



# Client Website Update Announcement

If you have not been accessing your account online and would like to, please feel free to call or email us.

Dear FIM Group Clients,

As part of our dedication to enhance our client services on March 1st we switched to a new website provider. As a result of the upgrade, FIM Group clients will not be able to access their accounts online beginning Sunday, March 1st.

If you typically access your account via [www.fimg.net](http://www.fimg.net) you will need to receive a new user name and password. Unfortunately your previous user name and password will no longer function with our new provider's system. *(While a slight inconvenience, it insures 100% security)*

In order to receive a new email and password please contact us the following ways:

- **Call us toll free 1.800.632.5528**
- **Email our client service website department at [webaccess@fimg.net](mailto:webaccess@fimg.net)**

We will be sure to respond to your request within 1 business day.

We are grateful and appreciate your patience during the transition. Rest assured that this upgrade will enhance your online experience and allow us to continue to make future improvements.

Blessings,

Paul H Sutherland  
President, FIM Group

## DISCLOSURE

Performance data quoted represents past performance. Past performance does not guarantee future results. All performance assumes reinvestment of dividends and capital gains. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance data current to the most recent month-end may be obtained by calling 231.929.4500.

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As per SEC Regulations, this is to inform all interested parties that Financial & Investment Management Group, Ltd.'s FORM ADV PART II is available upon request by writing FIM Group at: 111 Cass St., Traverse City, MI 49684.

# Current Observations

## Trusting Business . . . Not Fear

By Paul Sutherland, CFP®

For years my Mom tried to quit smoking. When asked about it she would reply, "Quitting smoking is easy! I've done it dozens of times." Today we have an economy that is in recession, and some may even consider it a depression. If our economy could speak about its poor health it would most likely say, "Moving from a recession to recovery is easy! We've done it dozens of times."

Nothing brings out passion like fear, and people today are quite fearful. Fear can also be quite a commodity. Fear sells – it causes people to become glued to news headlines and is a source of our ever-increasing consumption of liquor, pain relievers, fast food and anti-depressants. Today it seems "un-American" to be content or optimistic with the current state of affairs, but how can you be if you watch, listen to or read anything in the mainstream media? Frankly, fear is "in."

The stock market continues to hit record lows (an 11-year low as of February 23) and our government is considering owning 40% of one of the largest private institutions (Citigroup). All the while there seems to be passive responses to increasing government control. Even in the most free, democratic and patriotic market, Americans are throwing in the towel. Investors are selling great American corporations and buying government-regulated, government-sponsored and government-owned CDs, annuities, T-bills and other quasi-government-oriented money market investments. Why? Fear! Why? Ignorance!

Some readers may think it's unrealistic for me to say that people are being irrational and giving up on America's industry. They may say, rather, that we have gone into a cesspool of overspending, overconsumption, greed, immorality and non-virtue and may even have "facts" that support their emotion- and fear-driven "reality." They would discount the facts that the U.S. is still the largest importer and exporter in the world and that we are still the richest country in the world (we have around \$132,000 of



## The Future

by Edgar A Guest

"The worst is yet to come:"  
 So wail the doubters glum,  
 But here's the better view:  
 "My best I've yet to do."  
 The worst some always fear;  
 To-morrow holds no cheer,  
 Yet farther on life's lane  
 Are joys you shall attain.  
 Go forward bravely, then,  
 And play your part as men,  
 For this is ever true:  
 "Our best we've yet to do."

infrastructure behind every American – China has less than \$1,000). They would say that China owns all our debt, not realizing that the amount of debt China owns is around 2% of our household wealth.

Today, more than ever, we realize that a significant part of the economy is being controlled by the government! The amount of control is much too big for my tastes. I believe that free markets are powerful, and the inefficient will lose to the productive and efficient. I am also realistic that, as a nation, we are not trusting the markets or ourselves to handle things “on our own” without it being some new government program. The spawn of this *Obamanomics* will most likely be a complex array of special interests, embedded programs and a collective national love affair with entitlement programs.

We have decided not to trust the elegance of the natural economy and allow people acting in their and the collective interests of society to fix our current malaise without government’s intervention. Of course, we are a democracy, and thus the government is us, comprised of apathetic, lazy, industrious, courageous, innovative, optimistic and pessimistic citizens, most of whom have never been in a foreign country, read an economics book or picked up a history book since high school.

So, of course, we are attempting to solve problems with oversimplified solutions built and designed by individuals who are elected because they seemed nice or sincere, not because of competence. I think President Obama has hired good, solid advisers, has the

humility and foresight to go for the best, regardless of political affiliation, and has already made many of his supporters angry who expected him to act in their own special interest instead of the interest of all.

So is America on the right track? Is the current wave of policies, rhetoric and stated intentions of our officials in Washington the right course? I am not sure, but I do think we are stuck. We have been painted into a corner by our institutions, caused by our complacency about governance and our belief that the government will protect us from risks, both foreign and domestic, both financial and health-related.

The plan as outlined by the well-intentioned administration is better than nothing. Thankfully we are positioned to print money, and thankfully we are better off than most every other country in the world, which is good for our currency. (A strong currency is incredibly helpful if you need to print money.) The previous stimulus billions kept our economy alive and from freezing up and bought some time for us to figure out what to do. Those billions will not be inflationary; we basically used millions of hundred-dollar bills to put out a fire. The new billions will, of course, be spent and will help us in the short term. And they will not be inflationary as long as the U.S. dollar stays strong, but not too strong because that could cause us to fall into a deflationary spiral like Japan.

Unlike the weather, over which we have no control, we as individual investors can influence the markets, the economy and the future. Will

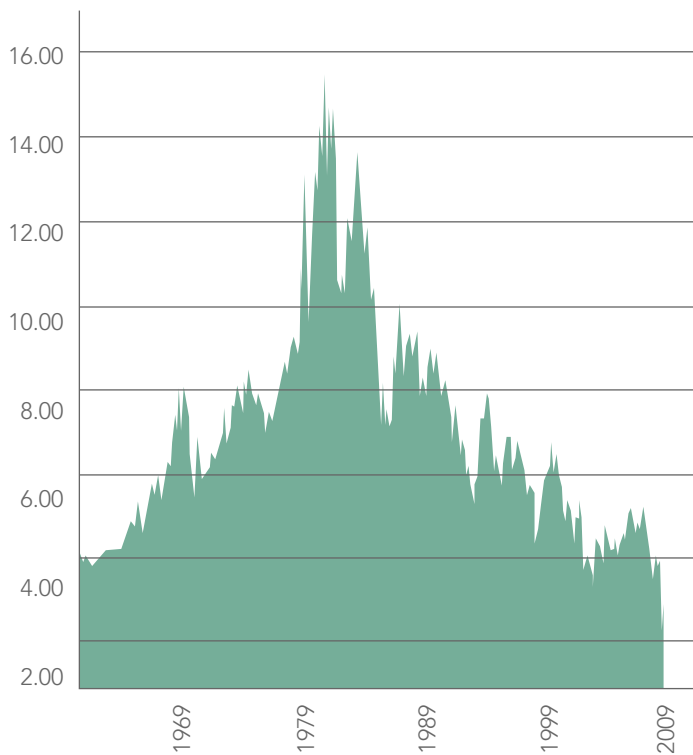
investors invest in solar, wind and energy or expect the government to? Will we as investors support the health care companies or let the governments do it? Both the U.S. on the whole as well as government and business leaders realize that the best place to create stability, happiness, jobs and prosperity is through good business. For now those reasonable voices that say, “Let’s create a fair, sustainable and good environment for business to thrive” will be muted a bit, but even the most socialistic-oriented citizen knows in their heart that governments have never been good at innovation, job creation and problem-solving, and that it is best to allow the private sector and the unencumbered economy to unleash the creative juices of entrepreneurs to do their magic. This will happen . . . business will exist in the future, stocks and bonds will exist, investors will invest, innovation and creativity will happen, and stocks and bonds will recover. Why? Because they’ve been through this dozens of times.

The bottom line is that I believe in small government and personal responsibility. I believe it is up to us to be responsible and act responsibly toward ourselves, our families, our neighbors, our country and our world. I think we should be able to benefit from the risks we take, and that it is rational to take the fall for our failures. I think that actions should have consequences no matter how well-meaning a government policy is; it will become an entitlement to citizenship and create envy, jealousy and become a bigger bother than the problem it was designed to handle. I trust the goodness of one person over the collective goodness of a government.

“ We have been painted into a corner by our institutions, caused by our complacency about governance and our belief that the government will protect us from risks, both foreign and domestic, both financial and health-related.”

## U.S. TREASURY BOND RATES

FIGURE 3



SOURCE : BLOOMBERG

“Bond prices move inversely to interest rates, so a move higher in interest rates will impact Treasury prices to the downside.”

On the fixed-income side, we remain focused primarily on Treasury Inflation-Protected Securities (TIPS) and discounted closed-end funds that hold TIPS, preferred stocks and corporate bonds. TIPS were bought over the past several months with effective real yields (after inflation) in the 2% to 3% range. These provide a good base for our Balanced Conservative and Yield Income portfolios and protect against the government’s likely use of inflationary monetary policy to help debtors (both private and public sectors) service and repay their liabilities. We are using closed-end funds in the beaten up corporate bond and preferred stock area where above-average discounts to net asset value provide an additional margin of safety.

With equities, we have been able to add larger capitalization, well-known

blue chips in basic areas including chemicals/materials, energy and health care that in normal times do not meet our “sufficiently cheap” tests. These companies, including DuPont, British Petroleum and Merck, have strong competitive positions, good balance sheets and solid business models that generate significant cash flow. Their management teams are taking the necessary steps to trim fat and seize opportunities from weaker competitors. We also continue to own lesser-known, smaller companies like Yip’s Chemical (China – solvents and coatings), Dynasty Ceramic (Thailand – decorative floor tiles) and Carmanah Technologies (Canada – solar-powered LED lights). These companies, whose management teams and fundamentals are also very strong, trade at seemingly giveaway prices, and we expect them to be major drivers of portfolio returns as investor sentiment normalizes.

The global economy’s indigestion could be with us for some time, as consumers, producers and bankers adjust to life without easy credit. Stock markets have already made significant price adjustments to reflect the likelihood of more restrained credit in a post-bellyache world. Other investments however, including straight long-dated Treasury bonds, may be priced to disappoint investors seeking shelter from volatility. Our team is staying with a patient and selective investment approach and is confident that our focus on company fundamentals and valuation will be rewarded in due course.



# Looking Beyond the Bellyache and Bellyaching

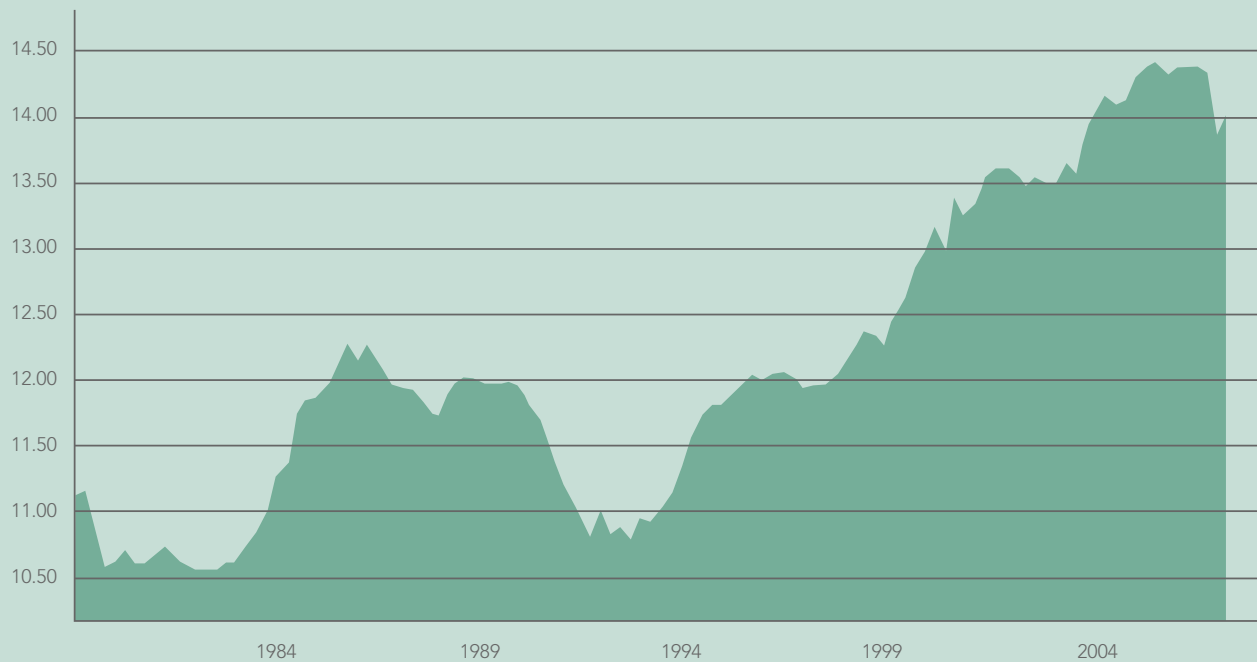
By Zach Liggett, CFA®

After gorging for most of the last decade on the financial equivalent of 99 cent burritos, the global economy has one heck of a bellyache. Bad debt, and lots of it, clogs the world's financial intestines, keeping credit markets barely functional and investors wondering how bad things can get from here.

Despite the best intentions of governments around the world to “fix” this situation, there really is no magic tonic. As shown in Figure 1, debt-servicing costs have become too high relative to income. Getting this back to a sustainable level will require restructuring of debt or increases in income. The former is now underway

## U.S. DEBT SERVICE RATIO

FIGURE 1



SOURCE : FEDERAL RESERVE, BLOOMBERG

as banks write off dud loans and the government considers various banking sector rescue plans and mortgage modification schemes. Income-boosting, on the other hand, is probably only going to be accomplished for the time being with inflationary monetary policy. These credit bust dynamics will take time to play out, with more bank failures, more job losses and subdued global economic growth as the world's economies adjust to a more moderate level of system debt.

With most global stock markets down more than 50% from their 2007 peaks, the impact this whole mess will have on future corporate income statements and balance sheets has already been significantly priced in. What threatens to take investor sentiment and market prices down further at this stage is growing anxiety that reactionary government actions may make the problem worse. Google “Porkulus,” “Chicago Tea Party” or “Bailout Nation” and you’ll see no short supply of bellyaching about the current

proposals (or lack of proposals) on the table to address the broken financial system. Perhaps my favorite is CNBC correspondent Rick Santelli's recent impromptu plea for fairness on the floor of the Chicago Mercantile Exchange (<http://www.cnbc.com/id/29283701>).

## Investing Headwinds Remain

Investing in the midst of this credit bellyache and public bellyaching is no easy task. On some measures, U.S. stocks in aggregate are finally trading below long-term historical valuation ratio averages. This suggests relatively attractive long-term return potential. These same measures, however, remain elevated versus previous secular bear market troughs, indicating at least a reasonable possibility for more short-term pressure on market valuations.

Figure 2 illustrates this point with the P/E10, a simple valuation tool developed by Yale University's Robert Shiller. The P/E10 takes the price of the S&P 500 index and divides by the average of the previous 10 years' index earnings to smooth out any particular

year's extreme readings. As of February 23, with the S&P 500 around 750, the P/E10 has fallen to around 13x. This compares to a 100-year average of 16x and previous secular bear market bottoms of 6x to 12x. In percentage terms, the S&P 500 would have to move around 24% higher to achieve levels implied by the historical average P/E10, although historical trough levels theoretically imply the possibility of a further drop in the U.S. stock index from here.

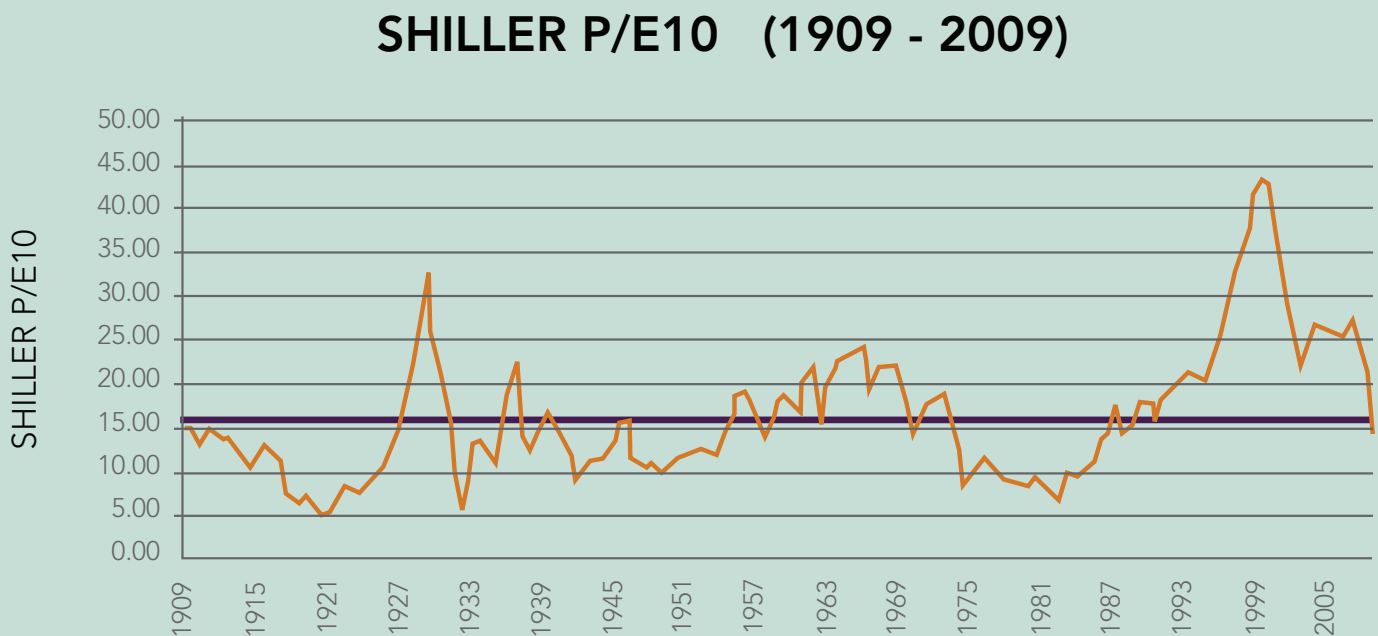
Bonds, traditionally viewed as safer than stocks, unfortunately offer no sure escape from volatility. Straight long-dated Treasury bonds, for example, saw significant rallies during 2008 as panicky investors flocked to their perceived safety. Subsequent announcements of massive stimulus plans and bank bailouts, meanwhile, have made these same bonds one of the worst-performing asset classes so far this year. On February 23, the 10-year Treasury bond yielded only 2.78%, not exactly spectacular given the long-term threats of inflation and diminished demand should foreign investors decide to look for other stores of value.

Figure 3 shows the long-term trend of interest rates offered on the 10-year Treasury bond. Bond prices move inversely to interest rates, so a move higher in interest rates will impact Treasury prices to the downside. For example, if 10-year Treasury rates increased to the 4.25% rate they averaged over the past five years, the 10-year Treasury bond price would fall around 11%, not exactly a shelter from the volatility storm currently experienced in stock, commodity and real estate markets.

## Patience and Selectivity

With the stock and bond market backdrop noted above, our strategy remains one of patience and selectivity. Many investors over the past few months have abandoned their long-term plans, choosing instead to "sell everything and buy Treasuries or sit on cash." We continue on a different course, knowing that attempts to pinpoint a bottom will likely prove futile and that our holdings are sufficiently cheap to justify patience.

FIGURE 2



SOURCE : ROBERT SHILLER [www.econ.yale.edu](http://www.econ.yale.edu)