July 2010

About Beacon Financial Advisors Ltd.

Beacon is an independent fee-only advisor with a clear mission statement: To provide our clients long-term value-added financial counsel and investment performance with *exceptional service.* **Beacon** is an RIA with the US SEC.

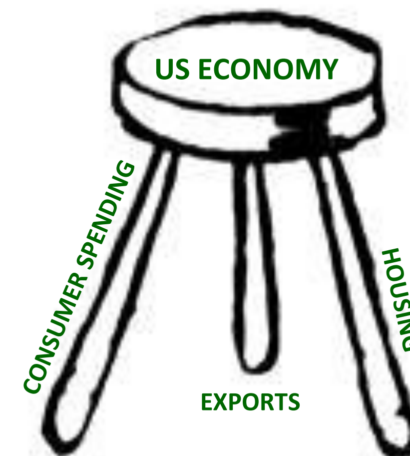
Beacon's Principals

MARCEL HEBERT has a B.S. in Finance, an M.B.A., and is a Certified Financial Planner (CFP) licensee and a Chartered Financial Analyst (CFA) charterholder.

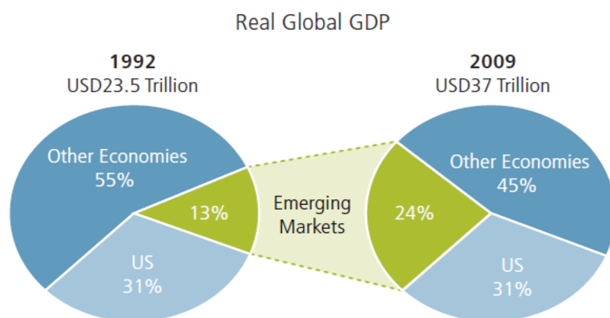
JOSH HEBERT has a B.S. in Accounting, an M.B.A., and is a Certified Internal Auditor (CIA). Josh is pursuing the Certified Financial Planner (CFP) license. Prior to joining Beacon in 2006 Josh spent 4 years with Ernst & Young.

Please remember to contact Beacon Financial Advisors, Ltd. if there are any changes in your financial situation or investment objectives, or if you wish to impose, add, or modify any reasonable restrictions to our investment management services. A free copy of our Form ADV, Part II is always available upon request.
An important note: Where reference is made in VIEW to Beacon's relative performance, or individual mutual fund performance, it applies to fully invested portfolios for the period. Actual results vary among clients, as risk tolerance levels and the timing of asset purchases & sales are unique to each of our clients. Each client's unique results are revealed in the performance reports inside their Investment Review.

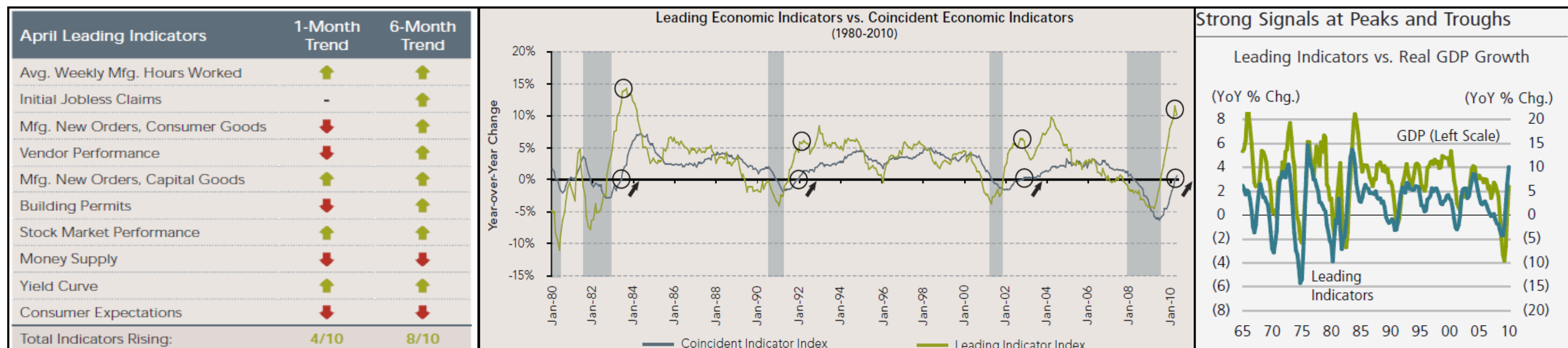
If the US economy were a three-legged stool, the primary legs would be **consumer spending** (all the stuff we buy from iPhones to new clothes), **housing** (houses, appliances, building materials, etc.), and **exports** (all the stuff we make and sell to others). In an interesting series on The History Channel called America: The Story of Us, the segment "Superpower" chronicles the time during and after WWII when America became a global economic and military superpower with technology fueling a boom in the economy and the population (so-called "baby boomers"). With Europe and Japan in tatters (literally), the US scaled heights that made the US consumer king of the world's economy. In every US and global economic slump since WWII, the world always relied on the vast size and wealth of the US consumer to return the world to growth. American companies dominated in almost every manufacturing segment from the 1950's to the 1980's while European and Japanese companies slowly re-emerged onto the global economic scene in the 1980's and more recently. All these companies sold products to the king—the US consumer. Long live the king—until the Great Recession of 2007-2009. The king (aka US consumer) in the 1950's spent from *rising earnings*. The king in the 1990's and 2000's spent from unprecedented *borrowings.* With help from politicians, the US housing industry (2nd leg of stool) boomed until the 2007 crash. Since then, the US consumer is busy retiring debt, and the US housing industry is seeking a bottom—two of the three legs of our stool need re-tooling.



And yet, the US economy is growing again. The US stock market has returned about 60% since the March 2009 lows. American companies are generating more cash from normal operations than at any prior time in history. Where is the growth coming from? The third-leg of the stool—**exports.** Who is buying American goods? The *emerging market* economies like China, India, and Brazil. The chart below from the International Monetary Fund shows the two-decade change in global economic growth (GDP or gross domestic product). Over that time the *emerging market* economies as a share of global GDP nearly doubled from 13% to 24%. Note during the same time the US share remained constant at 31%. That means China and India and Brazil et al gained at Europe and Japan's expense. American manufacturing companies have dramatically improved their competitiveness by making better products in a more efficient manner and the consumers in *emerging markets* are buying. Ford now makes vehicles that match the quality of Toyota. For the first time ever, the return to growth in the US economy is being driven by the third-leg—**exports**—a positive transformational shift for the future.



Double-dip not likely! The year-long 60%+ recovery in the S&P 500 Index from March 9, 2009 to April 23, 2010 roughly coincided with a bottom-signal from leading economic indicators, a pattern consistent with past recessions. Leading indicators typically detect a revival of economic growth *before* it begins. Yet, fears that the US economy might experience a rare "double-dip" recession prompted a recent stock-selloff—the S&P 500 Index closed at 1,217 on April 23 and closed at 1,022 on July 2—a decline of –16%. A "correction" of this magnitude is not uncommon following a 60% rise in stock prices. However, it came at a time when the LEI Index (Leading Economic Indicators) in April experienced weakening in all but four (4) of the ten (10) individual indicators (see chart below-left). In early May the debt crisis in Europe, notably Greece*, gave stock investors another matter to worry about and this has contributed to a global equity "correction" (*see **Beacon's** 5/20/10 Investment MEMO <u>Recent Stock Market Volatility—PIGGS In US and Abroad).</u> Yet despite April's hiccup, the multi-month trend in the LEI Index is still generally positive. Economists also use the CEI Index (Coincident Economic Indicators) to gauge if *current* economic conditions support or contradict the LEI Index trend. In this cycle both are trending *up* signaling economic recovery with *no* sign of a "double-dip" recession (see chart below-center). Historically there is a strong positive correlation in the direction and magnitude-of-change between leading indicators and economic growth (see chart below-right) because the LEI Index *aggregates* individual measures that have a solid record in successfully forecasting changes in the business cycle including trends in labor markets, manufacturing, construction, and finance (see 10 indicators chart below-left). <u>**Beacon's** "take" is that the leading economic indicators are pointing to a recovery that is still intact, likely to be choppy, yet is sustainable.</u> Washington, D.C. continues to pose "risks" to the recovery (more regulation, unprecedented deficit spending, higher taxes, etc.). We're not political scientists but it's interesting to note comments by major Democratic business leaders like Mortimer Zuckerman recently at the Aspen Institute: *"We really have, I think, some of the worst public policies in place today, there is outright "hostility" to the business culture that helped build the country…*[but]…*"We will recover the energy we frankly have lost in the last year or 18 months."* Maybe Zuckerman is thinking aloud about the nirvana days of political "gridlock" whereby neither political party dominates elections and legislation.



April Leading Indicators	1-Month Trend	6-Month Trend
Avg. Weekly Mfg. Hours Worked	↑	↑
Initial Jobless Claims	-	↑
Mfg. New Orders, Consumer Goods	↓	↑
Vendor Performance	↓	↑
Mfg. New Orders, Capital Goods	↑	↑
Building Permits	↓	↑
Stock Market Performance	↑	↑
Money Supply	↓	↓
Yield Curve	↑	↑
Consumer Expectations	↓	↓
Total Indicators Rising:	4/10	8/10

The picture was better for fixed income as this asset class extended solid 1st quarter gains with even better 2nd quarter returns. For example, MetWest Total Return (MWTIX) gained over 7.5% YTD, following a 17% return in 2009. These results again demonstrate the substantial benefit to balanced investing across different asset classes, as bonds once again have been for our client-portfolios the all-important "anchor-to-windward." ■