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3rd Quarter 2011 Summary & Outlook

In the 3rd quarter painful decline, the U.S. market actually did better than many foreign markets with the euro-zone sovereign debt fears and uncertainty driving down world markets. With corporate earnings at record highs and expected to still grow, the market keeps getting cheaper. The euro-debt issue has little direct risk to the U.S. economy, unless a major disruption plunges European economies and hurts U.S. exporters. But with all the uncertainly investors are afraid to invest and with large amounts of cash on the side.

"I've Lost So Much Money"

Investors lose money only when they have sold an investment and locked in a loss. It's the same thing with making money. There is no real gain or loss until it's realized by a sale. Obviously when market values are low its best to hold off selling if you can, and is the best time to invest for the long-term even if the short-term risks are still a concern.

U.S. Economic and Corporate Profit Data

Most economists don't expect another recession. But they also don't see growth accelerating much due to weak consumer spending, high unemployment, housing foreclosures continuing, stock market turmoil, and little hope from Congress with the grid lock in Washington. However, as the saying goes, crisis often also means opportunity but investors are tired of all the increasing opportunities as stocks continue to get cheaper.

September's reading of consumer sentiment rose to 59.4, recovering from a nearly three-year low of 55.7 in August. Reports on 9/30/11: Manufacturing activity in the Chicago region expanded at a more rapid pace, rising to 60.4 in September from 56.5 in August. Commerce Dept. data released on 9/30 showed personal income fell a seasonally adjusted 0.1%, the first decline since October 2009. Consumer spending increased a seasonally adjusted 0.2%

S&P500[1] earnings are estimated to grow 13.1% in the third quarter, according to analysts polled by FactSet, higher than the 11.4% growth in the second quarter The 13.1% estimate reflects a pullback in expectations from July 1, when analysts had forecasted earnings would rise 16.5% in the third quarter.

Money Market's Potential Euro Debt Risk

As Wall Street Journal 9/29/11 reported, the Boston Fed President warned that some money market funds are too aggressive investing in European bank debt. "Repo" lending is the biggest concern, where banks use securities as collateral for short term loans. There is discussion again that money markets should trade at actual daily market value of assets - not the classic fixed $1 price.

Grant's Interest Rate Observer, points out many large money funds to cover expenses and keep rates at or slightly above zero, has had fund managers "scurrying" into European bank debt at the same time as European banks are relying more on money funds as a major source of dollar-funding needs.

For example, the nation's biggest money fund, Fidelity Cash Reserves, only has 30% of its assets in American counterparties or securities with 45% invested in Europe, mostly with banks. Many other large funds also have these holdings. For its "international smorgasbord of risks investors are paid the princely sum of 0.01%"... The money fund industry is walking on eggshells."

Warren Buffett Spots Bargains

Wall Street Journal 9/27/11 - Warren Buffett, the stock market's most-revered bargain hunter, thinks his own stock is a bargain and is buying back what could be tens of billions of dollars' worth of his own stock in Berkshire Hathaway. In the first six months of this year, Berkshire Hathaway generated a net cash surplus of $9.7 billion, or nearly $54 million per day. As of June 30, the company's cash hoard totaled $47.9 billion, up $19.9 billion from one year earlier.

In August, 198 companies authorized new buybacks of their own shares, the highest monthly total since February 2008, putting 2011 on track to be the third-busiest buyback year on record**.**

Hedge Funds, Especially Paulson's, Fail Investors

"The Street" 9/28/11 reports: "The average hedge fund manager, who charges a 2% annual management fee and keeps 20% of any investment gains, is struggling to keep up with an idiot box known as an index mutual fund."

"Paulson's Advantage Plus hedge fund has lost 34% this year. Paulson became a star manager by going all-in on a bet against the housing market three years ago, earning him a reported $5 billion in one calendar year."

Paulson who runs some of the largest U.S. hedge funds, vowed to recover losses saying, "The problems in the U.S. can be solved. The U.S. isn't Europe. The U.S. economy and stock market will improve over the next year or so". Mr. Paulson began 2011 riding high notching another winning year in 2010 thanks to the U.S. economic recovery but then got too aggressive. Paulson also said, Price-Earnings ratios are at historic lows and stocks are attractive based on other metrics. "This has created many buying opportunities where companies are trading at extremely low valuations." Wall Street Journal 9/19/11

Also reported is that Goldman Sachs is closing its Global Alpha hedge fund, "the crown jewel of its so-called quantitative trading strategy, because of poor performance."

Other hedge fund managers are reportedly circling Paulson's portfolio like vultures, looking to pick off troubled assets in anticipation that he might have to sell some quickly in order to raise cash to meet redemptions, according to the Wall Street Journal.

Foreign Markets - Many did worse than U.S

As Marketwatch 10/1/11 pointed out, "Mutual-fund investors looking at stocks outside of the U.S. are either staring at bargains of a lifetime or standing at the brink of even more losses" The European crisis is far different from those in the past that largely required working through economic issues. This crisis (like the U.S. Congressional grid lock) is dependent on political action. "We're not used to dealing with that. It adds to volatility on top of all the other worries."

Many stocks in Europe are even cheaper than their comparable U.S. peers. While I do not recommend investing just for dividend yield, with the market declines in Europe the Stoxx Europe 50 index has a 5.5% dividend yield compared to about 2.6% for the U.S. S&P500. These yields exceed the 10-year government bond returns of about 2% for both German and U.S. bonds, considered the most secure in the world.

Unlike bonds, stocks have eventual additional potential to increase in value, so usually have lower dividend yields than 10-year government bonds. I note that Germany one of the strongest economies in Europe has very high tax rates and much higher social support spending than the U.S.

While the average U.S. invested mutual fund lost 16% in the third quarter many global and foreign market funds did worse.

Greece fell 38%, France CAC index and the German DAX both fell about 25%. Hong Kong Hang Seng index down 21% and both Brazil's Bovespa and U.K FTSE 100 were off 14%. Canadian stocks had their worst quarter since December 2008 with Toronto's S&P/TSX index down 13%.

Many Asian emerging markets had large losses despite the fact most have low debt and benefit from growth in China and India that is far outstripping developed markets - even if slowing a bit. China especially will continue to have a high growth in the middle class with increasing purchasing power.

Much of employment growth is shifting to better tech skill educating countries that are investing more for growth vs., the demand for huge cuts in the U.S. This will continue to result in job losses and reduce the competitiveness of the U.S. Most economist do not think the U.S. will have a recession again, but growth will remain slow with high unemployment. Large corporations continue to have increasing record profits as they invest in technology and don't need as many employees.

Another powerful driver of growth is increased infrastructure spending in India, China, Russia and much of Latin America as Philip Poole, Global head for HSBC Global Asset Management pointed out on 10/1/11. He also noted the economic growth in Indonesia.

Positive Long-term Outlook but Short Term risks

Before the latest Europe debt crisis markets had strong gains but most are now back into a "correction" of 10%+. The U.S. economic outlook is stronger than most of Europe and awash in cash.

However, European valuations are even cheaper. FactSet says Western European markets overall are now at 9 times earnings. Marketwatch 9/26/11 regarding Europe stocks: "At these levels investors are not only being paid to be patient by high dividend yields, but are also pricing in a very high margin of safety. They are mouth-watering attractive."

If as is expected, 3rd quarter earnings meet expectations many believe the U.S. market could decouple from European concerns based on such attractive valuations.

As Marketwatch concludes, "Investors, naturally, want to wait for the resolution of the crisis before committing any funds. However, markets don't always oblige us by staying cheap until the coast is clear. They are forward looking creatures."

[1]Investors cannot directly invest in indices.

Past performance does not guarantee future results.

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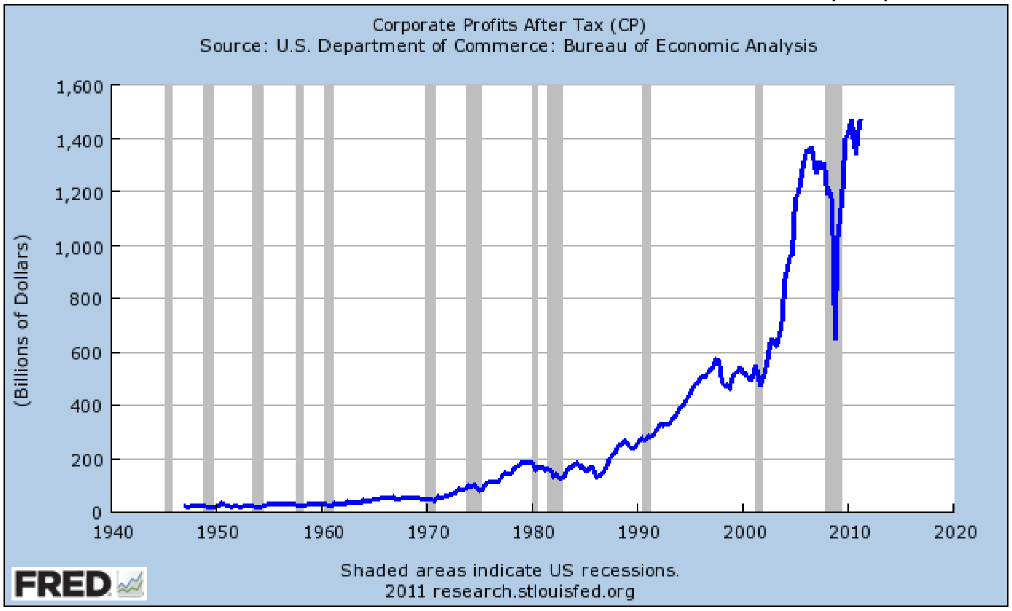
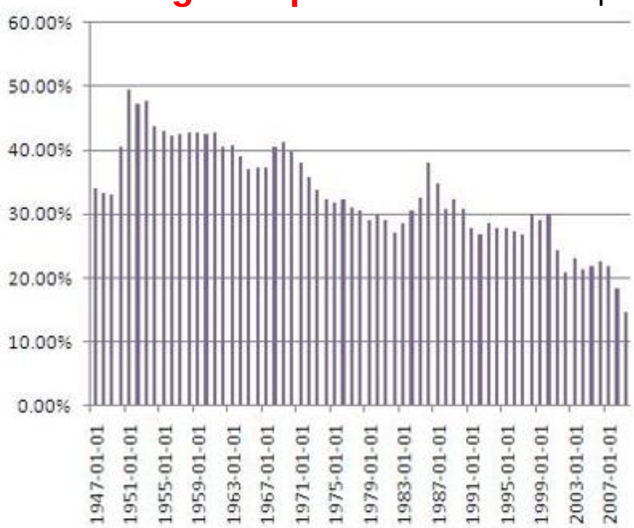
Corporate AFTER-TAX Profits at Record Level Source advisorperspectives article 9/19/2011



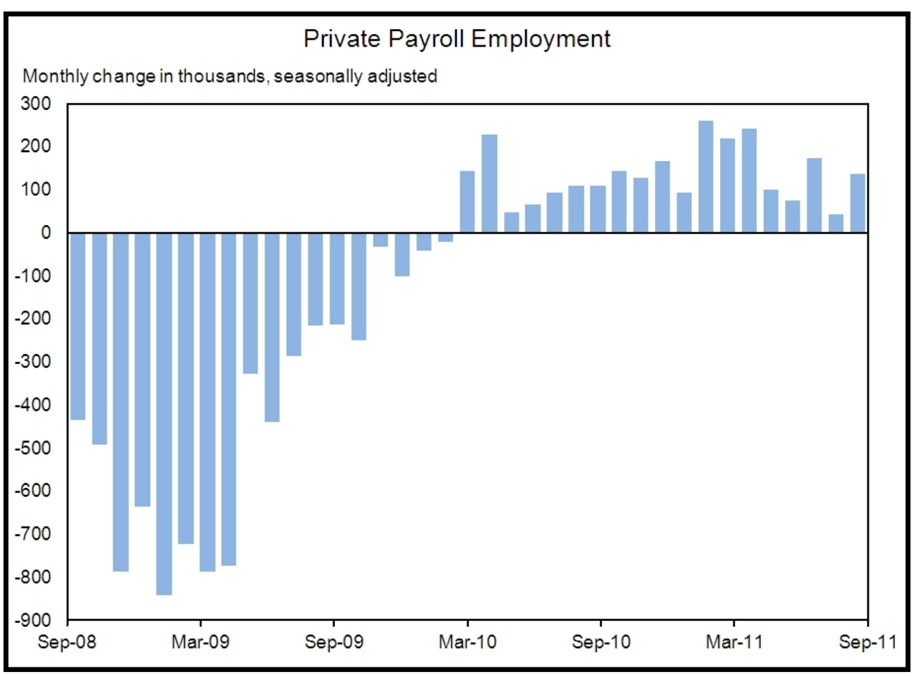
Average Corporate Taxes as a percentage of pre-tax profits thru 2010 at record low



Source advisorperspectives article 9/19/2011

While the highest corporate tax rate is 35% of taxable income is a high rate vs. many foreign countries, with all the U.S. deductions the percentage of profits is low historically after deductions and by most studies about average among developed countries.

Individual U.S. taxes of 35% on taxable income over $379,150 is among the lowest in the world and historically in the U.S. Even the pre-Bush tax cut rate of 39.5% is very low. Many European countries such as the U.K, Norway etc. have a 50% top rate on much lower income as well as a VAT tax of about 20% (U.K. France etc.)



Source: Council of Economic Advisers