WaldenCapital
ADVISORS

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The stock market posted solid gains for the quarter with the S & P 500 index gaining just under 6% and small- and mid-cap equities posting gains in the high 7% range. Growth outperformed value and domestic stocks fared better than international equities, with the EAFE index up over 3% and emerging markets increasing about 2%. Looking more closely at those numbers, however, you will see several ups and downs during the quarter. After surging 7% during the first six weeks, the S & P 500 cooled off the following month erasing the prior gains and then regained its mid-quarter level during the last two weeks in March.

Last quarter I wrote about how hard it is to rely on forecasts because for every positive opinion of the future there is an offsetting negative one, both of which make sense given the particular argument of each. This quarter we have witnessed firsthand another powerful reason why forecasts are not reliable and that is the effect of unforeseen events. At the beginning of the year, we were all wondering the following: were corporate profit levels sustainable, was consumer spending going to increase, would unemployment begin to creep down, how much further would housing prices decline before turning the corner, when would the Fed start tightening, when would interest rates start rising, when would inflation rear its ugly head, and how would the divided government solve the budget and deficit crisis. Three months later, we are still wondering about all of those issues as none of them are resolved just yet. However, much of the market volatility this quarter was due to events that were unexpected – unrest in the Middle East, rising oil prices and the devastating earthquake, tsunami and nuclear disaster in Japan.

So what is the moral of the story? The market is very unpredictable in the short-term, and it is affected by things we foresee as well as events that are not even on our radar screen. The only way to avoid market risk completely is to keep all of your assets in cash. As we all know, you won't lose money but you also won't make very much, especially in today's environment. Pursuing this all cash strategy also exposes you to inflation risk, the risk that your assets will not grow enough to keep up with inflation and the cost of your lifestyle.

Since we are not able to eliminate risk if we invest in the equity and bond markets, our job as your advisor is to manage and control risk in this risky environment. This is why we have allocated your portfolios across a variety of market sectors. With headwinds facing both the stock and bond markets, we moved assets from pure equities and fixed income into the real assets and diversifying strategies categories and also diversified your fixed income funds beyond just U.S. government and corporate bonds. In doing so, correlations among asset classes are reduced allowing us to help you better achieve your goals of realizing long term growth while minimizing short term volatility. In rising markets like the one we experienced this quarter, the portfolios may lag a bit since money was taken from equities to pursue this strategy. On the flip side, we expect less downside risk in declining markets. This is a tradeoff we are willing to make.

As we talk with clients this year, we will be reviewing the beneficiary designations on your retirement accounts to make sure that they still reflect your current wishes. This is also a good time to review your wills to ensure that they are up to date with your current thinking. As always, please call us with any questions you may have about your accounts or any planning issues.

Enjoy the spring weather!

Jill

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