DB&B Financial Services, LLC

Financial Insider

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INSIDE THIS ISSUE:

YEAR TO DATE PERFORMANCE (2009)

Dow Jones Industrials:	-2.01%
S&P 1500 Composite:	3.47%
S&P 500 (Large Cap):	3.16%
S&P 400 (Mid Cap):	8.47%
S&P 600 (Small Cap):	0.67%
Int'l Developed Mkts:	7.95%
Int'l Emerging Mkts:	34.26%

YIELDS & RATES

2-Yr T-Bond Yield:	0.80%
5-Yr T-Bond Yield:	1.67%
10-Yr T-Bond Yield:	2.67%
30-Yr T-Bond Yield:	3.53%
30-Yr Mortgage Rate:	4.20%

Asset Allocation Still Key in Managing Risk

A slew of recent articles have questioned whether or not the idea of reducing the risk of a portfolio by using asset allocation is dead. Indeed it is tempting to question the value of diversification when looking at the performance of various asset classes during the 2008 calendar year, when several asset classes each reported negative returns in roughly equal amounts. However, studies over longer time frames refute the short-term look-back conclusions. One key factor that is cleverly omitted from these recent articles is an analysis of the root cause of the precipitous drop in market values that occurred during 2008.

What do the Great Depression and the current deep recession have in common that is uncharacteristic of all the other recessions since the Great Depression? A collapse of the underlying financial support system in the United States. Hundreds of banks failed between 1929 and 1933. At the same time, the Treasury Department raised interest rates and tightened the money supply to the point that credit virtually dried up, causing businesses to go bankrupt for lack of borrowing power. Our recent deep recession also results from credit drying up, not because of Treasury action, but because of a failure of our banking system. Our current recession was caused by credit being too easy to obtain, leading home prices to reach unreasonably high values that were unsustainable once people began to default on their mortgages. Once home prices declined and defaults snowballed, banks became ultraconservative and wouldn't even lend money to each other. How were other recessions different? All other recessions were a result of the natural ebb and flow of the business cycle. The United States economy has never moved up in a straight line, becoming better and better each year. It runs in cycles of good years, and then slower years. The good periods have historically lasted twice as long or occurred twice as often as the slower periods. Asset allocation will always work when our economy behaves in accordance with the natural ebb and flow of business cycles. Nothing will work when we lose faith in the underpinnings of capitalism, as happened in 2008.

Mark Smith, CPA/PFS, CFP, CIMA and principal of MJ Smith and Associates in Englewood, Colorado did a study using actual market returns and actual inflation rates from 1973 to year end 2008. His study revolved around six hypothetical portfolios each beginning with one million dollars and each having an initial withdrawal rate of $50,000 per year, or 5%. The six portfolio asset allocations were as follows:

1. 100% large company stocks
2. 60% large company stocks 40% bonds
3. 50% large company stocks, 40% bonds, 10% small company stocks
4. 35% large company stocks, 40% bonds, 10% small company stocks, 15% foreign stocks
5. 25% large company stocks, 40% bonds, 10% small company stocks, 15% foreign stocks, 10% REITS
6. 15% large company stocks, 40% bonds, 10% small company stocks, 15% foreign stocks, 10% REITS, 10% commodities.

Portfolio number 1 ran out of money in 1991, portfolio 2 in 1995, portfolio 3 in 2002 and portfolio 4 in 2007. Portfolio 5 still had $288,000 left at the end of 2008. The clear winner was portfolio number 6, which still had $3.6 million dollars left at the end of 2008. (A portfolio of 100% bonds hit zero value in 1994 in this same study.)

Why, in this study, as in many others I have read, does the portfolio with the most diversification of asset classes come out on top? Is it because the asset classes that are added each time have a greater return than the initial ones? No. A quote from Smith is, "it's not the return, it's the risk." Each asset class has an inherent average rate of return and standard deviation (measure of risk). The more asset classes that are added together the lower the standard deviation, or risk, becomes. Since each of these portfolios were studied using all of the same data, the only differing factor was the risk each portfolio was taking. Portfolio number 5 had a standard deviation of 11.57% and portfolio 6 had a standard deviation of 9.86%. Each portfolio suffered losses in the down years but portfolio 6 had an average 6.47% loss, while portfolio 5 had an average loss of 10.68% in the same years. Lowering standard deviation in a portfolio protects the downside.

We've always been strong believers in the efficacy of asset allocation. When many asset classes behaved in unison as they did in 2008, it became our responsibility to find out why and to adjust our strategy, if necessary, to protect our clients' portfolios. The study by Smith is but one, yet it includes 2008 and also keeps most variables constant to allow for understandable comparisons. Because of this and other studies, we remain committed to the principle of asset allocation. We will continue to pursue the most current research in our efforts to bring the best thinking to our portfolio management approach. Please call if you have any questions regarding your individual asset allocation, your portfolio holdings or any other aspect of your financial situation. We appreciate your continued trust in our management.

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Kevin VandenBerg MBA, LIFA
COO, Director of Managed Portfolios

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Reality…..or Head Fake?

Thank goodness for a better market! The S&P 500 increased 15.9% during the second quarter and is now up 3.2% for the first six months of 2009. This is certainly welcome after such a dismal start to the year when the S&P was down 19% after February. The DOW has also increased nicely, up 11%, but is still negative for the year at –2%. All categories enjoyed handsome increases this quarter with mid caps up 18%, small caps up 20%, developed international up 22% and emerging markets up nearly 30%.

Despite the excellent quarter in the equity market and the perceived increase in safety of the banking and financial system, we believe the market may be a little ahead of itself. We suggested last quarter that the market's run needed a breather in order to move higher, over the long term, in a healthy fashion. While March, April and May saw the market increase 25%, June was rather lackluster as it was up only 1.4%. However, the back half of the month weakened and July has continued this trend in the first couple of weeks. The downward bias in the market has been in concert with weakening overall volume and poor fundamental data. We're not surprised by this trend at all. We're further emboldened in our belief that a pullback may be in its early stages as the main technical indicators we follow

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turned negative on June 17th.

Based on the facts listed above, we moved to a more defensive position in many portfolios. Since we're very concerned about preserving your hard earned investment capital, we've increased our cash position and purchased an ETF (exchange traded fund) that goes up when the market goes down. These two actions were taken during the latter portions of June and have done quite well in protecting the downside while the market has dropped. We will continue to trim weak positions (increase cash) and hold the inverse ETF until our technical indicators reverse positive and the market is back on an upward course.

The reversal of trend from positive to negative fits in line with our fundamental thinking of the economy and the consumer. It took us many years to get into this problem and there is little doubt that it will take awhile to get out of our current financial and economic mess. We're at the beginning of the second quarter's earnings season and volatility (both up and down) will probably rule the next few weeks, especially if earnings come in higher than expected while many investors are still bearish overall. This possibility could push the market higher and force many investors who are "short the market" to cover and drive the market higher. There will definitely be some positive and negative earnings surprises, but the important caveat to watch for is not necessarily the earnings produced by companies, but how they got to those particular earnings. If companies report good earnings, but mostly due to cost cutting, job layoffs and research and development delays, this is not necessarily good and is referred to as "poor earnings quality." We want to see higher revenue (top line) growth that produces higher earnings. This type of report would be bullish and will produce long term gains in both stocks and the market in general.

Overall, this earnings season will most likely separate the good companies from the bad. We expect that quality (Goldman Sachs, IBM, Apple) will rise to the top while the pretenders (Citigroup, Dell, AMD) will be left by the wayside. Growth in earnings may come in ahead of estimates as the bar has been lowered substantially of late. The fact remains, however, that the consumer is still debt laden and cash strapped while small businesses are still hurting from the lack of credit availability (for growth).

The last part of this two year financial crisis that could still be looming is in the form of commercial real estate problems. Although steps have been taken to prevent system-wide financial problems from spreading once again, a setback in commercial real estate could postpone economic recovery or cause more balance sheet difficulties for banks. This sector often experiences trouble in the late stages of the economic cycle after jobs have been lost and companies have gone out of business. We're keeping a watchful eye on vacancies, newly negotiated rents and leases, and bank write downs on commercial property in order to gauge any potential fallout from this sector.

Should our technical indicators reverse to positive from negative, we will, once again, go to offense from our defensive posture. After all, fighting the market is not healthy and we must remain agile in our portfolio management in this extremely volatile and erratic market. We expect the market to remain very volatile this year as the federal government's policies, unemployment, consumer credit woes, and budget concerns (federal, state and local) all take center stage.

If you have questions or concerns about your portfolio or the markets in

Michelle Jozefczyk

Michelle is at: CNY Yoga Center at 719 E. Genesee St., above Strong Hearts Café and SpaZend.

general, please don't hesitate to contact us. We would be happy to talk with you about these or other topics in the news.

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Moving On

We're sad to inform you that a member of our team, Michelle Jozefczyk, is moving on. Already a certified yoga instructor, Michelle decided to teach yoga full-time as a step toward her dream of one day opening her own yoga studio. We will miss Michelle's caring approach and attention to detail, but we wish her the best of luck in her new pursuits. If you'd like to attend one of Michelle's classes, you will find her at the newly opened branch of the CNY Yoga Center at 719 East Genesee Street, above Strong Hearts café and SpaZend.

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