F|I|M group

MAR 2010

Current Observations

FIM Group's Steadfast Approach to Investing

By Paul Sutherland, CFP®

For the foreseeable future it is very likely that most investors will be focused on the economy, inflationary and deflationary forces, and politics. They will settle for getting their financial advice from journalists and economists who have had little to no training or experience as investors, and all of this will result in overall market volatility. FIM Group clients need to keep in mind that we are neither indexers nor benchmarking, stock market-riding investors. Rather, we are disciplined financial managers, and we invest where we believe there is profit to be made. We think that the U.S. and developed European economies will eventually come to their senses and realize that stimulating investment and business is beneficial for the tax coffers and deficit reduction. Governments don't create wealth – they take their cut from a productive pocket, put it in someone else's pocket and call it "economic activity."

We believe the majority of Americans and Europeans want their companies and employers to grow, be sustainable and operate ethically. It appears that in many areas of the world, governments view business as a necessary evil or maybe just simply an enemy. Demonizing entrepreneurship, success and business will only cause business to go elsewhere, where it is welcome, and people feel grateful that they have a job. While the creative destruction going on in the old economies of our world are unpleasant, governments do little to fix it and a lot to mess it up. Regulating to deregulate and adding taxes upon taxes only discourage companies and form a barrier to long-term economic success. Vital and vibrant business activity will go on, and profits will be made by those with the vision, desire and ability to work harder and smarter. FIM Group's investment process is designed toward investors who are well-compensated for taking on risk and who have a reasonable and sustainable margin of safety.

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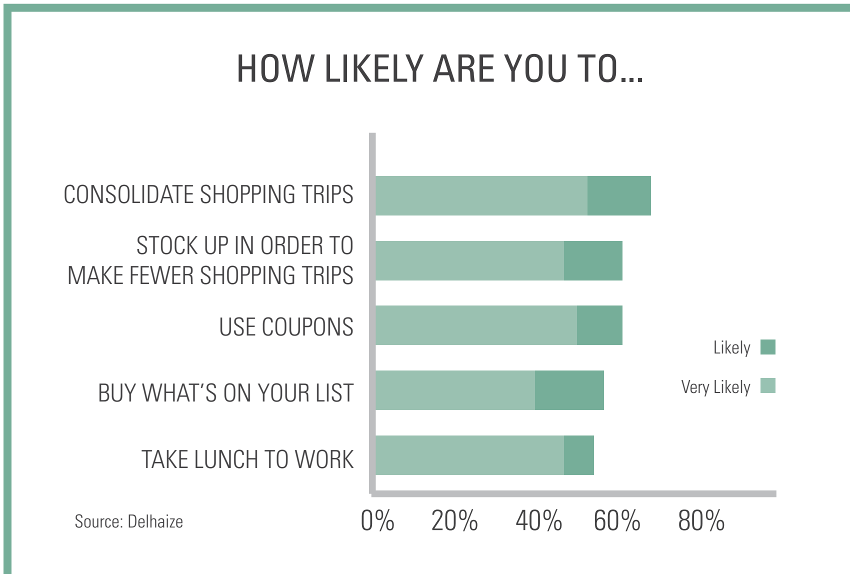
Imagine that your portfolio is constructed in such a way that even if the economy just quit growing, taxes increased and inflation doubled, you would not be concerned at all about your investments! Imagine further that if we experienced significant deflation, increased unemployment and government debts skyrocketed out of control that you still would not be concerned. We feel that every FIM Group portfolio is truly constructed to do well even if the normal economic and financial forces of recession, inflation, deflation, tax increases, unemployment, deficits and such continue. Why are we so confident? The reason is HEF.

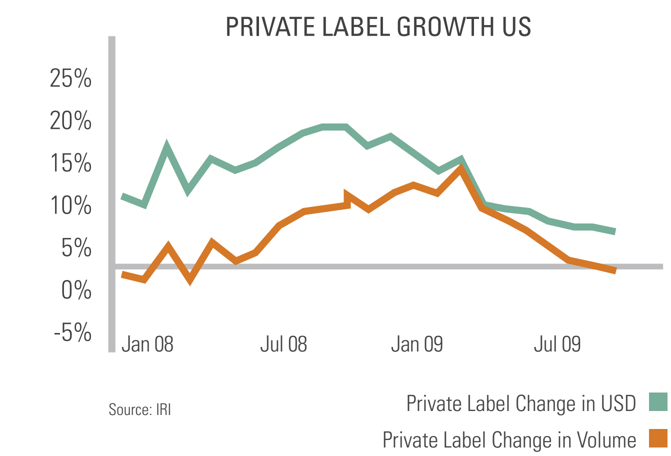
HEF = Health, Energy, Food

On page 3 is our stock selection investment process that continuously guides our choices. When we bake in all the inputs, we find that our portfolios are well-positioned to benefit from three areas of the economy – health, energy and food/commodities. What was a blessing in disguise about last year's financial tsunami was that it regarded both great and bad investments in the same way … it made them all cheap. It made great companies in the health care, energy and food businesses investment bargains. It also made companies in the areas of the world that are on the right side of the deficit's paradigm bargains. If you look at your portfolio and drill down on the "why" of your portfolio's holdings, you will find investments with great prospects regardless of how the overall economy, stock market, inflation or governments of the world performed. Of course they will fluctuate. Of course they will have volatility. But every year thousands of companies disappear. Our investments aren't with speculative companies that were constructed in cyberspace and passed off as investments. They are solid companies with good books of business and in industries where they have created a hard-to-replace niche, competitive advantage and are well-priced. We expect that these companies will grow earnings, dividends and sales over the next five years. Will they have some bad quarters? Yes! Will their sales fluctuate? Yes! What follows is why we believe the trend will be up.

Human Nature

Darwin maintained that those species that survive and thrive are not necessarily the biggest or the smartest, but are the most flexible. Humans survive because we are flexible. Americans are modifying their behaviors due to our recession. The chart on consumer behavior below compiled by Delhaize tells the story. People today are using coupons, consolidating shopping trips and "brown-bagging" it at work to save money. It's now "cool" to be frugal.





AD SPENDING BY REGION (Y-O-Y)

	2007	2008	2009	2010	2011
North America	**2.6%**	**-3.7%**	**-12.6**	**-4.0**	**0.8%**
of which USA	*2.4%*	*-4.2%*	*-12.9%*	*-4.4%*	*0.7%*
Western Europe	**4.3%**	**-1.5%**	**-11.2%**	**-1.0%**	**3.2%**
Asia Pacific	6.3%	2.3%	-3.1%	3.3%	6.5%
Central & Eastern Europe	**23.9%**	**16.2%**	**-20.9%**	**5.0%**	**9.6%**
Latin America	16.3%	14.7%	0.6%	6.4%	7.5%
Africa/M. East/ROV	**24.8%**	**22.4%**	**-11.4%**	**14.6%**	**10.5%**
Work	6.3%	1.0%	-9.9%	0.5%	4.3%

Source: Zenith Optimedia

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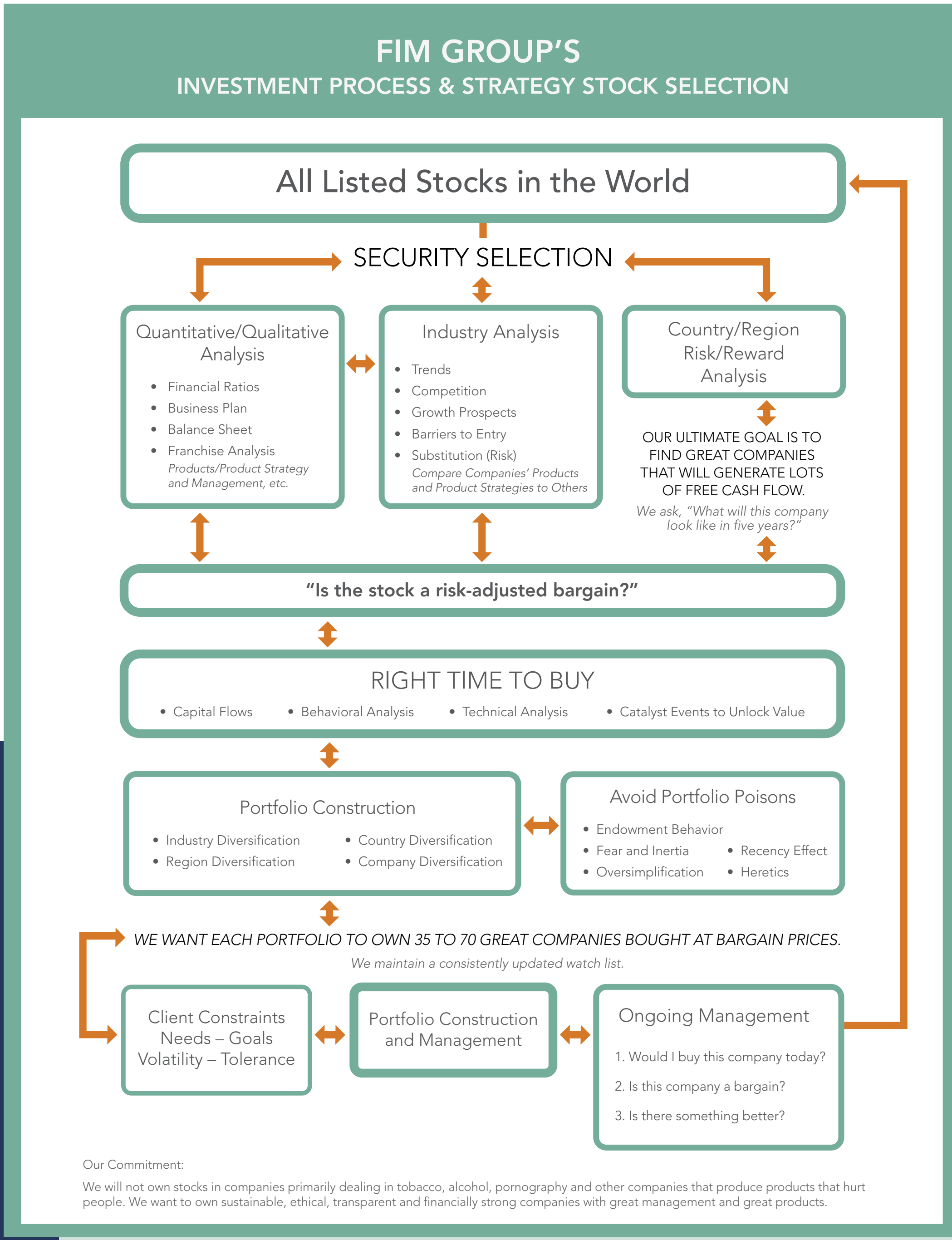
It's Cool to Be Frugal

More than ever people are becoming turned off by excessive consumption. For example, current luxury automobile advertisements are not pushing the "look at me, I am successful" button to compel consumers to select their brand. They are pushing the safe, value and durability buyer buttons. In other words, they are appealing to practicality versus stature. We are allowing our brand loyalty to slide in the name of common sense and frugality. Store brands are consistently gaining market share as consumers shop for better value. Private label growth demonstrates the significant decrease since January 2008. Also, consumers are making it more difficult to target and effectively receive marketing. Advertising was down significantly in 2009 as consumers made different choices and spending decreased. As shown in the chart on page 2, advertising spending worldwide has been affected by the slow worldwide economy and recession.

At FIM Group, we select each investment because we feel it will deliver positive returns going forward. We favor the companies that have solid management, produce needed products and will benefit from the trends in both the developed and developing worlds.



One Company at a Time

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Often it can seem overwhelming to view all the holdings in your portfolio. We welcome the opportunity to sit down in person or on the phone to discuss what you own and why. We have found that once clients really understands their portfolio, they sleep better at night and really see the benefit with our strategy. Please don't hesitate to call or e-mail us to coordinate a time to review yours.

Sleeping Well and Retiring Well

By Barry Hyman, MBA

Subsequent to the dislocation that occurred in global securities markets from 2007 to 2009, shaken investors and investment advisers have contemplated, "What should we do now?" At the center of this consideration are questions such as, "Should I move to cash?" "Should I get more conservative?" "Should I 'get out' now temporarily and 'get back in' after the uncertainty subsides, after the market drops again or after the recession is over?" There are many answers better suggested by different advisers to the dilemma of how to invest retirement savings to help investors sleep. The challenge is how to meet that objective and at the same time the overriding one: how to make sure investors can retire and stay retired.

As we have addressed in our newsletters several times before, timing the market is nearly impossible. There is no bell that goes off that says, "The coast is clear … you can now get back in." Going to cash with the intention of it being only temporary is simply not realistic. As many anecdotes and studies (such as the DALBAR study we have referenced in the past) have shown, investors are better off constructing an investment plan and sticking with it than trying to jump in and out of investment classes such as stocks or real estate. In order to benefit from the returns of investing "over a market cycle," success increases when you remain invested throughout the entire market cycle. So the better question is. "What portion of one's liquid assets should be invested, and how?"

One solution that was popular in the days of higher interest rates and has had resurgence of late is to "lock up" many years worth of a person's future expenses in "riskless" interest-bearing investments. The rationale is to lock in several years of guaranteed cash flow, empowering the investor to not worry about the rest during market volatility, since that portion of their wealth will not be needed until after the market has had time to recover. A common example of this recipe is to "ladder" 10 years (or longer) of living expenses in Treasury bonds or CDs with each year's allocation maturing as it is needed. There are other variations on this theme, but they all have one thing in common: a recipe to keep people invested during market declines.

That goal of remaining invested to benefit from the subsequent recovery is worthy. But the problem with trying to apply a static recipe to an ever-changing, volatile world is not unlike trying to solve today's problems having only yesterday's tools at one's disposal. It is also like trying to treat every ailment with variations of a single remedy. Flexibility is the missing and critical element.

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For example, a 10-year laddered Treasury or CD portfolio a decade ago would have had yields in the 4% to 6% range. Using historic averages as a guide, expected future returns of the stock portion of a portfolio would be in the 10%/year range over a market cycle. Thus, for an investor who put one-half his money in such a ladder and the other half in equities, the expected future average return on the entire portfolio would be in the 7% to 8%/year range.

Now, however, in what many economists are calling the "new normal," rates on one-year Treasuries are 0.33%, three-year 1.5%, five-year: 2.4% and 10-year: 3.8% *(Source: www.bloomberg.com/markets/rates/index.html, 2/22/10)*. Thus, the average annual return on a 10-year Treasury ladder would be in the 2%/year area. In this new normal world of debt, deficits, deleveraging and reregulation, those same economists, as well as many seasoned investment professionals, expect stock market indexes to return half of their historical averages. I might add that such a scenario does not address the effects inflation can have on real return, nor does it address the real possibility that there could be deflation as well, including negative returns on stock indexes. But let's look at the "our cup is half full" scenario first.

In an environment where bonds and CDs are paying 2% and stock indexes return 5%, investors who have

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sufficient assets to live on 7% to 8% of their retirement assets, but have too much allocated to "riskless" investments and stock indexes will be spending principal to live on. Within several years after retirement they could deplete a large portion of their wealth and, more important, their future income earnings power.

If that's not warning enough, what if the U.S. experiences what Japan has experienced in its recent two "lost decades"? That is not a stretch given that the source of Japan's maladies – overly leveraged banks and real estate investors coupled with inflated asset prices – is what the U.S. and other economies are facing today. Some may even consider ours a "worse" situation, since Japan's public started that period with ample savings, whereas our consumers are laden with debt to boot. In Japan, government bonds have had zero real returns for 20-plus years, and Japan stock indexes have produced negative returns for that period. Retirees who put their savings in the Japan stock index and a ladder of J-Bonds got killed financially.

By contrast, investors who invest in high-yielding securities with good management, solid balance sheets and sufficient cash flow, and who hold such investments only while they are bargain-priced, especially those who diversify globally in such a portfolio, fare well over nearly all full market cycles, including those with inflation, deflation, and low and high interest rates.

Bond ladders and equity index investing are a little like horses and boxcars. They had their day, but the world has changed. The premise of "locking up" a large portion of an investor's portfolio in riskless interest-bearing investments is no longer supported by financial reality. For all but extremely wealthy retirees, passive bonds/CDs and equity indexing does not make sense in the current environment (and most likely in the foreseeable future). Instead, I believe retirement savings, sans several months' living expenses, should be managed such that all assets are working as hard as they can in an income-favored, actively managed, dynamic portfolio in which the asset allocation fluctuates as values and opportunities do.

Retirement Planning Variables

By Jeff Lokken, CFP®, ChFC®

Having a secure, fulfilling retirement is a primary goal for most of us. At some point in the future we will no longer receive a "paycheck" from an employer and will instead rely on the income from assets we have accumulated and saved, plus income benefits from defined benefit pensions, Social Security benefits, distributions from retirement savings plans such as 401(k)s, deferred compensation, sale of our business and other investments. For most people, the overriding and often primary directive of financial planning is simply "retirement planning." However, planning for retirement is not a particularly easy process.

The retirement planning process involves creating a road map toward your retirement goal and developing a plan to achieve that goal. The plan generally considers post-retirement budgeting, savings, tax management, debt management, pre-retirement budgeting and a host of other inputs all geared toward ensuring a quality retirement. However, planning for retirement takes time and judgment, because it involves many unknown variables. Among the top variables that may determine when retirement is feasible are lifestyle/family goals, longevity, future income tax rates, portfolio returns, the effect of inflation on expenses and future investment returns.

Let's review the basics of these variables as they relate to your retirement plan.

Lifestyle Goals

Would you like to travel? Own one home or two? What is your retirement vision? These questions and others like them are necessary to help create a budget for your specific retirement needs.

Longevity

Attempting to gauge how long we're going to live in retirement is a task that's becoming more and more difficult. Medical advances have led to increased life spans and continue to increase the mortality age. This is best illustrated by the Social Security system. In its original design, participants in Social Security were expected to live only a few years after they have begun receiving benefits. People live longer now, and life spans are increasing each year. We believe it is wise to project a retirement plan that assumes you'll live to age 100.

Future Tax Rates

Since we can only spend our "after-tax" income, it is imperative that we consider what tax rates our retirement income will be subject to. However, as government bodies at all levels change with each election, so do virtually all tax laws, including property tax, sales tax, state income tax and the granddaddy of them all, the federal income tax. Taxes such as property and sales taxes should be adjusted to account for cost of living increases. One thing is certain – taxes will exist in retirement.

Investment Returns

How much you can withdraw from your "nest egg" each year is perhaps the most critical variable to retirement projections. Like the other retirement variables, the annual return on your nest egg will not be linear. As we know, the investments most suited for providing long-term income security into retirement are going to fluctuate. Financial markets can have long periods of up and down investment return cycles. We need continual income and that is the key. That's why we work toward constructing portfolios that can provide lifetime income security for our clients. Many retirees get caught up in "short-termism" and use CDs, short-term bonds and fixed annuities as core holdings in their retirement portfolio. But this investment strategy is very risky. While inflation causes things to cost more, deflation can keep interest rates low for many years, requiring the need for retirees to invade their principal savings to meet their budget needs.

At FIM Group, we balance the long-term asset volatility with the more stable fixed investments to construct our clients' portfolios. Our goal is to allow clients to live on the income generated from their portfolio with a goal of providing income that can increase over time. That way clients won't need to invade principal. Simply put, we call it living on the eggs (investment returns), not the chicken (principal).

Inflation

Loss of purchasing power caused by rising prices must be included in any retirement plan. It is safe to say that one dollar will buy less in the future. As you progress into retirement, you should factor in *giving yourself a raise* periodically to offset cost of living increases.

Family Constraints

Will you need to provide for or care for your parents and/or children in retirement? If so, how much will you help them?

In summary, we are realistic about retirement planning and take retirement seriously. While the future is unknown, we do know that life will go on, some businesses will grow and pay great dividends, interest rates will fluctuate, politicians will fiddle with taxes, and inflation and deflation will fight it out. One thing, however, is certain: we will retire someday.

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F|I|M group

111 Cass Street
Traverse City, Michigan 49684
231.929.4500

444 Hana Hwy., Suite D
Kahului, Hawaii 96732
808.871.1006

1837 E. Main Street
Onalaska, Wisconsin 54650
608.779.0300

www.fimg.net
e-mail: info@fimg.net