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Trusted Advisor

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Positive Outlook for the New Year

I will repeat what many commentators have observed in their wrap up of the past decade in finance: for the United States, it has been a time when stocks in general were a poor investment (despite twice achieving new all time highs!), real estate ran from red hot to ice cold, and the most commonly held investment, the greenback, went to hell in a handbasket. In general, Americans have become considerably poorer, especially when compared to citizens of emerging nations like China, Brazil and Russia. 7.2 million U.S. jobs were lost since the recession started two years ago. Hemorrhaging of middle class jobs began to bite the service sector just as it has long hurt the manufacturing portion of our economy. *"It's been a decade of delusion,"* says Richard Turlow, Professor of business administration of Harvard Business School in Cambridge, Massachusetts. *"In many ways, we're worse off than the 1930s, we've created problems of moral hazard and we're faced with an astounding public debt."* [1]

WHO WE ARE

Certified Financial Planner™ with 35 years direct experience advising investors

WHAT WE OFFER

Complete review of your budget, your tax situation, and your ability to build wealth. We can also review your safety net:
Sufficient emergency fund?
Properly insured?

WHY YOU CAN TRUST US

We are retained as direct consultants to you. Since we act as fiduciaries, we do not offer any products, insurance, or investments for sale.
We are your trusted advisor.

HOW WE ARE COMPENSATED

We are paid by you for rendering advice for your benefit. We may make a one time review or provide ongoing financial and investment advice. Our fees are very competitive and fully disclosed.

Certified Financial Planner™

Gary Miller is in his 36th year of providing financial guidance to individuals and pension plans. He is a Registered Investment Advisor and a Certified Financial Planner ™ Practitioner. Gary holds a Certificate in Personal Financial Planning from the University of California, Irvine and has served as a Board member of the Financial Planning Association, Orange County Chapter.

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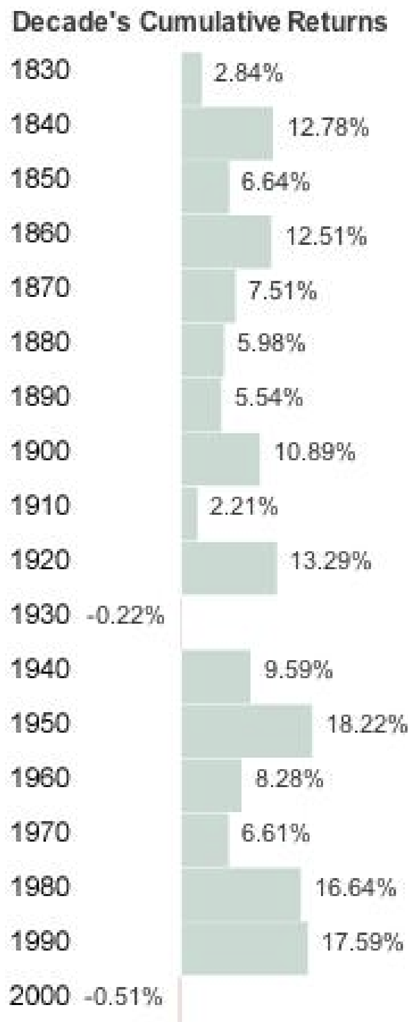
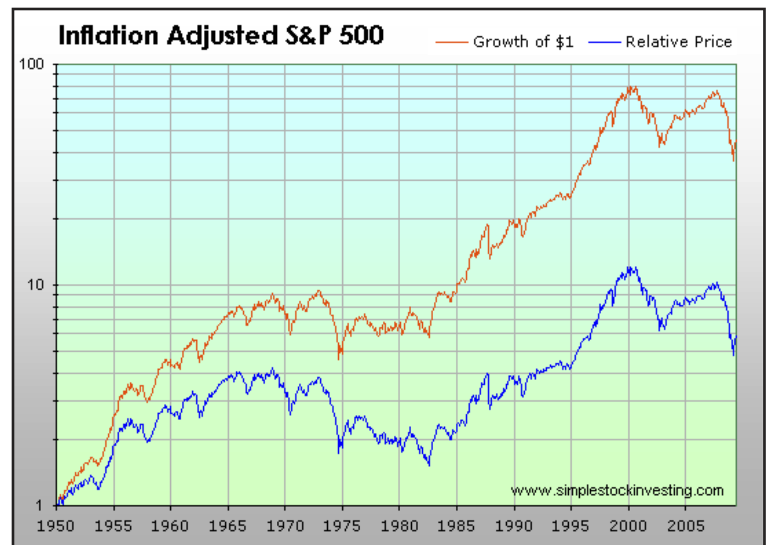
Some are labeling past ten years as "the worst" since the early 1800's. A graph attributed to the Wall Street Journal was published at the "SeekingAlpha.com" web site and if correct, appears to bear this out:



Further, returns for any investment need to be considered in light of the buying power of a dollar. Unless adjusted for the debilitating effect of inflation, investment returns appear better than they really are. In searching for an illustration of this effect, I came across a graph produced at the end of 2008[2]. The blue line follows the nominal performance of the Standard & Poors 500 stock index, adjusted for inflation. The orange line incorporates the assumption that dividends are re-invested. Two messages emerge: *dividends have been of major importance in stock market success*



(one of the reasons we at Trusted Financial favor stocks that pay dividends). Even adjusting for the 2009 rally, it is clear that by investing in an index, a buy and hold investor has made absolutely no progress since the mid-to-late 1990's!

Trusted Financial Advisors has a track record that only goes back to mid 2001, so we cannot compare our performance with indexes for the past decade. However, the investment approach we use for Balanced portfolios is identical to that I employed as a broker, my position just prior to joining the ranks of independent investment advisors. Interested parties may want to read our newsletters, in which we have continuously discussed our average performance. These can be found at our website. During the two major bear markets that occurred while we have been in operation, our clients experienced considerably less give back than did major U.S. stock indexes. This has allowed our clients to recover more quickly, both in the 2003-2007 period and again from mid March 2009 through year end.

I attribute this to the eclectic approach we take. We are buyers of any liquid investment that appears to be undervalued. We want our clients to own investments that generate significant amounts of free cash flow. To achieve this, our approach is to generally avoid indexes. Rather, like my mentors, Warren Buffet, Charles Munger and Benjamin Graham, I am absolutely certain

that by moving forward when individual stock and bond bargains present themselves, one will beat most indexes over longer periods of time (5 years minimum). By contrast, most financial planners who also manage money rely on index investing. This belies, in my opinion, a lack of knowledge or a lack of willingness to drill down and examine individual stock and bond investments.[3] Index investing is, in my opinion, a no brainer, and for that reason, index investors have been losers over the past decade.

I consumed two fat books on the life and investment strategies of Warren Buffet this past year, both of which improved my already considerable knowledge of his approach.[4] Buffet sniffs at index investing, and especially at trend followers. He does the challenging work of company-by-company financial analysis. Consider that while the S&P was losing value over the past 10 years, Warren Buffet's Berkshire Hathaway rose from about $52,000 a share to about $100,000, *nearly a 100% increase*. This was not the result of speculation, but reflected a steady increase in Berkshire's book value. In fairness, the ride for Berkshire holders has not been without its ups and downs. At its peak, the stock was quoted at over $140,000 a share.

Since we put a high premium on low volatility for our clients' Balanced portfolios, even Berkshire–like performance would be unacceptable if accompanied with Berkshire's level of volatility. My experience with investors over a 35 year career is that during rare but inevitable periods of sharp market declines, they often panic, leaving the party just when they should be putting on their party hats. The solution is to strive to keep volatility, which most people experience as "risk", to a minimum. I think we must be doing something right: in the face of a prolonged and massive bear market, we lost just four clients between mid 2008 and mid 2009. For the majority of our people, their fortitude has been rewarded. I believe this is a direct result of keeping short term losses in the "comfortable" range for most investors. Over our eight years in business we have regularly bested stock market indexes.[5] Even in 2008, while major stock indexes tumbled by 39%, our clients on average sacrificed about 14.5% of value. As the market melted further in the first ten weeks of 2009, our client portfolios held up well. Because our clients are never 100% invested in stocks, our client portfolios did not track as strongly upward when the stock market turned around. Nor did they need to: when you have not fallen into a deep well, the climb out is pretty easy. Today, most clients have recovered to within 4% of year-end 2007 portfolio levels. By contrast, and despite a terrific run in 2009, the U.S. Standard & Poors index remains off by about 25%.

How have we kept volatility low in the face of two bear markets over the past eight years? Considerable use is made of undervalued equities. If one does not over pay (i.e. technology companies in 2001), one does not get as bloodied when panic erupts. We also diversify across asset classes. Although this approach did not offer the usual traction during 2008, a year in which nearly every asset class did poorly, we were able to save the day by one other approach, one that is too often ignored by professional money managers: *we are not afraid to "go to cash"*. In fact, before the market meltdown began to gain momentum in September, 2008, our clients held more cash in their accounts than at any time in our history. A few complained about the low interest yields on money market funds, a couple took some money out and placed it in certificates of deposit. But thankfully, most clients left to us the timing of when to re-deploy that cash. This allowed me to scoop up good quality bonds and preferred stocks with yields of 7%-8%-9% even 11%. At the October 2008 market low, I gingerly positioned in a few great quality equities as well. When the Bear put down another leg, taking indexes below their October 2008 levels in March, 2009, I admit that I blinked. We sold off a couple of excellent companies, converting much of the proceeds to more high yielding investment grade bonds. The February–March sell-off proved to be the bottom,

and since mid-March, stocks have roared back to life. I did not believe in the turn around until an important technical signal in July.

I've never promised to make huge profits for our clients, and the past eight years have proven me correct. But our clients want something more valuable: *peace of mind*. When I sit down with a new, prospective client, I tell them that, above all, we seek to reduce the wild ups and downs they have probably experienced at the hands of other advisers (or at their own hands). I also suggest that we can capture 80% of the US stock market upside. We have successfully delivered low volatility (less than half that of the S&P 500) and so far, have *exceeded* market returns over an eight year span.[6] Thus, our performance is something attractive to those who understand the concept of risk adjusted returns.

Sincerely,

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Footnotes:

1. BusinessWeek January 3,2010
2. Simplestockinvesting.com
3. During the stormy weeks and months of 2008-2009, I personally examined financial statements, news articles and personnel profiles of every company and municipality which we considered for investment. Most were rejected, but of those purchased, nearly all are in profitable territory at this writing.
4. Buffet : the Making oa an American Capitalist by Roger Lowenstein ©1995,Random House; The Snowball by Alice Schroeder ©2008,Bantam Books.
5. This observation is based upon a composite of client accounts. Each account is individually managed and results may vary significantly from these averaged results
6. Interested parties are welcome to come to our office to review our composite performance.

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