

Investment Commentary

May 25, 2010

It seems like a long time since I have written a commentary – and it has been a long time (3 months), but here are my thoughts.

My view of the stock market today has not changed much from last year, but it has been too risky to pursue the same strategy in 2010. I had all clients reiterate their tolerance for risk by having everyone complete and send in a new risk questionnaire. In evaluating those questionnaires, I have been able to more clearly define where I see you on the tolerance spectrum.

At the same time I started revising the “portfolio models” I had created. In early January I started putting some stock funds back into most retirement accounts and some non-retirement accounts. In mid-March I did the same with most non-retirement accounts and the employer-sponsored accounts for those clients who have me manage that aspect of their wealth. So, at that point (mid-March) almost everyone had 50% of their ultimate stock allocations and 100% of their bond allocations. In April, I again put more stock funds into most retirement accounts, except that I left alone the employer-sponsored ones.

That brings us to now. I have read many opinions, listened to many interviews and reviewed a wide range of data. I have gone from a 100% bear to a 50-50 bear, but for now, I am back in the bear camp all the way. There is just too much negative news both here and abroad. The main difference for me between previous years of managing your accounts and now is that I do not foresee us going back into a “no stocks” scenario. I will manage the risk from a diversified portfolio aspect and the more conservative you appear to be, the fewer stocks you will always have in your entire portfolio. Technically, this would mean that I would be buying more stock funds right now for those who do not yet have your full allocation, but again, I want to wait a bit longer before pulling the trigger. Is this timing the market? Some would say “yes” but I call it prudent, considering the state of the world economies right now.

In the meantime, it is even more important in today’s environment that we have a large diversity of types of bonds, durations (similar to maturities), countries of origin, yields and credit qualities. To help manage that need for diversity, I have turned to what many think is the best bond management firm in the nation, PIMCO.

There are two recent additions to the usual spread of investments I use. One is PIMCO’s Emerging-Markets Local-Currency Bond Fund (PELBX). Emerging-markets local-currency bonds are a compelling opportunity from a relative-return perspective versus the other major asset classes I track. I think it can generate mid- to high-single-digit returns in the next three to five-year scenarios—admittedly not spectacular returns but better than any other asset class. The returns are driven by the underlying bond yields plus an expectation of at least mild currency appreciation in the years ahead.

The second addition is PIMCO's All Asset Fund (PAAIX), which I categorize as an alternative investment, along with your gold and silver positions. It is a hard fund to explain, so maybe telling you why I use it will help. This mutual fund is what is called a "fund of funds" meaning it is composed entirely of other mutual funds. This is not a new idea, but it has a twist. When I was researching how to further diversify your investments, I was looking at more non-traditional ways to putting money into the bond market. I had heard the money manager, Rob Arnott, speak numerous times, and his approach always intrigued me. Essentially, he uses many different PIMCO funds, but not the ones you already have, These funds invest in commodities, long-term treasuries, inflation protected treasuries, short-term bonds and when appropriate, equities. He goes in and out of these funds on a strategic basis, based on an analytical model he designed. Inflation and interest rates are at all-time lows, so he is managing these investments to help anticipate the negative fallout of rising interest rates, when that happens. Instead of having a couple of other PIMCO funds in your portfolio to cover more bases, you have one that manages a number of the others for these uncertain times.

There is one more move which I will likely execute in the next few weeks. I expect to sell 50% of all Total Return positions and put the proceeds into the PIMCO Unconstrained Bond Fund (PFIUX). What makes this fund different than the Total Return Fund or either of the two previously mentioned ones, is that, like the name, where the manager invests is not constrained by prospectus objectives, like the Total Return Fund is, for instance. Again, in this time of uncertainty in countries, types of bonds, and currencies, the Unconstrained Bond Fund uses futures and swaps to manage risk and to take advantage of the possible future changes in the landscape. In your taxable accounts, there will be taxable distributions, but on an after-tax basis, I believe you'll still be ahead of having the whole allocation in Total Return over a three year time frame.

So, in summary, if I cannot have you fully invested in the equities market, which I cannot, and if I know almost for certain that interest rates will rise in the next two years, I need to help mitigate the bond market's reaction to the rising rates by diversifying and reducing the overall risk on a three to five year basis.

Please call me with any questions or issues. I appreciate your business and your trust.

Sincerely,

Margie Mullen