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A mid-year Review of the Markets

on July 7th, 2010 the Dow Jones Industrial Average closed at 10,018, S&P 500 at 1060

After 2008's sharp decline and last year's recovery in stock markets, many hoped that 2010 would see a return to relative normalcy and stability. The first quarter started on a positive note as stocks turned in one of the strongest first quarter increases on record, but in rapid succession came:

- Greece's budget crisis and the impact upon Europe in general
- European budget cuts which would slow down global economies and the resulting devaluation of the Euro
- April sinking of a BP oil drilling rig in the Gulf of Mexico
- The May 6th "flash crash" in which US markets plummeted in a matter of minutes without explanation.

On top of the above issues are the mega-concerns about the "truer" jobless rate being 15-20%, US government deficit, elimination of Bush's tax cuts, the war in Afghanistan, general pessimism, and concerns about what the next catastrophe will be. As a result, during the second quarter all of the first quarter's gains plus more were given back as the US stock market plummeted almost 11% and the non-US stock market plummeted almost 15%. With significant volatility, the stock market has effectively gone sideways over the past 9 months.

The following principles were recently unearthed from a 1963 talk by Benjamin Graham, the father of value investing, titled "Securities in an Insecure World" which rings true in today's markets and reminds us of guiding principles that we need to bear in mind.

- **Principle #1** -- Invest in stocks and bonds only so far as you can live with fluctuations in prices. Graham responded to a question about whether or not to invest in stocks with the question, "Do you want to eat well or sleep well?" saying that the response to that question will determine what is recommended. We concur. Since 1926, US stocks have had average gains of over 9% before inflation and more than 6% after inflation.
- **Principle #2** – The price you pay when you buy stock investments is key. This principle is why we lean towards Value versus Growth style stock investing. A true Value manager goes to great lengths and analysis to determine what price a stock is worth and to purchase that stock at a significant discount to that price. Most investors should have an allocation of 25-75% in stocks, owning more stocks when the market seems low in relation to value and less when the market appears expensive. We realize these issues can be difficult to measure which is why we are big fans of actively managed flexible global mutual funds where the fund manager has a significant amount of discretion in the allocation of the portfolio's assets.
- **Principle #3** – Long-term goals demand long-term thinking -- Graham's student Warren Buffett has said that it only takes two things to make money – having a sound plan and sticking to it ... and that of those two, it's the sticking to it part that most investors struggle with.

Over the past two years a significant amount of our clients' portfolios have been repositioned to include flexible global mutual funds that have an objective of obtaining an absolute return over a market cycle. We like their approach to the global crisis and their willingness to go wherever they see undervalued securities. A recent comment from a meeting with Abhay Deshpande, First Eagle Global manager, was that their benchmark in security purchases for the fund is to try to determine what can go wrong as "Anything can and does happen." From our perspective, that's how we want a fund manager to think and to act accordingly.

While this week has been a positive week for the markets – especially for foreign markets, we are aware that things can reverse course just as fast. High frequency trading (typically performed by computers) now makes up almost 70% of the markets' daily volume. As a result, markets can make significant moves on very short notice and at any given time in reaction to current worldwide news. As long-term investors and advisors, we do not time the market, but traders will. We believe that individuals educated in some of these issues will have the proper response to the market noise that makes the daily news. However, should you feel the need for a reallocation or a greater allocation to the global flexible funds mentioned above, please do not hesitate to be in touch with our office.

Because the future is highly uncertain, we are not fans of forecasting. However, the stock indexes continue to be almost 30% below their October 2007 highs and while we do not anticipate going back to those highs for several years, from what we read and track, there appears to be reason to believe, while volatile, there could be more upside than downside over the next few years. My reading over the past 2 weeks include Bob Brinker's *Marketimer* expectation that the S&P 500 could be up 20% by next year; Bill Miller (well known mutual fund manager) states the market will not go into a double-dip and the S&P is set to spike; and BlackRock's Bob Doll (another well known fund manager) that the S&P will be up 16% by year-end. Everyone's view is based on their current economic assumptions which we know can be changed anytime.

"We make a living by what we get; we make a life by what we give."
~Sir Winston Churchill

Things to Consider

Mortgage Refinance – Mortgage rates remain low. If you haven't refinanced, we encourage you to consider doing so. If you need advice and direction to a trusted mortgage broker, please let us know. 15 year rates are 4.0% and 30 year rates are 4.5%.

Roth IRA Issues:

- **Make your 2010 Roth contribution** – if you qualify -- sooner rather than later. Invest when the markets are lower rather than waiting until you feel comfortable as they will be priced higher. If cash is not available and you have non-IRA assets, money can usually be moved from the non-IRA to your Roth IRA account.
- **Roth Conversions** – In 2010 everyone qualifies to convert all or part of their Traditional IRA to a Roth IRA. Earnings

within a Roth IRA are 100% tax-free and there aren't required minimum distributions. Conversions are taxable and best suited for those who do not need to withdraw money from their IRA during retirement.

Beneficiary Update – If there is any possibility you might die (☺), then we encourage you to make sure the beneficiaries of your Wills, Trusts, IRAs, retirement plan accounts, and life insurance policies are current. If you have questions about this matter, please contact us.

George Burns said he wanted to live until he's 100 as he heard not many die after that age.

Summary

If you would like us to review your current asset mix and make a recommendation more suitable for your current situation, please do not hesitate to contact us.

Congratulations to Karma and Nick – Brandon Nicholas was born on May 8th and weighed 6 ½ pounds. He was welcomed home by his siblings, Amanda and Eric. Both mom and baby are doing very well. We look forward to Karma returning from maternity leave towards the end of July.

Thank you for your on-going trust, support and referrals.

Prepared July 8th, 2010 by: Thomas A. Morrison, CPA, CFP®, Principal