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Glenn Woody
Certified Financial Planner

Just A Correction?

We finally have had our 10% correction! We have been saying for months now that a typical market rally, such as the one we have had since March 2009, has correction of 10% or so along the way.

We were way overdue. The average length of a rally without a correction is 331 days. We were fourteen months into this one.

So now the pundits are busy on both sides of the question whether this was just a correction or was it the mark of the top of the market with a double dip to follow?

While one never knows for sure, we think it is a correction. If so, while it is a bit gut-wrenching in the process, it would actually be healthy in the long run.

Corrections can be triggered by any one of the whole host of issues. This one came out of concern for the financial stability of Greece and the European Union, boosted along the way by the tensions between North and South Korea. The final chapter on neither of those issues has been written at this point.

The financial problems in Europe will be long term in nature and will have at least an indirect affect on our economy and our markets.

But what more directly affects our economy and our markets are a number of issues here at home. Most of them are quite positive.

- Manufacturing is improving.
- Unemployment claims are falling.
- We created 290,000 new jobs in April.
- Interest rates remain at virtually an all time low.
- Rising inflation does not yet appear anywhere on the horizon.
- Corporate profits are strong.

The most common measure of a market's valuation is the price/earnings ratio (P/E). The long-term historical average for the P/E ratio of the Standard & Poor's 500 is 15. A conservative estimate of the S&P 500 earnings for 2010 is \$80.00 per share. Some experts even predict it may go as high as \$90.00 per share.

At \$80.00 per share, the current P/E ratio is 13.5. At \$90.00 per share, it drops to 12. Those numbers do not present a case for a market that is overvalued.

Professionals we listened to are using this "correction" as a buying opportunity. We leave that sort of tactical maneuvering to the managers of our mutual funds.

PIMCO's Secular Forum

The PIMCO organization, based in Newport Beach, has a somewhat unique process which is a good part of what has made them arguably the premier fixed income management company in the country. Each May they convene their Secular Forum.

They bring over 100 of their top staff to Newport Beach, invite several of the most knowledgeable and noted outside experts in chosen fields to take their best look at the world of economics and investing over the next three to five years.

Then, to their credit, instead of holding their findings close to their chests and protecting them as being proprietary, they share their opinions openly.

From their May 2010 publication, "Secular Forum", we report these excerpts and findings:

Their stated bottom line is, "we are living through a remarkable time of change for the global economy and markets". And, "we are heading to a world that is re-regulated, delevered, and growing less rapidly in the industrialized countries". They observe that "politics matter a lot for markets and the economy".

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One of their guest speakers made the catchy observation, "The world is on a journey to an unstable destination, through unfamiliar territory, on an uneven road and critically, having already used its spare tire".

"We expect systematically important emerging economies to maintain their development breakout phase, including a gradual broadening of the engines for income and employment creation."

The robust developments in both the economy and the investment markets in the last year was noted but they questioned "the robustness of the handoff in industrialized countries from temporary sources of growth (stimulus and inventory restocking) to sustainable drivers of growth and employment (final private sector demand)".

The picture of a somewhat normal distribution curve and modified, in their opinion, for the future to one of flatter distribution of returns with fatter tails. That was their way of saying returns will be weaker with continued volatility and more frequent spikes (both positive and negative).

This observation was made: "Politics are not helping... Political parties seem more interested in accentuating differences rather than in agreeing on solutions".

"The global economy has embarked upon a multi-year journey that is subject to many frictions and tensions... between cyclical tailwinds and structural headwinds, large and small, old and new, Main Street and Wall Street, governments and markets, and core and periphery."

Throughout the entire report, there are several references to the expectation that emerging economies will perform noticeably better than the developed ones, even though they may experience slower growth than in the last year.

# Market Highlights

## June 2010

### Positive:

- Privately-owned housing starts in April were 5.8% above those of March and 40.9% above April, 2009.
- Sales of new one-family houses in April, 2010 were 14.8% above the March rate and 47.8% above the April, 2009 rate.
- Existing home sales in April increased 7.6% and were 22.8% higher than April, 2009.
- New orders for manufactured durable goods in April increased 2.9%. This was the fourth increase in the last five months and followed a slight decrease in March.
- Manufacturers' and trade inventories were up 0.4% in March from February 2010 but down 5.0% from March, 2009.
- Industrial production increased 0.8% in April after having risen 0.2% in March.
- Economic activity in the manufacturing sector expanded in April for the ninth consecutive month, and the overall economy grew for the 12th consecutive month.
- Nonfarm payroll employment rose by 290,000 in April, the unemployment rate edged up to 9.9%.
- The Consumer Price Index declined 0.1% in April. Over the last twelve months, the index increased 2.2%. The Producer Price Index declined 0.1% in April following a 0.7% advance in March.

### Mixed/Cautious:

- Spending on private construction in March was 0.9% below February 2010.
- The estimate of retail e-commerce sales for the first quarter of 2010 decreased 18.9% from the fourth quarter of 2009. Of course, Q4 2009 included the holiday shopping season.
- The Conference Board Leading Economic Index for the U.S. declined 0.1% in April, following a 1.3% gain in March, and a 0.4% rise in February. The Coincident Economic Index rose 0.3% in April, following a 0.1% increase in March. The lagging economic index increased 0.1% in April, following a 0.1% increase in March.

### Informational:

- In the month of May, all the major indices had negative returns. Value was off more than growth. Large caps lost more than small and international was down more than domestic.

## 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.*

### Short-Term vs. Long-Term

**T**his is yet one more plea for clients to be mindful of their need for funds from their investment accounts in the foreseeable future.

We have made this point with every new client and have reinforced it repeatedly along the way. But, it needs repeating.

The markets, both equity and fixed-income, experience price change, volatility. Equity markets tend to be more volatile than fixed-income, but both exhibit more volatility, from time to time, than most stomachs are comfortable with.

But, that volatility is somewhat short-term in nature. Day-to-day, week-to-week, month-to-month markets jump all over the place.

But, if we look at markets with a wider, longer view, we find there isn't any volatility to speak of. There is a wavy line with an upward slant. The "wavy" part of that is the short-term volatility.

So we ask clients to think of their funds as either short-term or long-term. Short-term is any money they anticipate needing in the next two-years plus some for unexpected emergencies. The other money is long-term.

**Short-term money should not be exposed to the short-term volatility of the investment markets.**

That money should not be in even our conservative managed portfolios. It should be in separate accounts, on high-ground, with absolutely NO exposure to the volatility of markets.

The money we manage should be the long-term money that can stay there through down-turns and come out the other side.

### Finally!

**W**e have been saying for months that we were overdue for a correction of 10% or so in what has been a remarkable rally since March 2009.

Well, we finally got it in May. It remains to be seen if that is all or whether there may be more downside from here.

Here are the results:

#### Dow Jones 30 Industrials

|                |         |
|----------------|---------|
| May            | -7.90 % |
| Last 3 months  | -1.82 % |
| Year to Date   | -2.79 % |
| Last 12 Months | +16.24% |

#### Standard & Poor's 500 Index

|                |          |
|----------------|----------|
| May            | -8.24 %  |
| Last 3 months  | -1.34 %  |
| Year to Date   | -2.32 %  |
| Last 12 Months | +15.50 % |

#### NASDAQ Composite

|                |          |
|----------------|----------|
| May            | -8.29 %  |
| Last 3 months  | + 0.85 % |
| Year to Date   | -0.53 %  |
| Last 12 Months | +23.40%  |

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