



Paul R. Ried Financial Group, LLC

Security for your future

A MESSAGE FROM YOUR FINANCIAL TEAM

First Quarter 2010

January 25, 2010

Dear Clients,

December marked the end of a good year but a poor decade for the market. The S&P 500 continued its rally which started in March to finish up 26% for 2009. However, that was not enough to make the decade's return positive. In fact, the S&P 500 lost an average of nearly 1% per year in the last decade. Fortunately, other areas were able to avoid the same fate of negative returns. These included many small, mid-size and international companies, as well as bonds and other asset classes. This provided opportunities for many active mutual fund managers and diversified portfolios to post gains in what otherwise has been termed the "lost decade".

Risks and Opportunities

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

The recently issued annual report by the World Economic Forum entitled "Global Risks 2010" touches on possible risks caused by those decisions. Massive borrowing by governments around the world for their economic stimulus and bailout plans does not come without its own 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 requiring large amounts of financing. However, the amount of spending required 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 among others.

This year, the World Economic Forum report put three "economic risks" in its highest "likelihood" category of "20% plus". While investor moods have dramatically improved, there is a growing list of risks that seem to be getting pushed aside. Some of these risks have been recognized for some time, but have been amplified by the responses to the recession. The three top economic risks highlighted in the report are: "Fiscal Crises", "Slowing Chinese Economy" and "Asset Price Collapse". While each of these risks are separate, they are each very much interconnected. It should also be recognized that factors affecting these risks can seem gradual, which eventually leads to complacency about them.

Unintended Consequences

Stimulus measures have definitely provided a much needed cushion for the economy. However, serious questions still remain about underlying economic fundamentals as many indicators have been dramatically influenced by worldwide stimulus. As an example, the "Cash for Clunkers" program is reported to have accounted for over one-half of third quarter GDP growth. This is despite the fact that it provided no real long term economic benefit. In fact, it encouraged many very usable vehicles to not only be turned in, but also destroyed. It also encouraged consumers, with already high levels of debt, to take on new large debt payments in order to finance their purchase. Fortunately, in spite of this, household debt to income ratios continue to shrink. While household debt levels still have a way to go before they reach a level which is healthy and sustainable, it is a welcome improvement.

Worldwide stimulus measures have not only artificially influenced economic indicators, a case can also be made that they have influenced the prices of stocks, bonds and other asset classes to a great degree. As the World Bank President, Robert Zoellick, said in November, "The global recovery, in part, has been fuelled by confidence, which may be undermined by asset bubbles".

A Surprise Stimulus?

While certainly not a surprise, the 2010 census will definitely act as a stimulus even if it isn't called by that name. The government plans on hiring 1.2 million temporary workers in the first half of this year for the census, with over 900,000 of those planned to be hired in the second quarter. Interestingly, approximately three times as many workers are being hired for the 2010 census as compared to the census in 2000. This will likely give a dramatic boost to the reported jobs numbers in the second quarter, and will provide a source of extra income for many. However, it should be recognized that like all the other stimulus measures, this too will be temporary as most of the jobs will end before the end of the year. True economic expansion can only come from solid, long-term employment opportunities as a result of a growing economy.

Taxes

Taxes are likely to be a frequently discussed topic this year -- well beyond the tax season. While few doubt federal income taxes will go up, a much less discussed topic is the future for state and local taxes. Outside of discussions about California, the conversations have been minimal. That is rapidly changing.

According to the Center on Budget and Policy Priorities, this latest recession has caused the steepest decline in state tax receipts on record. While the federal stimulus provided some help to the states, it did not make their problems go away. In fact, 25 states have already had to borrow from the Federal Government in order to pay unemployment benefits and nine more are expected to before the middle of the year. Arizona Governor, Jan Brewer, summed up their problems by saying, "We face a state fiscal crisis of unparalleled dimension." Many states are in similar positions. That is almost sure to result in a combination of reduced services and increased state taxes.

A Decade of Unknowns

While some risks can be identified, we enter this year and this decade just as those before it. The reality is that the years ahead are full of unknowns. In fact, it may easily turn out to be an event no one considered or, more likely, an innovation no one imagined which shapes the decade ahead.

As the world becomes more interconnected, so too do its risks. Investing involves risks, however, not investing carries its own risk. This only increases the importance of diversification as well as good research and advice. As always, we are here to serve you and encourage your calls and e-mails.

Sincerely, your Financial Team

Paul R. Ried, MBA, CFP®
Senior Financial Advisor*
Regional Director*
Financial Network

Timothy R. Kimmel, CFP®
Senior Financial Advisor *
Registered Representative*
Financial Network

Adam Jordan
Director, Investment Research and Management
Registered Principal*
Financial Network

Lucy Beppu
Associate Account Manager
Registered Representative*
Financial Network

Prepared By:
Adam Jordan
Director, Investment Research and Management
Registered Principal *
Financial Network

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