MacMillan Financial
John MacMillan, CRFA, CLTC, CSA
P.O. Box 66
Annandale, NJ, 08801
T: (908) 236-7500
F: (908) 236-7511
WWW.SENIORSBOOMERS.COM

SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

June 2009

..........Tiptoe Through the Tulips

I don't have to state the obvious, but I will. Finally, there are some *'green shoots'* out there. The 1st Quarter GDP report showed that personal consumer spending actually contributed 1.5% to the gross domestic product. Prices were marked down so aggressively for almost everything, (appliances, clothing, automobiles, luxury items, etc) the deals were too good to pass up…provided you had a job and some money to spend. This same report also showed a significant inventory drawdown which is an excellent sign. When the shelves are bare, companies must replenish them by producing more stuff!

Elsewhere, the much followed ISM index (Institute for Supply Management) has crawled back into the low 40's from the low 30's. When we hit a reading of 50 or higher, the economy will once again be officially expanding. Jobless claims are still unbelievably horrible, but they are less horrible than they were a few months ago. The prognosis is that the economy is still going downhill, but at a slower pace.

What about our esteemed financial institutions? Well, all the major banks passed the stress tests. Many in fact, are in the process of repaying their TARP loans. These events, if nothing else, have lifted the spirits of investment public. According to brokerage firms like TD Ameritrade, and others, this rally is being led by the retail investor rather than the institutional investors. This is unusual. Our run up since the March lows has been nothing less than spectacular. So much so that the institutional guys are being forced to come back into the market for fear of lagging the market, producing lousy returns and losing clients. Right now, cash on the sidelines still represents about 48% of the entire value of the S&P500. That's a lot of fuel for the fire. If and when this money comes back into the market, look out above.

New housing permits continue to fall. Hooray, we don't need more inventory! According to the U.S. Census Bureau, the number of unsold <u>new</u> single-family homes is down to a 10.7 month supply through April, and the number of <u>existing</u> single family homes is down to an inventory level of 9.8 months. These numbers are a significant improvement over the 12 month supply at the end of 2008. When we are at 6 months, we're back to normal.

The automotive industry cleansing is now taking place. This is very good news for the stock market because it removes a good deal of uncertainty (the market hates uncertainty). We can all cheer this event, but it comes at a price. Our government is now waving scalps all over Capitol Hill (General Motors Rick Wagoner's was the first of many) as they embark on running companies and boardrooms. Our Administration has issued orders for the overhauling of the boards of Bank of America, AIG, General Motors, etc. New executive compensation rules are on the way. Then they have mandated mergers. I don't know about you, but I get a little fidgety at the thought of too much government intervention in the private sector.

<u>ALL THESE ARE NICE GREEN SHOOTS</u>

But, I also see quite a bit of crabgrass.

The new administration's budget calls for tax hikes on the higher income earners. Abraham Lincoln once said, "you cannot help the wage earner by pulling down the wage payer". According to a recent study by the conservative think tank, the Heritage Foundation, in 2006 the top 20% of U.S. households paid a record high 86.3% of all taxes; the bottom 20% of U.S. households paid a minus 2.8% (this is because of child and other tax credits). Too much wealth transferring can be a double edged sword. (Ask Great Britain).

Washington is also changing important free market rules. Bondholders, **by law**, are first in the pecking order to get paid in the event of a corporate bankruptcy. The government has arbitrarily given most of Chrysler and a good chunk of General Motors over to their unions. Without getting into the moral issues of what's right or what's wrong, this is a matter of law. If secured creditors cannot count on our legal system to protect their legal rights, why on earth would anyone want to be a bondholder? This may have negative effects down the road.

The U.S. government and the Federal Reserve have lent or committed $12.8 trillion to prop up the economy. In case you're wondering, (and I was) that works out to $42,105 for every man, woman and child in America. Wow, it makes you think about how much stimulus we, the citizens, could have provided with that kind of money. Imagine a family of four getting a check in their mailbox for $168,420?

Next up, we have the proposed federal budget. Looking back at history, in 1982 the U.S. had $5.8 trillion of debt. In 2008 our national debt had ballooned to $52.6 trillion. From 2010 to 2019, the Congressional Budget Office projects deficits totaling $9.3 trillion (in addition to the 2009 deficit of $1.8 trillion). And to top it all off, these 10 year numbers are based on ***extremely optimistic*** assumptions: 1) inflation not to exceed 1.8% in each of the next ten years ; 2) economic growth to average about 3% a year 3) while spending on new social programs in healthcare, education and energy, the government will presumably cut the current deficit by 50%. **WHAT????** How do you spell I N F L A T I O N ???

Now, let's go back to our banking industry for a moment. Everyone cheered their 1st quarter results. Remember, there was a lot of our tax payer money that had been injected onto their balance sheets back then. The 2nd quarter is likely to be a lot different than the first. All the new stock offerings that the banks made over the past 2 months will be **very** dilutive for the shareholders. Over $50 billion of equities have been added to the stock market. That's about one half of one percent of the total of our entire system. There is very little likelihood that their earnings per share will come back to normal for quite some time.

The health of the entire banking industry is still poor. There have been about 40 banks taken over so far this year by the FCIC. This compares to 25 in 2008 and 3 in 2007. Vacancy rates and foreclosures in the commercial market have increased dramatically. Just look inside the malls. As commercial real estate loans begin to go sour, and small business loans default, the pain is not over yet.

At a recent shareholders meeting, JP Morgan Chase CEO Jamie Dimon cautioned that he expects credit card losses of 9% in Q2. Their Washington Mutual losses are estimated at 18-24% by the end of the year. Other divisions aren't looking so hot either. Home equity losses of $1.4 billion; subprime mortgages losses of $475 million; prime mortgage losses of $500 million.

It may seem that I'm really down on the banks. I'm not. What I'm trying to do is paint an accurate picture of what's going on there. They will come back to life and be healthy & prosperous once again. Now, however, is not the time. Maybe next year?!?

Since the March run up in the market, the Dow Jones now sells for 47 times earnings. The estimated forward 2009 earnings figure for the S&P 500 is 54.07. Believe it or not, I've seen *trailing figures* of 120 times earnings. Yes, that's 1 2 0. Now, that's expensive! Company insiders sold $2.1 billion in April and only bought $160 million worth of their stock. Do they know something we don't?

This spring, when all we were getting was horrible news that turned into only terrible news, we began to celebrate. At some point however, investors won't be satisfied with companies beating reduced earnings estimates Long term, investors will demand solid earnings and real revenue growth. The stock market is always about earnings. Muted growth will produce muted stock prices.

I am the 'eternal optimist' however; I get paid for being a realist. I think we have a shot of seeing the DOW back around 10,000 before this rally fizzles. I am very doubtful that we'll see the October 2007 highs for quite some time yet. The reason for that is the inflationary forces that will hit us before we get a chance to get into the second half of the party. Once we have dealt with those problems, then the road will be clear for another BIG leg up.

WHAT TO DO NOW:

1) **I believe that sometime in July/August, after the Q2 earnings announcements come in, we could see a pullback in stock prices. Protect your profits from the past few months.**

2) **Although stocks look cheap, many are NOT. Do your due-diligence research. Pick up new stocks with tweezers…not a shovel.**
3) **Date stocks…don't marry them.**
4) **Stick with companies with strong balance sheets that make things we NEED.**
5) **Avoid the financials for now.**
6) **If you really do want to dabble in financials, buy their bonds and not their stocks.**
7) **Look for industries with strong signs of improving business conditions and earnings growth, and check out their membership.**
8) **Beware of investing in companies offering pensions. You'd be amazed at some of the names that have troubles, and how underwater they are with their funding obligations.**
9) **Be willing to pay up for dividend paying stocks. They represent *real* money in your account every quarter.**
10) **I'm seeing unbelievable bargains in the gas & oil pipeline sector right now. These Master Limited Partnerships offer solid earnings (dividends for you) and <u>very attractive valuations.</u>**
11) **Ensure that you are correctly asset allocated, and if necessary, re-balance your portfolio.**

Three Ways to Prepare for Rising Interest Rates

What I mentioned earlier is that inflation -down the road- is pretty much baked into the cake. The Federal Reserve Board has flooded the U.S. economy with a tremendous amount of liquidity and sooner or later the bill for their efforts is going to come due. This probably won't happen this year, but it certainly looms large within the next 9-18 months. (Remember the stock market is a forward looking mechanism. You'll probably see market weakness before the headlines appear in the newspapers). As inflation pokes its ugly head over the tree tops, the tool of preference for the FED will be to raise interest rates.

What is also pretty much a given, is that higher interest rates generally cause the stock markets to falter and bond prices to fall. That doesn't necessarily mean you should move all of your money into cash. An alternative is to consider investments that tend to be less affected by interest rate fluctuations.

Commodities

About 95% of the commodities being sold worldwide are denominated in U.S. dollars. Therefore as inflation begins to be felt, commodity prices will rise. Another factor which will fuel this rally is the fact that about one billion people (one-seventh of the world's population) are moving away from poverty and going towards western style consumerism. That's a lot of new consumers. That means a lot of new things are going to be manufactured to fill that void. New things need commodities. Look to invest in metals, energy and agriculture.

Floating-rate bonds or "put" bonds

With floating bonds (also called variable-rate bonds), interest is periodically recalculated based upon a percentage of the prevailing rates for Treasury bills or other interest rates. And some "put" bonds have a feature which can allow you to redeem the bond at par value on a specified date before its maturity, so if interest rates increase, you might be able to cash in the bonds at any "put" date, recoup the principal, and purchase a higher-yielding bond. As this can be a complicated endeavor, it's often a good idea to talk to an experienced financial advisor about this strategy.

Short-term bonds and bond funds

When interest rates are rising and bond values are falling, you might not want to be locked in to a bond that doesn't mature for several years, since it could be worth less than a newer issued bond. However if you purchase a faster-maturing bond, you might be able to replace it much quicker. You can do this yourself by purchasing individual bonds. Or you can purchase shares of a short-term bond fund that that has a track-record for buying and selling bonds on a continual basis.

Dividend-paying stocks

In some cases, dividends could compensate for falling stocks prices. With this in mind, it may be worthwhile to consider stock investments in companies that have a track-record for paying consistent **and growing** dividends. Furthermore, dividend-paying stocks can be a reasonable investment from an income tax perspective, because dividends are currently taxed at 15% (the new budget calls for it to rise to 20%).

FOR MORE INFO

Mail or Fax back to:
John MacMillan
P.O. Box 66
Annandale, NJ, 08801
T: (908)236-7500 F: (908) 236-7511
www.seniorsboomers.com

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