KIELY WEALTH ADVISORY GROUP, INC.

# BEHIND THE SCENES

Volume 16 | Number 2 | Date: July 2009

## OPENING THOUGHTS

Between March 9th 2009 and May 9th 2009, financial markets around the globe signaled investors' belief that economic improvement is on the horizon with one of the largest rallies in history. Financial markets are forward looking, of course, and after a year of declining output, two years of falling employment, and a near collapse of our financial markets last October, the consensus among market participants is that things have begun to stabilize and we are beginning to climb out of the deep economic hole we dug for ourselves. At this point, the majority of economists surveyed believe that the second half of 2009 will mark the official end of this recession, which would be good news indeed. However, for many Americans the pain and suffering will continue into 2010 and beyond, whether we're in a recession or not. In spite of improvements in many areas, history suggests that a full recovery from a recession of this magnitude is a long, slow, and deliberative process. In truth, we don't believe much has significantly changed on the economic front over the past several months and we'd like to reiterate the same exact message we printed three months ago, when we were first beginning to see signs of improvement in the U.S. economy. In April, we wrote the following:

*"While we are quite confident about where the economy is headed in the longer term, many short term challenges remain and thus we are by no means out of the woods yet. These are clearly unprecedented economic times and it seems likely the road to economic recovery will be long and not without setbacks. As is the case with any patient recovering from a severe illness, the economy remains in an acutely weakened state and is more susceptible to a variety of potential afflictions than it would be ordinarily. On the positive side, fear and panic have finally begun to subside. However, many of the attractive investment opportunities they created still remain. As a result, our objective as we go forward is to position each individual portfolio to take advantage of the unique long-run investment opportunities that currently exist, while remaining cautiously cognizant of the potential for more short-term turmoil."*

In sum, we still believe there are excellent opportunities in stocks and bonds for patient long term investors. However, the financial markets WILL NOT continue their recent run upward without a few major bumps in the road. Future volatility is inevitable - but manageable - if you are prepared for it, remain patient, and proactively rebalance to minimize potential risk exposure.

**INSIDE THIS ISSUE:**


| | |
|---|---|
| Opening Thoughts | 1 |
| Market Returns & Volatility | 3 |
| Banks, Monetary & Fiscal | 4 |
| Portfolios & Managers | 8 |
| 10 Questions w/ Joe | 9 |
| A Final Note | 12 |
| 2009 IRA Chart | 13 |
| Compliance Notes | 13 |
| Quarterly Reports | 14 |


**NEW CLIENT PROFILE MAILING**

WITHIN A FEW WEEKS YOU WILL RECEIVE OUR NEW KIELY GROUP CLIENT PROFILE MAILING. WE STRONGLY ENCOURAGE YOU TO REVIEW AND FILL OUT THE FORMS INCLUDED AND RETURN THEM TO US.

**BENEFICIARY UPDATE REMINDER**

WE WOULD LIKE TO REMIND YOU TO UPDATE YOUR IRA BENEFICIARIES IF NEEDED! THIS IS A VERY IMPORTANT PART OF YOUR FINANCIAL PORTFOLIO AND SHOULD NOT BE OVERLOOKED.

## Panic, Opportunity & Gains

After the panic-induced selling we observed in February and early March, it was clear to many of us that there were incredible investment opportunities everywhere, particularly in the stock market. However, for those investors who were using their rearview mirrors to navigate forward (which includes much of the media) they saw nothing but storm clouds ahead, which prompted many participants to sell out of the stock market at the absolute worst time. History suggests rearview mirror investing of this sort is common, particularly in strong bear markets. Unfortunately, this strategy is almost always counterproductive to those who panic and sell. As if determined to prove a point, the stock market rallied from the lows reached on March 9th, 2009 to enjoy its best one-month and two-month runs in 70 years. This rally held up throughout the end of the second quarter, with unprecedented gains in stocks across the board, as evidenced by the style box performance data below.

**Russell Style Index Performance**
**03/09/2009-06/30/2009**

| Value | Blend | Growth | |
|---|---|---|---|
| 39.78% | 37.63% | 35.33% | Large |
| 48.13% | 45.29% | 42.91% | Mid |
| 47.91% | 48.89% | 49.86% | Small |

To be honest, the speed and magnitude of the subsequent stock market rally took virtually everyone by surprise and has left many of us wondering whether the market may have gotten a bit ahead of itself. This leaves us with concerns that a substantial dip and/or increased volatility may be inevitable in the near-term. We could easily be wrong, of course, and are well aware that predicting short-run moves in the market is virtually impossible. Still, as fiduciaries we need to make sure our client portfolios are prepared for any eventuality and the best way to accomplish this is through diligent rebalancing back to our target asset allocations. In many cases, this will mean moving some money out of stocks, which have been hot recently, and into fixed income alternatives. In other cases it may mean rebalancing within the style grid to make sure the areas which have done the best recently haven't become significantly over-weighted. As new mutual fund holdings data becomes available we will be proactively analyzing everyone's portfolios and making the appropriate adjustments as needed.

## The Worst is Behind Us

In terms of the overall economy, we believe the worst is over and thankfully Armageddon is off the table. Why? Because a number of broad economic indicators have started to bottom out and we have seen plenty of economic evidence that we're moving in the right (positive) direction on many fronts. However, we also keep stressing our belief that we've still got a long way to go before we're completely out of the rather large hole we've dug for ourselves. In other words, we believe long term investors will be rewarded for their patience…in spite of our view that in the short-run the stock market may have gotten ahead of itself. It's not hard to see why some might find these seemingly opposing views incongruous, but we assure you they are not. The truth is, like everything related to the economy there is a great deal of complexity in our economic viewpoint and we think it is important for you to understand not just what we believe, but why we feel that way. To that end, it is important to first review the events that got the economy into this mess in the first place.

## Hindsight is 20/20

With the benefit of 20/20 hindsight, it is frustratingly easy to see that during the recent real estate boom we all got lulled into a sense of false security regarding housing prices. This, in turn, caused a number of lenders and other real estate market participants to adopt far weaker lending standards than at any other time in history. Everyone—including banks and financial firms, households, investors, rating agencies, and the federal government—threw caution to the wind regarding long held inhibitions about lending to individuals with substandard credit and making home loans with no money down. The result was that by 2008, household debt had spiked to a record 133% of disposable personal income, the median home was selling for more than four times the median family income, investment banks had levered their balance sheets up to debt to equity ratios of 50:1, and the federal deficit exceeded 3% of GDP. All of these factors only served to fuel the boom, of course, and all was well so long as the good times rolled. But when the party ended, the extreme excesses and mountains of bad debt they fostered became all too apparent. The process of digging out from under the mountains of debt will be painful and it will not happen overnight. But make no mistake—in our opinion we WILL dig out.

(Continued on Page 3)

### The Biggest Loser

Many of you have probably seen the television show "The Biggest Loser". The contestants on this show have gained a great deal of weight for one reason or another. What's great about the show is that it provides a process for both losing the weight and for keeping it off over time. This is analogous to what our economy faces today. We became over-weighted with debt and eventually reached a point where we were forced to take action. Over the past six months the process of working this debt off has begun, but we still have a long way to go. Many people will view this long arduous task as virtually impossible - however we remain optimistic. To date, we have changed the landscape of investment banking, instituted a number of new regulations, and if we continue exerting a moderate degree of self-control, we believe this problem is imminently solvable. So we remain optimistic about our economic future, recognizing that it will be a future with less readily accessible debt financing. As such, it will be a future where short term economic growth will invariably be slower. However, longer term growth will be more steady and sustainable over time. In essence, we believe it will take time to adapt to a new world without as much debt. However, once this transition has occurred, we believe it will be a better economy long term and we believe we WILL come out stronger than when we went into this mess.

### Looking Forward

In terms of how we manage our portfolios, we believe caution continues to be warranted at this point. We think chasing the recent stock market rally would be a mistake, particularly for investors who are in retirement or who need to generate income from their portfolios. We also fear that some of our clients/friends may have become conditioned to expect recent trends toward lower volatility and rapidly rising stock prices to continue unabated. We feel this is unlikely, as we've still got a long way to go in the recovery and because recoveries almost never come without at least some bumps and bruises. The recent rally in stocks has been tremendous and has taken some pressure off the frayed nerves of investors. But the market was literally in panic mode just three short months ago and those fears still smolder below the surface, ready to rekindle with the smallest spark or gust of wind. We would not be surprised to see a retracement of 10-20% from where we're at today in the stock market and we are, quite frankly, very concerned about how some of our clients would react. The second drop in a bear market is generally more painful and emotionally trying than the first, even if it stocks don't go all the way back down to where they were. As a result, we believe it is critical for investors to keep their expectations in check at this juncture and to be ready for another sizeable dip. As we've said all along, there will be plenty of ups and downs in the market going forward. Investors who recognize this, will be the ones best able to cope with the inevitable dips when they occur.

## 2009 MARKET RETURNS & VOLATILITY

During the first three weeks of 2009 the S&P 500 index (large company stocks) and the Russell 2000 index (small company stocks) each experienced a broad sell off and fell by as much as 10%. Over the subsequent three weeks things basically trended sideways…until we reached mid-February. Things at that point were looking somewhat better on the economic front, with two of the largest banks in the country announcing they would be profitable for the quarter; the Obama administration passing a massive economic stimulus bill; and the widely revered and respected Oracle of Omaha, Warren Buffett, appearing on CNBC for three hours to preach patience and long term prosperity. Taken together, these items ordinarily would have a provided a substantial positive jolt to the financial markets. Unfortunately, these times were anything but ordinary. With fear and negativity reigning supreme, what followed was a panic driven sell off of historic proportions. As the decline began gaining steam, fear fanned the flames of panic, with individual investors once more leading the charge to the exits. We use "once more" in the previous sentence because we've seen this scenario play out many times in past markets. Fear turns to panic…which begets even more fear and even more panic…until ultimately we find ourselves in a full-blown selling frenzy. And this is precisely what occurred in February and early March of this year. Once in panic mode, investors tend to lose their ability to reason and just want out, regardless of the cost. But the cost is usually great and this time was no different. The style index table presented earlier provides a good estimate of the cost to investors who bailed out. Since the peak of the sell off a little over three months ago, stocks across the nine style boxes gained an average of 44%, with even the worst performing category rising more than 35%. For investors who panicked and sold near the bottom, those are gains that will likely never be recovered.

(Continued on Page 4)

### Panic, Optimism and Patience

Suffice it to say that the period from February through early March was painful for investors. During the sell off we wrote repeatedly about the need for patience and explained that the situation was being driven by emotion rather than reason. We frequently noted how unrealistic asset valuations had become and encouraged our clients to look beyond the sensationalistic network news, which seemed intent on covering only the worst and most sensationalistic stories. We consistently reinforced the importance of a long term perspective and detailed numerous positive signs of a turnaround. As validation of our efforts, the stock market enjoyed its best two-month run in 70 years (March 9th to May 9th) with the S&P 500 rising over 35% and the Russell 2000 increasing a staggering 45%! Since that time the markets have gyrated up and down, but have remained generally flat. During the second quarter, the S&P 500 increased more than 15%, while the Russell 2000 increased more than 20%. Over the first six months of the year, the S&P 500 (SPX) was up 1.78%, while the Russell 2000 (RUT) was up 1.77%. The Dow Jones Industrial Average (which is what most people unfortunately follow) finished the year off 3.8% through the end of June. Our managers, on the other hand, have had a better run…as you will see when you examine your quarterly statements and year-to-date returns. In fact, many of our fund managers are up double-digits through June 30th, including three of our bond managers.

### The Economy

The recent run-up in stock prices has been driven by a number of factors, including the opportunity to buy stocks at unheard of bargain prices, institutional portfolios rebalancing back into stocks, and increasing signs that the economy is indeed healing. Key consumer, housing, retail and manufacturing indicators have all bounced up from earlier lows. And if you're looking for a silver lining in the real estate crunch, the housing affordability index is now at an all-time high due to a combination of falling home prices and rock bottom interest rates. Consumer confidence is now at a nine-month high and even the employment picture is less bad, with jobless claims (although still over 500,000 a week) trending lower each month. In addition, there are encouraging signs of improvement in the credit markets, particularly for the obligations of lower quality corporations and municipalities. Finally, interest rates are low, commodity prices have stabilized and government policies have brought the financial system back from the abyss. There are clearly all sorts of reasons to be optimistic looking forward, yet we remain cautious. Why? To answer this question, we have to examine the four factors we believe will drive our economy over the next five to ten years.

## Banks, Monetary Policy, Fiscal Policy and the Consumer

### Banks

At this point, we all know that large investment banks played a key role in the near collapse of our financial system last October. Since that time, the government has intervened in a number of ways, most notably by purchasing billions in preferred stock from commercial banks. Over the past few months, the U.S. Treasury has engaged in a series of bank stress tests and results have been promising. Based on Treasury Department reports the threat of financial system collapse has passed. In fact, according to the Treasury, none of the 19 largest U.S. banks would become insolvent even with a combined unemployment rate above 10% and further home price declines of 20%. The tests did determine, however, that nine of the banks need to collectively raise over $65 billion in capital (a staggering figure) and will have six months to do so. To date, more than half of that amount has been raised, which is clearly a good sign. Of course, the best way to raise capital is to make money, and although revenue growth is likely to be weak going forward, the banks do benefit from government funded debt guarantees, a steep yield curve and ample credit spreads. That said it is clear future earnings for banks are likely to grow more slowly given the economic slowdown and more rigorous lending standards. Thus, to speed up the capital raising process, many banks have begun issuing new stock and selling off unwanted assets. Expect to see more of the same going forward. And if these measures fall short, expect the government to convert preferred shares into common equity and to provide even more assistance to banks.

**Our take:** Slower bank revenue growth is really just the end of the beginning for a differently shaped economy that will NOT be rebuilt on unsustainable amounts of consumer debt. Banks will necessarily become smaller and more conservative in their lending practices and they will be more tightly regulated than before. The shadow banking system (i.e. non-bank lenders like insurance companies and brokerage firms) that securitized trillions of dollars of debt

(Continued on Page 5)

will likely remain moribund. Gone are the days of 50:1 leverage with the financial sector accounting for 30% of total S&P 500. Frankly, we expect tangible innovation and value creation to drive the next economic cycle…which will be a welcome change from the greed and leverage that drove the previous one. But this process may prove to be slower than we're used to seeing as many viable businesses will face higher obstacles accessing the necessary capital they need to grow.

### Monetary Policy

In the new economy, where credit availability is tighter, record low interest rates will not have their usual effect of jump-starting the economy, particularly following a period of great excess like we've just been through. Households and businesses will be looking more to save than borrow, so the Federal Reserve and the world's other central banks will have to supplement extraordinarily low interest rates with other policy innovations such as "quantitative easing"—which is an attempt to improve the supply, not just the price, of credit. Although such a massive and unprecedented extension of government makes many observers queasy, the Fed's quantitative easing policy, by backstopping the residential mortgage, interbank lending, and commercial paper markets has, in our opinion, been a vital step in both shoring up the financial system and in preventing greater carnage on Main Street. This year's decline in home mortgage rates can be attributed to the Fed's acquisition under the quantitative easing program of $366 billion in residential mortgage-backed securities, none of which it owned a year ago. Fed intervention late last year in private commercial paper financing also revived that market and probably averted a rapidly spreading disaster among money market mutual funds. As a side note, for all of those concerned that the U.S. is turning into another Japan, note that the Bank of Japan did not pursue an aggressive quantitative easing policy until a full decade after their real estate and equity bubbles simultaneously burst. (This is just one of many instances where our economy and Japans economies differ).

### So, Is Inflation Coming?

Many people argue there is no free lunch, and we agree. Yet, quantitative easing implies printing money to buy government and corporate debt as well as mortgage-backed and asset-backed securities, and as such, many economists feel that "inflation is always and everywhere a monetary phenomenon." So are we headed back to 1970s-style inflation? We don't think so…as three items need to be in place before inflation can rear its ugly head. First, the velocity of money (or the speed at which money changes hands) must increase. Today, deflation pressures remain a much greater risk. If consumers and businesses expect prices to continue declining, they will likely postpone consumption or investment plans, further weakening the economy, reducing the velocity of money and thereby reducing inflationary pressures. Second, there has to be upward pressure on overall wages. With a global workforce and unemployment getting close to double digits, there is currently no wage push and there won't be for the foreseeable future. Third, productivity can offset the potential effects of inflationary pressures. As long as productivity increases, the net effect of inflation will remain subdued.

Remember, the primary goal of quantitative easing is to re-inflate the broad economy. Ironically, any sign of near term inflation would imply returning prosperity…which when last we looked was a good thing. Nonetheless, the Fed can reduce the money supply by selling securities back into the market as soon as inflation expectations rise above the Fed's comfort zone, which is precisely what they did in 2003 and 2004. Of course, there is a fourth reason not to worry about inflation, but that would presuppose all of our clients read "white papers" like we do. One such "white paper", written by the ICON fund, indicates that over the last five recessions there have been two prevailing themes. First, inflation stays moderated (by an average of 41%) over the four years following a recession (which is why the Fed sees little risk in increasing the money supply at this point). Second, small cap stocks always lead the rally back into black numbers… which is something we'll examine in more depth later on.

**Our Take:** It's a lot easier to criticize monetary policy than to make it. We believe we are fortunate to have perhaps the best financial manager on the planet (Ben Bernanke) at the helm of the Federal Reserve during this crisis and think he has performed brilliantly. Economists will argue about the role of the Fed in creating this crisis for years, but those discussions will all focus on actions that occurred long before Bernanke took charge. Since he inherited the position his role has been one of guiding us out of this current crisis. In that role, he has performed laudably.

### Fiscal Policy and Entitlement Programs

We believe Congress will have far more difficulty "sticking the landing" in reigning in stimulus spending than the Fed will on unwinding its monetary policy. For all the talk about excesses in the private sector, the federal government has not exactly been an innocent bystander.

(Continued on Page 6)

Despite one of the greatest expansions in history over the past two decades, our lawmakers have unthinkingly failed to save for a rainy day…and suddenly now it's pouring. As a result, they have to spend to keep our economy afloat. Spending of this magnitude is clearly unsustainable long-term, but at this point we have little choice. Consumers and businesses have necessarily reduced their spending by significant amounts during the recession and Washington's spending response is intended to replace private demand and stimulate the economy. The spending plan was designed as a "time-release pill" for the economy with its effects extending into 2010 and beyond. But the federal budget deficit has now reached an astounding 7.8% of GDP (and growing) making the federal government's options limited. They can either raise taxes (likely), cut services (i.e. government jobs, also likely) or borrow more money and potentially crowd out private investors (likely but not sustainable). None of these options are exactly pro-growth policies but much like the excesses of the private sector, past excesses in federal spending have left us with too much debt and no real options beyond a painful and protracted period of belt tightening.

### Future Deficits

If current policies lead to a robust economy in the long run, there is a good chance we can get our deficits under control – particularly if Congress and the President can keep spending under control. If for some reason these policies do not lead to a robust economy, or if we don't get our government spending under control, we believe there will be longer-term inflationary consequences and continued weakness in the dollar. Fortunately, this is not something we need to worry about today or over the next few years, as the overriding concern right now is getting the economy back on track as quickly as possible. Once we get the economy off and running, then we will need to tackle the issue of deficits. But if you just can't help yourself and need to worry about potential inflation anyway, remember that over past inflationary periods the best place to be invested was in the stock market, as this was the only asset class where your money would have kept pace with inflation.

**Our Take:** We have yet to meet anyone who likes the idea of more government debt opposed to less. However, at this point the government has little choice. Jump-starting the economy requires deficit spending. And even though the stock market has had a nice run, the overall economy still has a long way to go before it gets back to normal. This is why a federal stimulus plan makes so much sense. However, once the engine is running the jumper cables need to come off. We cannot afford to let the federal budget deficit get out of control as it has in the past. If we expect investors to buy our Treasury bonds over time (which is how we finance our debt) the national debt has to remain at a reasonable level relative to GDP. Managing debt is really no different than managing inflation. Some inflation is fine as long as it remains low (below 3%) and the inflation rate remains reasonably steady. Having national debt is not a problem either, so long as it remains at a reasonable percentage rate (relative to GDP) and so long as that rate remains reasonably steady over time. Once we recover from this recession, it is essential that we reduce spending and keep debt at a reasonable level relative to GDP. Right now, the federal deficit is 8% of GDP and growing. Over time, that is simply unsustainable and we have to stop spending beyond our means. This means we will have to reduce spending of all types, including spending on entitlement programs. We simply have no other choice. Cuts will need to come in both health care and Social Security; taxes will need to be increased; and a number of government programs will need to be cut or eliminated. Politicians have historically been loath to confront any of these issues as they have been surefire ways to lose during re-election. Unfortunately, the time has come where they have to step up and make some very hard choices. We hope this happens…

### The Consumer

U.S. household nominal net worth has taken a big hit over the past two years and rebuilding this wealth will not be an easy task, particularly with a slack job market and the slowest wage growth since the Department of Commerce started keeping records in 1960. Without an improvement in wages, households will be left waiting for home prices or equity valuations to recover. This will not happen quickly, as home prices continue to trend lower across most of the country and inventories of unsold homes remain well above historical averages. The dramatic spike in stock prices since early March has helped increase consumer confidence and consumption levels but it's not enough. In essence, the consumer has moved from panic mode to just-recession mode, which has led to a welcomed increase in spending but has still left it well below "normal" levels. Since spending has been so anemic, any rebound in consumption from current levels will feel quite large. The bigger question will be whether we have permanently changed our spending habits. Household debt, at 129% of disposable personal income is still extremely high. This has greatly limited spending and has led to an increase in our savings

(Continued on Page 7)

rate from almost zero to 4.5% in short order. While this behavioral shift may be a good thing for the economy's long-term viability, it is not a harbinger of near-term robust growth. If history is a good guide, pent up demand will build over time and consumer spending will rebound, just as it always has. But it will take time for this to occur since consumers, who have been the central engine of the U.S. economy for decades, will have a limited ability to spend. Sluggish consumer spending will therefore hamper the ability of the U.S. economy to recover as rapidly as it has from previous recessions.

**Our take:** Consumer spending will remain muted for some time to come. Given this, we believe the foreseeable future will be one of below average economic growth. When you combine a tapped out consumer with banks that are reducing the overall availability of credit and companies that are cutting back on future expenditures, it's hard to be overly optimistic about robust growth anytime soon. We believe there will be growth, but think it will be subdued over the short-term. Given this viewpoint, you might question our premise that the future is bright for long-term investors. Remember there are now two subsets of consumers – domestic and global. In our opinion, the U.S. consumer will recover and as a result of the lessons learned, both the domestic consumer and the economy will be better for the experience. In addition, consumers across the globe (particularly in the Asian economies) will continue to see unprecedented ability to both earn and spend, and this spending will have a major impact on companies in the U.S. and, in turn, on the U.S. economy. Global consumers are essentially the wildcard in all of this and may well render our predictions of a slower economic recovery overly pessimistic (and we certainly wouldn't mind being wrong).

**So, what does this all mean for Investors?**

An old Chinese proverb says, "The cautious seldom err." Perhaps, but this isn't always true in investing. The cautious have most assuredly underperformed since the stock market hit its recent low on March 9th. For those investors who finally capitulated in early March and sold out, the "opportunity cost" of missing the rebound in stocks and bonds has been quite high. We have written many times that no one can effectively "time the market" and that the perceived safe havens of cash and Treasury Bills are often the worst places to retreat to. This market cycle has proven no different, as cash and short term Treasuries have underperformed significantly compared to the returns on other riskier assets like stocks and corporate bonds.

Still, the recent record rally across all equity (stock) sectors has left us guarded. As we noted earlier, the rally and improvement in the economy have taken Armageddon off the table, but there will undoubtedly be bumps in the road ahead. In fact, any number of issues (economic, geopolitical, etc.) could lead a significant sell off. Please note that we're not calling for or predicting a sell off. We're simply calling for caution and a rational response should one occur. Sluggish growth, constrained spending and restrictive lending practices do not bode well for highly levered companies that need to roll their debt or for the many S&P 500 companies that require a rising tide to prop-up earnings. In a deleveraged world, growth is likely to come from companies we've never heard of and whose names we cannot pronounce. Small cap innovators in niche markets and companies with a competitive advantage in serving emerging economies should lead in generating the growth that will drive returns in the next cycle of prosperity. And if history provides a clue as to what will happen down the road, it's the small and mid cap companies that will lead the way back to prosperity. That said, markets will remain volatile and as we have consistently said, we're not trying to be heroes by hitting home runs. Our approach continues to be the same as always. First, we must diversify properly. This means we embrace small and mid caps in our portfolios, which has been a mainstay of our strategy since day one. Second, we must continue to seek out and use the small handful of excellent managers who have a proven, successful, long-term track record in both good times and bad. When you peruse our stable of managers, we think you'll be pleased with how well they have responded to the current crisis. Finally, we need to continue monitor individual client portfolios to make sure their holdings are well-diversified and that they match each client's time horizon and penchant for risk. In essence, we're going to continue to use the same proactive time-tested strategies that have proven to work so well over time. Unfortunately, many impatient investors tend to abandon these types of strategies at the worst possible time.

(Continued on Page 8)

# Our Diversified Portfolio of Managers

### Stock Strategies

The core funds we utilize in our portfolios are continuously evaluated and we generally add a few new fund managers and drop an underperforming fund or two during any given year because they no longer meet our demanding criteria. As you know, we focus a great deal of our investment research on our core **stock fund managers**—and for good reason. Our core stock funds provide the bulk of investor returns over time and the volatile nature of stocks makes successfully managing a stock portfolio a very challenging task. This year our research has paid off handsomely as the vast majority of our stock managers are beating their specific benchmarks through the end of June. In fact, we have a number of managers in each equity style box who are up double-digits year-to-date. This type of performance shouldn't be surprising because a major component of our selection process involves evaluating a manager's ability to recognize bargains and capitalize on them, particularly in difficult times. One thing all our managers have in common is a rational, commonsense approach to stock picking devoid of emotional demons that plague many investors, and that gives us great confidence in their services.

### Stock Manager Spotlight

There are a number of excellent stock managers who have had nice returns this quarter and year-to-date through June. (Please examine our equity managers at the end of this newsletter on page 14 to see their performance) Two managers who we've wanted to highlight for a while now are our mid-cap value managers James Kieffer and Scott Satterwhite of the Artisan Fund. Why highlight these guys? Because they are the exact type of fund managers we love to own after major market dips. First, we know that our small and mid-cap value funds are going to typically lead the market higher out of this mess and they will generally hold the type of companies that set the tone (through creative innovation) for what our new economy will look like. Their double-digit returns through 6-30-09 come as no surprise. Second, we love managers, like Jim and Scott, who manage relatively smaller amounts. Their smaller size gives them a great deal of latitude to change their portfolio without any meaningful effect on our clients or the markets they operate in. In essence, they operate under the radar which gives them a huge advantage over some of their peers and some of the other much larger managers out there. Another reason we like them is their consistent long term track record in both up and down markets. This gives our clients protection on the downside with potential upside returns. For example, last year, they provide downside protection by beating their benchmark by 9%. This year in very tough up and down market, the Artisan fund is up more than 11% through the second quarter. Finally, we like the fact that there is little written about them in the general press. This keeps a lot of the "hot money", out of their portfolio over time. So called "hot money" tends to be much more speculative and short term in nature, which affects both pre- and post-tax returns. All of these little nuances help our clients and their portfolio's over time.

### Bond Strategies

If the past decade has taught us anything, it has taught us that economic bubbles have become more prevalent and are likely to occur with greater frequency over time. This phenomenon provides great opportunities for flexible investors who are not afraid of change and who remain on the lookout for new opportunities. For example, last year, (prior to the market collapse) we were consistently promoting steady income earners like Bill Gross of PIMCO and Thomas Pappas of Vanguard GNMA for our retirees and those needing short term cash flows. However, after the near collapse of our financial system last October we recognized some significant mispricing in a number of financial markets—particularly in non-government bonds. Many looked at the negative 2008 returns associated with corporate and convertible bonds with concern…but we saw a rare opportunity to buy in at unheard of prices.

Since last October, we have discussed corporate and convertible bonds at our client dinners, in our year-end newsletter, and in a recent three-part email update, so we're not going to go over our strategies again here. Primarily, we wanted to point out that forced selling on the part of financial services firms desperate for cash (i.e. commercial banks, investment banks, insurance companies and hedge funds) drove corporate bonds prices down to levels we'd never seen. Although we knew the stock market would eventually bounce back, we also felt it made sense for almost everyone to have at least some exposure to corporate and convertible bonds since their prices were so attractive and their downside risk at those prices was minimal. And although these securities have had a nice run over the first half of the year, we still feel believe there is plenty of upside potential over the next few years.

(Continued on Page 9)

**Bond Manager Spotlight**

At quarter end (06-30-09), our discounted corporate bond fund (Loomis Sayles Strategic Income Fund) was up 17.98%, while our convertible bond fund (Calamos Convertible Bond Fund) was up 14.01%. Dan Fuss at Loomis Sayles is considered one of the best bond fund managers by his peers in the debt market. And since the market meltdown in October, he and his team have been buying bonds at seriously discounted prices. In effect, they have been able to collect high rates of interest income on significantly underpriced bonds while they wait for the prices to return to fair value. Usually pricing gaps like this close quickly, but in this case serious disconnects in the yield spreads between Treasury and corporate bonds still remain, meaning the upside for corporate bonds relative to Treasuries remains bright. The same can be said for convertible bonds too, although convertibles have the added advantage of being convertible into shares of stock when stock prices rise – which means their upside is even greater over time.

**Other Opportunities: Global Natural Resources**

We have historically used specialty funds sparingly in our client portfolios, preferring instead to let our portfolio managers make decisions about which areas they feel are most attractive. But extraordinary times can result in extraordinary opportunities and we believe there is potentially such an opportunity in natural resources. The slowdown in global economic activity has driven down the prices of commodities (i.e. oil, copper, coal, etc.) and the stocks of the companies who mine and process them to levels below where they should be. As the economic recovery begins, natural resources prices will invariably increase and in our opinion this increase could be dramatic. However, these investments are very volatile and not appropriate for the fainthearted. For example, in May of this year global natural resource funds increased by over 20% only to see losses of 10% in June. We think global natural resource investments have excellent long term potential, but due to their volatility they are only appropriate in small quantities. As a result, we recommend a maximum of 5% of any portfolio be invested in this sector of the market.

**In Sum**

We don't want to give the impression that we've given up on our diversified stocks funds or the stock market in general—we haven't. In fact, we're extremely pleased with the performance of our core stock fund managers. As of June 30, 2009 virtually all of our core stock funds are in the black and most are beating their benchmarks. In other words, our core stock fund managers have been doing an excellent job of finding and capitalizing on undervalued assets, just as we hired them to do. Overall, we still believe the strategy of using a diversified stock portfolio will provide the best long run returns. However, by adding corporate bonds and convertible bonds to some of our core portfolios we have helped mitigate the effects of increased volatility in the stock market in the short run. In addition, the opportunities in these asset classes provide excellent upside potential as the global economy begins to recover. And at the end of the day, that's precisely what we're trying to accomplish: Risk minimization with excellent upside potential.

## 10 QUESTIONS WITH DR. JOE

**1. Dear Dr. Joe, I have been anxiously awaiting your new web-site. How are the new web-page and your "Virtual University" coming along? J.M.**

**Dear J.M.:** Good question!! On August 8th our new web-site officially will go live. You can logon by going to www.thekielygroup.com. It has taken us a bit longer than we expected to work out a few of the little kinks, but we are happy with where the current version is headed. You can look at our bios, our services and our community "Pay It Forward" giving programs. We still have some text to add, and a few kinks to work out, but we feel like users can get a good feel for who we are and what we do. The Virtual University is a different story. We have a few video's and a number of presentations done, but we are still working on the software that will be needed to logon (with a password) to our Virtual University. We also want the University to work in tandem with the new book Scott and I are working on, so it may be a while until that piece goes live. In the meantime, please logon to our "Under Construction Site" at http://kiely.development-evolve.com/home and send us your thoughts about the current version and what you'd like to see in our Virtual University down the road.

**2. Dear Dr. Kiely, I recently received a letter from TD Ameritrade outlining their new Money Market Mutual Fund (MMMF). Is Kiely Wealth Advisory Group using this new MMMF fund? Can you provide some background on this fund for me? J.D.**

**Dear J.D.:** At KWAG, we only use MMMF's that invest in ultra-safe investments. We view a MMMF as a safe place to hold cash and thus do not like to take any unreasonable

(Continued on Page 10)

risks to get an extra .10% return. To us, the risk simply isn't worth the reward.

Unfortunately, many investment companies (and advisors) try to "time" when they get in and out of the stock market with their client investments. As such, they tend to hold lots of cash over long periods of time, which earns very little interest when the assets are not fully invested. We believe this strategy is foolhardy, counterproductive, and potential very harmful to your portfolio and the research supports our view. Timing strategies have been found to underperform the stock market over time, precisely because so much money is sitting in idle cash holdings for significant periods. Market timers know this too, of course, so they will often attempt to earn as much as they possibly can when their clients money is in cash. This has led to unnecessary risk-taking in MMMF's over the last few years…all in the name of getting a little extra return that generally amounts to just hundredths of a percent annually.

Last year, as you may recall, some of the investments within the highest paying MMMFs failed when the mortgage market and commercial paper markets froze up. This, in turn, led to a freeze in clients MMMF holdings, which as you might imagine did not go over to well with clients who needed to access the cash in a timely manner.

Since that time, many custodial firms (like TD Ameritrade & Charles Schwab) have revisited how they build MMMF's as an alternative to "cash" holdings. And, as such they wanted to put in safeguards to insure this type of thing never happens to any of their clients. The result is a new fund called the TD Bank USA FDIC Insured Deposit Account (also called the Advisor Core IDA). Since it's insured by the FDIC, it's as safe as the money you hold at the bank, which we really like. We plan to use this money market fund exclusively for our clients going forward, since we see no need to take risks with any of our client funds in their money market accounts. If you would like more information on the new insured money market account, please e-mail Katie Burr and she'll send you the updated link on this account.

**3. Dear Dr. Kiely, Last year you provided an IRA table regarding the new rules for 2008? Can you provide the same for 2009? W.W.**

**Hey W.W.:** We would be happy to provide that table again. Please see Page 13 of this newsletter for an updated version of the new IRA rules for 2009 provided by Marge Vollmerhausen (of Johnson & Vollmerhausen), a local CPA firm in Asheville, N.C.

**4. Dear Joe, How do you view the market over the last three years? And how do you view your own personal portfolio? M.C.**

**Dear M.C.:** Let me answer the second question first. With one exception, everyone in our firm (including myself) owns the exact same funds we recommend to our clients. Dr. Scott is the exception and he owns TIAA-CREF funds through the UNC Retirement System because he has few other options. Trust me; he would love to hold the funds we use at KWAG instead.

In terms of how I view the last three years, I try to focus on what I can control and not get too tied up in focusing on the past, since it's impossible to change. I try to learn from it, of course, but don't dwell on it. I am also a long term investor, so I try to be rational about how I look at stock market performance over short periods of time. After four fantastic years (2003 - 2006) of growth with very little volatility, we suspected 2007 might be a trying year…and we wrote about our concerns in our newsletters. Since 2007 was another positive year for our portfolio's and many of our managers, we viewed it as a good year. Had our managers underperformed, I would have been disappointed. But instead, we had another positive year in an environment in which we knew was probably going to be challenging.

I view 2008 as a story of the three weeks where the financial markets nearly collapsed. Outside of those three weeks, the market was down a bit…but the decrease was minimal. The thing that really irks me is the fact that those three weeks were impossible to predict, since most of the trading that led to the near-collapse was in collateralized debt obligations (CDO's) and collateralized debt swaps (CDS's) which were completely unregulated. As a result, no one knew the extent of the problem until after the fact…and by then it was too late.

I view 2009 as a year of opportunity. And as I write this, 2009 (like 2007) is another positive yet very challenging year. In my opinion, the near-collapse in late 2008 led to a number of market dislocations early this year, which we have (for the most part) identified. We believe these dislocations will result in excellent long run returns for those who remain patient. So I guess you could say that in my view, the last three years have been driven by three crazy weeks in late 2008 where the global financial markets nearly collapsed.

Unfortunately, many (including the media) like to look at the high point of the market in September 2007 and use that as their gauge for how much pain they have suffered.

(Continued on Page 11)

This usually leads to an emotional response from investors, which can in turn lead to some very bad investing decisions over time. I hate the fact that our financial markets nearly collapsed last year and I hate the fact that it affected every asset class and all of our clients. However, instead of focusing on the past—which we have no control over—we have made a concerted effort to remain calm by focusing on the things we can control. In doing so, we have captured “tax losses” for all of our taxable accounts; rebalanced accounts to take advantage of irrationally discounted prices; and made sure our portfolios remained positioned properly for the long term. The net result is that we have positive portfolios at mid-year and we’ve put a nice dent in last year’s losses.

**5. Dear Dr. Kiely, What is your biggest worry regarding the economy & stock market going forward? P.W.**

**Dear P.W.:** This is another excellent question. To be honest, my biggest worry is whether or not Ben Bernanke will be reappointed. It’s clear that the Federal Reserve (prior to Bernanke) played a major role in the near melt-down by encouraging deregulation on a number of fronts and by not acting to rein in speculative behavior. The thought at the time was investment banks (as a whole) would act in their own self-interest and their survival instinct would thus make the likelihood of an implosion miniscule. We now know that’s not true, of course, but that fact has nothing to do with Bernanke, who merely inherited all these problems. Without Bernanke at the helm, I worry about what would happen if we faced another major hiccup in the economy. Very few people understand the incredible job he has done in almost single-handedly bringing us back from near-collapse. He is a well grounded, levelheaded main street guy who happens to be one of the most brilliant economists on the planet. In my opinion, we need more people like him in critical decision-making positions, not fewer.

**6. Dear Dr. Kiely, Do you still like Global Natural Resource funds after their huge run-up? G.K.**

**Dear G.K.:** We do. We believe the supply of many natural resources will become constrained over time. And as Asia grows and as the global economy bounces back, natural resource prices will most certainly increase. Many of our managers agree and they have been adding natural resource companies to their portfolios as well. That said, everyone agrees natural resource prices will be volatile due to their susceptibility to speculation, which is why our managers only overweight them a bit in their portfolios and why we would never recommend taking more than a 5% position in a natural resources fund.

**7. Dear Dr. Joe, Many people say "This Time Different". In fact, they say the fundamental nature of the economic landscape has changed so much that comparisons to post-WWII recoveries is at best problematical and could be misleading. What do you think? B.B.**

**Dear B.B.:** I agree…this time is different. Of course, every recession and every subsequent recovery is different from the previous one…and they always will be. What’s not different is the role that fear and greed play in the behavior of the markets. It’s clear that the new economy will be built with less debt. In the short run, this means the economy is not likely to bounce back as quickly and growth will probably be restrained for a while. However, in the long run, greater savings, new technologies, a growing global economy, and innovation will result in growth spurts that will surprise people on the upside. The economy always surprises people, and that’s where the role of fear and greed fit in. Fear-induced selling has presented some excellent opportunities. Over time as the economy gains steam and people become more confident, you will see fear subside and prices will take off. Ultimately, greed will take over and we’ll see the prices of some asset classes driven to irrationally high levels (like tech stocks, oil and real estate were in the past). If you examine the history of financial markets, it always works this way. So, I agree – the specific issues that led to the current recession are different from those in the past. But the underlying impact of emotion on the markets is always the same, and will be until human nature changes. If Warren Buffett is correct, and we think he is, our best days are ahead of us. Just remember that those days won’t arrive overnight.

**8. Dear Dr. Kiely, When is your next educational seminar? I went to Dr. Scott’s educational seminar in May and want to send my wife and her sister to your next one. D.N.**

**Dear D.N.:** At this point, we have a number of seminars planned this fall. Brownie will be doing two seminars on September 13th and 14th in Ocean Isle and on October 11th and 12th in Ocean Isle. I will be doing two five week seminars on Tuesdays and Thursdays in October and November in Asheville at UNCA. And Scott will be doing a number of seminars in our conference room in Greenville in late September or October depending on his

(Continued on Page 12)

university schedule. In addition, now that we have our website up and running, our goal is to put each of these seminars out on the web, so our clients can stream them over the web on demand. We will send out an update when they are ready for viewing.

**9. Dear Dr. Kiely, One of my biggest worries is the role that health care will play in our economy as we go forward. As it stands right now, health care represents the largest piece of our deficit. And if we continue down the current path, it will eventually bankrupt us. What are your thoughts on this issue? S.H.**

**Dear S.H.:** My concerns are similar to yours. In terms of government run healthcare programs, we have promised more than we can deliver in the future. And at some point, we will be forced to cut a number of the programs we provide to the public and the longer we wait, the deeper those cuts will need to be. I am certain our politicians and current administration understands this. The problem is…this is a very complex problem. Right now, the Obama administration is trying to reduce costs by improving the technology and efficiency of current programs. This is a good start. But at the end of the day, a number of programs will need to be cut and these cuts will be contentious. I personally have no idea how this play out…and don't believe anyone does. But we have to start somewhere, and the Obama administration seems intent on tackling this exceedingly prickly issue against some very steep odds. Typically, our politicians wait until the very last moment to make tough decisions, but given the deficit problems many states are experiencing we can't afford to wait. The longer we wait the more healthcare programs will need o be cut across the board. And if history is any indication, it will be the folks in the lowest income brackets who take the biggest hit, which is truly sad.

**10. Dear Dr. Kiely, What are your thoughts on the Chinese and their desire to have a different world currency? Do you think they are our friends or foes? I'm very worried about them. M.P.**

**Dear M.P.:** I'm not overly concerned when it comes to the Chinese. For a long time to come our countries will need each other if we are going to survive and prosper economically. Our economy is still the largest – by far – and if we sneeze, the rest of the world will catch a cold. At this point, the Chinese economy is not even as large as California's economy, so they have a long way to go before they are the economic engine that drives the world. You may read a lot about how the Chinese want a new currency and how hesitant they are about buying our dollars, but I think most of it is nonsense. Why? First, the Chinese buy our dollars when they want to be sure their assets are safe. Our currency is (and will) continue to be the safest world currency in the world – probably at least through our lifetimes. Second, they have to buy our currency to keep their currency and their economy competitive. It's in their best interest. If the dollar gets too weak and the Yuan gets too strong…the U.S. and other nations will stop buying Chinese goods. That's something they simply cannot afford. Third, China has a very poor reputation regarding the quality of their products. They need our technology, our accounting systems, and our innovative methods to upgrade their entire economy and national infrastructure. Finally, if our economy fails…so does China's. They know this. So, in my opinion, we'll end up working together, growing together and thriving together over the long term. Of course, there will be a few spats along the way. That's just human nature.

## A FINAL NOTE

As usual, I want to thank each of you for your continued confidence in our services. Our overall philosophy, which combines the best managers with research-driven asset allocation strategies, has provided excellent returns to all of us over the long term. As we go forward, we remain committed to continuing to refine and improve these proactive strategies. As always, our goal is to provide each of our clients with the best possible mix of assets given their particular situation.

If you need anything or your goals or time horizons have changed, please do not hesitate to contact us. We are here to serve your financial needs, whatever they may be. Thank you for your kind comments, your considerate referrals and your feedback regarding this newsletter.

Enjoy this wonderful summer!

**~ Joe and The Gang at KWAG**

# 2009 IRA CONTRIBUTION TABLE

| | Traditional IRA | Roth | Coverdell ESA | SEP IRA | Simple IRA | 529 Plan | 401K Plan |
|---|---|---|---|---|---|---|---|
| **Contributions** | Tax Deductible | Not Tax Deductible | Not Tax Deductible | Tax Deductible | Tax Deductible | Tax Deductible Depending on State | Tax Deducti-ble |
| **Earnings** | Tax Deferred | Taxed | Taxed | Tax Deferred | Tax Deferred | Taxed | Tax Deferred |
| **Withdrawals** | Taxable | Not Taxable After 59 ½ * | Tax Free Qualified Education Before 30 | Taxable | Taxable | Tax Free from Federal & State Income Tax | Taxable |
| **Who's Eligible** | Less than 70 ½ | No Age Restrictions ** | Less than 18 or special needs | Typically Self Employed w/ only a few employees | Appropriate Plan for 100 or fewer employees | Anyone | Less than 70 ½ |
| **2009 Contribution Amounts** | $5,000 < 50 $6,000 >50 | $5,000 < 50 $6,000 >50 | $2,000 Per year until minor reaches 18 | Up to 25% of Income or $49K | $11,500 < 50 $14,00 >50 | $12-$60K a Year Single State Limits Vary | $16,500 < 50 $22,000 >50 |
| **Penalty Free Withdrawal** | After Age 59 ½ | After Age 59 ½ | Qualified Edu. Expense From Ages 1-30 | After age 59 1/2 | After age 59 1/2 | Qualified Education Expense After High School | After Age 59 ½ |
| **Required Distribution** | 70 ½ | None | 30 | 70 ½ | 70 ½ | NONE | 70 ½ |

# COMPLIANCE NOTES

**A Personal Note from KWAG's Chief Compliance Officer**

We would like to take this opportunity to remind each of you of the importance of updating your IRA Beneficiary Forms and your Client Profiles. Beneficiaries and Investment Profiles are all important areas of Investment Planning and should be updated periodically or whenever investment objectives, time horizons or personal financial changes take place.

If you would like to update your Beneficiary forms or have questions on who your current beneficiaries are, please contact me or your specific advisor. We will be happy to send you copies of the current paperwork we have on file and/or send you new beneficiary applications.

Regarding your Client Profiles, we will be sending out, within the next week of so, a new Kiely Wealth Advisory Group packet. Included in this packet will be a new Client Profile. We strongly encourage you to fill it out and return it to us. This form helps your advisor better understand your financial profile, goals and objectives and any time horizons you may have with your account.

As always, thank you for your continued confidence in our firm. And please let us know how we can assist you.

Best Regards,
Katie Burr
katie@thekielygroup.com

# KIELY WEALTH ADVISORY GROUP, INC.
# Office Locations


**OUR HEADQUARTERS LOCATION:**
1290 East Arlington Blvd,
Suite 102
Greenville, NC 27858
Phone: 252-439-1888
Fax: 252-439-1348

| Oak Ridge Location | Asheville Location | Sunset Beach Location | Outer Banks Location |
|---|---|---|---|
| 4405 Stafford Glen Court | 4 Highland Place | 8839 Carenden Court | 25736 NC Hwy 12 |
| Oak Ridge, NC 27310 | Asheville, NC 28804 | Sunset Beach, NC 28468 | Waves, NC 27968 |
| Phone: 336-298-4316 | Phone: 828-350-8681 | Phone: 910-579-8075 | Phone: 252-916-4467 |
| Fax: 252-439-1348 | Fax: 828-251-1806 | Fax: 910-579-8075 | Fax: 252-439-1348 |


***IMPORTANT DISCLOSURE INFORMATION**

***Performance results** represent results reported by each reflected mutual fund during the corresponding time period. Kiely Wealth Advisory Group, Inc. ("KWAG") currently utilizes these mutual funds in managing actual client portfolios. However, the individual mutual fund performance results **do not** reflect the results of any specific KWAG client portfolio or any KWAG composite.*

***Past performance** may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, or equal either the performance results reflected or any corresponding historical index. The historical index performance results are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of a specific investment meets, or continues to meet, investment objective(s). It **should not** be assumed that any account holdings will correspond directly to any comparative index. The performance results do not reflect the impact of taxes.*

***<u>Please Note</u>**: the individual depicted mutual fund results **do not** reflect the results of any specific KWAG client portfolio or any KWAG composite. **For reasons including** variances in portfolio account holdings, market fluctuation, and any account contributions or withdrawals, the performance of a specific client's account may have varied substantially from the indicated reported mutual fund results. In addition, the above results only reflect the results as reported by each respective mutual fund company. Portfolios managed by KWAG would also incur a KWAG advisory fee, the deduction of which would result in decreasing the reported performance results. **<u>For example</u>:** a KWAG advisory fee of 1% compounded over a 10 year period would reduce a 10% return to an 8.9% annual return).*

***<u>Please Remember</u>:** In the event that there has been a change in a client's investment objectives or financial situation, he/she/it is encouraged to advise KWAG immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investments purchased and/or investment strategies devised or undertaken by KWAG) will be either suitable or profitable for a client's or prospective client's portfolio. **In addition**, the mutual funds depicted are funds that KWAG may utilize and/or recommend as of specific date, and are subject to change without notice **Accordingly**, no client or prospective client should assume that the above reflected mutual funds serve as the receipt of, or a substitute for, personalized advice from KWAG, or from any other investment professional. **Information** pertaining to each depicted mutual fund is set forth in each respective fund's prospectus, a copy of which is available directly from each mutual fund company or from KWAG upon request.*

***All performance results** reflect the performance results reported by each respective mutual fund to Morningnstar**,** and have not been independently verified by KWAG. KWAG also maintains all information supporting the reflected mutual fund performance results.*

***Information pertaining** to KWAG' advisory operations, services, and fees is set forth in KWAG' current disclosure statement, a copy of which is available from KWAG upon request.*