

# Second Quarter 2009

July 10, 2009

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## Behind the ILLUSIONS

His shows were brilliant. His dancing was unmatched. He was probably one of the most talented entertainers in recent history. A few weeks ago, Michael Jackson couldn't sell a record. Although he still had fans that recognized his talents, he was shunned by most of main stream society and his music was lost in the limbo of old songs occasionally heard on the radio.

After he died, everything changed. Stores immediately started to sell out of his CDs and the internet buzzed with downloads of his music and videos. All of his transgressions were instantly forgotten. The media put aside the rest of the news and buzzed with Jackson commentary while millions of people tuned into his memorial.

Why did this happen? What does this have to do with stocks? Simple. The value of all things is based purely on perception. The U.S. Dollar is still considered the strongest currency in the world. It is backed by nothing but perception and faith and those perceptions change quickly. With his death as a catalyst, sentiment instantly changed. People stopped dwelling on the negatives and started to think about the positives of his life and career. It is human nature.

The stock market reacts to human emotion and the current perception. It does not always dwell on or analyze the facts. One of the greatest of human emotions is fear and that is what the markets reacted to earlier this year. We have to keep in mind, however, that at some point those fears will be forgotten and we will be in a new manic wave. We will never be able to figure out when that change will take place, but when it does, it can all happen very quickly.

The fact is that the fundamentals of the economy have not changed much over the past month or so. But the perception did slightly change. This led to a very quick



### Other Bits of Info.....

**Ed McMahon and Michael Jackson:** They were both scrambling to make ends meet, in debt up to their eyeballs, and practically bankrupt. Imagine telling a street person who was just given a new shirt that he was worth "on paper" more than a superstar who just passed by in a limousine. Michael's estate may get lucky and make up some of the three to four hundred million dollar deficit he wracked up. Ed McMahon's home was in foreclosure shortly before his death.

**Bernie Madoff:** One illusion that goes beyond Michael Jackson is the Bernie Madoff story. How he did it is still a mystery. So far he got 150 years. His family is still being investigated. People have a tendency to think that investing is easy and the right guru could invest money and never lose a dime. This was the illusion that investors bought when they invested with Bernie Madoff. They learned their lesson the hard way.

**TIPS:** Treasury Inflation Protected Securities adjust upward in price when inflation rises. This is

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jump in the overall markets. When the perception of Michael Jackson changed, the value of his portfolio instantly went up and I think we could simply say that he (or his estate) is making more money now than it did in a very long time—and he needs it!

### **Is The Glass Half Full Or Half Empty?**

After the markets hit some extreme lows in March, they quickly turned and leaped over 30%. This left the Dow down 2%, and the S&P up 2%, for the year. Investors became more confident that Bank of America and Citigroup were not going to fail or be taken over completely by the U.S. Government. They were comforted when the bankruptcy of Chrysler and GM did not translate to instant and massive layoffs that would disrupt the entire economy and leave millions standing in bread lines.



*Unemployment is now at 9.5% versus 10% in 1982, which was the highest in recent history.*

The second reason people started to buy was even more fundamental. A few months ago, investors were not at all interested in getting a rate of return. They just wanted to know that their money was safe. A return of zero on a 3 month Treasury bill was more than satisfactory. But it didn't take long for their greed to set in. A little relief in the news and they started to nibble at other things.

So, as investors began to feel the world will probably not end, the prospect of a long recession rather than a depression began to materialize. The question now becomes, “How bad is it and how long will it last?”

### **Un and Under - Employment**

At the moment the rise in unemployment poses the biggest risk to this economy. It has been widely accepted that a spike in unemployment usually occurs at the end of a recession. Unemployment is the unfortunate result of lower corporate sales. This time, however, it is difficult to accept the fact that the current unemployment situation is “classic” and easily dismissed. In fact the biggest concern is if, this time, unemployment becomes the “cause” of lower corporate sales.

There are a few things happening. First, the slowdown we are in is severe and it is more likely that unemployment figures will continue to increase for a longer period than past recessions. Second, tied to these numbers are what economists call “the underemployed”. These are people that lost a higher paying job and take a much lower paying position to stay afloat. This is nothing new, but keep in mind the aftermath of the tech meltdown and 9/11 already left a pretty significant number of underemployed in the system.

Also, the population is aging. There are more people retired or ready to retire than at any point in modern history. They are also living much longer on limited incomes.

Finally, the markets are not helping retirees. It has become extremely difficult for retirees to live off their investments. Interest rates are historically low, bond rates are low and the stock markets are difficult to depend on. This cuts retirees’ income and their spending power.

All of this results in lower demand for products and keeps the economy moving at a very slow and

*(See Illusions on page 3)*

*(Illusions from page 2)*

potentially negative pace.

## **Oil**

Going back a year, it was all about oil. The price of oil moved from the high teens to almost \$140.00 per barrel in the span of a few years. We could now look back and call oil the catalyst for the current meltdown. But late last year, oil prices collapsed with everything else and crude dropped below \$40.00 per barrel. For a while it looked like the pressure from high priced oil was off. Unfortunately, we are seeing the price of oil creep back up again. It now sits just under \$70.00. Most of this is due to speculation and investors hoarding supply, but it doesn't matter why. High oil prices will not help us to recover.

## **The States and Taxes**

California is on the brink of collapse. It is virtually out of money and it is asking the U.S. Government to back its debt. If it does not get some kind of government support, it will be forced to refinance its outstanding bonds at much higher rates. This could be good for investors willing to take the risk and buy them but not good for California. Currently (20-30yr) California municipal bonds are now available at 5-6% tax free returns and these rates could go up. Although California may be in worse shape than the rest of the country, many states are struggling to keep the doors open. State incomes have been slashed due to a dramatic loss in tax revenue. Connecticut is hurting from the loss of Greenwich bonuses. The problem is the revenue has to come from somewhere and the average state taxpayer will end up carrying the burden. The high tax on individuals and businesses will not help anyone to pay bills or spend money and slows down the prospect for a recovery.

## **Interest Rate Pressures**

Interest rates are being kept artificially low. A piece of the bailout program allows the Fed to buy mortgages and sit on them. This takes mortgage securities off the open market, reducing supply and forcing mortgage rates as low as possible.

At the same time, the Treasury is borrowing more money than ever. In simple terms, there is a tremendous amount of money being "printed". Some of this money is being hoarded by banks but if this cash really comes into circulation there will be a serious spike in inflation. Some say it will be catastrophic. The Fed, however, remains confident that it could reverse these programs and take money out of the system without causing an inflationary spiral. Since all of these programs and policies are new and none of this has been done before, we just have to wait and

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the reverse of standard Treasury bonds that drop in price when interest rates go up. Both are backed by the U.S. Government. As a hedge against a future inflationary spike there are several funds and exchange traded funds that invest in TIPs.

**Target Funds:** Many retirement plans and education funds advertise "target funds" that automatically adjust the investment mix to become more conservative as you get closer to your retirement age or college age, respectively. The problem is that these funds are not all the same and many took huge losses in last year's meltdown. These funds offer what appears to be a simple solution to a complex problem and in some respect offer no more protection than a standard mutual fund.

**Estate Planning:** Be careful using joint accounts with your children. Many people think that a will directs the proceeds of your full estate. This is false. A joint account becomes the legal property of the joint account holder and an IRA or any program with a direct beneficiary also bypasses the instructions of a will. Also, be sure to review and update beneficiaries on accounts especially if you have been through a divorce or a death in the family.

**Junk Bonds:** Most people hate the idea of "junk bonds" simply because they are low quality corporate debt. But buying these bonds in a fund or an index can have benefits. The risk of default is greatly reduced because the fund owns hundreds of bonds. The dividends are high in the 8-12% range while the price tends to drift with stock prices. They are great in a flat or slightly positive market—but not good in a depression.

**Jackson Again:** Looks like Michael Jackson's memorial service may cost Los Angeles tax payers \$1.5 million. Ask your mayor to pay for your funeral!

**Apollo 13:** If you haven't seen the movie, watch it. If you saw it before, watch it again. Imagine being stuck in a tin can 200,000 miles from the Earth on the other side of the moon, freezing, and making calculations on an old HP calculator. They did things that were never done before and survived. That's what we are doing with the U.S. Economy. ■

*(See Illusions on page 4)*

*(Illusions from page 3)*

see what happens. It is very difficult to try to predict the outcome.

### **Investing In Illusions**

Magicians make tigers disappear but then we find out they are just back stage eating—hopefully not the help. Money also seems to disappear but in reality it doesn't. It just moves from one place to another. At the moment it is parked in Treasury bills. The question is, "Where will it go next?" The little bit that moved out of the treasury market spurred a 30% jump in stock prices. There is a lot more behind that when the real recovery starts to take place. So it is very reasonable to assume that if the prospect of Armageddon continues to fade, money will continue to move out of Treasuries and into the markets.

Since many people need income, my feeling is that income generating investments will be a good place to start. This includes bonds, preferred stocks and those stocks that continue to pay stable dividends. These types of investments will not have explosive returns in a strong upward market but the income they generate will offset or cushion the losses should things once again start to reverse. There is a potential for inflation so Treasury Inflation Protected Securities (TIPs) could be a good thing to hedge against that situation.

Other than that it is more than likely going to be a market that will fluctuate in a range plus or minus 1000 or so points on the Dow. The good news is that the Fed has had time to put a lot of programs in place in order to stave off a real depression. The bad news is the government is now at risk. It has the ability to accrue deficits and print an infinite amount of money, but by doing so, it could be solving one problem while creating another. We are in the eye of the storm, hoping the second half somehow fades out to sea. In the mean time, the solution to this current problem may generate at least a partial recovery of the markets which by the way are still down, in rough terms, 40% from where they once were.

### **Behind The Illusion**

The current perception is that our markets are at risk. We are looking at a glass half empty. But that will change. At some point we will see that there is a lot of water still in there. When that happens, perception changes and millions of people will forget the problems we had and focus on the good things. They will invest in the future and pour money into real estate and the markets. Once again there will be another bubble in something. It is only a matter of time and it will probably happen sooner than you think - or when we all least expect it!

Have a great summer!

*John R. Ruocco*

Asset Management Associates is owned and operated by John R. Ruocco who has been providing a *fee only* investment advisory service for over 20 years. For more information and advisory fees, please contact John R. Ruocco at 1-800-208-8588 in South Windsor, Connecticut *The first consultation is always free.* Information, brochure, and form ADV part II is available upon request or log-on to [www.assetmanagementassociates.com](http://www.assetmanagementassociates.com).

*Note: My pledge to the members of the military serving in Iraq or Afghanistan and their spouses is to waive my fees for investment advice as long as they are deployed or for one year after they return.*

## Focus on Exchange Traded Funds 2nd Quarter 2009

Sector	Symbol	Percent of S&P	YTD 2006	YTD 2007	YTD 2008	YTD 2009	Annual Expense	
Technologies	XLK	21.83%	12.16%	8.99%	-41.66%	<b>19.20%</b>	0.28%	Internet, telecom, computers
Materials	XLB	3.16%	18.22%	22.13%	-44.12%	<b>14.73%</b>	0.28%	Chemicals, materials, mining.
Discretionary	XLY	8.90%	18.41%	-13.01%	-33.67%	<b>8.59%</b>	0.28%	Autos, apparel, hotels, media.
Energy	XLE	12.07%	18.01%	36.74%	-38.92%	<b>1.52%</b>	0.28%	Oil, gas and equipment.
Health Care	XLV	14.43%	7.05%	7.11%	-23.31%	<b>0.30%</b>	0.28%	Health care, equipment, pharm.
Utilities	XLU	4.12%	20.85%	18.85%	-29.20%	<b>-1.91%</b>	0.28%	Water, electrical and gas.
Staples	XLP	12.58%	14.47%	12.93%	-15.30%	<b>-2.19%</b>	0.28%	Retailing, personal consumption.
Financial	XLF	13.28%	18.82%	-18.59%	-55.14%	<b>-3.30%</b>	0.28%	Financial services
Industrial	XLI	9.62%	13.50%	13.70%	-38.95%	<b>-4.66%</b>	0.28%	Aerospace, machinery etc.

*Note: If you own all of the above in the specified percentage, you then own the S&P 500 - which trades under the symbol SPY - listed below.*

Coal	KOL	***	***	***	-63.68%	<b>60.10%</b>	0.65%	Coal Stocks
Steel	SLX	***	***	***	-63.87%	<b>43.20%</b>	0.55%	Steel Stocks
Golden Dragon	PGJ	na	53.30%	63.27%	-56.13%	<b>40.20%</b>	0.60%	China
China 25	FXI	na	83.17%	54.75%	-47.76%	<b>35.20%</b>	0.60%	China
Emerging Markets	EEM	na	31.90%	33.08%	-48.89%	<b>31.70%</b>	0.76%	Emerging Markets
Silver	SLV	***	***	***	-23.79%	<b>28.80%</b>	0.50%	Physical Silver
Agribusiness	MOO	***	***	***	-51.03%	<b>23.90%</b>	0.65%	Agricultural Stocks
Nasdaq 100	QQQQ	49.67%	6.93%	19.14%	-41.72%	<b>22.20%</b>	0.20%	Largest 100 NASDAQ
Pwr Pref. Financial	PGF	***	***	-15.91%	-27.18	<b>17.63%</b>	0.72%	Financial Preferred Stocks
Clean Energy	PBW	na	7.20%	58.50%	-68.87%	<b>17.40%</b>	0.60%	Alternative Energy
Nuclear	NLR	***	***	***	-44.75%	<b>16.10%</b>	0.55%	Nuclear Stocks
I-Shares Preferred	PFF	***	***	***	-23.84%	<b>15.68%</b>	0.48%	Preferred Stocks
Gold Miners	GDX	***	***	***	-26.07%	<b>12.30%</b>	0.55%	Gold Stocks
I-Shares High Yield	HYG	***	***	***	-17.40%	<b>10.43%</b>	0.50%	High Yield (junk) Bonds
Oil	USO	***	***	***	-56.31%	<b>10.20%</b>	n/a	Physical Oil
Gld Sachs Resource	IGE	33.49%	16.41%	33.47%	-42.88%	<b>9.70%</b>	0.50%	Energy - Resources
EAFE Index	EFA	29.80%	25.81%	9.97%	-41.04%	<b>7.80%</b>	0.35%	European Index
TIPs Bond Fund	TIP	na	0.28%	11.93%	-0.53%	<b>6.30%</b>	0.20%	Inflation Protected Securities
Global Alt Energy	GEX	***	***	***	-60.82%	<b>5.80%</b>	0.65%	Alternative Energy
Gold Trust	IAU	***	***	***	5.11%	<b>4.70%</b>	0.40%	Gold Bullion
Russell 2000	IWM	48.00%	18.27%	-1.75%	-34.15%	<b>2.70%</b>	0.20%	Small Cap Stocks
S&P 500	SPY	28.17%	15.85%	5.14%	-37.22%	<b>2.50%</b>	0.11%	S&P 500 Index
Japan	EWJ	38.73%	5.95%	-5.48%	-26.99%	<b>2.10%</b>	0.84%	Japan Index
Dynamic Biotech	PBE	na	2.31%	5.82%	-26.75%	<b>1.60%</b>	0.60%	Biotech
Water Resources	PHO	na	22.17%	16.74%	-32.43%	<b>1.60%</b>	0.60%	Water Prod. & Supply
Rydex Euro Currency	FXE	na	10.90%	14.54%	-1.15%	<b>1.10%</b>	0.40%	Inverse Dollar/Euro
Diamond Trust	DIA	28.00%	0.19%	8.79%	-32.31%	<b>-2.40%</b>	0.20%	Dow Ind. Average
Dow Sel. Dividend	DVY	na	19.44%	-5.67%	-32.80%	<b>-12.40%</b>	0.40%	High dividend Stocks
Cohen & Steers Rlty	ICF	36.75%	38.50%	-18.21%	-41.01%	<b>-15.50%</b>	0.35%	Real Estate Inv. Trusts

*The above is a brief list of some of the more popular indexes currently used.*

## Managed Fund Performance for 2nd Quarter - 2009

		<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>Back</u>	<u>Annual</u>	
	<u>Symbol</u>	<u>Total</u>	<u>Total</u>	<u>Total</u>	<u>YTD</u>	<u>Red. Fee</u>	<u>Expense</u>	<u>Description</u>
<b><u>Bond</u></b>								
Pioneer High Yield A *	TAHYX	10.60%	7.00%	-37.00%	<b>30.10%</b>	0.00%	1.10%	<i>Junk and Conv.</i>
Vang. High Yield	VWEHX	8.20%	2.00%	-21.30%	<b>19.80%</b>	0.00%	0.26%	<i>Lower Quality</i>
Price Spectrum Income	RPSIX	8.40%	6.20%	-9.40%	<b>8.20%</b>	0.00%	0.80%	<i>Conservative Bond</i>
Amer. Cent. Inf. Adj. Sec.	ACITX	0.00%	11.00%	-1.00%	<b>5.00%</b>	0.00%	0.49%	<i>TIPs</i>
American World Bond	CWBFX	7.60%	8.60%	-0.60%	<b>2.90%</b>	0.00%	1.04%	<i>Int'l Bond</i>
<b><u>Balanced</u></b>								
Vang. Star	VGSTX	11.60%	6.60%	-25.10%	<b>6.80%</b>	0.00%	0.20%	<i>Several Vang. Funds</i>
Dodge and Cox Balanced	DODBX	13.90%	1.70%	-33.60%	<b>6.60%</b>	0.00%	0.55%	<i>Bond Stock &amp; Cash</i>
Vang. Wellington	VWELX	14.90%	8.30%	-22.30%	<b>5.10%</b>	0.00%	0.36%	<i>60%/40% Stock Bond</i>
Vang. Balanced Index	VBINX	11.00%	6.20%	-22.20%	<b>4.20%</b>	0.00%	0.22%	<i>Index of Wellington</i>
American Cap Income Bldr	CIBFX	22.00%	10.60%	-30.00%	<b>3.60%</b>	0.00%	0.79%	<i>Diversified U.S. Int'l</i>
<b><u>Stock funds</u></b>								
Price Science & Tech.	PRSCX	7.10%	11.90%	-43.80%	<b>34.70%</b>	0.00%	1.11%	<i>Tech.</i>
Invesco Gold *	FGLDX	28.50%	22.80%	-28.70%	<b>21.70%</b>	0.00%	1.89%	<i>Gold - Sector</i>
Neuberger Partners	NPRTX	13.20%	10.10%	-52.00%	<b>20.70%</b>	0.00%	0.90%	<i>Value - Aggressive</i>
Third Ave. Value	TAVFX	14.70%	5.80%	-45.60%	<b>17.30%</b>	0.00%	1.07%	<i>Diversified Value</i>
Invesco Energy *	FSTEX	9.70%	45.10%	-44.00%	<b>16.80%</b>	0.00%	1.23%	<i>Energy - (phase out)</i>
Price Blue Chip	TRBCX	9.70%	13.00%	-42.60%	<b>16.50%</b>	0.00%	0.96%	<i>Large Cap</i>
Vang. Energy	VGEXX	19.70%	37.00%	-42.90%	<b>14.70%</b>	0.00%	0.40%	<i>Energy Sector</i>
Vang. Explorer	VEXPX	9.80%	5.10%	-40.40%	<b>10.70%</b>	0.00%	0.70%	<i>Small Caps</i>
Vang. Primecap	VPMCX	12.30%	11.50%	-32.40%	<b>7.90%</b>	0.00%	0.49%	<i>Growth</i>
Mutual Discovery	MDISX	23.40%	11.30%	-26.60%	<b>7.80%</b>	0.00%	1.04%	<i>Specialty &amp; Int'l</i>
Rydex Biotech	RYOIX	-3.10%	5.70%	-10.50%	<b>6.80%</b>	0.00%	1.38%	<i>Biotech Sector</i>
Fidelity Contrafund	FCNTX	11.50%	19.80%	-37.20%	<b>5.70%</b>	0.00%	0.99%	<i>Large Cap</i>
Investment Co. Of America	AICFX	16.00%	5.90%	-34.80%	<b>5.70%</b>	0.00%	0.70%	<i>U.S Growth - Large Cap.</i>
Neuberger Genesis	NBGX	7.30%	21.90%	-32.90%	<b>4.40%</b>	0.00%	1.08%	<i>Small Cap - Closed</i>
Royce Total Return	RYTRX	14.50%	2.40%	-31.20%	<b>3.30%</b>	0.00%	1.20%	<i>Div. Paying Small Cap</i>
Vang. Index 500	VFINX	15.60%	5.40%	-37.00%	<b>3.20%</b>	0.00%	0.18%	<i>Index - S&amp;P 500</i>
Vang. Windsor II	VWNFX	18.30%	2.20%	-36.70%	<b>2.60%</b>	0.00%	0.42%	<i>Value</i>
Vang. Health	VGHCX	10.80%	4.40%	-18.50%	<b>1.80%</b>	0.00%	0.29%	<i>Health - 25k Min.</i>
Prudent Bear	BEARX	9.10%	13.40%	26.90%	<b>-5.40%</b>	0.00%	1.76%	<i>Short-Gold</i>
Cohen & Steers Realty	CSRSX	37.10%	-19.20%	-34.40%	<b>-10.20%</b>	0.00%	1.09%	<i>Diversified REITS</i>
<b><u>International</u></b>								
Price International	PRITX	19.30%	13.40%	-48.00%	<b>21.20%</b>	0.00%	0.92%	<i>Diversified Int'l</i>
American Cap World	CWGFX	22.30%	17.50%	-38.40%	<b>7.10%</b>	0.00%	0.91%	<i>U.S. and Int'l</i>
1st Eagle Sogen Overseas A*	SGOVX	22.30%	8.40%	-21.00%	<b>5.40%</b>	0.00%	1.39%	<i>Smaller Cap Int'l</i>
1st Eagle Sogen Global A*	SGENX	20.50%	9.90%	-21.10%	<b>5.00%</b>	0.00%	1.34%	<i>Int'l with 38% US</i>

\* purchased at N.A.V. with sales fees waived on these loaded funds

*Bonds, Technology and Energy led the markets in a second quarter rebound. Some of the best managed funds significantly out performed the broad indexes.*