

YSWM, LLC

Mid-Year
2010
Update

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YOLLES-SAMRAH WEALTH MANAGEMENT, LLC

The second quarter ended on a down note with the stock market near the bottom of its 2010 trading range as consensus expectations shifted from a strong post-recession economic recovery (4-5% GDP) to slowing growth (2-3% long-term average) and then eventually subpar or even negative growth for at least a few more quarters (less than 1%). After peaking in late April, the stock market moved lower for most of the quarter with daily volatility and volume increasing. Daily price volatility bottomed in April at just 0.9% then jumped to 3.4% in May before settling back to around 2.4% during June and July which is still above the 1 to 2% historical range. The ride has certainly become more roll-coaster like in mid-2010 following a very strong fourteen month rally off the 2009 recession lows.

Table 1 below shows key inflection points thus far in 2010 using the S&P500 monthly high, low and closing prices to calculate the percent change in price (excluding dividends), the inflection period (green=buy and yellow=sell) and cumulative year to date change.

The S&P500 ended the first quarter at 1,169, up 4.8% year-to-date (YTD) and continued to rally another 4.3% during the first quarter earnings reporting season before topping at 1,220 on 4/23. At that point the S&P500 had a YTD price gain of over 9.4%. Unfortunately at that level, the S&P500 price had already exceeded the upper-end of its fair value range (975 to 1,200) for 2010 using the consensus earnings forecast and a 16x p/e multiple.

Table 1 – S&P500 Monthly and YTD Performance for 2010					
Month-End	Close	Monthly High	Monthly Low	Monthly Change	YTD Change
July (7/22)	1,094	1,099	1,011	6.1%	-1.9%
June	1,031	1,131	1,028	-5.3%	-7.6%
May	1,089	1,205	1,041	-8.2%	-2.3%
April	1,187	1,220	1,171	1.5%	6.4%
March	1,169	1,180	1,105	5.9%	4.8%
February	1,104	1,112	1,044	2.8%	-1.0%
January	1,074	1,150	1,072	-3.7%	-3.7%

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Then came a number of macro events including increasing Euro sovereign debt problems (PIIGS), the BP oil spill and resulting economic damage and the flash crash of May 6th all of which reduced the demand for risky assets as investors rushed into the safety of U.S. Treasury Bonds despite the historically low yields (high prices). The dollar index also rallied strongly during the quarter as the Euro tumbled from the 1.40's through 1.30's before finally getting some traction in the 1.20's.

As shown in **Table 2**, the S&P500 ended the second quarter down -11.9% with a YTD decline of -7.6% while the Small Cap 2000 performed slightly better down -10.2% with the EAFE index falling -14% dragged down further by currency declines. Most benchmarks closed Q2 at or very near their respective lows for the year.

The flash crash has raised concern with many bear-market-hardened investors at a time when many already distrust the financial markets and the institutions that keep them functioning on a day-to-day basis. We recognize both the good and bad in an ever expanding offering of sophisticated securities that allow literally all investors big and small to quickly add exposure or reduce risk in almost every major market and segment; however, the flash crash appeared to be a structural market-making problem as the bottom on that day (S&P500 @ 1,060's) is a level the market traversed many times in June and July. The challenge most trading days, but especially on May 6th is to stay with your investment discipline and avoid reacting emotionally to volatility.

Table 2 - Benchmark Returns 6-30-10		
Index	2nd Quarter Return	Q2 YTD Return
S&P 500 Large Cap	-11.9%	-7.6%
R2000 Small Cap	-10.2%	-2.5%
EAFE International	-14.0%	-13.2%
Total Bond Market	3.5%	5.3%

Source: Standard and Poors

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The S&P500 reached its intraday 2010 low price on July 1st at 1,011 a decline of over -17% in just 48 trading days from the 4/23 high of 1,220. The 1,010 handle was retested on the 2nd and again after the Independence Day Holiday on the 6th. Since then a valuation rally has pushed stocks back near the middle of the S&P500 fair value range around 1,100. **It's been a rough ride** but at the time of this report, the S&P500 has bounced over 8% from the bottom on July 1st with Q2 earning reports showing more strength than has been evident in broader economic measures such as retail sales growth, consumer confidence and GDP growth rates.

Table 3 below shows the YTD yield and total return for our core stock and bond ETF securities using the 7/22/10 closing prices. Clearly bonds have dominated all other asset classes in 2010 and we have reached a point in relative value such that the **aggregate bond index total return now exceeds aggregate stock market return over a five, ten and even a twenty year period when comparing average annual total returns.** Bond market prices today provide very little protection against inflation with shorter maturities like the two-year Treasury note priced with a lower yield than during the height of the financial crisis in late 2008 and early 2009.

Table 3 - 7/22/10 YTD Sector Returns		
Sector	YTD Yield	Total Return
Commodity	0.00%	-8.96%
Emerging Stock Markets	0.69%	-0.83%
International Developed Stock Markets	1.69%	-6.07%
Large Cap Stocks	0.94%	-0.84%
Mid Cap Stocks	0.67%	4.34%
REIT (General Real Estate)	1.83%	13.88%
Small Cap Stocks	0.58%	2.15%
Aggregate Bond	2.23%	6.53%
Corporate Bonds	3.16%	8.29%
High Yield Bonds	5.32%	6.01%
L.T. Treasury Bonds	2.08%	10.19%
Mortgage Bonds	2.24%	5.74%
S.T. Treasury Bonds	0.66%	2.09%
Treasury Inflation Protected (TIPS)	1.83%	3.75%

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The U.S. financial system is flush with cash including approximately \$1 trillion sitting in commercial banks because of low loan demand and \$1.4 trillion on the aggregate balance sheet of U.S. Corporations because collectively they are waiting for a higher rate of return on new capital investments than is currently available in today's economic environment. Both monetary and fiscal policy stimulus is at historical levels which suggest that the impact of additional government intervention is unlikely to modify business and consumer sentiment and ultimately spending and investing patterns. Risky asset prices (stocks, real estate, commodities, etc) reflect this reality and therefore, many segments likely offer good value (above average returns) for long term investors willing to buy despite

an “unusually uncertain” economic environment.

Finally, **Table 4** below shows the 2010 and 2011 federal tax rate changes assuming the Bush Tax cuts are allowed to expire in 2011. To illustrate the difference we calculated the tax liability and average rate for an AGI of \$200k and \$400k and found both income groups should expect a 10% increase in their federal tax liability in 2011. Note that there is a growing consensus on the street that only the upper marginal tax rates and capital gain tax rate will be increased. We expect the mid-term election results in November will bring more clarity to the tax rate debate and reduce some of the uncertainty currently pressuring risky asset prices.

Table 4 - Federal Tax Rate Changes		
Year	2010	2011
Marginal Tax Rates	10%	n/a
2	15%	15%
3	25%	28%
4	28%	31%
5	33%	36%
6	35%	39.6%
Capital Gain Rate	15%	28%
Tax with AGI @ \$200k	44,244	48,652
Tax with AGI @ \$400k	110,308	120,421
Average Tax Rate @ \$200k	22.1%	24.3%
Average Tax Rate @ \$400k	27.6%	30.1%