

CITY SECURITIES WEALTH ADVISORS

Your Life. Your Goals. Your Advisors.

August 4, 2009

On March 9th, the S&P 500 closed at 676, and it ended yesterday at 1002, marking one of the most spectacular rallies ever seen. While this certainly doesn't mean all is well in the world economy – there are still substantial risks to sustainable growth going forward, and current difficulties related to employment – there are some things that are working quite well, both on a national and personal level. Here is my short-list of what's working:

Monetary stimulus

First, the actions taken by our monetary guys, the Federal Reserve and Treasury, have worked, at least in the short term. Absent the intervening steps that were taken, it is almost certain that the U.S. would have experienced a systemic collapse of the financial system in late 2008 and early 2009. The risks of a depression were real, and it was successfully averted. What remains to be seen is whether or not our monetary authorities can continue to navigate the current situation successfully, without stepping too far toward either side of the tight rope and creating excessive monetary inflation or, worse yet, deflation. The actions of Congress will likely make this balancing act increasingly difficult. We will be watching this very closely.

Stock and bond market valuations

In March, both the stock and bond markets were pricing in the risk of a depression. Absent a depression actually occurring, a significant rebound from those lows was a near certainty – and we got it. At the present levels, the markets are much more fairly valued. For those who remained invested while the markets were undervalued, the return to fair value has been a financial blessing. But it also creates a more difficult investment environment for the present time. When market valuations are within a range that is considered fairly valued, it is nearly impossible to predict the next move. Will the markets continue to climb into overvalued territory? Or will they retest lower levels and create another buying opportunity? We'll find out soon. For now, our portfolios are fully invested but are in a defensive position. For some clients, the last 9 months solidified that their portfolio composition needed to be shifted into a fundamentally more conservative position. March was not the time to be making such changes. With the S&P 500 above 1000, we are now beginning to revise investment policies for these families and make the needed changes.

Systematic savings during a negative market

I could not be more proud of the families I work with! Late last year, we began urging clients in the wealth accumulation phase of life to significantly increase their automatic monthly contributions into various investment accounts, and many responded by making significant cash flow changes and increasing their savings rates. Systematic savings coming through our office have increased dramatically during the market downturn, with the expected corresponding positive effect on client wealth.

Cash reserves

Having a cash reserve of 3 to 6 months' living expenses, plus an amount equal to all known large expenses coming in the next year, is the first item of advice I give to anyone who asks, along with advising them to eliminate all consumer debt. During an economic downturn, nothing works better than a cash reserve, and it's never too late to build one. This past year, I have observed clients take advantage of their cash reserve during a period of unemployment; retired clients have been able to

reduce or stop withdrawals from their investment portfolio while asset prices were undervalued; while others have been able to use cash to take advantage of bargain recession prices on an asset they've always dreamed of having – an RV, for example, can be acquired for less than half the pre-recession used price. The strategy of having a cash reserve continues to work very well.

Cash for Clunkers

Finally, I can't resist pointing out that the Cash for Clunkers program is working quite well. I'm not saying I endorse the idea, but as far as short-term economic stimulus goes, this one is pretty good. The largest Ford dealer in the country is completely out of three models of the fuel efficient cars that qualify for the program, and Ford's July sales rose for the first month in a long time. It does concern me that some buyers that can't really afford a new car are being enticed to behave irresponsibly – the type of excess consumption and debt that got us here. But if I had to choose between the \$1 Billion Clunker program and the \$700 Billion TARP, I'd take the Clunker.

All the best,

A handwritten signature in black ink, appearing to read "Kenneth R. Klabunde". The signature is fluid and cursive, with a large initial 'K'.

Kenneth R. Klabunde, MS, CFP®