

# Investing Today...

## Timely Topics

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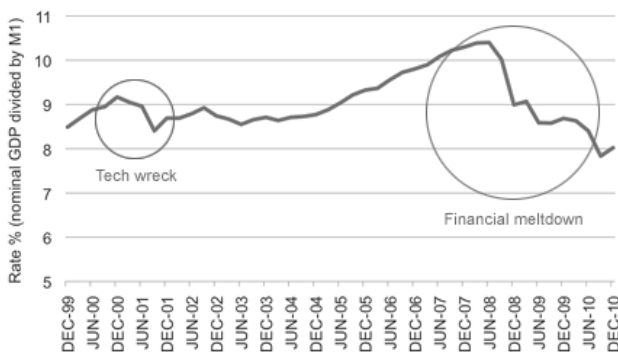
### The Velocity of Money & What it Means for the Economy

While there are gathering signs that the U.S. economy has begun to pick up the pace by putting more of its capital back to work, the road forward is far from clear.

Most agree that the Federal Reserve (Fed) has provided ample liquidity to spur the economy. In fact, the central bank's balance sheet, one measure of the Fed's net assets deployed in financial markets, has expanded by nearly 300% over the past three years.

But while the Fed has poured money into the system, it can't force that money to circulate and produce new goods and jobs. Despite the central bank's efforts, the rate at which that money has been used since the 2008 financial crisis has declined sharply — to a level even lower than after the tech bust of 2000-01. That rate, known as velocity, is a critical measure of economic activity; the more velocity, the faster the pace of growth.

Yet, there are signs that this may now be changing. Velocity accelerated in late 2010 — which might be the result of a pickup in loan activity and business spending; and even in the growth of jobs.



#### Picking Up The Pace?

M1 Velocity

December 1999 to December 2010

Source: Bloomberg, as of 12/31/2010. **Past performance is no guarantee of future results.** This information is provided for illustrative purposes only and does not reflect the performance of an actual investment.

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If this is the case, the Fed might very well decide not to pursue additional quantitative easing measures after "QE2" ends in June — which could be a harbinger of a Fed hike in short-term interest rates. While rising short-term rates are not normally an investor's friend, they could be seen as good news — a sign that the Fed is ready to tangibly demonstrate its belief that a sustainable economic recovery is indeed under way.

Of course, there are external forces that could further suppress confidence and delay any emerging pick-up in velocity in the U.S. Several other central banks around the world have in fact been raising rates to combat inflation in their own countries, and fiscal policies — both here and abroad — are becoming more restrictive as debt loads soar. And if that isn't enough to give pause, oil prices have been on a tear while the crisis in Japan has disrupted supply chains worldwide.

In short, it may be a bumpy road ahead; and therefore it's still important to keep a firm grip on the wheel — with broad exposure to asset classes, (depending on your risk tolerance and personal goals) perhaps including global investments, which can potentially lower overall portfolio risk might be prudent. Please call if you would like to review your situation and your portfolio.

## Questions For Conservative Investors

Everyone's financial situation is unique. By addressing a few questions we can assess some of your goals and help you find a solution to create a plan designed to achieve them. Check all that apply and give me a call:

- CD Buyer—I like the idea of buying CDs, but rates are very low. I would like to put my money somewhere that could earn more interest, is not subject to stock market losses and is easy to understand.
- Retirement Accounts—I have an IRA or other retirement account that I am not going to use for a few years and my main goal is to preserve the account value. I am more concerned about losing money than I am about large returns.
- Reduce Volatility—I have weathered the market with my equity accounts. I know that the stock market has made a strong push and I have recovered since the market hit the bottom. I believe that I may want to move a portion of my money out of the market to a more conservative investment.
- Sideliner—I have been sitting on the sidelines in a savings or money market account earning either a very low interest rate or no interest at all. I am interested in learning about fixed alternatives that will offer me more interest on my money and still offer a hedge against market loss.
- Income—I need income starting now or in the next few years. I am worried about outliving my money. I would like to have a guaranteed lifetime income and be able to access my money in case of an emergency.



### ***S&P 500 Riddle***

How can we pay relatively less for something that's nearly doubled in price? That's the riddle posed by the current price/earnings (P/E) ratio of the S&P 500. Since its low in March '09, the S&P 500 has nearly doubled in price.<sup>[1]</sup> Yet paradoxically, the P/E is lower now than it was two years ago — and has barely budged over the past year, despite the market's surge.<sup>[2]</sup> One reason? Growth in earnings that outstripped the rise in prices.<sup>[3]</sup> As a result, earnings got lower on a dollar for dollar basis — exactly what's measured by the P/E ratio.

[1] Source: Bloomberg, as of 3/30/2011. The S&P 500 bottomed at 676.53 on March 9, 2009. At the end of March 2011 it was priced at 1325.83, a rebound of nearly 100%. [2] Source: Standard & Poors, as of 3/22/11. In March 2009 the S&P 500 Operating P/E was 18.6x earnings. In March 2011 it was 15.45x earnings. [3] Source: Standard & Poors, as of 3/22/11. Annual S&P 500 Operating earnings per share (EPS) were \$83.76 at the end of December 2010, an increase of 111% from the bottom of \$39.61 in 3Q09.

## Thoughts on Municipal Bonds

**When complacent investors suddenly question long-held assumptions, opportunities to capture value often emerge amid the uncertainty — but it may take an outsider with a very different perspective to recognize them.**

Case in point: municipal bonds. The recent drop in prices generated by retail investors' anxieties over potential defaults was big enough to stir the interest of hedge funds and other institutional seekers of short-term return — whose main priority is clearly not tax-exempt income. These non-traditional investors are backing up their newly-found interest with dollars — an indication that the current prices offered for munis overall might more than offset the perceived risks of default.

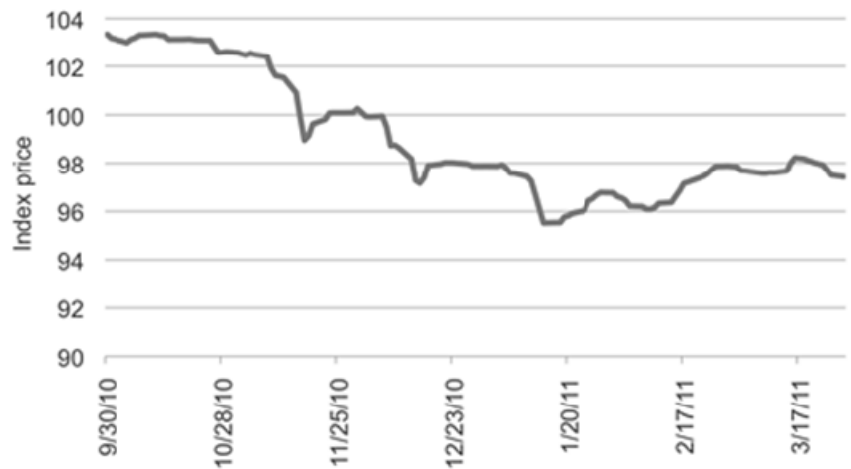
The influx of this so-called "smart money" has helped the market for municipal bonds find its footing. As of late March, municipal bonds had already recovered nearly 20% of the drop that occurred in late 2010 and early 2011. Yet even after the rebound, the relative value of municipal bonds remains quite attractive by historical standards, with the benchmark yield now measurably greater than for ten-year Treasuries.<sup>[1]</sup> Historically, it's usually been the other way around — thanks to the tax advantaged status of muni-generated coupon payments.

### Low Prices Attract High Interest

Barclays Municipal Bond Index (price) 9/30/2010-3/28/2011  
 Source: Barclays Capital, as of 3/28/2011.

**Past performance is no guarantee of future results.** This information is provided for illustrative purposes only & does not reflect the performance of an actual investment.

Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity.



All this doesn't change the fact that some state and local governments still face long-term fiscal headwinds, including underfunded pension obligations that will take years to replenish. On the other hand, states and municipalities are now addressing these issues forthrightly and with great fanfare — along with the expected political consequences. Of course, the challenges they face, and the political will to face them, vary tremendously from place to place.

The new reality in the world of municipal bonds is not like the pre-crisis world. Most likely, municipal bonds will continue their transformation from a low-risk asset class — driven by rating agencies and bond insurers — to an asset class governed by fundamental analysis and a thorough understanding of each issuing authority. In this new environment, long-term success will ultimately boil down to a thorough understanding of the financial health of individual issuers. Please call if you would like a comprehensive review of your municipal bond and/or overall fixed income portfolio.

[1] As of 3/28/11, the 10yr Treasury yield was 3.47% compared with a yield to worst of 3.80% for the Barclays Capital Municipal Bond Index.

Income from municipal bonds is not subject to federal income taxation; however, it may be subject to state and local taxes and, for certain investors, to the alternative minimum tax. Income from taxable municipal bonds is subject to federal income taxation, and it may be subject to state and local taxes. Please consult an income tax professional to assess the impact of holding such securities on your tax liability. A credit rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revision, suspension, reduction or withdrawal at any time by the assigning rating agency. Ratings do not remove market risk.

### Tax Freedom Day

This year the Tax Foundation has declared April 12 as Tax Freedom Day, the day the average American has earned enough to pay this year's tax obligations at the federal, state and local levels. To find the Tax Freedom Day for your particular state, visit [www.taxfoundation.org](http://www.taxfoundation.org).

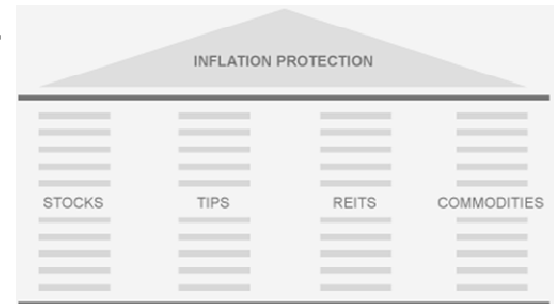
## Inflation Expectations...

"The more you learn, the more you see how little you know" is one of Socrates' more quotable aphorisms. But you don't need to be a Greek philosopher to recognize that the deeper you delve into the topic of inflation, the less obvious the solutions seem to be.

Though it's fair to say we know more about it now than in the past, one thing is clear — investors seeking to hedge against inflation should recognize that it can arise in different ways and for different reasons. For example, in the late 1960s inflation exceeded 6%<sup>[1]</sup> as government spending (Vietnam and domestic social programs) created excess demand for goods; while in the 1970s it rose to double-digit levels as surging energy prices, courtesy of an oil embargo and Iranian revolution, rippled through the entire economy.

Even now, with inflation very low (depending on your goals and risk tolerance), it's important to consider ways to potentially backstop portfolios from a possible resurgence. In part, it's because inflation can creep up on investors. It's also a matter of cost; the price of inflation hedges is likely to be lower when the threat seems far away and interest in them is slack.

## Raising The Roof...Four Pillars That May Help A Portfolio Keep Pace With Inflation



[1] Inflation References measured by the consumer Price Index (CPI)

Source: Legg Mason

Historically, stocks have been celebrated as a long-term hedge against inflation, because companies can bolster earnings through price increases. Of course, not all stocks are created equal in this regard — and it would be a mistake to assume that stocks alone can provide adequate defense against an enemy as insidious as inflation.

Indeed, relying too heavily on any single inflation hedge has the same drawbacks as any non-diversified strategy — heightened exposure to portfolio volatility and missed opportunities. TIPS, REITs and commodities can also provide a measure of defense, and to varying degrees may contribute to total return even when inflation is not a clear and present danger.

That said, each of these strategies comes with its own set of risks, and potentially optimizing their contributions in a diversified portfolio can be critical. For example, in the course of an inflation cycle, REITs might be deployed most effectively when inflation expectations are growing, commodities when energy prices are rising, or TIPS when consumer prices are rising.

Inflation is a complex issue, but the ideal foundation to keep pace with it is a dynamic, diversified strategy — one that is appropriate for you even in non-inflationary environments.

### **Exchange Holiday Schedule—The office will be closed**

May 30 in observance of Memorial Day, July 4—Independence Day, September 5—Labor Day



#### **About Liza Campa-Flanagan...**

Liza (pronounced Lizza) has been an active professional in the financial services industry for 25 years. She is a Certified Financial Planner™ and Certified Investment Management Analyst in addition to satisfying the educational requirements to be Registered as a General Securities Principal with Raymond James Financial Services, Inc. Liza also holds life, health, and variable annuity licenses in the State of Florida. She graduated with distinction from Eckerd College in Florida with a B.A. in Business and Management.