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Glenn Woody
Certified Financial Planner

Pro or Con?

The current theme of economic reporting by the media is one of pessimism. The data points for that pessimism are several:

- Two months of negative market returns
- The on-going oil spill debacle
- Congress's defeat of the unemployment extension
- Uncertainty over the nature and fate of the financial regulation bill
- The European debt crisis
- The recent uptick in unemployment claims
- A breakdown below technical support levels on the major equity indices.

A milder, and more realistic word for it all would be "uncertainty".

As usual, opinions are rather evenly divided among those commentators that we read most and find helpful.

The wildest comment we have seen is one predicting a drop in the Dow of another 40% or so by year-end. It was delivered by a guy who is rather prone to making wild predictions.

Several others are talking about being more cautious and reducing risk.

From a contrarian viewpoint, the more negative are the predictions, the more bullish it is.

The more realistic comment we have read, ties the immediate future of the markets to the weekly unemployment claim filings.

Most recently, they have trended sideways at about the 450,000 level; a result that would support the trendless stock market we have had since year-end. A rise back toward the 500,000 level would be negative for our markets and keep fears of a double-dip recession high. Or, a drop toward the 400,000 level would likely spark a fresh rally in the stock market, maybe even carrying it to new recovery highs before year-end.

Such divided opinions are not at all unusual. As always, the media does us no favor as they hype the negative and the sensational with a short-term bias, with no regard to what makes sense to a long-term investor, such as ourselves and our clients. But then, we understand their agenda is to sell their publication or broadcast and not to protect capital and earn a reasonable return over the long-run.

We watch carefully, listen intently, and all the while, try to keep our head on straight.

PIMCO Institute

During the third week in June, we had the privilege of attending the semi-annual PIMCO Institute, presented by the pre-imminent portfolio managers in Newport Beach. Of course, it was a most interesting four days.

There were many presentations and a lot of discussions with the attendees, who came from around the world. I will give a very brief, cryptic summary.

By way of history, a speaker talked about the six epochs our economy/markets have experienced since 1914:

Epoch 1 1914-1929 WW I and Roaring 20's

Epoch 2 1929-1941 Grt. Depression/New Deal

Epoch 3 1941-1960 Post WW II

Epoch 4 1961-1980 The Great Inflation

Epoch 5 1981-2000 Disinflationary Bull Mkt.

Epoch 6 2000-Present The Great Unwind

He pointed out that each odd numbered epoch brings euphoria.

There followed a dissertation we have all heard

about how we got into the situation we are now in:

- Living beyond our means in the last 20 years.
- World supply outpaced demand
- Low world prices and interest rates
- Credit Boom
- Wage levels in U.S. not competitive
- Our unwillingness to do what is necessary to be competitive
- Attacking with old demand-side policies

The cornerstone of their decision-making process is their annual Secular Forum held each May. There they attempt to anticipate what may unfold over the next 3-5 years.

This year's result was a reinforcement of their "New Normal" characterized by deleveraging, de-globalization, and re-regulation.

All week they stressed how stretched the balance sheets are of the developed nations, including the U. S., and how much stronger were those of many of the emerging nations.

They indicated their "most likely" scenario for the next 3-5 years is a global Gross Domestic Product of 3-4% (not the old 5-6%) rather indefinitely.

When asked what sign-posts along the way would indicate a more favorable scenario, they spoke of the need for global coordination among nations, avoiding protectionism, guarding against nationalism.

Their favoring emerging nations confirmed what we have been thinking for some time. As a result, we are increasing the exposure to emerging markets, in both equities and fixed income, in our portfolios.

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# Market Highlights

## July 2010

### Positive:

- Nonfarm business sector labor productivity increased at a 2.8% annual rate during the first quarter of 2010.
- Industrial production advanced 1.2% in May after having risen 0.7% in April.
- Manufacturers' and trade inventories were up 0.4% in April from the month before, but down 2.8% from April, 2009.
- Retail e-commerce sales in the U.S. for the first quarter of 2010 increased 1.5% from the fourth quarter of 2009.
- Economic activity in the manufacturing sector expanded in June for the eleventh consecutive month.
- The Conference Board Leading Economic Index for the United States increased 0.4% in May, following no change in April, and a 1.4% rise in March. The Coincident Index rose 0.4% in May, following a 0.4% increase in April. The leading index is 12.0% above its most recent trough of March, 2009 and is 4.6% above its most recent peak in December, 2006.
- The Consumer Price Index declined 0.2% in May and increased 2.0% during the last twelve months. For the second month in a row a decline in the energy index accounted for the monthly drop. The Producer Price Index moved down 0.3% in May.

### Mixed/Cautious:

- Sales of new single family houses in May, 2010 were 32.7% below the April rate and 18.3% below the May, 2009 rate.
- Advanced estimates of retail and food services of sales for May were down 1.2% from the previous month, but 6.9% above and May, 2009.
- Existing home sales were down 2.2% in May from an upwardly revised surge in April.
- New orders for manufactured durable goods in May decreased 1.1%. This decrease followed five consecutive monthly increases including a 3.0% April increase.
- The index of consumer sentiment was 76.0 in June, up from May's 73.6 and from 70.8 in June, 2009.

### Informational:

- International funds were up in June while domestics were down. Small caps were down more than large.

## FYI: Short-Term Observations

*These comments are offered for your information and thought. They are short-term and tactical in nature. We invest for the long-term, three to five years plus. Don't confuse these short-term observations with what may be the best decisions for the long-run. Some even believe it is confusing, at best, and distracting, at worst, to involve short-term issues in long-term investing.*

### Inflation?

**T**he prospect of coming increases in interest rates and inflation is universal among investors and economists.

However, the opinion as to the timing of those increases is equally universal, "Not for a year or so".

The Federal Open Market Committee (FOMC), the rate-setting arm of the Federal Reserve, held their annual two-day meeting on June 22-23. To the surprise of no one, they left interest rates at their near-historic lows and indicated they were likely to do so for some time to come.

The conclusion that increased rates are in our future seems obvious from the level of debt increases being incurred by the government. Those debts have to be repaid at some point, either by increasing taxes or inflating the dollar, or both. The government can, of course, simply print more money, which would be highly inflationary.

Economists are agreed that the prospect of higher interest and inflation rates is not on the immediate horizon, largely due to the slow pace of the economic recovery. Some have said that we will not begin to see rising rates as long as the unemployment rate stays high.

So the rate of unemployment and the level of weekly unemployment insurance claims seem to be the key for watching and anticipating any major change in either interest or inflation rates.

Actually, there continues to be some talk among economists of some degree of deflation in the economy before we see any hint of rising rates.

So, we will keep a sharp eye on the employment picture as the coming days unfold.

### A Two-Month Dip

**A** second month of negative returns in the major U. S. stock indices was enough to make the entire 2nd quarter and even brought the year-to-date returns to the downside.

The U. S. stock market is teetering on a level from which it can go either way.

Here are the results:

#### Dow Jones 30 Industrials

|                |          |
|----------------|----------|
| June           | -3.58 %  |
| Last 3 months  | -10.00 % |
| Year to Date   | -6.27 %  |
| Last 12 Months | +14.93 % |

#### Standard & Poor's 500 Index

|                |          |
|----------------|----------|
| June           | -5.33 %  |
| Last 3 months  | -11.80 % |
| Year to Date   | -7.53 %  |
| Last 12 Months | +11.70%  |

#### NASDAQ Composite

|                |          |
|----------------|----------|
| June           | -6.56 %  |
| Last 3 months  | -12.05 % |
| Year to Date   | -7.05 %  |
| Last 12 Months | +14.25%  |

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