



# M.K. BROWN AND ASSOCIATES

A Registered Investment Advisor



## July 2009

### Office News

We have a new practice capability. It's called Parent Care Solutions, a unique process that helps parents and their children have meaningful conversations about all of the long-term issues they may face in the future.

You may still access your accounts on [mkbrown.com](http://mkbrown.com)!

We have expanded into the popular networking site LinkedIn.com as well. Our address is [linkedin.com/in/mkbrownandassociates](http://linkedin.com/in/mkbrownandassociates)!



### Quarterly Update

As we look back on a tumultuous first half of the year, we are struck by the degree to which conflicting signals characterizing the investment and economic environment. After a horrendous 2008 and a dismal first quarter in 2009, the second quarter saw robust gains- stocks in fact had their best quarter in more than 10 years. Our clients' portfolios, boosted by successful, tactical shifts in portfolio allocations (especially a large weighting to corporate bonds), and by significant outperformance from our managers, did considerably better than their market benchmarks.

The conflicting signals of the economy include several positives that help drive the market's rebound from its March low. The prospects of a meltdown of the financial system appears past; the government has demonstrated it will do whatever is necessary to avoid a disaster of this scale. And though economic activity continues to worsen, it is doing so at a slower rate, which suggest we may be getting closer to an economic bottom. However, the global economy remains in a fragile state as the effects of massive wealth destruction and the unwinding of a huge debt bubble continue to play out. The ultimate result will likely be lower spending by both consumers and businesses in the years ahead, as the economy in effects resets to the level where it might have been without the artificial boost of the credit bubble. While they probably allowed us to avoid a depression, the massive bailout and stimulus spending (along with longer-term demographic factors such as increasing health care and other entitlement spending) are causing the federal deficit to balloon, which could lead to dollar weakness and inflation down the road.

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Other conflicts are at play that will influence how the environment unfolds in the years ahead. One of these is housing, which started the cycle of damage we are now in. There have recently been a few positive signs including a stronger demand and historically high levels of affordability. But a wave of new supply from foreclosures over the next two years suggests the market may continue to struggle. There is more than a trillion dollars in adjustable mortgages that are underwater and that have yet to reset to higher payments, and higher unemployment will make things worse by pushing more of these homeowners over the edge.

Broadly speaking, these conflicts create a very wide range of possible outcomes. We recognize that no amount of analysis will allow them to determine exactly how the coming years will unfold, therefore we direct our analytical effort toward thinking very carefully about what could happen across a range of possible outcomes. This process of scenario analysis gives us important insights on how to position our clients' portfolios.

In all but our most optimistic scenario, and while we cannot predict future results, we believe returns from stocks and bonds over the next five years will be no more than mediocre- resulting in average returns for the types of stock/ bond allocations in our portfolios that probably won't get above mid-single digits. Fortunately, as we invest for our clients we are not limited to just what the broad stock and bond markets give us, and this is a source of optimism for us. Because we have been in an environment in which stocks and bonds have traded at prices below what their fundamentals suggest what they are worth, our managers have

made investment selections that added a lot of value over their benchmarks. While some of the lowest-hanging fruit may have been taken, pricing disconnects remain that we think could continue to give out managers a tailwind in the years to come.

Pricing disconnects exist at the asset class level as well, and we expect to see more opportunities if markets experience further periods of high volatility. We have already enjoyed strong returns from our tactical positions in bonds, both corporate and high- yield. We have also begun to add a tactical position in emerging market equities, based on our analysis that over the next five years emerging markets equities have the potential to produce higher returns than large cap U.S. equities in all the scenarios

we consider. We recognize that emerging markets may be more volatile in the shorter-term, but we are prepared to accept that for suitable portfolios because of our confidence in the potential longer-term reward.

Looking ahead, although we are not concerned about imminent inflation, we are considering asset classes that could help hedge our portfolios in the case of a declining dollar and/or increased inflation. These asset class moves could include emerging market bonds, Treasury Inflation- Protected Securities (TIPS), commodity funds, and gold.

Overall, our clients' portfolios have a modestly conservative bias. We believe that prudence is called for given the current high level of uncertainty in the economy and financial markets, but that good investment opportunities do exist. We will continue to work hard to identify and take advantage of these opportunities.

**We recognize that emerging markets may be more volatile in the shorter-term, but we are prepared to accept that because of our confidence in the potential longer-term**

Best Regards,



Martin K. "Bo" Brown, CFP®, CIMA®

Financial Consultant

*Alternative investments are available only to those who meet specific suitability requirements, including minimum net worth tests. Please review any offering materials carefully, and consult with your tax advisor or accountant prior to investing. There are special risks involved with alternative investments, including investment strategies, and different regulatory and reporting requirements. There can be no assurance that any investment will meet its performance objective. Futures trading is speculative, leveraged, and involves substantial risks.*

*The information contained in this report does not purport to be a complete description of the securities, markets, or developments referred to in this material.*

*The information has been obtained from sources considered to be reliable. Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation.*

*Any opinions are those of Martin K. "Bo" Brown and not necessarily those of RJFS or Raymond James.*

*Past performance may not be indicative of future results.*

*Investments mentioned are not suitable for all investors.*

*International investing involves additional risks such as currency fluctuations, differing financial and accounting standards, and possible political and economic instability. Also, investing in emerging markets can be riskier than investing in well-established foreign markets. There is no assurance any of the trends mentioned will continue in the future. Investing involves risk and investors may incur a profit or a loss, including the loss of all principal.*

*Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.*

*Commodities are generally considered speculative because of the significant potential for investment loss. Commodities are volatile investments and should only form a small part of a diversified portfolio. There may be sharp price fluctuations even during periods when prices overall are rising.*

*High yield bonds are not suitable for all investors. When appropriate, these bonds should only comprise a modest portion of your portfolio.*

“A critic is a man who knows the way but can’t drive the car.”

*Kenneth Tynan*

“Knowledge can be communicated but not wisdom.”

*Herman Hesse*

“Every man is the architect of his own fortune.”

*Gaius Sallustius Crispus, aka Sallust*