

## **KWAG June E-mail Update**

Good afternoon. We hope this update finds everyone enjoying the beautiful (but hot) weather this spring. To say that May was a volatile month for the stock market might be an understatement. However, we hope neither the volatility, nor the slight market correction were unexpected, as we've been discussing the possibilities of both since the beginning of the year in our monthly updates. As you all know, a 10%-15% dip at some point in the year is quite normal, and frankly welcome to those of us who like buying new companies on sale. For comparison purposes, last year, the S&P500 was down 1.5% through 5-31-10. This year the S&P500 was up over 5% through 5-31-11.

### **An Honest Assessment**

Sensationalistic news headlines notwithstanding, if you objectively examine the direction of the world economy and the overall health of publically traded companies, it is clear that we're headed in the right direction. The domestic economy is by no means perfect but jobs are being created; productivity is increasing; banks have increased lending activity; and corporate profits are continuing to surprise on the upside. In addition, companies are currently holding huge cash reserves which, when combined with increasing profit margins, makes it hard to argue that stocks are overpriced. In fact, based on the world demographics we laid out in our April 2011 Newsletter, one could make a pretty compelling argument that stocks have lots of room to grow over the next five and ten years. So then why does everything still seem so gloomy?

### **If it Bleeds...It Leads?**

Everything seems gloomy, because our politicians are starting to gear up for the 2012 election. And the most effective way to get your message out to the public, is to differentiate yourself (and your idea's) from the current regime. Thus, over the past few month's we've seen the financial news dominated by three core issues: Our deficit, the debt ceiling and unemployment. These make for tantalizing

headlines, but they really have nothing to do with a well-diversified long term global portfolio that is being driven by global (versus domestic) growth. Remember, we're buying well run American companies - we are NOT investing in our political system. If you can't reconcile those two items, and you place too much emphasis on the daily news, you'll worry too much about your portfolio.

### **Looking Back**

Last year (in June), we wrote about the Greek deficits, a crumbling Euro and an unprecedented oil spill in the Gulf of Mexico, that were dominating the airwaves. At that time (May, 2010), the market had experienced a normal pause (or dip) and was actually down for the year. People were clearly concerned about the potential fallout in the U.S. given Europe's fiscal problems. We noted, that it seemed unfathomable that the economic powers in the Euro Zone would allow Greece to drag their economies down with them. And, we pointed out that less than 3% of our \$13 trillion economy had direct exposure to the European export market. Hence, it seemed unlikely that the European debt crisis would have much of a direct long term impact on the U.S. economy. Since that time, both large and small cap stocks have rallied and are up more than 20%. Of course, we also felt Europe's budgetary woes would provide a much needed wake up call to our politicians, serving as a possible silver lining to what seem like black clouds hanging over our economy...

### **A Silver Lining?**

Don't forget that normal volatility (and market dips) provide necessary buying opportunities for our managers. Whenever I speak, one of the first things I note, is "my love of short-term volatility." Why? Simply, put, short term "herd behavior" helps those of us who are long term investors. This is often echoed by our managers who often make the case that short term dips are normal speed bumps on the road to our recovery. While many investors get caught up in the current short term news cycle, our managers are always looking for *"those companies who we believe will be the beneficiaries of a potentially better world*

*economy three years from now. As always, we do so with a preference for solid balance sheets and a history of above average returns, while staying mindful of risk.*” Don’t forget, good well run global companies are going to excel, regardless of whether (or not) our domestic debt ratios increase, decrease or stay the same. And, they will excel even if our unemployment rate never changes. Spain’s unemployment rate is 20.7%. If you don’t think their unemployment rate affects how our companies run their business’ - then it shouldn’t take much of a stretch to recognize our unemployment rate won’t either. Remember, we’re investing in global firms that depend on global growth.

### **What Worries us at KWAG?**

Our biggest concern right now is not the economy, but fear. Fear-induced panic selling can often lead to more fear-induced panic selling and pretty soon we're off to the races...straight down. We've seen this happen before, of course, as recently as last February and March (2009). The tightness in the gut from that experience still lingers for many investors. Fundamentally, the economy is fine right now and even ahead of most expectations. But fundamentals don't mean much when investors are scared spit-less. We’re not worried about our portfolios because our allocations are conservative and our managers are terrific. What we do worry about is the long-run impact of market panics on the psyche of investors in general, and on our clients in particular. We also worry about how much more volatility investors can take before they throw up their hands in surrender. We’re not personally concerned about market panics because we know they’re irrational, temporary and provide great opportunities to buy on the cheap. But we worry that many investors, and even some of our own clients, will not be able to maintain a rational perspective should irrationality return.

### **The Long Run**

In today’s world we understand how hard it is to get good rational information on the global economy and our financial markets. We realize there are many things that can sometimes make it difficult to see beyond the short run. We get it. We

also know there are problems out there in our economy and we understand how concerned people are. We talk to our clients every day, so we understand all of your concerns. However, we seriously believe our best days are ahead of us. And we know the best way to capitalize on those days is to invest in the stock market over the long run. Our biggest hurdle as advisors isn't the investing process, although we work hard on that too. Our biggest hurdle as advisors is educating our clients about what we do, why we do it that way, and helping them keep their emotions in check. That's why we write these updates, because the biggest risk for investors—bar none—is allowing their emotions to dictate their actions.

### **Please stay in touch**

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 anytime. Enjoy the wonderful spring weather...and thank you for your continued confidence in our firm. The recent referrals are much appreciated and as you know, we remain 100% committed towards your financial well being at all times.

### **Joe and The Gang at KWAG**

#### **KIELY GROUP ADVISORS & OFFICES**

##### **Asheville, NC**

Joe Kiely, PhD

[jkiely@thekielygroup.com](mailto:jkiely@thekielygroup.com)

828-350-8681

##### **Sunset Beach, NC**

Brownie Cordell, RIS

[bcordell@thekielygroup.com](mailto:bcordell@thekielygroup.com)

910-579-8075

##### **Greenville, NC**

Scott Below, PhD

[sbelow@thekielygroup.com](mailto:sbelow@thekielygroup.com)

877-366-5623

**Katie Burr**

Kiely Wealth Advisory Group, Inc.  
Operations & Client Services Director  
Chief Compliance Officer  
4405 Stafford Glen Court  
Oak Ridge, NC 27310  
336.298.4316

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