Investments & Wealth Management July, 2012

By: Scott Walker, CFP®

I hope this finds you in good health and enjoying the summer. Last quarter proved to be a challenging environment for stocks with domestic political uncertainty, European debt and banking concerns, and slowing global economic growth. We have taken some risk off the table this year by reducing equity exposure and increasing our allocation to bonds and cash. We are in the middle of the seasonally weak summertime period and are exercising patience while we continue our quest for diamonds in the rough. Stay tuned for the upcoming quarterly earnings announcements and future guidance which always provides some fireworks and opportunities to deploy capital at more favorable prices.

Wisconsin voters have chosen to keep Scott Walker as governor, with the majority voting for pension reform and fiscal austerity. The cities of San Diego and San Jose also passed voter initiatives in early June to rein in large projected unfunded liabilities for public sector pension plans. It was too late for the cities of Stockton and Mammoth Lakes, which declared bankruptcy and will be restructuring operations.

Our gains in April and June were not enough to overcome the big dip in May, so for the past 3 months our consolidated client return net of fees was -1.3%. Our overall net year-to-date return is +4.2%.

Bonds – In contrast to the troubled areas, the vast majority of the municipal bond market remains strong. Prices are up and yields have continued to decline on new offerings amidst a steady demand from retail and institutional investors for the **tax-exempt** interest that these securities provide. Holding a ladder of staggered maturity individual bonds from 1 - 15 years is the way to go. Last quarter we added a land-backed bond from the City of Encinitas. This new bond issue was used to refund older original bonds that had been called, or redeemed by the issuer. Our source of repayment is a special tax on each parcel that is added to the property tax bill. We also own the steady **American Century CA High Yield Bond Fund** with an above average 4.7% current yield.

Interest rates are at generational low levels on bank instruments and U.S. Treasuries (10-year 1.60%). For yield enhancement we own corporate, mortgage-backed, and foreign bonds. The **Doubleline Total Return Bond**, **Loomis Sayles Bond**, and **Templeton Global Bond** funds pay monthly dividends with yields in the 5 – 6% range. The **SPDR Barclay's High Yield Bond** (7.2% yield) is our favorite fixed-income exchange-traded fund. Splitting exposure between individual bonds and bond funds provides the best of both worlds. Individual bonds have the certainty of a fixed semi-annual interest payment, with a return of principal on the maturity date. Bond funds and ETF's provide more diversified exposure and more frequent cash payments from monthly dividends.

Stocks – Utilities were the star last quarter with **Sempra Energy** being our top performer. The parent of San Diego Gas & Electric and Southern CA Gas has a slow and steady regulated business with a well-covered 3.5% dividend yield for risk wary investors. Bank stocks crumbled last quarter with **J.P. Morgan Chase** disclosing a $2 billion trading loss. We sold and cut our loss at 10%, but also booked a short-term gain on **Bank of America** common stock. I prefer to own **Wells Fargo & Co.** with a more conservative domestically focused business. **Berkshire Hathaway** also owns 7.6% of Wells Fargo.

The slowing global economy and strong dollar will hinder export growth for U.S. multi-national companies. Consumer demand for generic and store brands is a major headwind for **Proctor & Gamble**. The lumbering giant continues to struggle, so we took our profit at $63.50/share and will look to redeploy into another blue-chip dividend paying stock with better fundamentals.

Technology stalwart **IBM** has unveiled a new converged system for the large enterprise market called PureSystems. The new product combines storage, virtualization, networking gear, and software into a more flexible easy to manage system. Priced in the $100,000 - $300,000 range, PureSystems is designed to cut users costs. It's basically an all-in-one computer that can be adapted to the specific needs of a business. It represents a significant threat to providers of stand-alone products like storage maker EMC and gear makers NetApp and Cisco Systems.

The energy majors have declined along with the price of oil, so we have increased our position in the two largest U.S. based producers with **Exxon Mobil** and **Chevron**. They own finite resources along with the distribution network and a dominant retail presence. They are well capitalized with strong cash flow yields and a history of dividend increases. Current yields respectively are 2.7% & 3.4%. Shares of **Newmont Mining** dropped into our buy zone last quarter, so we bought the only gold producer in the S&P 500. This stock is trading 35% off its 52-week high with an attractive valuation and a 2.9% yield.

Retirement and Tax Planning – If you are age 50 or over and still working, be sure to take advantage of the "catch-up" provision with your retirement savings plan. This provision allows an additional annual contribution of $5,500 for a 401(k), 403(b), or 457 plans. This is in addition to the standard $17,000 annual salary deferral limit. The $22,500 deferrals must be completed by 12/31/12 to be excluded from taxable income for the current tax year. Additional discretionary employer contributions are allowed via matching or profit-sharing.

IRA's – For traditional and Roth IRA's, the catch up amount is $1,000 on top of the $5,000 annual limit. You have up until April 15, of next year to deposit the money. A Roth IRA is funded with after-tax dollars (no tax deduction) and offer tax-free accumulation and distribution of earnings after 5 years and age 59 ½. Contributions are penalty free anytime. Roth IRA's are exempt from required minimum distributions at age 70 ½ for longer tax-deferral, while traditional IRA's must begin annual distributions.

Long-Term Care Insurance – Did you know that premiums for a long-term care policy may be paid via a tax-free 1035 exchange from an annuity or life insurance policy on the same insured? The new provision provides a tax-free avenue for the premiums to fund this coverage.

U.S. Savings Bonds – The bureau of public debt projects that the government will save $120 million over the next five years by discontinuing the issuance of paper bonds and going digital. Visit www.treasurydirect.gov to see what old bonds are worth and more information about Series EE and I savings bonds. You can also access a downloadable gift certificate for a special occasion.

If you have any questions or comments regarding your portfolio, please let us know. Thank you for your trust and confidence, we are working hard to continue to earn it.