

KIELY WEALTH ADVISORY GROUP, INC.



From Left To Right: Joe Kiely, Scott Below, Katie Burr, Brownie Cordell, and Kellie Kiely

BEHIND THE SCENES

Volume 21 | Number 4 | Date January 2012

OPENING THOUGHTS

Turning the calendar on 2011, we look back on a year of unsettled emotions and equally unsettled markets, helped along by a number of largely of unexpected psychological blows. These include, the Japanese tsunami, the Arab uprisings, the debt ceiling debacle and subsequent S&P downgrade of our nation's debt. Of course, ongoing problems in Europe contributed to an acute case of nervousness on the part of investors across the globe, particularly in the second-half of the year. Making matters worse, investor reactions to these events were amplified by advances in computer-driven high frequency trading. The result was a year in which the Russell 2000 index moved by more than 1% in fully 208 of the year's 252 trading days, making for a ride that was a lot bumpier than many would have liked.

As expected, the heightened market volatility caused many investors to lose focus on the big picture in favor of the crisis du jour, of which there was no shortage. Predictably, individual investors

pulled money out of stocks en masse in 2011, with the largest withdrawals occurring nearest the market lows of the year. Fear-driven selloffs in response to increased volatility are what behavioral finance studies have long documented, and when the herd panics and heads for the exits as one, volatility gets even worse... and many get trampled.

Few things in investing are predictable with a high degree of reliability over the short-run, but the herd mentality of individual investors around volatility spikes is an exception to the rule — and the smart money knows it. So, while the herd was selling, the smart money was bargain hunting. Mutual fund managers, corporate insiders, and investment pros like Warren Buffett used the selloff to reposition their portfolios and pick up high-quality assets while they were on sale. As a result, they (and our clients) were the primary beneficiaries of the double-digit rebound in the fourth quarter, as a little sanity began to return to the markets.

INSIDE THIS ISSUE:

Opening Thoughts	1
Investor Psychology	2
Behavioral Finance	3
The Numbers	6
Questions w/ Joe & Scott	8
A Final Note	12
Quarterly Reports	13

PLEASE BE SURE

TO

CHECK OUT THE

ENLOSED

MORNINGSTAR

REPORTS

TO SEE HOW EACH OF

OUR

CORE PORTFOLIOS

HAVE BEEN

REBALANCED THIS

QUARTER



INVESTOR PSYCHOLOGY

The Psychology of Fear

Unfortunately, as damaging and irrational as the herd mentality was for some stock investors in 2011, the behavior of many bond investors was equally ill-advised. In a year when the U.S. lost its prized triple-A bond rating - an event that ordinarily would have spooked investors away from U.S. Treasury bonds - investors across the globe instead piled into Treasuries at a record pace, driving their prices up and already record-low yields even lower. While the price run-up made Treasuries one of the best performing asset classes of 2011, it was also a slippery slope, as Treasury yields near zero are unsustainable. In other words, the flight to the safety of Treasury bonds in 2011 managed to make the already sizable Treasury bubble we've been warning about even larger.

In contrast, 2011 was also a year where U.S. corporations (as a whole) experienced one of their most profitable years ever - an event which ordinarily would have evoked a stampede into stocks - yet the herd (individual investors) continued pulling money out of stocks month after month. While the vast majority of our clients remain focused on the long term, many other investors' decisions are still dictated by their experiences during the sub-prime meltdown more than three years ago in 2008.

The Case for Optimism

As long term investors our main goal is to purchase well-run companies at reasonable prices, and right now prices look very cheap, in large part because so many investors remain so pessimistic, in spite of all the evidence to the contrary. Most academics and financial economists believe the equity risk premium - or the excess return of the overall stock market over risk free treasury bills - is one of the best guides to how equities will perform over the next three to five years. Today, it stands at roughly twice its long-run average. This suggests that over the next three to five years, the equity risk premium is going to come way down, which is something that can only happen if either interest rates or stock prices rise sharply. Since the Federal Reserve doesn't believe we'll see a significant rise in interest rates anytime soon, we think stocks are particularly well positioned at this point, especially for patient investors who won't be spooked by the next inevitable market dip.

The case for optimism goes well beyond the equity risk premium, however. The truth is, corporate America is thriving and corporate earnings continue to beat

expectations by sizeable margins. Combined with attractive prices, our managers are almost giddy about the opportunities they're seeing. They've also been able to use the recent volatility to refresh and reposition their portfolios. In the aggregate, they believe the risk-reward picture for stocks looks as promising as any they've seen in a long time, and we agree.

In terms of the domestic economy, it's no secret that over the past three years emerging market economies like those in Brazil, Russia, India, and China, have been critical to the GDP growth of the U.S., and they will undoubtedly continue to be significant contributors going forward. That's been a good thing, because demand from these markets has allowed the world's largest economy - America - time to heal and get back on our feet. Recent economic data suggests that the economy is now growing at around 2.5% annually, which is close to its long-term average and strong enough to support a continuation of the significant job creation we saw from in private sector in 2011.

In addition to recent declines in the unemployment rate, both the number of hours worked and payrolls continue to expand upward each month. If you factor in the extremely accommodative monetary policy (i.e. low interest rates) and low rate of inflation, it is clear there are many positives in place for the domestic economy going forward. Thus, we believe the global economy will continue to expand and this expansion will benefit greatly from an increasingly robust U.S. economy.

However, this is not to say the world is without its problems. The debt issues in Europe are serious and will likely remain so for quite some time. At home, we remain as stunned as everyone else and we are as thoroughly dismayed at the level of dysfunction and partisanship that continues to plague Washington.

On the other hand, corporate America recognizes we live in an imperfect world so rather than dwell on things they can't control, they're focusing instead on those they can. And in case you haven't noticed, during the course of the recession and subsequent recovery, America's corporations have rolled up their sleeves and gotten to work - becoming more efficient, more productive, more competitive, and significantly more profitable.

Today, domestic corporations continue to generate record cash flows and there are no signs of a slowdown. American companies have been able to grow stronger in this difficult economy because they've aggressively



capitalized on the low cost of capital, abundant supply of low cost labor, declining trade barriers, and America’s technological superiority. As a result, we believe domestic companies are well positioned to compete (and even dominate) in the global economy going forward.

Yeah, but...

There will always be pessimists and naysayers who will look at a year like 2011 and say it was a bad year. We disagree. While stock indexes finished the year either flat or in negative territory, virtually any fundamental metric you choose suggests stocks are currently underpriced. Ironically, the primary reason stocks look so attractively priced is the overt pessimism still shared by so many investors. However, if you look at underlying factors like corporate cash flows and the large number of steadily improving macroeconomic indicators, it’s difficult not to get excited about the prospects for stocks.

In investing, emotions can trump rationality for substantial periods of time. However, in the end, rationality always wins out. The big unknown is always how long it will take for emotions (fear and pessimism in this case) to subside and rationality return. No one knows for sure, but we do know that in the meantime stocks look very cheap and when prices finally do correct, the bounce could be substantial.

Over the past 100 years, the stock market has been a very good barometer of corporate health. However, over shorter periods of time investors’ emotions can hold sway and cause prices to diverge significantly from their intrinsic values (in both directions) and cause volatility to spike. In other words, the behavior we’ve witnessed in recent months has been occurring off and on since the advent of financial markets.

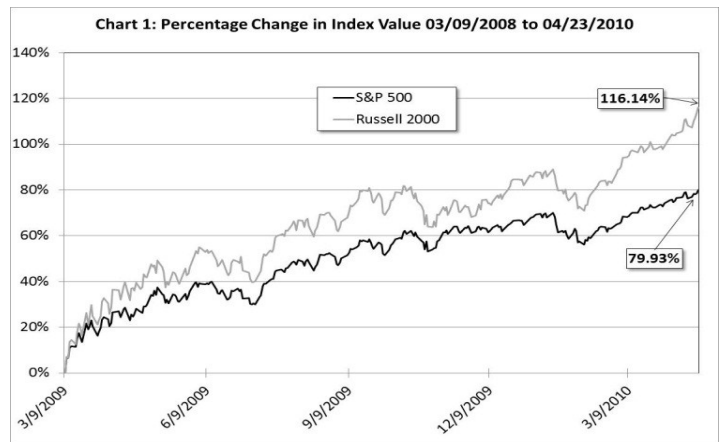
In fact, the previous three years provide a perfect example of the interplay between investor emotion and intrinsic value and are therefore an excellent way to illustrate some important concepts of behavioral finance and investor psychology. We believe a re-examination of these concept may be just what the doctor ordered.



BEHAVIORAL FINANCE

Emotion and Intrinsic Value: 2009

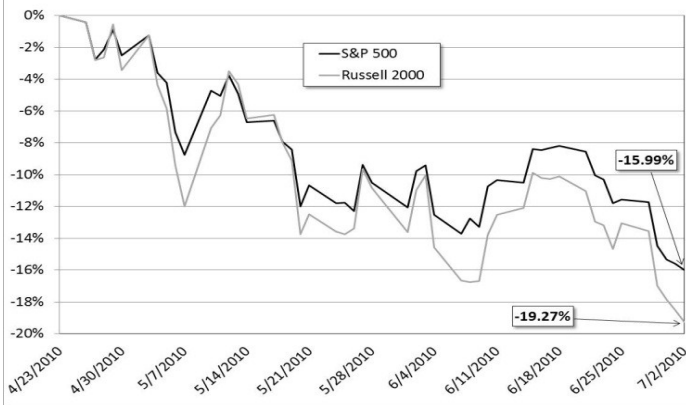
Nearly three years ago, we devoted much of our April 2009 newsletter to an examination of how the Federal Reserve had taken swift action to fix the worst of the credit issues facing the country, and how we believed investor fear and panic-selling had created an opportunity to purchase companies at once-in-a-lifetime valuations. Based on numerous financial metrics, it was clear the market had seriously overreacted and stocks were significantly underpriced, even assuming the worst case scenario. In other words, emotions had trumped rationality and the histrionic headlines of the day were only serving to make things worse. We encouraged clients to ignore the headlines and focus on the issues that actually matter, like price and intrinsic value. Specifically, we noted the ridiculous “prices” one could pay to acquire corporate America’s future “cash flows.” The results displayed in Chart 1 show that between the market low reached on 03-09-09 and the intermediate high reached roughly one year later (on 04-23-10) the S&P 500 index rose almost 80%, while the Russell 2000 more than doubled. It was an amazing year!



The following year, in our April 2010 newsletter, we noted the significant run-up in stock prices over the previous year. We were as happy as anyone with the rally, but cautioned that markets never go straight up and that equity markets average a 10%-15% peak-to-trough decline each year. Based on the previous year’s performance we noted that we were probably due for a “normal” healthy dip.” The results, displayed in Chart 2, show that over the next quarter, between 04-23-10 and 07-02-10, the S&P 500 dropped roughly 16%, with the Russell 2000 falling by almost 20%.



Chart 2: Percentage Change in Index Value 04/23/2010 to 07/02/2010



This dip was typical and representative of the kind of normal, healthy dip history tells us we should expect in stocks each and every year. Since we were expecting a normal dip, we used the opportunity to rebalance our portfolios and, wherever appropriate, do a little tax loss selling. However, what looked like a normal dip to us, was used as fodder for the naysayers and pessimists who couldn't move on from the events in 2008. The naysayers felt the dip represented impending doom. They were wrong...mostly because they were focusing on the wrong issues.

Déjà vu All Over Again: 2010

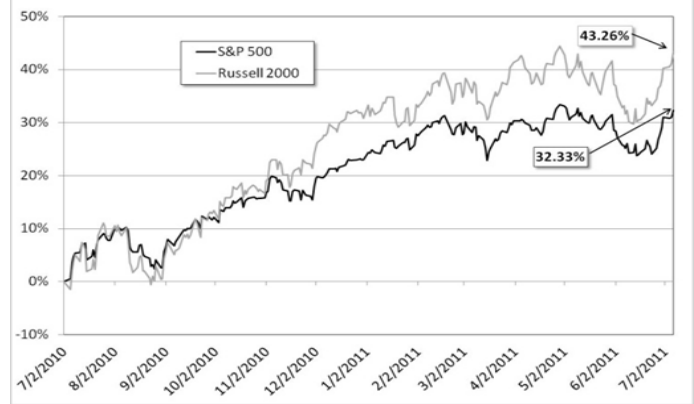
So what did we advise in the subsequent July 2010 newsletter? We spent much of the allotted space examining why investors who focus too much on "the now" do so at their own peril. We explained how focusing on the short-term tends to obscure the longer-term perspective that is critical to investing success.

Furthermore, we encouraged investors to look beyond the short-term transitory problems of the recovery and focus instead on factors that would be in play over the longer term, like cheap labor, low interest rates, technological innovation, and the rapidly expansion in the number of middle-class consumers across the globe. We noted that these macroeconomic issues would define the prospects for the global economy going forward—and hence the prospects for stock investors as well.

In essence, we warned against becoming mesmerized by the melodramatic headlines because, beyond all the pessimism, there was (and still is) plenty of good news regarding the global economy – especially when viewed on a company by company basis. In fact, we pointed out that from the standpoint of balance sheets, cash flows, and profitability, publicly traded corporations had seldom been in better shape. As a result, we weren't surprised to see the strength of the subsequent rally. As Chart 3 illustrates, over the next twelve months (through 07-07-11) the S&P

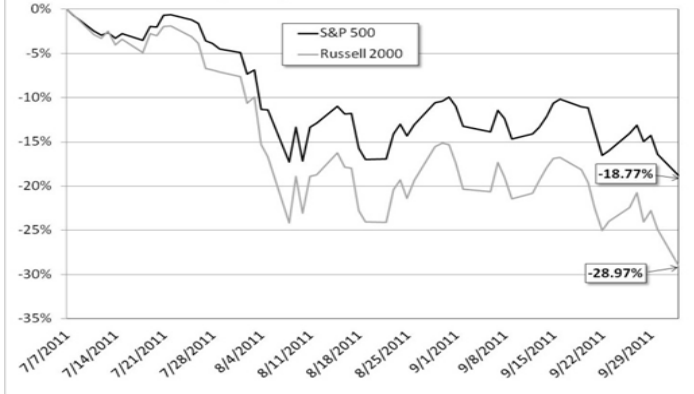
500 rose more than 32%, reaching its highest level in more than four years, while the Russell 2000 gained more than 43% and in the process reached a new all-time high.

Chart 3: Percentage Change in Index Value 07/02/2010 to 07/07/2011



Again, we cautioned that markets don't go straight up and that a peak-to-trough dip of 10%-15% should be expected every year...and 2011 was certainly no exception. Over the third quarter of 2011 we got the expected annual dip, albeit on steroids, due to a fractious and unsettling debt ceiling debate, subsequent downgrade of U.S. bonds by Standard and Poor's, and "new" news regarding the European debt crisis. As a result, between the peak of the market (reached on 07/07/2011) and the trough (reached on 10/03/2011) the S&P 500 and Russell 2000 indexes dropped almost 19% and 29% respectively, as seen in Chart 4.

Chart 4: Percentage Change in Index Value 07/07/2011 to 10/03/2011



So what was the overriding message in our 2011 third quarter newsletter?

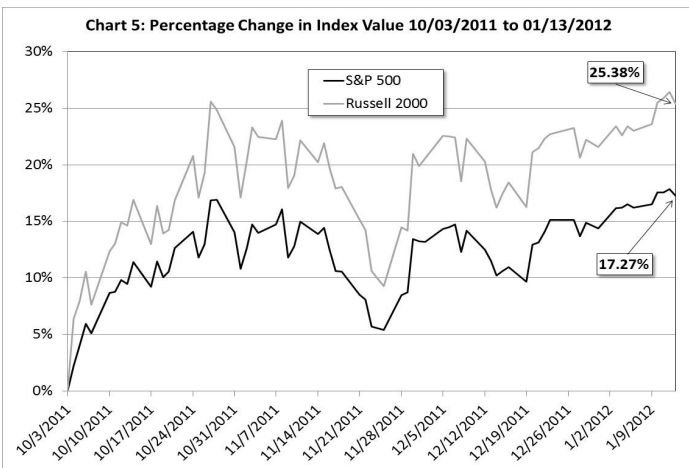
Déjà vu All Over Again: 2011

We wrote that to achieve investing success in today's global economy you need to have a good understanding of what drives stock prices in the long run (i.e. cash flows) and you need to have a strategic plan for dealing with today's heightened market volatility. There will ALWAYS be a crisis



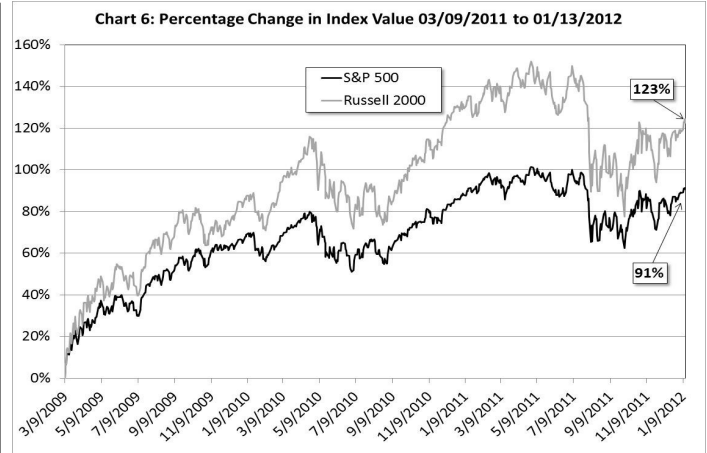
of the moment, and if you lose sight of the forest for the trees you will become intractably pessimistic and incapable of maintaining the long-term, big picture view investors need to have. Any worthwhile endeavor - be it gardening, life relationships, or investing - will have its ups and downs. The key to success in the long term is to not let setbacks and negative events define you. Instead we need view dips and setbacks as a normal part of the process, learn from them, and keep on doing what we know works in the long run.

In our third quarter newsletter we wrote that our country has an extraordinary track record of overcoming even the most daunting obstacles, including the credit crisis of 2008. We went on to lay out seven reasons why we thought a bounce back was inevitable and, as seen in Chart 5, a fourth quarter bounce back is what we got, with the S&P 500 gaining 17% from its October 3rd low through this writing on 01-13-12, and the Russell 2000 rallying 25% over the same period.



Our Take

As you may have guessed, our view is that the most recent dip and subsequent rebound is business as usual for the equity market. Historically, the long term trend of the stock market is upward, with normal setbacks and declines along the way. As shown in Chart 6, from the bottom of the market on March 9, 2009 through year-end 2011, the S&P 500 has increased 91%, while the Russell 2000 has grown a whopping 123%! And over this roughly three-year period we have experienced three fairly typical peak-to-trough declines and are currently in the midst of our third rebound.



So to sum things up:

1. In 2009, the normal market dip occurred in the **first quarter** of the calendar year.
2. Over the next thirteen months, the equity markets exploded upwards as seen in Chart 1.
3. In 2010, the normal market dip occurred in the **second quarter** of the calendar year as seen in Chart 2.
4. Over the next twelve months, stocks rebounded to multi-year and all-time highs as seen in Chart 3.
5. In 2011, the normal market dip occurred in the **third quarter** of the calendar year as seen in Chart 4.
6. Finally, the last three-plus months, stocks have recovered significantly as seen in Chart 5.

Overall, the last three years have been tremendous for the stock market. What's odd is...many investors still have no real appreciation for the size and scope of the rebound. And since the calendar year finished flat and slightly down, many investors interpret that as a move backwards. If you can move away from the constraint of a calendar year, and look over a longer time frame, it pretty obvious that the stock market is behaving just as you expect it to over the last three years. The long term trend is upwards, with some normal dips. The difference this year, was the dip just happened to occur later in the year. We believe those who remain patient and focus on corporate cash flows will be adequately rewarded over the next one, three and five years. The last three plus months would indicate we are already well on our way.

**THE NUMBERS**

The stock market recovery from the lows in March 2009 has been quick and powerful, but not without some bumps along the way. This is normal market behavior and so far the recovery has played out very much like we expected it would. The first quarter of 2011 started with a bang. The second quarter was a bit more volatile, but virtually unchanged. The third quarter saw a selloff that left the S&P 500 and Russell 2000 indexes down 10.0% and 17.8% on the year respectively. However, as promised we experienced a nice rebound in the fourth quarter. For the year, the S&P 500 recouped all of the third quarter losses and finished virtually flat for the year. The Russell 2000 rallied even more, but still finishing the year down 5.45%. In other words, large cap stocks essentially finished the year where they began, and small caps - which had outpaced large caps in eight of the past ten years - finished the year with a furious 15% fourth quarter rally, but still wound up a little short on the year.

So while the calendar year shows a loss overall, we think that's a little misleading based on where we are in the recovery. Going back to the lows experienced in March 2009, the S&P 500 the past year fully 86% above its low point, while the Russell 2000 was up more than 116%. Hopefully this provides some perspective, particularly for those prone to becoming entangled in the crisis of the moment. As we've said from the outset of the mortgage market collapse in late 2008, recoveries from credit-driven recessions are generally long and slow, with numerous setbacks and bumps in the road. That's why periods like the first quarter of 2009; the second quarter of 2010; and the third quarter of 2011 should NOT come as a surprise to anyone. In fact, the only surprise for us during the current recovery has been the incredible resiliency and profitability of corporate America in what we knew would be a challenging period. However, U.S. corporations have not only met the challenge, they've thrived—even though their stock prices still fail to fully reflect this fact in 2011.

The Style Index Numbers

Looking back over the previous year, we observe positive returns ONLY among the large cap style boxes, making this just the second time in ten years where large caps have outperformed small and mid cap stocks. As a result, our allocation to small and mid caps hurt us this year. However, as long term investors we're willing to accept an off year once in a while, as long as the longer term performance trends remains in place.

**1-Year Russell Style Index Performance
Year Ended 12/31/2011**

Value	Blend	Growth	
0.39%	1.50%	2.64%	Large
-1.38%	-1.55%	-1.65%	Mid
-5.50%	-4.18%	-2.91%	Small

Looking at the fourth quarter numbers it's clear that small and mid caps finished the year strong. In fact, small and mid cap stocks beat their large cap peers across the board during the quarter and that trend has continued (thus far) into early 2012.

**Russell Style Index Performance
4th Quarter, 2011**

Value	Blend	Growth	
13.11%	11.84%	10.61%	Large
13.37%	12.31%	11.24%	Mid
15.97%	15.47%	14.99%	Small

Looking back over the previous three years, the return pattern remains typical of an economic recovery, with small and mid cap stocks outperforming their large cap counterparts by a decent margin.



3-Year Annualized Russell Style Index Performance ending 12/31/2011

Value	Blend	Growth	
12.93%	17.11%	21.46%	Large
21.70%	24.51%	27.28%	Mid
13.96%	18.20%	22.84%	Small

Since the lows reached on March 9, 2009, the pattern of performance is also typical of an economic recovery, with small and mid cap stocks outperforming large caps fairly substantial margins. In fact, the average TOTAL return across the six small and mid cap style boxes since the 2009 market low is 127%. This compares favorably to the 97% average TOTAL return across the three large cap style boxes, giving a 30% performance advantage to small and mid caps versus large caps over the period.

Note in the following table, we are looking at TOTAL returns. In all other tables, we are looking at Average Annual Returns.

Post-Crash Recovery for Russell Style Indexes 03/09/2009-12/31/2011

Value	Blend	Growth	
101%	100%	91%	Large
137%	129%	123%	Mid
121%	124%	127%	Small

As we've frequently discussed, the academic literature has long documented a significant size premium, where smaller stocks tend to outperform larger stocks over long periods of time. This pattern isn't new and has been found to exist in every country and over virtually every era ever studied. Looking at the 10-year style index numbers one can

see the size premium quite clearly, although stocks across all styles performed below their longer term averages over the decade. This underperformance is largely because the time period encompasses the latter part of the collapse of tech stocks and two recessions, with the second recession being the largest since WWII. Going forward, we believe stability will return to both the economy and the financial markets and that long term investors will be rewarded with substantially higher returns...just as they have been over the last three years.

10-Yr. Annualized Russell Style Index Performance ending 12/31/2011

Value	Blend	Growth	
4.65%	3.90%	2.92%	Large
10.94%	9.66%	6.74%	Mid
8.60%	7.28%	5.50%	Small

Bonds

Even though we believe stocks will continue to outperform bonds for the foreseeable future, bonds should still play a role in almost everyone's portfolio. If you stay abreast of the financial news, it will come as no surprise that most analysts and economists expect bond investing to become both riskier and less lucrative over the next several years, and we've been echoing these sentiments for over a year now. At the same time, we continue to tweak our fixed income funds and strategies in light of both the evolving bond market and our belief that the likelihood of generating above average returns in "conventional" bonds over the next several years is essentially zero.

Investors need to accept the fact that the days of 9% or 10% annual returns in a bond portfolio are gone, at least for the foreseeable future. As the economy continues to recover, interest rates will invariably rise, and rising interest rates will drive bond prices lower. Perhaps more importantly, investors need to recognize the considerable risks inherent in some of the more aggressive bond strategies to avoid potentially catastrophic damage to their portfolios when rates do begin to rise.

(Continued on Page 8)



Given the current environment we believe it is critical for fixed income (i.e. bond) investors to focus first and foremost on wealth preservation. Wealth accumulation is very nice, of course, but in today's environment reaching for a tiny bit of extra yield in your bond portfolio can magnify your risk geometrically. That's why it's critical to use managers who fully understand the risk/reward dynamics we face today and who will manage their portfolios accordingly. We're confident that these are precisely the kinds of managers we've got in place.

Diversity and Flexibility are Our Friends

In addition to using skilled fund managers, it's also important to construct a bond portfolio that is as well-diversified as possible. We find it interesting that many investors tend to neglect diversifying their bond holdings, even though diversification in bonds is every bit as important to overall risk reduction as diversification in stock your stock portfolio. This means it's important to seek out bond funds that vary as widely as possible in terms of their holdings, yet still maintain the safety and security of principal as discussed above.

Finally, each of our clients has a unique set of needs with respect to the fixed income portions of their portfolios, so individual investment objectives are also factored in when building bond portfolios. For example, one client's objectives may dictate a very conservative approach, while for another it may be appropriate to accept some increased volatility in expectation of generating higher long-run returns. In other words, the fixed income portfolios of each KWAG client are based on their personal investment needs, objectives, and risk tolerances – and no two clients are identical in this regard.

Overall

Since the chances of generating above average returns in conventional bonds over the next several years are very small, and we believe it is important to remain conservative on the fixed income side of our portfolio, while also adding flexibility to our menu of options. We believe we have an excellent mix of managers who have demonstrated the ability to create positive returns even in very difficult interest rate environments. However, we don't believe it's wise to be overly aggressive on the fixed income side and our managers feel the same way. Once interest rates have risen and stabilized we'll obviously reassess, but for now we believe the risks of chasing yield in the bond market far outweigh any potential rewards.

Q & A WITH DR'S JOE & SCOTT

As lifelong educators, our favorite part of this job is fielding questions and providing clear, concise answers to those questions. Last year, the questions ran the gamut, from the federal budget deficit, monetary policies, inflation, and consumer confidence, to gold and the European debt situation. We've covered many of these questions before, but they continue to crop up in our email inboxes and in conversations with clients, so we thought we should address a few of them again. As always, if you have any additional comments or follow up questions, please feel free to call or contact us at any time.

Q1: Dear Dr. Kiely, It looks like the economy is finally turning the corner. Do you think we've finally hit escape velocity where the economy will expand at a rapid rate? J.W.

Joe: Dear J.W. The simple answer is...No, I do not think we've hit escape velocity and I don't think we'll get there for some time. That said, the unemployment picture is getting much better. Over the second half of the year, the US job market strengthened and added 212,000 jobs in December, almost all of which came from the private sector. The private sector has now added at least 100,000 jobs each month over the last half of the year. In a separate survey - which includes farm workers and the self-employed – they found an average of 321,000 jobs per month were created since July. The unemployment rate is now at its lowest point in three years at 8.5%. In addition, for the first time in three years, the majority employers say they will be looking to hire in the coming year.

Even with this good news, however, far too many Americans remain out of work and the nation is still about 6 million jobs below the peak pre-2008 employment level. However, the recent gains are nothing to sneeze at, given all the obstacles that were hurled at the economy this year. Remember, just a few months ago, many economists were predicting a double-dip recession. In the meantime, as long as our economy grows more than 2% annually, there will be very little negative impact on stocks.

Scott: I agree. There are clearly lots of positives, like low inflation, near zero interest rates, robust holiday sales numbers, a significant reduction in consumer debt, and a



surprisingly robust domestic manufacturing sector. The economy is undoubtedly headed in the right direction, but it's like an extremely long freight train in that it will take quite some time to get back up to normal operating speed. The weight from the overhanging housing crisis and the recession in Europe (they're in a recession whether they recognize it or not) is going to continue to act as a drag on the economy, but I like the economic momentum we've seen building recently. It's been very encouraging. But as we have been saying since the outset of the sub-prime mortgage meltdown, this recovery will be long and slow, because it simply takes time to work through debt problems. It took us a number of years to get into this mess and it will take a number of years to get back out of it. But we're moving in the right direction and the economic indicators have been strengthening each month, so I'm very pleased with the state of the recovery so far.

Q2: There has been much written about the role of the Federal Reserve regarding this recent recovery. Are you guys still high on the Federal Reserve and Ben Bernanke? R.S.

Joe: We are. I think we view the Fed differently than many politicians and newscasters because of our background in financial economics. We can clearly see the huge difference the Fed has made with QE1, QE2 and more recently Operation Twist. By keeping interest rates low, the Fed has provided a huge boost to our economy in a number of ways. In addition, the Fed made \$78.9 billion (yes, BILLION) in profits last year...\$76.9 billion of which they gave back to the Treasury. This comes on top of 2010 when they made \$81.7 billion, and deposited \$79.3 billion with the Treasury. Do you think our politicians and newscaster noticed this positive contribution??

Scott: I doubt it. Our politicians struggle to cut \$1 billion from the budget, while the Fed pumps roughly \$160 billion into the Treasury over two years. Is it any wonder so many politicians don't seem to like the Fed? It is too bad most people don't recognize how critical Fed independence from Washington is. We've all seen the mess politicians have made of fiscal policy...do we want them controlling our monetary policy too? One of my greatest fears is that the Fed will one day lose its independence.

Q3: Dear Dr. Joe, I hate to be a pessimist, but it seems like everything is going to "heck in a hand basket". Everywhere I turn to get news, it seems like the economy, the stock market and the world

in general is getting worse. I need a dose of your optimism. L.M.

Scott: As we've covered in the newsletter to this point, the economy has been growing for several years now and virtually every economic indicator we look at has been steadily improving. The improvement isn't as fast as many would like, but we knew that would be the case because this isn't a "normal" recession we're recovering from. I'm actually as optimistic about stocks over the next 3-5 years as I've been in a long time. There will continue to be rallies and pullbacks, just as we've seen recently, so stock investors will need to continue to keep their emotions in check and maintain their long-run focus, but we're building momentum in the global economy and I think stock valuations are extremely attractive at this point. And remember, I'm generally the skeptical one.

Joe: Okay, if it's good news you want, how about a few of these gems...

•**The world is getting more peaceful.** Though it might not seem so, with the conflicts in Iraq and Afghanistan grabbing so many headlines, the past decade has seen a remarkable drop in the number of war casualties around the world. According to data compiled by the Peace Research Institute Oslo, 55,000 people a year have been dying in war since the dawn of the new millennium. That's a little more than half of the rate during the 1990s, a third of the rate during the Cold War and one hundredth the rate during World War II. That's some improvement!!

•**The troops are coming home.** Whatever one might think of the decision to invade Iraq in 2003, it's nice to see U.S. service members coming home. At the war's peak, about 160,000 were posted in Iraq. Though it might be hard to have a rosy outlook on Iraq's future, given this week's political turmoil and bombings in Baghdad, a U.S. presence couldn't go on indefinitely. This year, thousands of troops will celebrate the holidays with their families after fulfilling their missions admirably and honorably. They deserve it. Of course, we also caught and disposed of Bin Laden.

•**America is importing less oil.** Net oil imports have dropped from more than 12 million barrels per day in 2005 to 8.8 million today, according the Energy Department. The trend is driven mainly by more efficient cars and the newfound ability to extract oil from tight rock formations here at home. This makes the United States less dependent on imports from unstable or unfriendly nations. More of the nation's oil imports are coming from our friends in



Canada and Mexico. Who would have thought this would happen? For years, rising oil imports were thought of as a constant, like death and taxes.

•**Traffic fatalities are falling.** The latest number from the Department of Transportation is that 32,788 people died last year in traffic accidents - still too many, but part of a multiyear downward trend. Measured against miles traveled (1.1 deaths per 100 million miles), it is the lowest level ever recorded. No one knows exactly which factors are most important in the drop. But safer cars, with airbags and rollover protections, combined with improved driver awareness about the dangers of driving while intoxicated or without buckling up, are main factors. Just don't text this news while you're out driving!

•**Crime is still dropping.** Violent crime fell 6.4% during the first six months of this year, according to the latest FBI report, defying hard economic times and continuing a trend dating to the 1990s. Criminologists aren't sure how to explain this downward trend. Most theories involve some combination of demographic changes, higher incarceration rates and better police work. In the end, the reasons are less important than the fact that crime continues to fall. These FBI reports have begun to sound like a broken record - while also being music to our ears.

The New Year will, of course, bring challenges, scandals and setbacks. But the New Year will also bring more good news, large and small. In 2012, people we don't even know yet, will do amazing things that will change our lives. Science will advance; Enterprise will flourish; And mankind will move forward in a positive way...regardless of what you read or hear to the contrary.

Q4: Why are companies sitting on so much cash? Is it politically motivated? R.B.

Joe: Big corporations are sitting on cash because it's cheaper to use other people's money. While the average American has reduced his debt and mortgage obligations, corporate America has been borrowing at a very nice clip. This way they can grow their business...and have cash available...just in case something unforeseen happens. The cost of borrowing capital is as low as it has ever been, so companies are taking advantage of it. Companies could care less what's happens in Washington. They are growing, using their existing technology and now hiring. And will continue to do so...for some time...

Scott: A lot of the cash buildup we saw was the result of caution on the part of corporate management. In the 2001 recession many companies got caught short of cash and were forced to borrow at some pretty unattractive

interest rates in order to support operations. But they clearly learned their lesson, and this time around raised large amounts of cash at the first sign of trouble. As things continue to improve, more investment opportunities will arise and we'll see more and more of that cash be put back to work. We're seeing that already, actually.

Q5: Dear Dr. Joe: Where do you think we are in the business cycle? And if we are in an expansion why hasn't this shown up in stock prices? P.A.

Joe: I believe we're on the expansion side of the business cycle. And I base that belief on three things. First, it's hard to argue against an expansion when you look at the profits and cash flows being reported by U.S. companies. Second, the economic data clearly supports this notion on a number of fronts. Finally, when you examine the increase in hiring; insider buying; merger and acquisition activity; and economic forecasts, it all points to an expansion. It may be tepid compared to past expansions, but it's an expansion nonetheless.

Scott: In normal times, stock prices are based on expectations of future cash flows and stocks therefore trade at or near their intrinsic values. However, in non-normal times, emotions like fear and greed can cause investors to lose sight of the underlying fundamentals of the companies they own and this can cause prices to deviate substantially from intrinsic values, and that's the situation we face today. Corporate cash flows are strong and expected to continue to grow, but current stock prices are well below where they should be based on those expectations.

A lot of this underpricing is due to the residual fear and panic many investors still feel following the market collapse of 2008 and early 2009. Emotions are powerful things and it's going to take time for investors to fully recover from the psychological trauma inflicted by the huge decline in the stock market between late 2008 and early 2009. It's normal for people to remain scared, and we get that. But we also know that as things improve the fear will eventually subside and stocks prices will return to where they should be based on the fundamentals. I think residual fear is the primary reason why stocks look so cheap right now. So for patient, long-term oriented investors, this is a good time to be in stocks because the upside is tremendous.

Q6: Last week, I was reading an article in the WSJ (11-26-11) and it discussed this new investment concept known as "factor Investing?" In a nutshell, the article said "factor investing" originated in



academia two decades ago and was now finding favor among institutional investors and high end financial advisors. When I read further, I thought I was reading one of your newsletters. I've been with your firm since the 1990's and I was shocked that this strategy was just starting to be used!! S.R.

Joe: We're just as shocked. In the past, traditional investors purchased large cap stocks, some international stocks, corporate bonds, municipal bonds and a money market account. This was considered diversification...and it still is in many brokerage firms. Factor investing replaces this traditional train of thought by looking at different "risk factors" like size (large versus small), style (value versus growth) and other esoteric factors like fear and greed.

Scott: We've known for a long time that there are certain factors that seem to drive returns more than others. For example, earlier in the newsletter we talked about the "size premium" which is the name researchers have given to the tendency for smaller stocks to outperform larger stocks over time. There are other factors we use as well, like the "value premium", which refers to the tendency for value stocks to outperform growth stocks over time. There is also a momentum factor that's pretty well documented, where things that get "hot" tend to stay hot for a while before their prices finally reverse. Our underlying investment philosophy takes all of these factors into account, which is why we tend to have much more exposure to value stocks and small and mid caps than other investment advisors. It's also why we regularly rebalance, because we know things that were hot last year probably won't be hot again next year, so it makes sense to sell some of whatever's become overweighted in your portfolio and replace it with what's probably undervalued and waiting to get hot.

In essence, the academic studies cited in the WSJ documenting size, value, and momentum factors have been the core of this company for almost 20 years! Studies that we personally did long ago proved that equally weighting across style indexes and then rebalancing when something becomes overweighted tends to perform better in terms of both risk (lower) and return (higher) than other strategies, because we're using the various risk factors to our advantage.

Joe: We have actually taken that train of thought into the bond arena as well, creating higher than average returns. First, we embraced discounted bonds. Then we embrace convertible bonds. Now we're embracing a new way to purchase mortgage bonds. By purchasing these bonds at a discount, we feel like we have reduced our risk exposure

– and – at the same time increased our return potential by embracing both an interest payment and a capital gain component.

Scott: Maybe other advisors will catch on 20 years from now...

Q7: George Soros told an audience in Bangalore, India today, "The crisis in Europe is more serious than the crash of 2008." He believes the world faces the possibility of a "vicious circle" of deflation. And how is Soros protecting himself? By buying gold. According to SEC filings, Soros Fund Management sold almost all its shares in SPDR Gold Trust (GLD) and iShares Gold Trust (IAU) in the first quarter of 2011. His timing was solid, as gold dropped from its highs and the dollar rallied. But Soros started buying again in late 2011, according to financial news site Emerging Money. Soros seems to be anticipating that a spasm of global deflation will send the central bankers running for the printing press...sending more money to "solve" the problem. So perhaps he's betting on another round of quantitative easing. If Europe implodes and the "vicious circle" of deflation becomes a reality, are we protected? As always, preservation of capital is paramount. B.B.

Joe: Soros is a notorious short term trader, who is wrong on his trades as often as he is right. We are NOT short term traders - we are long term investors. Investors who like to buy companies when they are reporting record earnings and priced at levels that scream "buy". Most people believe Gold is in a bubble. If the Fed does engage in another round of Quantitative Easing, - which is 50-50 right now - many people believe gold will get one most boost and then Pop!!! Everyone knows gold will eventually come back to earth - including Soros – so it's NOT a matter "if" but "when."

Scott: Call me skeptical, but Soros owns a ton of gold and the price since November when he started buying it again went from \$1,800 an ounce down to \$1,540 by the end of December. What do you think he's going to say?

In terms of preservation of capital, gold is actually one of the most volatile assets you can own, far riskier than either stocks or bonds. In addition, since 1980 gold has an annual average return of just 3.6%, and this takes into account the recent huge run-up we've seen in gold prices. Over the same period you would have averaged 5.6% annually in T-bills and 10.7% annually in the S&P 500, and with far less volatility than owning gold.



A FINAL NOTE

Thank You

As usual, if you have any questions about this update, our newsletter, your accounts or our managers, please feel free to call or e-mail us at anytime. The recent referrals are much appreciated and we thank you for your continued confidence in our firm and our services. As we go forward, we remain committed to continuing to refine and improve our proactive strategies and portfolios. As always, our goal is to provide each of our clients with the best possible mix of assets given their particular situation. If you need anything or your goals or time horizons have changed, please do not hesitate to call or drop an e-mail to set up an appointment. We are here to serve your financial needs, whatever they may be.

We wish you and your family a happy and healthy New Year!

~ Joe and The Gang at KWAG



KWAG Actively Managed Funds & Benchmarks Past Recommendations, 2011

Funds and Benchmarks	Ticker Symbol	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	YTD	1-Year Avg	5-Year Avg	10-Year Avg
Large Value - A*									
Excelsior Funds Value	UMBIX	5.12%	-2.36%	-23.44%	13.52%	-10.79%	-10.79%	-1.76%	4.57%
Coventry Group	FMIEX	6.24%	-2.11%	-17.23%	11.62%	-3.92%	-3.92%	0.54%	6.22%
Morningstar Category Avg.		6.04%	-0.36%	-16.16%	11.97%	-0.75%	-0.75%	-2.00%	3.22%
Large Growth - B*									
Growth Fund America	GFAFX	5.29%	-0.66%	-16.19%	8.56%	-4.83%	-4.83%	-0.56%	3.63%
Morningstar Category Avg.		5.55%	0.10%	-15.63%	9.30%	-2.46%	-2.46%	0.79%	2.29%
Mid-Cap Value - C*									
Artisan Mid-Value	ARTOX	10.26%	0.09%	-14.80%	13.19%	6.42%	6.42%	4.53%	10.57%
Morningstar Category Avg.		7.05%	-0.79%	-19.59%	12.83%	-3.96%	-3.96%	-0.20%	5.91%
Small Value - D*									
Vanguard Small Cap	VISVX	6.88%	-1.87%	-20.67%	15.18%	-4.16%	-4.16%	-0.31%	6.12%
Morningstar Category Avg.		6.90%	-2.16%	-20.98%	15.86%	-4.45%	-4.45%	-0.20%	7.10%
Small Blend - E*									
RS Partners Fund	RSPFX	6.56%	-2.35%	-20.97%	12.38%	-7.59%	-7.59%	0.06%	10.68%
Morningstar Category Avg.		7.92%	-1.52%	-21.77%	15.25%	-4.07%	-4.07%	0.16%	5.96%
Small Growth - F*									
Advisors Inner Circle	CIPSX	8.57%	0.32%	-16.05%	13.54%	3.88%	3.88%	6.13%	-
Morningstar Category Avg.		9.22%	0.12%	-22.32%	13.56%	-3.55%	-3.55%	1.30%	4.38%
Global Funds									
Capital World Growth & Income	CWGFY	3.63%	1.66%	-17.87%	6.84%	-7.56%	-7.56%	-0.95%	7.48%
Dodge & Cox International	DODFX	2.52%	0.46%	-21.72%	4.23%	-15.97%	-15.97%	-3.45%	7.99%
Sogen Funds International	SGENX	3.36%	1.77%	-9.94%	5.36%	-0.19%	-0.19%	4.59%	12.02%
MS-World Stock		4.18%	0.39%	-17.70%	6.71%	-7.93%	-7.93%	-1.94%	4.29%
Long Term Bond Funds									
PIMCO Unconstrained Bond	PFIUX	1.14%	-0.07%	-1.06%	0.65%	0.64%	0.64%	-	-
BarCap Aggregate		0.42%	2.29%	3.82%	1.12%	7.84%	7.84%	6.50%	5.78%
Loomis Sayles Strategic	NEFZX	3.63%	3.04%	-6.38%	3.39%	3.35%	3.35%	6.14%	10.64%
MS-MultiSector Bond		2.18%	1.11%	-3.27%	3.09%	3.37%	3.37%	5.48%	7.30%
Loomis Sayles Global Bond	LSGLX	2.02%	3.30%	-3.46%	1.74%	3.50%	3.50%	6.07%	8.21%
MS-World Bond		1.31%	2.38%	-1.19%	0.66%	3.39%	3.39%	5.96%	6.64%
Convertible Bond Funds									
Calamos Convertible	CCVIX	5.25%	-1.84%	-10.36%	3.69%	-3.98%	-3.98%	3.03%	5.27%
MS - Convertible Bond		5.44%	-1.33%	-13.17%	4.89%	-5.62%	-5.62%	1.85%	4.89%

Mutual Fund Styles*

	VALUE	BLEND	GROWTH
LARGE	A		B
MEDIUM	C		
SMALL	D	E	F

**It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list. These numbers are compiled from proprietary websites (Morningstar.com, Standard&Poor.com and Russell.com) and are not guaranteed to be totally accurate. If you see a discrepancy, please notify us immediately.*

*Indicates benchmarks for each market sector
Data Source: Morningstar & Wall Street Journal, 12/31/11*

** Indicates Mutual Fund class in style box below*

¹ Formerly 1st Source Monogram Income



THE GANG AT KIELY WEALTH ADVISORY GROUP



Left to Right: Brownie Cordell; Katie Burr; Joe Kiely; Kellie Kiely; and Scott Below

***IMPORTANT DISCLOSURE INFORMATION**

Performance results represent results reported by each reflected mutual fund during the corresponding time period. Kiely Wealth Advisory Group, Inc. ("KWAG") currently utilizes these mutual funds in managing actual client portfolios. However, the individual mutual fund performance results **do not** reflect the results of any specific KWAG client portfolio or any KWAG composite.

Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, or equal either the performance results reflected or any corresponding historical index. The historical index performance results are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of a specific investment meets, or continues to meet, investment objective(s). It **should not** be assumed that any account holdings will correspond directly to any comparative index. The performance results do not reflect the impact of taxes.

Please Note: the individual depicted mutual fund results **do not** reflect the results of any specific KWAG client portfolio or any KWAG composite. **For reasons including** variances in portfolio account holdings, market fluctuation, and any account contributions or withdrawals, the performance of a specific client's account may have varied substantially from the indicated reported mutual fund results. In addition, the above results only reflect the results as reported by each respective mutual fund company. Portfolios managed by KWAG would also incur a KWAG advisory fee, the deduction of which would result in decreasing the reported performance results. **For example:** a KWAG advisory fee of 1% compounded over a 10 year period would reduce a 10% return to an 8.9% annual return).

Please Remember: In the event that there has been a change in a client's investment objectives or financial situation, he/she/it is encouraged to advise KWAG immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investments purchased and/or investment strategies devised or undertaken by KWAG) will be either suitable or profitable for a client's or prospective client's portfolio. **In addition,** the mutual funds depicted are funds that KWAG may utilize and/or recommend as of specific date, and are subject to change without notice. **Accordingly,** no client or prospective client should assume that the above reflected mutual funds serve as the receipt of, or a substitute for, personalized advice from KWAG, or from any other investment professional. **Information** pertaining to each depicted mutual fund is set forth in each respective fund's prospectus, a copy of which is available directly from each mutual fund company or from KWAG upon request.

All performance results reflect the performance results reported by each respective mutual fund to Morningstar, and have not been independently verified by KWAG. KWAG also maintains all information supporting the reflected mutual fund performance results.

Information pertaining to KWAG' advisory operations, services, and fees is set forth in KWAG' current disclosure statement, a copy of which is available from KWAG upon request.

KIELY WEALTH ADVISORY GROUP, INC.

Office Locations

OUR HEADQUARTERS LOCATION:

1290 East Arlington Blvd, Suite 102
Greenville, NC 27858
Phone: 252-439-1888
Fax: 252-439-1348

Oak Ridge Location

4405 Stafford Glen Court
Oak Ridge, NC 27310
Phone: 336-298-4316
Fax: 252-439-1348

Asheville Location

4 Highland Place
Asheville, NC 28804
Phone: 828-350-8681
Fax: 828-251-1806

Sunset Beach Location

8839 Carenden Court
Sunset Beach, NC 28468
Phone: 910-579-8075
Fax: 910-579-8075

Outer Banks Location

25736 NC Hwy 12
Waves, NC 27968
Phone: 252-916-4467
Fax: 252-439-1348
