KWAG June Update

If you regularly read our monthly updates and our quarterly newsletters, the market dip we experienced in May (and into the first few trading days of June) should come as no surprise. In every piece we write, we remind investors that the stock market experiences a double-digit peak-to-trough dip almost every year. So what we've seen thus far is simply normal market behavior and is therefore to be expected…almost every single year!

As a result, savvy long-term investors need to build their portfolios with the expectation that these market dips will occur. If you fail to accept these dips for what they are – the normal, inevitable consequences of stock market investing – then you'll likely wind up becoming panicked when they occur. Panicked investors are prone to making emotional and irrational decisions in their portfolios. So if you find yourself worrying about the most recent dip and getting caught up in the short-term, sensationalistic news cycle, please go back and read our most recent quarterly newsletter. It pretty much describes what's been happening in our markets this year, and what we think we can expect going forward.

Our Recent Quarterly Newsletter

For those who can't go back and re-read last quarter's newsletter because you've either misplaced it or recycled it, please recall that we spent much of it discussing a concept called "Climbing the Wall of Worry." Over the last three-plus years, our markets have jumped from one major worry to the next in relatively quick succession - yet stock values have continued to grow significantly. In fact, since the market lows reached in early 2009, we've seen one of the best three-year periods for stocks in history – in spite of all the worries!

In essence, the “Wall of Worry” creates opportunities for; 1) those who are long term oriented, 2) those who expect the dips and volatility, and 3) those who embrace them by rebalancing their portfolios into (as opposed to away from) the assets that are on sale.

Known Risks

In other writings, over the past few years, we have also examined the difference between “known” versus “unknown” risks. When the risks are “known” and trading is orderly - as it is today - market dips provide opportunities to rebalance portfolio’s and buy stocks on the cheap. If you’re still skeptical, think about how the markets have behaved over the last three years. We have experienced double-digit market dips every single year, and in each case the S&P 500 (and our portfolios) have subsequently rallied to multi-year highs.

With respect to identifying known risks, all you need to do is ask one simple question, “Is the headline news we’re seeing broadcast today providing some insight into a new problem no one knew existed?” If the answer is no, as is the case currently, then chances are the dip provides an attractive opportunity to buy on the cheap. Think about it…for nearly five years now we have been discussing the Euro-crisis and the problems in Greece, meaning those issues have largely been “priced” into the market. The fact is, dips which occur during periods where little or no new information is flowing into the markets, are generally being driven by investor emotions, meaning they are also likely to be short-lived.

What is KWAG Going To Do?

We will continue to do the exact same things we have always done in periods like this, meaning we will proactively manage our portfolios with an eye on the long term. We are fully aware of the constant "din" of bad news about Europe, the federal budget deficit, possible inflation, and a slowing Chinese economy. Each of these risks is real and potentially damaging over the short run. However, each of these risks is also very well "known" and therefore already factored into current stock prices. This is one reason we remain so optimistic. When the risk-factors driving market prices are known, it's much easier to manage a long-term portfolio. It's the things we don't know about that concern us, because it's the unknown risks that create disorderly trading and bone-jarring market drops like we saw in late 2008 and early 2009.

In essence, we view this dip in the exact same light as the dips we've experienced over the last few years. It's an opportunity for our managers (and us at KWAG) to rebalance portfolios and acquire assets while they're on sale.

One Last Thought

As you know, we build well-diversified portfolios using only professional money managers with stellar long-term track records. These managers have been through various economic wars and, at a minimum, have dealt with every economic threat and opportunity thrown their way over the last 10 years – and yet, they have thrived! If they hadn't thrived, we wouldn't be using them…

Many investors seem to forget that their individual portfolios change each and every day, as each manager proactively alters his or her portfolio based on where they're seeing the biggest values. In a nutshell, our portfolios are being tweaked and adjusted each and every trading day by each of these individual fund managers. In addition, we make portfolio adjustments, when and if a client portfolio reaches a point where their portfolio is out of balance, either in

terms of the Morningstar style grid or the target allocation between stocks and bonds.

So our managers make the necessary micro level changes in their individual funds each and every day in order to take advantage of any opportunities presented to them – such as selling overpriced assets and using the proceeds to buy underpriced ones. On the other hand, it's our job as advisors to keep an eye on the macro level aspects of our client portfolios. This involves making sure that the daily changes made within our fund managers' portfolios, or changes in the overall market, don't create portfolios that have become comparatively unbalanced. If this does occur, then we rebalance the overall portfolios back to where they need to be in order to remain in line with the client's longer term goals. As a result, sometimes we will need to rebalance quite frequently, while at other times we will seldom make changes.

In Closing

Until next month's quarterly newsletter we'd like to leave you with the following thoughts…

1. We are NOT overly concerned by the current market dip, as it has all the markings of the sort of normal, orderly stock market decline which we see virtually every calendar year.
2. We are fully aware of Europe's issues – and so is the rest of the world. This means these issues are already "priced" into the market, and have been for some time. In fact, the companies we own adjusted to these issues years ago!
3. We also fully aware of other well-known issues, such as the "fiscal cliff" approaching at the end of this year. We believe this is also

"priced" into the market, which means any "positive outcome" will result in a market up-tick.

4. Our managers have made, and will continue to make, a number of proactive changes to their portfolios in response to both market valuations and economic developments. That's why we own pro-active managers.
5. Do not lose sight of the fact that we DO NOT own Greek or European debt. Instead, we own well run, profitable companies with REAL cash flows. Cash flows which are being shared with investors in the form of very healthy dividends.
6. Today, there are entire industries that pay a higher dividend than anyone could earn in CD's, money markets accounts, treasury bills and many corporate bonds. Thus, savvy long term investors get paid to be patient.
7. Where necessary, we at KWAG have made additional changes to our long-term portfolios by rebalancing <u>into</u> areas of the market that are undervalued and <u>out of</u> area's that have rallied. In essence, we don't like following the "herd".
8. We have always been long term investors, who embrace the normal market dips. We DO NOT try to time the market by going to cash…EVER. Market timers have exceedingly poor long-term track records.
9. The truth is, no one knows what the market will do over the short run, no matter how much they try to convince you otherwise. Think about it. If someone really knew how to predict short term market swings, why would they tell anyone?
10. For over 20 years now, we have developed a long-term plan for each and every client, which factors in normal short-term volatility.

It's why we take the time to craft well balanced portfolio's which own an array of both stocks and bonds.

11. This is particularly true for retirees. During normal market dips, we ignore the stock market, and use bonds for income. When the stock market rises, we leave bonds alone, and take profits from our growing stock portfolio's instead.
12. We believe the current dip is temporary since there is no really "new" news behind it. There is no question that Greece is going to be making headlines for quite some time. However, we have well diversified portfolio's that have prospered over the last three years – and will continue to prosper going forward.

As usual, if you have any questions about this update, our newsletter, your accounts or our managers, please feel free to call or e-mail us anytime. The recent referrals are much appreciated and we thank you for your continued confidence in our firm and our services. As we go forward, we remain committed to continuing to refine and improve our proactive strategies and portfolios. 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 call or drop an e-mail to set up an appointment. We are here to serve your financial needs, whatever they may be.

- ***Joe and the Gang at KWAG***

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