, does not come without risks. As the report states, 'Though their intervention proved vital, governments now need to avoid becoming the main cause of the next crisis.' Countries may have found it easy to issue debt when they were one of the few needing large amounts of financing. However, the amount of spending needing to be financed has increased dramatically. While the US is often the focus, other countries are of equal or greater concern including the UK, Japan, Italy, Greece and Spain just to name a few."

-April 27th, 2010-

"Speaking of the underlying fundamentals, economic numbers do indeed show solid stabilization, and even growth. However, It should not be forgotten the degree of artificial stimulus it has taken to see these numbers.

It is easy to say we must keep pumping stimulus into the economy or risk stalling the recovery. However, in doing so, the result could be spending our way into the next crises. The reality is that you cannot continually spend what you do not have without eventual consequences. As Jeffrey Lacker of the Federal Reserve Bank of Richmond recently put it 'The government's debt cannot grow indefinitely at a rate much faster than the economy itself grows, so ultimately, something has got to change -- either taxes are raised, spending is reduced, or the real value of the debt is eroded through an increase in inflation'.

While it can no longer be said that government debt issues worldwide are not getting enough attention, it is possible that they are still not properly understood. Additionally, the seemingly slow moving nature of the issues involved can cause complacency."

-July 26th, 2010-

"We do not intend to sound like a broken record regarding the importance of differentiating between growth in underlying economic fundamentals and that driven by stimulus. However, seeing economic growth independent of stimulus is a key sign to its sustainability.

Real growth should result in lasting jobs being created and standards of living increasing. We are not there yet. As Federal Reserve Bank of Atlanta President Dennis Lockhart put it last

month, 'The economy has not yet arrived at a state where healthy and sustainable final demand is underpinning growth'.

As we said in our letter last July, 'While we can be hopeful for a quick recovery, we must realize that this indeed can be a long, hard slog.' That seems equally fitting this year"

-November 18th, 2010-

"Regardless of the outcome regarding taxes, it is clear the growing government debt problems cannot be solved simply by addressing taxes. Therefore, spending is also front and center. Today's government debt problems are the cumulative result of countless choices made over many years. These include the numerous wars resulting in an ever increasing defense budget, company bailouts and unsustainable entitlement programs, among others.

Without a doubt, new choices will need to be made in the near future. In fact, not addressing key issues would be a choice of its own. As Ben Bernanke recently put it at a speech in October, 'One way or the other, fiscal adjustments sufficient to stabilize the federal budget will certainly occur at some point. The only real questions are whether these adjustments will take place through a careful and deliberative process that weighs priorities and gives people plenty of time to adjust to changes in government programs or tax policies, or whether the needed fiscal adjustments will be a rapid and painful response to a looming or actual fiscal crises'."

-February 22, 2011-

"The markets have taken well to our government's decisions to delay tough choices. The danger is that this is more than simply 'kicking the can down the road' as these decisions have generally been characterized. In that case, when you get back to the 'can' it's basically in the same condition (albeit slightly dented). A better analogy for this is rolling a snowball down the street. Indeed, the issues become bigger and at an increasing rate.

Concerns about interest rates and recent strong returns from the equity markets are making many investors wonder if they should increase their allocation to stocks. There is a danger here of exchanging one risk for another, possibly greater risk.

.....the S&P 500 is currently in the ranks of the top 10% of most expensive markets using data going back to 1871.

Similar high valuations were seen in 1928-1930 and prior to the 2000 tech wreck. High valuations have a bad habit of eventually ruining the markets fun."

The current environment

Governments around the world seem eager to "do something" about the current problems. However, it remains to be seen when they will choose to address a problem of debt with something other than more debt.

While the market (as measured by the S&P 500) still remains historically expensive, it is no longer within the ranks of the top 10% of most expensive markets (however, it still is in the ranks of the top 25% of most expensive markets using a valuation measure called the P/E10 ratio, which takes the inflation-adjusted earnings of the last 10 years divided by price). The trade-off has been that while stocks became slightly cheaper, many bonds have become more expensive. At 2.00%, the current yield on a 10-year Treasury bond has only been lower than this during four months in 1940.

In the current environment, it is important to remember that there are a wide variety of possible outcomes which can be largely determined by the unpredictable decisions of elected officials (and unelected central bank officials). We believe flexible active money managers, broad diversification and not relying too heavily on one outcome remains key.

We are here to serve you, don't hesitate to e-mail or call us with your questions.

Sincerely, your Financial Team

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WEDNESDAY, NOVEMBER 9, 2011 at 10:30AM or 2:00PM**

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