



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

A MESSAGE FROM YOUR FINANCIAL TEAM

Third Quarter 2010

July 26, 2010

Dear Clients,

The market (as measured by the S&P 500) managed to rally for over a year from its March 2009 lows without as much as a 10% correction. The market seemed to ignore, or otherwise brush aside, most negative news. That changed in pretty quick fashion. From this years peak which was reached on April 23rd, the S&P 500 declined as much as 16% and erased all of its gains since last September. It has since rebounded slightly and remains nearly flat for the year.

Double-Dips & Technicalities

While there has been increased talk regarding the possibility of a double dip recession; interestingly there is not even a definition of what that means. Some economists consider the back-to-back recessions of 1980 and 1981 to be a double-dip. Others, including the committee which dates recessions, think of that period as two distinct recessions.

As we discussed in our October letter regarding recessions, we believe the technicalities of the terms are not that important. The reality is that the number of employed people still remains more then 5% lower then the peak levels reached in December 2007. Not even during the worst parts of the last 10 recessions was employment off that much from its peak. Retail sales also remain off by more then 5% from its peak. This is certainly an improvement, as it was off more then 11%. However, by comparison, during the 2001 recession retail sales were never down more then 2%. It is noteworthy that retail sales are down over 1.5% just in the last two months.

One interesting observation comes from the Economic Cycle Research Institute's Weekly Leading Index. This is an index made up of seven different components. The growth rate of the index turned back into negative territory in June. Its latest reading was -10.5. What stands out is that a negative reading of at least -8 has appeared in six of the last seven recessions. Also, a reading of -8 or worse has never occurred outside the context of a recession. In fact, a reading below -8 has always indicated we were either in a recession or a recession was no more then six months away.

Although it may be possible that shifts in the structure of stimulus may be artificially impacting the Weekly Leading Index, it is still worth noting.

The Statistical Recovery

The committee which officially dates recessions has not yet declared the end of this recession. However, a delay of this length is not unusual. Consensus continues to be that the end of the latest recession will be dated 10 to 12 months ago.

There has been a pretty strong recovery in GDP. There has also been a decent recovery in retail sales and other metrics, at least off their lows. However, many have termed this the "statistical recovery". That is because the only place this recovery seems to be felt is in the statistics. Even Lawrence Summers, Obama's Chief Economic Adviser, picked up the phrase in January when he said that "What we see in the United States and some other economies is a statistical recovery and a human recession."

This still feels like a statistical recovery to people and businesses. As mentioned earlier, we still remain further from peak employment levels than was ever experienced during any of the prior 10 recessions. Also, the average length of unemployment is now over 35 weeks. Never in the last 10 recessions was it over 22 weeks.

On the business side, earnings for many companies are certainly looking better. However, the most recent monthly survey by the National Federation of Independent Business shows that small businesses are not feeling optimistic. In fact, since the start of the survey in 1986, the index has never been this low, even in the middle of the previous two recessions. The biggest single problem being reported is "weak sales". Never before 2008 was weak sales cited as the biggest problem, usually it was taxes.

These certainly are not conditions people or businesses would usually associate with a recovery that is supposed to be up to a year in progress.

Stimulus

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.

A report released in May by the Congressional Budget Office (CBO) appears to confirm that much of the growth is indeed stimulus driven. In the report they provide a high and low estimate of the likely impact on GDP as a result of the stimulus from the American Recovery and Reinvestment Act. Using the average of their high and low estimates shows that since GDP turned positive in the 3rd Quarter of last year, over 70% of the growth in GDP is from the artificial stimulus. In fact, for the 1st quarter it shows that all of the GDP growth may have been from the stimulus. While the 2nd quarter GDP growth is not yet released, it too is likely to be composed largely of stimulus.

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."

Final Thoughts

If there are some things to be gained from the strong swings in the markets over the last few years it has likely been a better understanding of our own individual risk tolerances. It is a reminder that all assets have their own risks. It is also a reminder that diversification is important whether your risk tolerance is high or low. Lastly, it is an understanding that taking on more risk does not always provide higher returns, it only provides an opportunity for higher returns.

We have developed customized diversified portfolios consistent with each of your objectives using the principals of asset allocation along with professional active money managers. As always, we continue to monitor the overall portfolios in conjunction with each individual fund management team, and make changes as necessary.

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. We continue to believe a diversified portfolio which is not overly reliant on one outcome is key.

Should you have any questions, don't hesitate to e-mail or call our office.

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SAVE THE DATE
CLIENT ECONOMIC UPDATE SEMINAR
THURSDAY, NOVEMBER 11, 2010 at 10:30AM OR 2:00PM

For Early Registration, please contact Glenda at 425.646.6777 or
glendag@paulried.com. We hope to see you there!