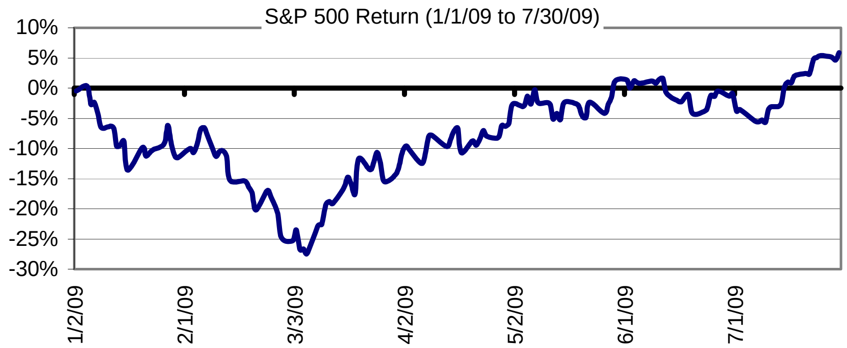
WJM FINANCIAL, LLC
Fee-only financial planning and investment management

Mid-year Investment Commentary – August 3, 2009

To say that the first half of this year has been an eventful one for investors would be an enormous understatement. After losing 38% in 2008, the stock market fell precipitously for the first three months of this year and had lost an additional 27% by the middle of March before rallying strongly and moving into positive territory for the year to date.



We do not pretend to know what the future holds, and it is impossible to tell whether the rally that we have experienced for the past three and a half months is the beginning of sustained recovery or simply a "bear market bounce." That said, while Jean and I recognize that significant challenges and obstacles remain to be addressed before we see sustained economic and investment market recovery, we are cautiously optimistic that the worst is behind us and that better days lie ahead.

We thought it might be helpful if we shared some of our thoughts based on the conversations that we have had with a number of clients.

Signs that the worst may be behind us

In early March, the prospects for our economy and investment markets seemed grim, particularly if you spent much time listening to the financial media. Much of the conversation at that time revolved around the possibility of a second Great Depression, the collapse of our financial system (and way of life), or a Japan-like lost decade. It seemed as if the global economy was standing on the edge of a cliff, and many feared that it was headed over that edge.

Fear was extreme, and it dominated the actions of most investors. Not only were investors afraid to invest in stocks, but the market for even high quality bonds had dried up, and many investors were even afraid to deposit their money into bank accounts for fear that their bank might collapse. This was an exceptionally scary time for a lot of people.

Since early March, we have stepped back from the cliff and regained our footing. Although our economy and investment markets continue to face significant challenges, and there is certainly no shortage of negative prognosticators, the consensus view is now that that the worst is behind us and that a long (and potentially sluggish) recovery lies ahead.

Reasons for caution

We believe that the worst of the financial crisis is behind us, and that the financial Armageddon scenario that many feared has been averted thanks to unprecedented intervention. However, that does not mean that we are in the clear, and we believe that there remain significant challenges for the global economy and investment markets in the foreseeable future.

Here are some of the reasons that we remain cautious (note that some of these may be positive in the mid- and long-term, but they may be problematic in the short-term):

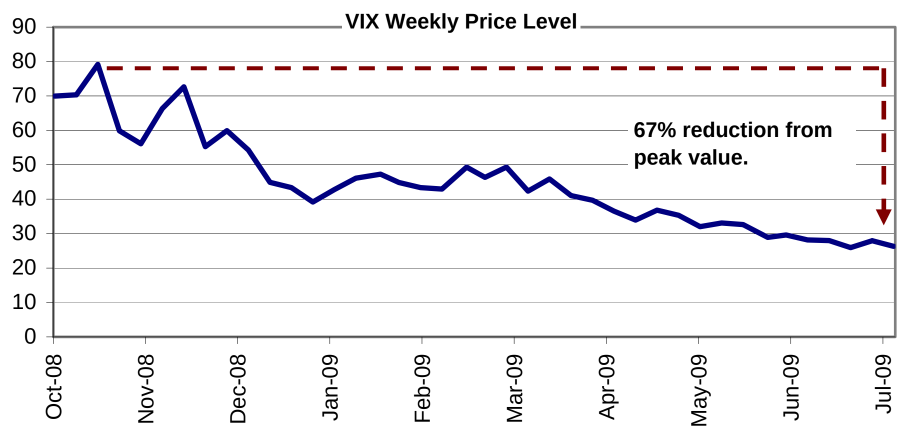
- Consumer spending, which accounts for about 70% of our economy, has been curtailed and the personal savings rate recently reached a 15-year high of 7%.
- A higher savings rate, may prove to be a positive long-term benefit for our economic stability (economists have argued for years that our savings rate has been much too low), but more savings means less spending, and less spending would dampen short-term growth.
- Home prices have shown some signs of stabilizing and bottoming out, but approximately 20% of mortgages exceed the value of the house. Most economists polled by The Wall Street Journal expect that housing prices will not bottom until the end of this year and then begin a modest recovery after that.
- Businesses and financial institutions continue to “deleverage,” which means that they are reducing their debt levels and risk exposures. Lower debt and less leverage may increase overall long-term financial stability, which is a good thing, but it may also have the effect of moderating corporate earnings growth potential.
- The unemployment rate remains uncomfortably high at 9.5%, and low levels of operating capacity utilization (68%) suggest that employment may lag as the economy begins to recover. Robust and sustained and sustained growth will be difficult with this level of unemployment.
- The government is funding stimulus spending with record levels of new debt and budget deficits. We believe that this intervention is absolutely necessary, but at some point it will have to be repaid and the potential for higher taxes and/or lower government expenditures should not be ignored.
- The government’s stimulus spending also runs the risk of fueling inflation down the road. While we do not anticipate a short-term spike in inflation (low global utilization and a high unemployment rate could be strong factors against higher inflation), we do believe that there is a longer term risk of above average inflation and/or a weaker US dollar.
- Much of the good news, or “green shoots,” that have been discussed are instances of data that is “less bad” than prior data. While this is an encouraging and necessary sign, much of the data itself is not yet good and it is hard to get too excited, or sustain an extended rally, with “less bad.”

Reasons for hope

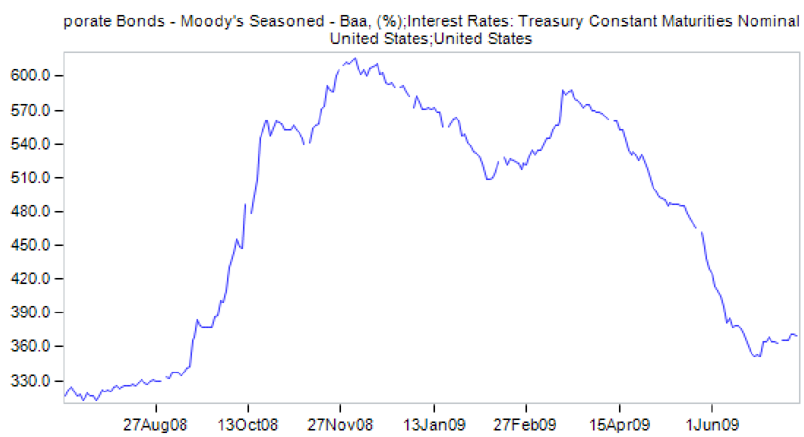
All of the above challenges are real and cannot be ignored, but we believe that they are manageable and that they are outweighed by the mid-term and long-term positives, which we believe include the following in addition to those listed above:

- Global economies have stabilized somewhat, and early March appears to have been the point of maximum stress. While investment markets remain well below the highs that were established in 2007, most have rallied and posted very strong second quarter returns.
- Consumer and business sentiment has shown modest improvement and some important economic indicators have improved. Although most have not yet reached the levels necessary to suggest sustained growth, this is a step in the right direction.
- According to Moody’s, businesses are becoming more positive in regards to their outlook for the end of the year, and these expectations are considered a fairly reliable leading indicator of economic activity.

- Most economists polled by the Wall Street Journal (90% of respondents) believe that the recession will end in the second half of this year (the majority predict positive GDP in the third quarter of 2009), and that we will experience modest growth in 2010 and 2011. Few expect growth to be robust, but this is a step in the right direction.
- An unprecedented level of coordinated efforts by central banks and governments around the world appears to have stabilized the economy and prevented the catastrophic decline that many had feared. The majority of stimulus spending is planned for 2010 and onward (only about 10-20% has been used so far), which should provide a strong tailwind for economic recovery.
- Some of the most extreme fears regarding our banking system appear to have been exaggerated. The results of the government's stress tests gave *most* (albeit not all) banks a clean bill of health, and a number of banks have already begun repaying the funds they received earlier this year.
- Investors appear to have become less risk averse over the past few months. The VIX, an index of volatility that is often referred to as a "fear gauge" has dropped sharply since spiking last fall when Lehman Brothers failed. It remains above average (higher fear), but this is a significant improvement.

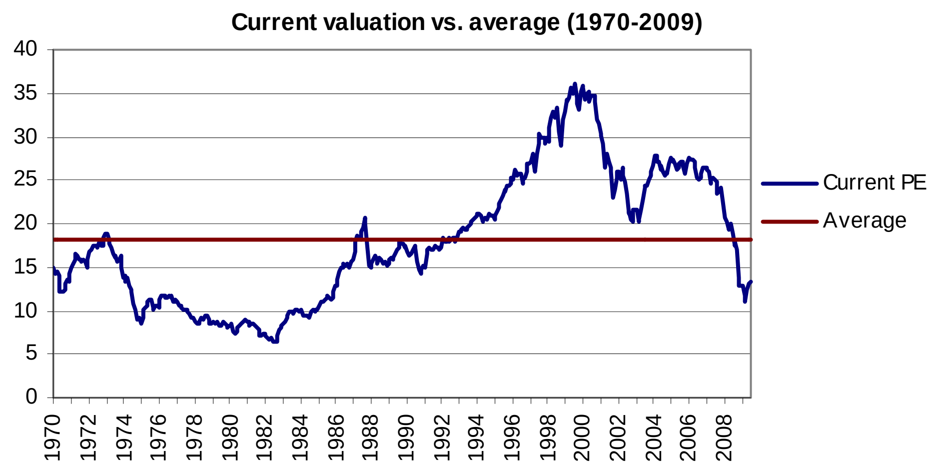


- Reduced risk aversion also shows up in the narrowing of "credit spreads," or the difference between the returns that investors demand for corporate bonds relative to treasury bonds (which are presumed to be risk-free). This level has dropped from over 6% to under 4%.



- As credit spreads narrow, it becomes easier for companies to obtain or refinance existing debt in the form of bond issuance. While credit remains tight, there are signs that it is thawing, which will be beneficial for companies and consumers.

- We are likely to come out of this crisis with a much better regulated financial system. While we do not agree with every decision that has been made, we feel very confident in the level of talent, expertise, and focus being applied to addressing the current challenges by the current administration's financial and economic team.
- Importantly for investors, much of the bad news appears to be priced into current stock valuations. Whether we consider the trailing 3, 5, or 10-year earnings, the market's price-to-earnings ratio (P/E),or the price that investors are paying for each dollar of corporate earnings, is 18-27% below the average since 1970, and the lowest that it has been in over twenty years.



Where do we go from here?

As mentioned earlier, we are cautiously optimistic that the worst is behind us. We expect to see gradual improvement in the economy, but we believe that improvements are likely to take time and that they may be met with occasional set backs. We do not anticipate a sharp recovery, but rather a gradual one that will require some time to take hold.

Given the challenges and uncertainty that remain, we would not be surprised to see above average levels of short-term investment volatility. Consequently, our goal remains to ensure that your portfolio is very well diversified, and that it is consistent with your goals, time horizon, and risk tolerance.

In terms of financial planning and investment management, we are trying to balance risk management, which we believe remains very important, with the risk of becoming overly conservative in response to the past 18-24 months.

Here is what we are considering:

1. A slight reduction in domestic equity exposure (US stock market) in order to reduce what is currently the most heavily weighed equity asset class, and to take some of the recent gains off of the table.
2. Slightly increase exposure to foreign equity by adding a small exposure to emerging markets in certain portfolios. While this is a volatile asset class, we believe that it is one that presents above average potential for long-term returns. Given its volatility, however, exposure will be limited.
3. Slightly increase exposure to non-traditional equity markets by increasing the "diversifier" asset class in our portfolios. This will also allow us to increase our exposure to "real assets" in order to reduce the impact of higher inflation rates if they materialize, as well as to other assets classes that tend not to move in lockstep with domestic or foreign stock markets.

4. Continue to focus on high quality and low cost bond funds for the fixed income portion of our portfolios in order to provide portfolio stability, but also consider an increased exposure to inflation protected bonds (TIPS) and selectively hedged global bonds in order to address our concerns over the potential for long-term inflation and US dollar weakness.
5. Continue to incorporate robust stress testing in our retirement plans by considering the impact of below average returns, further market declines, above average inflation, and the risk/return trade-offs of a range of portfolio structures through the use of simulation analysis.
6. Continue to use what we believe are realistically conservative assumptions for investment returns and inflation when calculating required savings levels for retirement and other goals.

Please do not hesitate to contact us if you have any questions, or if there is anything that we can do for you. And as always, we encourage your feedback regarding ways that we can improve the value of our services.

Sincerely,

Bill Moeckel, CFA, CFP

Jean Fullerton, CFP