

Investor Insights & Outlook

December 2011

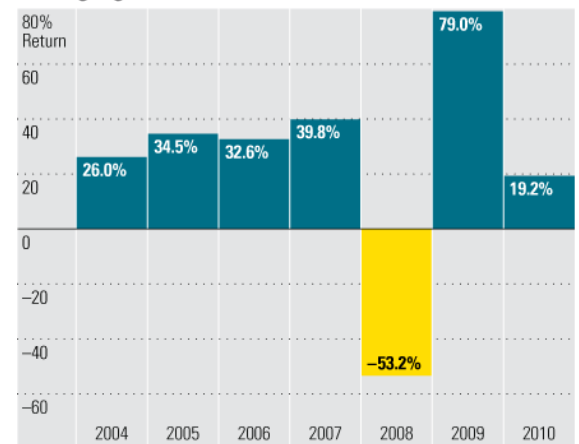
Vol. No. 1

Investment Updates

Overconfidence: False Perception

Consider the performance of emerging-market stocks from 2004 to 2010. For the first four years, stocks in these regions produced impressive returns. Based on this stellar track record, a typical investor may expect more of the same. Well, 2008 was quite dismal for emerging-market investors, as they lost more than half of their investment—53.2%. In 2009, however, emerging markets rebounded, producing a return of 79.0%. In 2010, emerging-market returns were still positive, but down to 19.2%. When investing, investors must consider the possibility of another year like 2008 in the future. Strong positive returns may be enough to create overconfidence among investors. Investors should avoid overestimating their ability to predict future outcomes and avoid focusing on only the upside potential while dismissing the possibility of poor performance.

Historical performance of emerging-market stocks 2004–2010



Source: Emerging-market stocks are represented by the Morgan Stanley Capital International Emerging Markets Index. An investment cannot be made directly in an index. Returns and principal invested in stocks are not guaranteed. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards. Emerging-market investments are more risky than investments in developed markets.



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Advisor Corner

Bill Roller is experienced in financial planning and investment analysis. He focuses his consulting practice on estate, retirement, and financial planning for businesses and individuals. Bill started BR Capital Inc. in 2003. Before that he worked for a large Wall Street firm for over nine years. He served for seven years as a U.S. Army officer in Infantry and Special Forces (Green Beret)

units. Bill is a Chartered Financial Analyst as well as a Certified Financial Planner. He is the VP of the Estate Planning Council of Southwest Washington. He earned a Bachelor of Science degree from the United States Military Academy at West Point in 1982, and a MBA from the Wharton School of Business in 1991. He provides the morning and afternoon market reports and

financial commentary for AM 1360 KUIK. A link to Bill's articles and interviews is available at www.brcapitalinc.com/newsletter.

Monthly Market Commentary

Strong retail sales, an improving employment report, falling gasoline prices, and rising auto sales all painted a picture of a stronger U.S. economy these past few weeks.

GDP: GDP for the third quarter was revised downward to 2.0% from 2.5%, based on a larger-than-estimated inventory reduction and lower-than-expected imports. Fourth-quarter GDP estimates remain in the 2.5%-3.0% range, which would bring the full year to the 1.5%-1.75% range. One of the strongest determinants that could make these numbers true is consumer demand, which is expected to remain high at least during the holidays.

Employment: November employment numbers continued on a slow but steady upward trend. Although the recession officially ended in June 2009, private employment continued to decline until Feb. 2010. Overall, 8.9 million private-sector jobs were lost during the recession, and only 3.0 million were recovered since the February 2010 bottom (roughly equivalent to a 140,000-150,000 per month average). Consistent along these lines, employment numbers in November increased by 140,000 (better than 117,000 in October, but not as good as 220,000 in September). Longer store hours this holiday season translated into 50,000 jobs added in the past month, but these positions are mostly temporary, and the trend will find itself reversed once the busy season is over.

Unemployment: The drop in the unemployment rate to 8.6% from 9.0% may well be the best news of the week. However, only half of the decline was due to people actually finding jobs. The other half of the decline happened because of people who stopped looking, which is unusual, to say the least, in a still-uncertain economy. While a decline in the unemployment rate is good, the key metric that will move the economy forward is the number of new jobs added, which has been good, but not stellar, so far.

Income data: Real disposable income grew by 0.3% in October after declining three months in

a row because of high inflation, falling Medicaid payments, and collapsing interest receipts. Consumption slowed from 0.5% in September to an even more depressing 0.1% in October. But then again, a year-over-year analysis using a three-month moving average shows consumption more steady, at about 2%.

However, the biggest detriment to consumer incomes has been taxes. Cessation of various stimulus programs, increases in state tax rates, and the progressive federal tax system mean that a 2.7% jump in incomes has been accompanied by a 15.9% jump in taxes. High earners were probably the ones who felt it most, but a look at luxury retailers contradicts this, as high-end spending has remained fairly constant.

Retail sales: In terms of year-over-year percentage change data, retail sales seem to be slowing down, but the comparison is very tough, since November was one of the strongest months in 2010. Weekly data is strong and suggests a potentially better picture for December sales, especially since it seems that many consumers have not begun their holiday shopping yet.

Auto industry: Automakers recently reported new U.S. light-vehicle sales with the best seasonally adjusted annualized selling rate since Cash for Clunkers in August 2009. In absolute terms, November sales totaled 994,786, up 13.9% from November 2010, and every major auto manufacturer except Honda posted a year-over-year sales increase.

In light of these mostly positive economic indicators, the overall consensus seems to finally indicate that the U.S. economy will not double dip. On the other hand, nobody is yet willing to project a robust 2012, either.

A Quick Guide to Lagging Economic Indicators

Lagging indicators are economic indicators that lag behind the overall pace of the economy, and can confirm or deny the trend shown by leading indicators. Examples of lagging indicators include the average duration of unemployment, average prime rate, inventory-to-sales ratio, and the change in the Consumer Price Index.

The average duration of unemployment measures the average number of weeks an unemployed individual has been out of work, and is inverted to indicate a lower reading during a recession and a higher reading during an expansion of the economy. This statistic is measured by the Bureau of Labor Statistics on a monthly basis, and is seasonally adjusted to reflect the impact of predictable seasonal patterns. For example, retail businesses tend to hire more part-time employees during the holiday season. This is a lagging indicator because during an economic recovery, real wages increase first, followed by hours worked, and finally by an increase in hiring. This indicator is a good gauge for the overall business confidence sentiment.

The Consumer Price Index is released mid-month and measures the average rate of change month-to-month in the prices paid by consumers for a broad basket of consumer goods and services. This is the most widely-used measure of inflation today and is used as a guide by both Congress and the Federal Reserve to formulate fiscal and monetary policies. More specifically, the Core Consumer Price Index, which excludes the most volatile components of the index like energy and food prices, is used by the Fed to measure whether it is meeting its annual target inflation rate of 1.7% to 2.0%. For example, depressed CPI numbers coupled with high unemployment figures were key factors in the Fed's decision to start buying \$600 billion in Treasury bonds to boost investment and consumption rates at the end of 2010. Thus, investors who are interested in investing in government bond ETFs should take note of this indicator (prices of long-term bonds might go up, while yields would fall). This is a lagging indicator because it represents prices that

have already changed; announces that inflation arrived—one month ago.

The prime rate is what banks charge their most credit-worthy customers, mainly large corporations. Since Dec. 16, 2008, the Wall Street Journal determines this rate by polling the 10 largest banks in the United States, and will update the published rate when at least 7 of these banks have changed their rates. The prime rate is largely based upon the Federal Funds Rate set by the Federal Open market Committee every 6 weeks. The rule of thumb for the value of the prime rate is 300 basis points (3%) above the current fed funds rate, which is currently between 0% and 0.25%. This is a lagging indicator because the Federal Reserve sets this interest rate in response to economic growth rates, and to stimulate growth, the federal funds rate will be set low for a period after the economy is recovering. This is important to investors because many banks use the prime rate as a basis to price loan products such as student loans, credit cards, and car loans, and is a good indicator if one wants to invest in stocks or ETFs in the financial sector.

The inventory-to-sales ratio is reported by the Department of Commerce and measures how many months it would take to deplete the backlog of goods, adjusted for inflation. An increase in this ratio generally means that sales estimates were missed, and businesses will respond by postponing future orders and cutting production rates, resulting in a slowing economy. Beyond looking at the overall figures published monthly, serious investors should look at the numbers for manufacturers, retailers and merchant wholesalers since each sector has different sensitivities to an economic downturn.

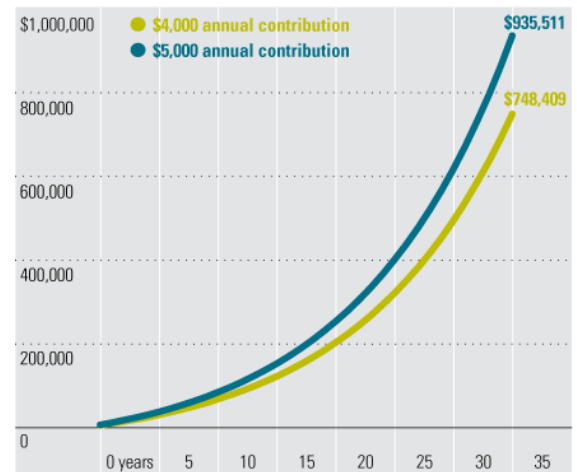
Government bonds are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than other asset classes.

Don't Forget to Raise Your IRA Contribution

In 2012, contribution limits for both traditional and Roth IRAs (individual retirement accounts) will remain the same as in 2011: \$5,000 a year for those 49 years of age or younger. If you are 50 or older, the maximum contribution is \$6,000. This limit can be split between a traditional and a Roth IRA. These annual contribution limits are imposed by the Federal Government.

The graph shows both a \$4,000 and \$5,000 annual contribution growing at a hypothetical 8% annual return. Notice the dramatic impact on the ending value of the portfolio. This may be a great time to re-evaluate your financial situation and increase your annual investment to your IRA. Even if you are unable to max out your contribution, any increase you can afford may help you reach your savings goals more easily in the long run.

Hypothetical Growth of Annual IRA Contribution



This is for illustrative purposes only and not indicative of any investment. Funds in a regular IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. Contributions to a Roth IRA are not tax-deductible, but funds grow tax-free as money withdrawn is not taxed. Penalties may apply for withdrawals prior to the age of 59 1/2.

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