TFC Financial Management

# TFC Market Update
# September 12, 2011

## That Uneasy Feeling: Financial Market Volatility Redux

Renewed financial market volatility brings back that uncomfortable sense of anxiety for all investors in risk assets. Markets abhor uncertainty, and wherever one turns today, the unpredictable overpowers any feeling that equilibrium has been reached. The Washington crowd continues its time-honored approach of treating the symptoms, ignoring the long-term causes. Our vulnerability to misdirected politically-motivated policy initiatives persists. In a quest for viewer share, media headlines and sound bites build concern without context.

Meanwhile, the financial market malaise in the U.S. weighs heavily on consumer sentiment, and individuals are intent on rebuilding their personal balance sheets. Since consumer spending is 70% of U.S. Gross Domestic Product (GDP), businesses expecting weak demand are loath to expand, banks remain cautious in their lending policies, and, burdened with regulatory hurdles at every stage, entrepreneurs see little to be gained by starting new ventures.

In Europe, as the rest of the world is aware, the Germans and French struggle to decide to what extent they are willing to support their profligate, southern-tier dependent states. Eurozone banks holding massive amounts of public and private debt on their balance sheets, which should be marked down to market, appear to need substantial amounts of new capital to replenish diminishing loan reserves.

All of this might seem a recipe for another 2008-2009 investment market meltdown, or perhaps for the U.S., something similar to the post-crash (i.e., since 1989) Japanese financial market doldrums. But the negative economic case is easily discerned, well publicized and now accepted wisdom. Investing for the longer term (next 3-5 years) suggests patience, a careful look at equity market valuations and the willingness to maintain a certain level of portfolio risk.

## "Our Best Investments Are Made When No One Else Is Interested or Willing"

Warren Buffet, today perhaps suffering from a bit of media over-exposure, has just invested $5 billion in Bank of America. Perhaps the paraphrase in the above quote isn't verbatim, but the sentiment, it's fair to say, would be his. So, why might this be the best opportunity in 30 years for equities to outperform bonds well into the future?

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Despite the widely understood slowdown in U.S. economic activity, American corporations continue to perform remarkably well. Profit margins are back to 2007 levels and earnings appear to be heading for record results over the next 18 months. Cash flow per share for the S&P 500 companies (80% of U.S. stock market value) approximates $150 per share. In 2001, the comparable figure was $75; in 2007, $83. Today's market multiple on cash flow is 7x versus an average of 12x over the past 13 years. Worldwide, stock market multiples on future corporate earnings today appear to be in very attractive ranges. Earnings yields (reciprocal of the price/earnings ratio) at 8%, relative to 10-year U.S. Treasury yields (2.0%) represent a seldom witnessed near-record premium. A marked increase in reported Insider Purchases indicates corporate managers' increased confidence in their companies' futures. The ability of American corporations to improve productivity should not be ignored. As long as the case for global corporate earnings can be sustained, current account allocations to equities seem appropriate.

**Portfolio Strategy (Some Rebalancing May Be Appropriate)**

Despite the near-term difficult psychological environment, where client Investment Policy allows, some further adjustments are contemplated. In retirement and endowment accounts, Treasury Inflation Protected Securities (TIPS) fund holdings, which are presently providing a negative real yield, will be reduced and the proceeds reinvested in shorter duration global bond funds. Current yield, as a result, will improve slightly. Depending on the established portfolio policy mix and client objectives, for balanced accounts, fixed income holdings may be trimmed and reinvested in large company U.S. domestic funds.

**Website Enhancements**

Over the past few months, the firm's website has added a few features and further additional innovations are anticipated. Recently added are links to TFC's SEC Narrative Form ADV (Parts 2A and 2B). Also, we plan to add links to Dimensional Fund Advisors (DFA) website which offer some interesting articles and "white papers" for those interested in exploring financial market research in greater depth. In the future, we are also planning videos featuring our own views on topics important to investors. Currently, of greater interest might be the below URL link* to a *Wall Street Journal* article describing an interview with Jack Bogle conducted by Jason Zweig.

Should you have any questions or comments, please let us know.

Best,

Jim

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* http://online.wsj.com/article/SB10001424053111904103404576560913892680574.html