Paul R. Ried Financial Group, LLC

Security for your future

A MESSAGE FROM YOUR FINANCIAL TEAM
Third Quarter 2009
July 6, 2009

Dear Clients,

The first half of this year has shown that while the economy is often like a slow moving ship, investor sentiment can shift quickly in short periods of time. Just as the S&P 500 reached new lows in March by falling approximately 26% from the start of the year, that decline was erased in less than two months and currently the market is essentially flat for the year. However, the market remains down just over 42% from its peak reached in October of 2007.

THE ECONOMY

While the recent rally since March has resulted in a more optimistic tone being sounded by market pundits, we believe continued caution is warranted. Much of what has been cited as signs of improvement or imminent growth mainly turns out to be only a slowing in the pace at which various economic indicators are declining. While this is a positive development, it should be taken in context.

Many have pointed at the decline in the pace of monthly job losses. While the 322,000 loss in May and 467,000 loss in June is an improvement from the 600,000+ pace it had been on, context is key. What is often not mentioned is that the best month we have seen this year for job losses is approximately equal to the worst month that was ever seen during the last two recessions. It is true that the unemployment rate, which stands at 9.5%, tends to be a lagging indicator. However, other aspects of employment, such as the average length of the workweek and temporary help services can provide more insight. The length of the average workweek fell to its lowest level since 1964. Jeff Frankels, a member of the official committee which dates the beginning and ending of recessions, recently observed that, "If firms were really gearing up to start hiring workers once again, why would they now be cutting back as strongly as ever on the hours that they ask their existing employees to work?"

It is also pointed out by many that the number of continuing claims for unemployment benefits has actually dropped. At first this may look like a sign of improvement. However, a deeper look at the rate which benefits are being exhausted reveals that this drop is mostly due to people running out of benefits, rather then finding a job so that they no longer need the benefits. Indeed, the number of those unemployed for 27 weeks or longer is the highest since record keeping began in 1948. This is a major reason why the number of people receiving food stamps is up nearly 20% since last year.

THE GOVERNMENT

The recent Government stimulus package, named the American Recovery and Reinvestment Act, has been taking effect and is already visible in some economic statistics. The pace of the stimulus is also picking up speed. While this is welcome news, these artificial boosts will give false signals about the underlying health of the economy. This was already evident when you look at personal income statistics. While personal income showed a 1.4% gain in May, nearly the whole gain was from government payments (such as welfare, social security and unemployment insurance). In fact those benefits currently make up 18% (or nearly 1 in every 6 dollars) of personal income, a record high. While this is a needed cushion to many, it is not a strong sign for the economy. As investors try to decipher the underlying health of the economy, false or contradicting signals can very easily add to the market volatility.

Just as the Federal Government is ramping up their spending, state governments are making large cutbacks, including layoffs, as their tax revenues decline. In fact California just began paying many of its bills with registered warrants or "IOUs". However, for many states the Federal stimulus has filled important gaps and held off deeper cuts.

THE ROAD AHEAD

The Governor of the Bank of England, Mervyn King, recently said in regards to a recovery that "There has to be a risk that it will be a long, hard slog" and that "Having an open mind and not pretending to foresee the future when it's so uncertain is important". While those comments were made in reference to the British economy, we believe that it is just as relevant to the situation in the United States.

While we can be hopeful for a quick recovery, we must realize that this indeed can be "a long, hard slog". In a market with such dramatic ups and downs, it's important to pay attention to the tangible (and much less volatile) returns of a diversified portfolio which are as a result of the dividends and interest paid out of the investments. That is the case whether they are used for current income or are reinvested for future income.

The credit driven boom of the past has ended and it is now important that the economy finds its new baseline level of activity. Or as some have termed the "New Normal". This is the level which is supported by real incomes and real savings. Once that level is established then a solid foundation can be built. As the San Francisco Federal Reserve President, Janet Yellen, recently said "In the long run, higher saving promises to channel resources from consumption to investment, making capital more readily available to retool industry and fix our infrastructure. But, in the here and now, such a rediscovery of thrift means fewer sales at the mall, and fewer jobs on assembly lines and store counters."

Unfortunately, the process of building a foundation takes time, but there are positive signs of that foundation being set. The savings rate has moved up to a healthier rate of almost 7% from it's near zero level 2 years ago. We have also seen the beginning of a drop in household debt-to-income ratios which have started to come down from the record levels of 2007. They do, however, have quite a ways to go to reach levels which remotely represent the historical norm. In the meantime there will likely be continued high rates of defaults on all types of consumer debts as well as increasing bankruptcies from those companies that rely on the consumer.

While the road ahead is indeed uncertain, we believe it is best to prepare for it to be a long and bumpy one. Along the way the market will provide many turns. One of the most important investment principles is to not let your emotions dictate your investment decisions. Market swings bring out emotions and the market often seems determined to give investors many chances to listen to those emotions and to act on them inappropriately.

We continue to diligently evaluate long term economic and market fundamentals, as well as individual fund management and performance. A well balanced portfolio consistent with your risk tolerance and objectives continues to be the key to effectively accomplishing your goals. Naturally, past performance is not a guarantee of future results.

On another note, earlier this year, we were named by Barrons as one of the top 1,000 wealth managers nationally for 2009. We thank you for your continued confidence and trust during these challenging economic times, as well as for referring us to your associates and friends. Should life events alter your goals or objectives, it is important that you contact us. As always, we are here to serve you.

Sincerely, your Financial Team

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