

## **Quarterly Review and Outlook – Second Quarter 2010**

Stock and bond markets diverged this quarter bringing an end to the impressive rally in the equity markets. During the quarter the S&P 500 declined 11.4% making the year to date loss 6.7%. International stocks fared slightly worse declining 12.2% during the quarter and 10.8% for the year. Small and Mid Cap stocks did slightly better with both the Russell Midcap and 2000 indices down nearly 10% for the quarter and 2% for the year. Bonds were up 3.5% and 5.3% for the quarter and year to date periods respectively as measured by the Barclays Aggregate index. The HFRX Global Hedge Fund index was down 1.2% for the year.

Investors seem to be questioning the sustainability of the recovery in an environment marked by significant deleveraging, declining inflation, high unemployment and an oversupplied housing market. On top of that we are beginning to see some weakness in China at the same time a sovereign debt crisis is erupting in Europe. With those major issues facing the market, it is hard to stay focused on the improved earnings we are seeing for many companies here in the U.S.

We believe the best way to manage portfolios in any environment is to establish an investment plan that focuses on each client's goals and objectives. We deal with uncertainty and volatility by designing an asset allocation that gives us the best opportunity to earn returns over the longer term. We attempt to further manage risk by selecting investments and managers that help mitigate volatility in the markets through their own investment process. Achieving your goals takes time, dedication, and patience.

### **Lessons Learned from Ironman Coeur d'Alene**

On June 27<sup>th</sup>, I completed my fifth Ironman triathlon in Coeur d'Alene, Idaho. For those of you not drawn towards extreme athletic endeavors, an Ironman consists of a 2.4 mile swim, 112 mile bike, and 26.2 mile run...all in one day. I had taken a few years off from Ironman racing and it was great to be back. I had an awesome day finishing the race in 10 hours and 3 minutes and it made all the hard training very worthwhile.

I am often asked by friends and family why I like to do Ironman and my answer is simple. It allows me to get a fresh perspective on things that are important. The sacrifices are many and the training is significant but it allows me to reflect on work, family, and friends. As I was preparing for this race, it occurred to me during a long, lonely training day that my perspective towards managing portfolios is influenced by my experiences in triathlon. I believe this perspective is beneficial for you as clients of BT Wealth Management as we navigate the ever-changing investment landscape. Since my experiences help shape our approach to managing wealth, I wanted to share some of this insight as we move forward towards your goals.

- 1) The importance of coaching – I have been doing triathlons since I was 14, so I consider myself a subject matter expert. When I made the decision to commit to an Ironman again, I knew, despite my ability to develop a plan that made sense, I needed a coach to keep me focused and avoid making poor decisions about my training by working myself too hard or too easy. Investing is no different. Having a thoughtful investment plan and asset allocation that is based on a client's individual goals and circumstances is critical. But, I believe that one of the greatest benefits we can provide a client is to help them by acting as an emotional barrier that prevents a poorly timed decision.
- 2) Following the plan consistently – There is not anything more important in preparing your body for a 10, 14, or 17 hour race than consistency. Over the course of months the training process is focused on creating adaptations where the body gets used to the amount of stress you will put it through on race day. These adaptations are most effective when done consistently over a long period of time. Sometimes it takes years to get to the point where we can achieve the goals we set forth and the investment process is no different. It requires a consistent focus on the overall

goals and objectives while ignoring things that can cause us to compromise the plan. If we are able to apply the principles of diversification and

prudent asset allocation without straying, we believe we have the highest probability of investment success.

- 3) Managing the doorways – This is one of my favorite analogies in triathlon. A doorway is an obstacle that has the ability to derail us from our goals. Oftentimes we find these doorways closed but passing through is a necessary step to getting to where we are going. Investing and triathlon will both force us to deal with good days and bad. When presented with these challenges, we must find a way to get through it with minimal disruption to the goal. I haven't come across all the doorways the markets may throw our way, but I do know that each of them is manageable with persistence and perseverance.
- 4) It is more important to be efficient than fast – Don't get me wrong I want to get to the finish line as quickly as possible, but in Ironman you get fast through efficiency. At BT Wealth we take a similar view in helping clients reach their goals. We are mindful that we are trying to reach each client's individual goals and selecting investments that minimize the chance of missing those goals. We attempt to do that by selecting investments that have attractive valuation characteristics, low volatility, low correlation with other investments in the portfolio, and appropriate costs. We desire efficiency in the portfolio by having these characteristics which will give us the best opportunity to reach your goals.
- 5) Patience – An Ironman requires countless hours of preparation and focus. The race is long and the obstacles are many. Patience is required because results won't come over night. Growing and preserving wealth requires the same dedication towards patience. The markets are volatile and uncertain in the short-term, but if we allow ourselves to look out towards our time horizons the picture becomes clearer. We believe that growing wealth takes time and losing patience only distracts us from the goal.
- 6) Enjoy the process – Not everything about Ironman is enjoyable, but when I step back I can always take satisfaction out of the process that I endured to achieve the objective of finishing the race. I enjoy the training, the camaraderie of my coach and teammates, and for the most part I enjoy the race (even though it hurts). In my five Ironman races, I always look back at the process of getting to the starting line and feel the most proud. I am not saying that meeting with us to review the portfolio or reading this report is supposed to be fun, but the way in which we manage the portfolio together should be a process that gives you satisfaction and helps you sleep well at night. Furthermore, we hope you know at BT Wealth Management when we wake in the morning we are thinking about how we can help you achieve your goals...even if it is during an early morning run.

### **More cautious than optimistic**

Turning to our current outlook on the investment environment we are growing more concerned about the fact that we are currently experiencing one of the weakest recoveries on record. Considering the amount of monetary and fiscal stimulus that has been pumped into the economy, the weakness of that recovery is reason to worry. Normally at this point in the cycle, GDP growth has historically been much more robust than the 3.2% real growth we have seen since the bottom in 2009. We believe the impact of deleveraging has offset much of the stimulus and this is likely to continue for the foreseeable future. The most recent Fed minutes support that as well as they reduced their outlook for GDP growth, while rising projected unemployment, and lowering expected rates of inflation for the next several years. David Rosenberg, Chief Economist at Gluskin Sheff, summarized this recovery as follows:



“So, let’s look at the situation from a top-down view. We have seen real U.S. GDP growth average 3.2% at an annual rate during this

statistical recovery from the 2009 bottom. Of that, 2.1 percentage points came from the inventory swing – or about two-thirds of the growth. The remaining 1.2% average annual growth rate of GDP excluding inventories – otherwise known as “real final sales” – is the weakest post-recession recovery on record. The weakest ever, despite a 10% deficit-to-GDP ratio, a debt-to-GDP ratio rapidly heading to 100%, a near zero Fed funds rate, record low mortgage rates, an unprecedented tripling in the size of the Fed balance sheet, shifting accounting rules to help rejuvenate profit growth in the financial sector, cheap and easy FHA financing to virtually anyone who wants to buy a home, relentless government pressure on banks to modify defaulted loans, and bailout stimulus galore (Fannie and Freddie are no de facto “Crown Corporations” and their stock still trades!!) – and with all that, all we get for our money is a paltry 1.2% growth rate in final sales. Yuk.”

Rosenberg has a hard time expressing what he really thinks, but I am certain you get the picture of how lackluster this current recovery has been. In essence, we live in a world that is over levered relative to the amount of income available to support that debt. Until this imbalance normalizes, it is unlikely that global GDP growth will come anywhere close to its potential. Policymakers will attempt to manage this process through their policies, but it is essential that we have the political will to make difficult decisions. One thing we feel pretty confident about is that the Fed will keep rates low for a long period of time. We believe that it is unlikely our economy can handle higher rates at this point.

It is important to point out that our belief that the global economy will continue to exhibit sluggishness does not mean that stocks, bonds, and alternative investments will not be able to produce good portfolio returns. What it does mean is that in our view companies, governments, and municipalities will face greater challenges. These challenges will force difficult decisions and many weak players may not survive if more robust economic activity does not occur. Our focus in the portfolio will continue to be to manage the portfolio towards your objectives and within a well defined risk profile. We are confident that over the longer term we are best able to generate good returns through thoughtful asset allocation and diversification while focusing on investments that have proven the ability to add value to the portfolio. These principles will continue to guide our investment decision-making and we believe it is the best way to deal with any uncertainty we may face.

### **Our 2<sup>nd</sup> Year Anniversary**

We are proud to report that we just passed the 2 year mark since forming BT Wealth Management. As you know, Bennett Thrasher has been assisting clients with the management of their investment portfolios since 1998, but two years ago we formed BT Wealth to enhance our previous offerings and expand the capabilities of our investment services. We are pleased with the growth of the firm and we are hopeful that your experience working with us has exceeded your expectations. Our goal at BT Wealth is to provide an investment experience that is unmatched in the industry. We look forward to continuing to serve you and will strive to grow the firm in a disciplined manner. We appreciate the referrals that you have provided to foster our growth, and we accept them as your greatest compliment to us for a job well-done.

As always, we appreciate the opportunity to serve as your investment advisor. Please let me know if you have any questions about your quarterly report or our outlook. Thank you.

Best regards,

Steven P. Barth, CFA, CPA  
Chief Investment Officer  
BT Wealth Management LLC