



## Pacific Crest Financial Advisors, LLC

Dear Clients and Friends,

The second quarter of 2012 closed with a spike in volatility, this time on the upside, as news out of Europe sparked widespread optimism that fiscal and monetary cooperation in the region could keep the worsening fiscal crisis from spinning out of policymakers' control. Large-cap U.S. stocks (as represented by the Vanguard 500 Index Fund) rallied to end the month up 4.1%, but lost nearly 3% over the course of the quarter after declining 0.6% and 6% in April and May, respectively. Small- and mid-cap stocks fared similarly, up 5% and nearly 3% in June, but down 3.5% and 4.4% in the quarter, respectively. While developed foreign stocks staged their biggest one-day rally of 2012 on the final day of June to end the month up 7.2%, they did decline 7% over the quarter as a result of losses in April and May. Emerging-markets equities followed the same pattern, up nearly 5% in June, but falling 8.4% for the second quarter as a whole.

Domestic investment-grade bonds (the main category of bonds we use) once again dominated all fixed-income categories in the quarter, up 2.1%, and foreign bonds were up as well. We continue to believe Treasuries will offer poor relative returns. Risk free investment returns are practically zero in this low interest rate environment. We strongly feel and have focused our fixed-income exposure on areas offering better values. Over the long term, we are confident the higher yields we capture will more than compensate us for the ground we would lose in a shorter-term market scare that drove a flight to Treasuries.

Earlier this month Liz Ann Sonders, the Chief Investment Strategist at Charles Schwab & Co. offered a perspective on the market. The main points were as follows:

- When markets expect nothing and get something it can be a recipe for a rally.
- Investors of every ilk have de-risked, unleashing a scramble on the last day of the quarter.
- The US economy does not look strong, but still better than much of the world.

We have seen several examples of the overall tone of negative news, be confronted with good news and having the market jump significantly. We saw one example of strong positive reaction to encouraging news on the last day of June. Remember the market is pricing future earnings expectations and not present economic activities. Between Europe's financial woes and China's slowing economy, there is lots of negative news already priced into this market. We have been in a pattern of sharp rallies followed by sharp disappointments and pullbacks. With Europe still reaching for only short-term solutions, Schwab's Chief Investment Strategist and Economist, expects to see continued ups and downs in the market over the next couple of quarters.

### **Contrarian Data**

ISI Group tracks the invested position of institutional stock managers as well as hedge funds. The former exposure to stocks is presently at a low 66%, lower than at the market's bottom in early 2009. At a 44% net exposure to stocks, hedge funds are slightly less bearish relative to early 2009 (when they were at 42%), but well below the 50-55% that was pervasive in 2010 and early 2011.

As the Financial Times noted in a recent article, "...institutional investors, from pension funds to mutual funds sold directly to the public, have slashed holdings in the past decade. Stocks have not been so far out of favor for half a century. Many declare the cult of the equity dead." That is music to a contrarian's ears.

The general public has lots of pessimism on the equity market currently as indicated by the NDR Crowd Sentiment Poll. We view this in a positive light being that the market has fully digested a negative economic view. We note that the best performance for equity markets have come when sentiment moves back into neutral territory from excessive pessimism. We are at a state of high pessimism now.

We at PCFA believe equities offer a much more attractive 10 year return potential than fixed income investments in the current low interest rate environment. However, we still need both asset groups to aid in stabilizing the risk levels within a client's overall portfolio.

### **Social Security Finances**

The Social Security Administration Trustees Report, 2012 was recently released and the major points are as follows:

- Currently running a \$69 billion/year surplus (2011).
- Reserves of \$2.7 trillion.
- Trust funds are 100% sound until 2033.
- 75% sound after 2033.

The conclusion of the Trustee Report is changes are needed for permanent solvency. Changes are being debated. The report indicates viable funding to 2033 and thereafter the system is able to fund 75% of commitments. Over the years, we have held the view that Social Security could meet about 70% of its commitments. In our long-term projections, we don't just drop social security funding by 30% (we doubt that is politically viable). Instead, we have the Social Security dollars lose 2% of purchasing power each year and so in 15 years the projections account for the inadequate resource funding with the reduced Social Security distributions.

We frequently get the question "what do I lose or gain in Social Security monthly benefits if I retire early or late?"

If Social Security Retirement Benefits are started early at age 62 (easiest age possible) the monthly benefits are at 75% of Full Retirement Age Benefits. If you delay retirement benefits to age 70 (the latest possible) the monthly benefits are at 132% of Full Retirement Age Benefits. It is approximately a 7% increase in monthly benefits per year of delay. Of course there are always other factors to consider when making the decision of when to begin drawing Social Security benefits.

### **Settling Your Affairs**

We want to remind you to communicate your wishes in dealing with your body and the supporting services around your memorial. At a point of high stress and great loss, survivors must deal with funeral arrangements and handling of the body. We ask you to communicate your wishes to your potential survivors so they are not having to make decisions but rather are just completing your instructions.

The cost of your wishes can vary widely. The Peoples Memorial offers a basic cremation service for \$699 while a full service funeral and body burial can cost \$17,000 plus the cost of the burial plot. In Alec's family, we just minimized the cost of the handling of the body and deliberately spent the money on a fun party with great food not mourning her death but rather celebrating her life, just as my mother wanted. Whereas, with Darron's father he was quite clear in his desires for a burial next to his parents (and already owned the plot). However, he did not give direction on his desire for a memorial service. Thus, we were left negotiating various package deals that the funeral home was laying out to us. Ultimately, we decided that Dad would be better remembered through our own celebration and not one designed by the funeral home. So, no matter one's wishes we feel that it is important that they are not kept secret. Let your family know your desires, be aware of the associated costs, and identify funding sources you have made available.

## Hood Canal Picnic

We had another great gathering at Hood Canal earlier this month. As usual we had fresh sautéed oysters and barbequed salmon. Jenny Kuehn (Darron's wife) produced a raspberry cobbler to die for (along with her famous "Good For Your Brain" salad). We sampled some wine from Alec's annual California family farm trip. The rain that day was threatening and even rained a bit in the morning but by lunch the skies were opening up and let the sunshine through. We all had a great time and can only say if you missed it you missed a fun gathering. With a growing younger clientele, we will try having a Saturday gathering next year so those still in the working world can join the gathering.

## Personal Events

Alec took his children (two daughters age 9 and 11) on his annual trip down to the family farm in Northern California. He saw lots of old friends and family. I rode my bike for an hour or two each morning drinking up the countryside along old winding country roads. The girls spent each morning at a local horseback riding camp. For the first time, Darron, Jenny and the kids also came down for a few days joined by his mother and stepfather. The girls (all four of them) all loved the visit. This visit was part of a 10 day trip to California by Darron and his family. They visited some family in San Jose before a good stay in San Francisco and moving on to the farm. After that was a great couple of days in the Redwoods.

On a sad note, Darron's father passed away earlier this month. This has, of course, left his family with a hole to fill. However, it also brings to light that the memories we create with our families and friends truly do last forever and can bring solace to any situation.

Sincerely,



Alec Williamson, CFP®  
Managing Director



Darron Kuehn  
Managing Director