



HEDEKER WEALTH MANAGEMENT GROUP, LLC

*Independent Thinking. Thoughtful Advice*



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***Dean R. Hedeker's***

2011  
*2<sup>nd</sup> Quarter Recap*

## ***Quarterly Economic Update***

At first glance, the market results of the second quarter didn't appear to be too bad. Despite the significant volatility and stock market fluctuations, the Dow still finished the quarter up 0.8% (up 7.7% YTD)—its 4<sup>th</sup> quarterly gain in a row, making it 8 out of the past 9. Unfortunately, the larger indexes didn't do as well. For example, the Standard & Poor's 500 Index increased by 0.1% (up 6.0% YTD) and the NASDAQ Composite decreased by .3% (up 4.6% YTD) during the second quarter.

"Risk on, risk off" is a common saying on Wall Street and describes how the stock market is rising and falling as investors become alternately optimistic and then despondent about global economic growth, such as Europe's debt woes and the impact of Japan's earthquake and tsunami.

There have been a number of negative events that have occurred throughout the quarter. For example, while personal income increased slightly during the second quarter, many consumers didn't spend it. That meant that the National Savings Rate inched up from about 4.9% in April to 5% in May—good for individuals, but not good for an economy where consumer spending represents 70% of GDP. (Source: Bob LeClair's Newsletter, July 2, 2011)

There are a number of reasons why consumers are not spending, including:

- Low consumer confidence
- High gasoline prices
- Falling stock prices
- Falling house prices
- Continued high unemployment

Another major issue was that the credit rating firm Standard and Poor's had to deal with a number of countries with debt problems. It reduced Portugal's credit rating to "junk" status. Greece was a significant subject throughout the quarter, as fears of European contagion reached critical levels. In addition, Standard and Poor's has warned the U.S. that they may decide to reduce our credit rating if we do not handle our deficit problems and get our financial affairs in order.

Another cause of anxiety and uncertainty was the end of the Federal Reserve's \$600 billion bond buy-back program, referred to as Quantitative Easing 2 (commonly called QE2), on June 30<sup>th</sup>. (Source: WSJ July 1, 2011) The long-term effects of this are unknown, but many investors predict it could also cause interest rates to rise.

Even with such a grim experience of worries, many investors largely expected (and continue to expect) the economy to ride out the troubles, paving the way for stock gains, even though it might be a long and winding

road to get there. “In the past, some of these events would have been a detour for the markets; now they are just a speed bump,” said Mathew Lloyd, chief investment strategist at Advisors Asset Management. (Source: WSJ, July 1, 2011)

Even against this negative backdrop, many U.S. companies are expecting to report surprisingly robust profits when second quarter earnings are announced in mid-July. The combined earnings of companies in the S&P 500 Stock Index are projected to rise 13.6% from a year ago for the second quarter, according to an analysis of Wall Street Forecast by Brown Brothers Harriman. One of the reasons for this is that cost cutting during the recession helped improve productivity and profitability for many companies. (Source: WSJ, July 5, 2011)

Despite the downbeat economic news, the stock market recorded one of its best weeks in years; go figure. The major indicators were up every day as we ended the second quarter and headed into the holiday shortened week.

This is another great example of the inability to time the market. Many investors were very concerned with the market dropping about 7% in May and decided to sit on the sidelines. Then the stock market bounced right back at the end of June and many of these investors did not participate in the rise. We suggest making sure that we revisit your Asset Allocation and keep invested at least to the degree that you should be based on a long-term plan. (Source: Bob LeClair’s Finance & Markets Newsletter, July 2, 2011)

## *Quantitative Easing*

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As we’ve already mentioned, the Fed’s controversial \$600 billion bond-buying program known as Quantitative Easing, or QE2, ended on June 30<sup>th</sup> with mixed opinions about its success. Quantitative Easing pumped money into the banking system through the purchase of approximately \$1 trillion in Treasury securities, which in turn gave banks abundant funds to lend out to businesses and consumers. The Fed officials hoped it would prevent very low inflation from giving way to a Japan-style bout of deflation—this occurs when the overall consumer price level decreases, dragging the economy down with it. The Fed also sought to stir the economy by holding down long-term interest rates, which in turn would hopefully boost prices for stocks, corporate bonds and other financial assets. In addition, they believed more job growth would follow.

Although the Fed succeeded in putting deflation worries to rest, economic growth is slower now than what it was when the program was enacted last year. Although stock prices are higher and corporate bond yields lower, prices for oil, grains, and other commodities have surged, pinching many consumers.

While analysts and investors debate whether the end to the bond-buying effort will have a significant impact on financial markets, the Fed faces a major decision: when to start draining the excess credit out of the economy by raising interest rates. Many investors are also worried that interest rates will rise now that the Fed has stopped purchasing treasuries, which amounted to about 85% of government debt sold by the Treasury since the program started in November, 2010. Who will replace the Fed as a new buyer now that QE2 is over? (Source: WSJ April 25, 2011)

If the demand for government treasuries is not enough to replace the Fed, it is very likely that interest rates will go up, which in turn could cause even more problems for the real estate market and additional costs for everyone involved, especially for mortgages and the deficit.

Unfortunately, a number of economists predict that the financial markets and the economy still are not strong enough to stand on their own. They argue that the economy, job markets and asset prices might stumble. If such a significant weakening of the economy does occur, that might force the Fed to buy Treasuries again to prop up the markets: Enter QE3. It is still very questionable whether or not the Fed would need to initiate a third round of quantitative easing because such a program would be dependent on a significant weakening of the economy. (Source: WSJ April 25, 2011)

## *Unemployment*

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Many have expressed shock at the recent employment data. About 14 million Americans are unemployed—9.2%. That figure does not include those who have simply given up on trying to find jobs, or those who are underemployed. Taking that into account, the underemployment rate stands at a stunning 19.1%, according to Gallup Organization.

Our current employment problem is different than the challenge we had from what it was in the past. We currently export many of our jobs to lower-wage nations like India and China. For example, the average wage in India is about \$.40 an hour and in China it is about \$2. Here in the U.S. the average hourly rate is \$20 plus \$1.24 in Social Security tax. If you add it all up, an engineer in Southeast Asia costs less than \$10,000 a year compared to \$90,000 in the U.S. This big problem is expected to haunt our employment market for the foreseeable future. (Source: Forbes, July 18, 2011)

Many big public companies are likely to report strong second quarter profits, but that isn't the story on Main Street, where many small business are grappling with jittery customers, rising costs and tight credit. The owners of many small businesses say economic uncertainty and inflationary pressures have led them to delay hiring and capital expenditures. 70% have no plans to expand their staffs over the next 12 months, according to a recent U.S. Bankcorp survey. (Source: WSJ, July 6, 2011)

## *The Economic Rebound*

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Although the U.S. economic recovery began in June 2009, many investors and business owners still don't feel the full rebound from the recession, and a range of indicators show that the economic recovery has been the worst, or one of the worst, since the government began tracking such data after World War II:

- The only time unemployment was higher than May's 9.2% rate at this point in a recovery was 2 years after the 1980 recovery during the 1982 recession.
- The inflation-adjusted after-tax incomes of America are up only 2% since June 2009 and haven't grown so meagerly in the early stages of any other post-WWII upturn.
- The nation's annual inflation-adjusted economic output is up 5.5% from where it stood at the recession's end and has advanced by less only one time in the first 2 years of a recovery—the 1980 recovery.
- Home prices were down 8.8% 18 months into the recovery, adjusting for inflation, and are much worse than they were during the 1991 recovery.
- Bank lending to businesses and households is down 4% since the recovery started, which is also the worst on record.

Another problem is that, for the first time in decades, America is losing and not attracting net growth capital. That may be the single most important explanation for our persistently high unemployment and stagnant wages.

In addition to this, many Americans are taking their investment dollars abroad at a faster pace than foreigners are bringing capital to the U.S. In 2010, for example, U.S. investment abroad was \$351 billion—\$115 billion higher than foreign investment here. (Source: WSJ July 5, 2011)

One of the other reasons that we have had a lack of economic recovery is due to our U.S. tax system, with its high rates and global reach. Many savvy investors and entrepreneurs constantly search for ways to minimize the impact of U.S. taxes, and some private-equity firms have relocated U.S. companies or divisions to tax-friendly countries. Some U.S. start-ups are even beginning life offshore. As other countries have reduced corporate taxes, the U.S. has one of the world's highest tax rates, at 35%. The U.S. is also one of the few developed countries that still seeks to tax their companies' global earnings; most countries tax only profits earned inside their borders. (Source: WSJ, June 24, 2011)

However, as mentioned earlier in this report, the news isn't all bad. Corporate profits, manufacturing employment and exports are performing at least as well as they have in several other recoveries. Profits, for example, were up 47% over the first 21 months of the recovery. On average since WWII they have risen about 35% over that stretch. (Source: WSJ July 5, 2011,)

Many corporations around the world responded aggressively to the global recession, clamping down on spending and hoarding massive piles of cash. In the United States, where cost-cutting was especially dramatic, non-financial firms hold close to \$2 trillion in cash, equal to a record 7% of total assets. (Source: WSJ July 5, 2011) Much of this excess cash will be used to increase dividends or be channeled into acquisitions and other capital investments aimed at improving competitiveness and productivity. There is also a good possibility that they may rehire some of the employees that were laid off during the recession. Many investors believe these corporate actions could be a major catalyst driving stock prices higher.

## *The Bond Market*

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Many investors continue to prefer bonds, even with interest rates at historically low levels. "Every time there is a little bit of a ripple, you see....individuals moving into Treasuries and other bonds," said Lisa Shalett, chief investment officer at Merrill Lynch Global Wealth Management. "There is an absolute focus on principal protection and capital preservation, with a desire to drive returns almost exclusively from income," Miss Shalett said. (Source: WSJ, July 1, 2011)

Many investors acknowledge that although bond yields are low, many think that prices of Treasury securities could keep climbing (at the same time their yields are falling) as long as the economy continues to show signs of sputtering and the threat of financial chaos in Europe continues. Many investors wonder whether the bond market can still continue its solid return. "Investors in U.S. Treasuries are being lulled into a false sense of security by positive returns this year because their yield isn't high enough relative to inflation," according to Bill Gross who oversees the largest bond fund at Pacific Investment Management Company, LLC. (Source: Investment News) Past performance is no guarantee of future results.

One of the major concerns of bond investors at this time is the possibility of rising interest rates, which can translate into losses for bond investors. As you probably know, interest rates and bond prices work opposite

of each other. As interest rates go up, the value of bonds goes down. In a recent presentation, Daniel O’Neil, president and chief investment officer of DirexionShares, said, “A 1% rate hike could drop the value of a 30-year U.S. Treasury Bond by 14.5%.” (Source: Financial Advisor Magazine, July 2011)

Countries such as the U.S. are intentionally keeping interest rates low to help reduce record debt levels, Mr. Gross said. The Federal Reserve has kept its target rate at a record-low range of 0.00-0.25% since December 2008 to help stimulate growth in the face of the worst recession since the Great Depression. (Source: Investment News, June 5, 2011)

Let’s now change the subject to municipal bonds. Since late last year, many investors have been selling their municipal bonds amid fears that cash-strapped states might not be able to make their bond payments. Many advisors, however, say that these concerns are overblown and that the entire sector is getting judged unfairly.

## *The Current U.S. Budget Deficit*

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There is another dark cloud on the investment horizon—the ongoing political struggle concerning the federal deficit and the U.S. debt ceiling. It is important to remember not to confuse the *debt* with the *deficit*. The deficit is the measure of the amount of money coming in versus what goes out on an annual basis. Last year the U.S. tax revenues were approximately \$2.3 trillion and we spent \$3.8 trillion. Our deficit for only one year was \$1.5 trillion—that’s 1,500 billions of dollars! That amounts to about 42% of the \$3.8 trillion in Federal outlays, which is equivalent to Washington borrowing \$0.42 of each dollar it is spending.

Here are the actual numbers presented by a recent Congressional Budget Office (CBO) report. Our current national debt is \$14 trillion. The CBO estimates that we will be \$20 trillion in debt by 2015 and \$27 trillion in debt by 2021. Let us take a look at how this impacts us. For example, in 2021, which is only one decade from now, the interest on \$27 trillion would consume ½ of all Federal tax revenue!

In addition, don’t confuse the debt with the unfunded liabilities for programs like Social Security, Medicare and Medicaid. Social Security alone has an unfunded liability estimated at \$19 trillion! This figure is not absolute, because we could change the programs at any time, which would increase or decrease the programs’ unfunded liabilities.

All of these numbers suggest that we are on a path to “doom and gloom.” However, it is important to remember that there are solutions to this problem. All we have to do is make decisions as opposed to just talking about them and start implementing these solutions. (Source: Senior Market Advisor, May 2011)

Many investors are also concerned whether the U.S. could *default* on its debt.

There isn’t any doubt that the entire U.S.—many government entities, many corporations and many households—has borrowed beyond its means. Although it is possible for the U.S. to be downgraded to below a AAA status, most economists believe that there is very little likelihood that Uncle Sam would actually default. Think about it—in the worst case scenario, the Fed would simply run its printing presses to help the Treasury cover its debt. The debt would get paid off, but at a cost. If we flood the world with more dollars, this makes each dollar worth less, which leads to inflation at home. (Source: WSJ, April 19, 2011)

Despite all of these concerns, investors continue to keep lending money to the U.S. and assume policymakers will address and solve our fiscal problems before they lead to an actual crisis. Many take confidence in

Winston Churchill's famous quote: "You can always count on Americans to do the right thing—after they have tried everything else." (Source: Fortune Magazine, July 2011)

## *The Debt Ceiling*

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The major debate in Washington today is whether the U.S. should raise its debt ceiling so it can borrow more money to stay afloat. The statutory ceiling on our national debt—our legal borrowing limit—is \$14.3 trillion. That limit was reached on May 16<sup>th</sup>, according to the Treasury Department. The Treasury says it can still operate until early August, when the ceiling must be raised by \$2.4 trillion.

Since 1962, the U.S. has reached its debt ceiling 74 times, about once every 8 months. Every time prior to this one we are faced with today, the ceiling was raised with little notice outside Washington and little if any change in government spending. When opposing parties have held the White House and Congress, the process has been very difficult to resolve. (Source: WSJ, April 28, 2011)

The Republicans want to raise the limit only if it is accompanied by spending cuts and no income tax increases. Democrats, on the other hand, want to raise the debt ceiling and have agreed to a \$2 trillion package of spending cuts over the next decade, but also want to raise about \$400 billion in revenue by eliminating tax breaks and deductions from many taxpayers. There have been significant discussions and debates about what to do and there is a chance that there won't be any agreement by the August deadline. (Source: The Week, July 15, 2011)

If no agreement is reached, many people are concerned about what happens next. Nobody knows for sure, because this has never happened before. However, many economists warn that the dollar could crash, interest rates could rise significantly and equity markets could have a major meltdown. Foreign investors could also lose confidence that America is worth risking their money and that Washington is able to face and handle this crisis. Many investors believe that cutting expenses and reconciling our differences would illustrate to the world that we can make tough decisions in a crisis and reassure our creditors and increase faith in the United States. (Source: WSJ, June 4, 2011)

## *Inflation*

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Inflation is upon us, even if most reports on wholesale and retail prices downplay the immediacy of the threat. The Federal Reserve says that inflation is well under control even when we see prices heading skyward. This downplaying of the increase of the cost of living is necessary to justify keeping short-term interest rates artificially low at the cost of savers. Don't forget that the CPI is used in all government indexed expenses like Social Security, government wages and inflation-indexed securities.

Unfortunately, many people forget that the inflation number quoted today is considered "core" inflation—an alternative CPI calculation that excludes most food and energy prices, which are volatile and more subject to extreme short-term price swings. Core inflation, as the argument goes, provides a more accurate, long-term picture of price movement. Unfortunately, the dramatic rise of food and fuel costs can make core inflation figures seem widely off base. (Source: Kiplinger's Personal Finance)

Food costs are up in part because oil prices are making it more expensive to produce and transport beef, lettuce, and everything else we eat. We paid \$3 a gallon for fuel in 2010 and now we are paying \$4. Since

petroleum is used to make plastic, the cost of everything from computer monitors to plastic kitchen utensils are on the rise. It is no wonder that more than 2/3 of the 23 economists recently surveyed by CNN Money.com identified high oil prices as the most serious risk facing the economy. (Source: Money Magazine, May 2011)

A key issue for many companies is whether they are able to pass on higher costs for raw materials and other commodities, including cotton, oil and scrap steel. Passing on higher costs to consumers is often difficult. Several consumer-product makers and retailers have recently announced that they will raise prices to offset higher commodity costs, even though consumers were already being hit by increased prices of food and fuel, plus high unemployment. Profit margins and sales volumes will show whether the price increases were effective. (Source: WSJ, July 5, 2011)

Another cause of inflation today is that the Fed has flooded the world with dollar liquidity through QE2 that has lifted stock and other asset prices, in turn eliminating the risk of deflation (if such a risk really existed) and hopefully preventing a double-dip recession. On the other hand, this has contributed to a boom in commodity prices around the world, spurring inflation in countries with links to the U.S. dollar and prompting investors to seek returns in non-dollar assets that are often risky. (Source: WSJ, April 26, 2011)

There are additional reasons why food and energy prices have risen so sharply. Political unrest in the Middle East has led to increased crude oil prices. In addition, violent weather patterns, including floods in Australia and drought in China, have decreased the global crop supply while recovering economies have increased worldwide demand.

Investors should care about inflation for a number of reasons:

Higher inflation often accompanies higher interest rates—

- Bad news for bonds, as prices tend to decline when interest rates rise. Most bonds pay a fixed coupon rate, and inflation erodes the value of that payment over time.
- Rapidly rising prices boost operating costs for companies. If companies lack pricing power, those higher costs erode profits, which can lead to lower stock prices.
- Wall Street values stocks based on future growth prospects, and inflation erodes the present value of the dollar expected in the future. Higher inflation means lower P/E ratios, which also means lower stock prices.

Weakness in the job market appears to have put a lid on inflation. Sluggish hiring limits wage growth, perhaps the most dangerous contributor to the type of inflation that affects financial markets.

One of the ways to keep inflation in check is to raise interest rates. For example, the European Central Bank raised its interest rates for the second time since April and signaled more increases are likely despite the debt crisis in Greece and evidence of slower growth. The decision about if and when to raise interest rates will be challenging. If our economy grew slowly in the second quarter, this would justify leaving rates at its low level. But with price increases for various commodities, the Fed is under increasing pressure to respond to inflation threats with higher interest rates.

The impact of increasing interest rates can affect many different financial areas, including real estate. Home prices in many parts of the country have sunk to 2002 levels, effectively wiping out a decade's worth of home equity across the U.S. and imperiling our fragile economic recovery as many Americans confront the falling value of their biggest investment.

“Home prices continue on their downward spiral with no relief in sight,” said David M. Blitzer, chairman of the S&P index committee. This doesn’t bode well for the economy, which has historically depended on home buying and other consumer spending to rebound from a recession. Falling prices hurt economic growth in a number of ways. Not only do homebuyers curb spending when their homes are losing value, but continued price erosion keeps families stuck in homes that they can’t sell because they are worth less than what they owe. Declining home values, rising prices and unemployment continue to weigh on consumer confidence. (Source: WSJ, June 1, 2011)

At least a bit of good news—home prices slowed their pace of decline in April, feeding hope that housing is near a bottom. Unfortunately, tens of thousands of foreclosures are expected to leave markets bumping near their current level for the rest of the year. (Source: WSJ, June 29, 2011)

## *Commodities*

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Although the prices of many commodities fell sharply in early May, many analysts expect developing markets’ demand for raw materials to keep growing. In fact, many investors have a strategy that they buy during the dip if commodities go down. Well, as we all know, there is no one strategy that can constantly predict anything accurately. No one rule always works. Even the best investors don’t get it right every time. Please note that crude oil and some other commodities in June took a big hit, leaving many would-be investors to wonder whether the dip was turning into a long-term reduction in prices. Only time will tell what is going to happen next.

Even with the recent declines, many commodities remain far more expensive than a year ago. Corn, for example, is up 78%, crude oil is up 26%, and copper has increased 46% over that period. In fact, if we look over the last 10 years, the gains are particularly shocking. For example, a decade ago, oil cost \$26.25 per barrel, compared with \$95.42 on June 29, 2011. Back then, corn cost about a \$1.89 a bushel, whereas on June 29<sup>th</sup>, it settled at \$6.29. Gold prices have more than quintupled since mid-2001.

There are also valid arguments and plenty of reasons to think that we aren’t at the end of the commodity rally, and this is merely a pause. For example, prices could increase from Japanese demand for commodities, as it rebuilds from the devastating March earthquake. More broadly, China is still growing rapidly, even if its significant pace has slowed down a bit. Many other emerging nations are getting wealthier too. That leaves intact the fundamental idea that these nations will probably continue to use more raw materials to fuel their growth and satisfy richer populations and that commodities producers will struggle to keep pace with this demand. (Source: WSJ, July 1, 2011)

## *Gold & Silver*

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For thousands of years, gold, silver and other precious metals have served as stores of value, prized for their beauty and used as safe havens during times of war as well as periods of social and economic upheaval. In the past two centuries these metals, particularly gold, also have served as hedges against the effects of inflation. More recently, a dramatic surge in the price of precious metals is again occurring amid worries about high debt levels and declining currency values. However, other factors have now been added to the mix, including the expanding demand for precious metals from emerging economies.

Through 2009, gold prices had more predictably moved with inflation. Coming out of 2009, gold prices began to move up even though core inflation as tracked by the consumer price index remained low. That rise has been relatively steady ever since. What is different this time? Many economists believe that the price of gold has moved up in response to rising food and energy prices, which are not reflected in core inflation measures. In addition to that, there is also the law of supply and demand. “What explains the recent significant increases in precious metal prices is the response to the unprecedented growth in money supply,” according to Carol Miller, Federated portfolio manager.

An investment in precious metals has the potential to deliver attractive benefits: a hedge against inflation, long-term potential price increases and an added measure of portfolio diversification. However, perhaps more than with other investments, this market is the product of numerous influences and forces—economic and psychological, realistic and irrational. Deciding whether or how to invest in it requires careful consideration. Gold and other commodities are subject to additional risks and substantial price fluctuation in short periods of time due to unpredictable international monetary and political policies and lack of regulation. As with any investment, past performance is no guarantee of future results. (Source: By The Numbers, Federated)

Gold could lose its increased demand if investors conclude that the world has returned to a benign investment environment, where growth is sustainable without extraordinary government support. The risk of a swift reversal is even greater because so many investors have piled into the gold market so quickly. The gold market, while popular, is relatively small compared to stocks and bonds, making it more sensitive to sentiment swings. (Source: WSJ, April 22, 2011)

## *The U.S. Dollar*

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The dollar today is lower than at any time since major currencies began floating in 1973. It is 13% lower than it was 30 years ago and 28% below its 2002 peak.

So what does that actually mean? A weaker dollar makes Americans poorer. In other words, U.S. paychecks buy less of what the world sells us. By pushing up prices of imports, it drives inflation. Not necessarily a big problem today, but potentially one in the future. The latest declines in the dollar have also contributed to the rising price of commodities such as gold. On the positive side, it gives exporting U.S. factories a boost by making their goods cheaper to foreigners at a time when the U.S. game plan is to rely more on exports. Many U.S. officials are unfazed by the dollar’s steep slide, but might get more concerned if the dollar showed signs of disturbing other financial markets. (Source: WSJ, April 29, 2011, May 5)

## *China*

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The big picture is familiar: China’s long-term growth trajectory is creating a vast middle and upper class eager to buy clothes, cars and cosmetics in ever-larger quantities. This increased demand has caused China to be concerned about inflation. China’s Central Bank increased its interest rates, its third rate increase this year and its fifth increase in the latest round of tightening to combat inflation. (Source: WSJ, July 7, 2011) This in turn has caused a slowdown in China, yet this has not reduced enthusiasm since many investors are taking a longer-term approach that should outlast any short-term market downturn.

Another major current issue regarding China is its currency, the Yuan. The Yuan has strengthened against the dollar and euro over the past several years and the rise of China's currency could reshape the global monetary system and fundamentally alter the world's main engine of growth. China's government in Beijing is forging ahead with a campaign to bring the Yuan onto the world's stage. The Yuan is more widely used in international trade and investment and could eventually challenge the dollar's supremacy. It is not too late for the U.S. to get a grip on its own debt and limit its vulnerability to foreign rivals. (Source: Time Magazine May 9, 2011)

## *Greece*

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Another major current subject of discussion is Greece. Greek debt is in trouble—again. After a month of discussion, it seems likely that the International Monetary Fund (IMF) and the European Union will agree to roll over Greece's debt so bond holders will be paid in full. The reason for this is that most of the bond holders are banks. If Greece defaults, then important French and German banks will be in deep trouble.

In addition, Ireland, Portugal, Spain, and Italy may soon follow. This scenario is beyond the EU's bailout capability, and it would leave the European financial system in shambles because again, the banks are holding that debt. Unfortunately, many stocks in Europe fell as concerns rose about the health of the global economy and confidence regarding a resolution to the Greek debt situation. Over the last few days, it looks like they are finally working out a solution. Let's hope for the best.

## *Summary*

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A question that is always on investors' minds recently is this: "Is the market overvalued?" The answer is the subject of substantial controversy right now.

There are valid arguments and rationale indicating a positive economic outlook, but also pointing toward another recession and financial crisis. The stock market has roared back from its March 2009 lows, doubling in value in less than 2 years. However, the last part of the rally, which began last summer, largely has been driven by the Federal Reserve, whose policy of buying Treasury bonds to inflate asset values across the economy ended on June 30<sup>th</sup>.

Although many predictions are made, it is important to remember that it is impossible to actually predict the future. Not many people would have factored in a nuclear crisis in Japan or major developments in Libya, Egypt and Europe. Still, these events are not unlike many that have unfolded in the past: the internet bubble, the Cuban missile crisis or the inflation of the 1970s. We made it through these crises and we should be able to make it through these current problems we are faced with today.

Someone once said, "The world is only going to end once, and the odds are that it isn't now."

We are now at the second anniversary of the global recovery. There are several factors to consider. First, although unemployment is high, as a result, wage growth and the cost of borrowing are low. Both factors strongly support corporate profitability.

Many investors believe that stock prices are too high now based on the various reasons mentioned throughout this report. As mentioned earlier, there are record amounts of cash sitting in bank accounts, and

we probably won't see more rapid growth and faster job creation until businesses start spending some of their cash and consumers become more confident. Many economists believe that if only a fraction of the money on the sidelines went into the stock market, the market would most likely experience a significant rally.

One of the biggest challenges investors face is how to tune out the prevailing mood of the market. Sticking with a long-term investment plan often requires ignoring the news, your friends' advice and even your instincts. Too often emotion, not logic, rules our investing habits, so the first step in declaring mental independence is realizing how these influences, known as biases, affect us.

Perhaps the most powerful influence is "herd mentality", a phenomenon in which people abandon reason and simply follow the crowd. Herd mentality is often magnified by another psychological quirk: recency. Investors often pay too much attention to the recent past when making decisions.

The media has a lot to do with the volatility. We now live in a world where information flows so quickly that sometimes we can all get overwhelmed with the amount of information that we receive in a single day. Unfortunately, most individuals do not have the ability to organize all of this data into a rational framework for making decisions.

While most investors understand that there will be some volatility in their investment portfolios, even the strongest of nerves can be tested when tsunamis, country-wide protests and bankrupt nations are constantly in the news. It is imperative to look at the long-term and remember that short-term volatility is something we cannot control.

Market fluctuations are based on emotion. Unfortunately, emotions can undo the best laid financial plans. Unfortunately, finance theory makes a basic assumption about investors: They behave rationally all the time. However, the panic during the latest financial crisis is just the latest evidence that that isn't so. However rational and well-thought-out a financial plan might be, it is useless if abandoned when the markets get volatile. Indeed, studies by Barclays and others show that emotional trading can cost investors up to 20% in returns over the long-term. (Source: Investment News, June 13, 2011)

The key is to not play into the market vacillations by letting your feelings dictate your financial strategy. Do not panic and remember that fluctuations are temporary, while your investment strategy should be long-term. As you know, we work with you to develop a long-term strategy and our goal is to help our clients achieve their financial goals, especially through these difficult times. Prosperity is a process, and usually a slow one at that. Take a deep breath, stay calm and stick to your plan.

Someone said a long time ago: "When waters are calm, anyone can steer the ship. When waters are rocky, people want to see their captain."

In summary, many chief executives dismissed the notion of a recession returning, although most note the recovery will probably be rocky. Unfortunately, prospects for the rest of the year are constrained by the persistently weak housing market and rising raw material prices. (Source: WSJ, July 5, 2011)

If you feel the need to discuss your situation before our next review meeting, as always, please call our office!

We remain cautiously optimistic and believe that there are more positive reasons that the economy will improve compared to the negative influences that the market faces today.

## *About Dean R. Hedeker*



Dean Hedeker has over 30 years of experience assisting clients in all aspects of financial planning, and is committed to prudently preserving and growing his clients' wealth. Dean is directly involved with investment management and financial planning for our clients and manages the wealth of more than 100 hard-working families. Dean is also an experienced attorney in the fields of estate planning, business law and tax law. Dean earned both his undergraduate and Juris Doctor degrees with highest honors. He also became a Certified Public Accountant in 1977. He was admitted to the Bar of Supreme Court of Illinois in 1981, the United States District Courts and the United States Tax Court. Practicing the triple role of attorney, certified public accountant and registered financial consultant gives Dean unique qualifications. Dean is a sought-after speaker, he has been invited to speak for many various organizations.. Hedeker Wealth clients directly benefit from this experience by being invited to workshops each year, which cover the latest news and valuable advice for tax planning, estate planning and investment management.

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**Dean R. Hedeker is a Financial Planner with Hedeker Wealth Management Group, LLC – An SEC Registered Investment Advisor**

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Due to volatility within the markets mentioned, opinions are subject to change without notice. Information is based on sources believed to be reliable; however, their accuracy or completeness cannot be guaranteed.

Indexes cannot be invested in directly, are unmanaged and do not incur management fees, costs or expenses. No investment strategy, such as asset allocation, can guarantee a profit or protect against loss in periods of declining values. International investing involves special risks not present with U.S. investments due to factors such as increased volatility, currency fluctuation, and differences in auditing and other financial standards. These risks can be accentuated in emerging markets.

There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment.

This optimism about the future does not minimize the fact that we have gone through one of the worst economic periods in market history. Remember that equity markets are volatile and an investor may lose money and there is no guarantee that securities will appreciate. This material contains forward looking statements and projections. There are no guarantees that these results will be achieved.

The price of commodities is subject to substantial price fluctuations of short periods of time and may be affected by unpredictable international monetary and political policies. The market for commodities is widely unregulated and concentrated investing may lead to higher price volatility.

In general, the bond market is volatile, bond prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. The investor should note that investments in lower-rated debt securities (commonly referred to as junk bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default.

Investments in real estate have various risks including possible lack of liquidity and devaluation based on adverse economic and regulatory changes.

Sources: Wall Street Journal (10/25/10, 11/4/10, 11/13-14/10, 11/16/10, 11/20-21/10, 11/18/10, 11/29/10, 12/10/10, 12/14/10, 12/17/10, 12/23/10, 12/29/10, 12/30/10, 12/31/10, 1/3/11, 1/6/11, 1/7/11, 1/8-9/11, 1/10/11, 1/13/11), Barron's (11/8/10, 1/3/11), Money Magazine (Jan/Feb 2011), Bloomberg Business Week (10/18-24/10, 11/18-14/10, 1/3-9/11, 1/10-16/11), Kiplinger's Personal Finance (1/2011), By The Numbers (1/8/10), Fortune Magazine (12/27/10), Investment News (11/10, 11/15/10), The Economist (9/4/10, 10/30/10, 12/18/10,

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