

KWAG November E-mail Update

Good Morning. Our updates and newsletters generally focus on items and issues that affect our core portfolios over time. One of our common themes recently, has been the "disconnect" between investor perceptions and economic realities. For example, in today's world we believe the primary driver of stocks is the global economy, as opposed to our fairly anemic domestic economy. But while we have been writing about this for quite some time, it appears investors in general are only now beginning to get the message and, for the first time in several years, are beginning to cautiously tiptoe back into the stock markets. The impact of this is clearly evidenced in the fresh year-to-date stock market highs we've seen recently.

Our Markets are Resilient...Very Resilient

Frankly, the strength of the stock market this year has caught many by surprise. After all, the Euro zone is still in crisis mode; China is tightening its money supply to combat inflation; and there is no shortage of criticism (much of it politically motivated) directed at the U.S. Federal Reserve over monetary policy. Yet the stock market fell only modestly from its highs in November and began December by setting a fresh round of new yearly highs. The end result is that many have been left wondering why equities are proving so resilient in spite of all this bad news. We believe there is another "disconnect" between the investor and pricing realities.

Another Disconnect...The pricing Mechanism

What many investors don't realize is that stock prices reflect both good AND bad news—and that any new news that hits the news wires is impounded into stock prices very quickly. You see, stock prices fluctuate intraday because they are adjusting to the news announcements that occur throughout the day. Thus, the crisis in Europe, the weak economy and many other uncertainties are already

reflected in today's stock prices and have been for a very long time. What causes prices to change, is when new information (good or bad) enters the market place. This is precisely why we have been so confident about the stock market over the past few years. When pessimism reigns, as it has since the mortgage market collapse of 2008, investors tend to expect the worst, they extrapolate bad news out into the future, and stock prices become overly biased downward. A glut of pessimism is not necessarily bad, however, because it can create tremendous opportunities for patient long-term investors. **Simply put:** If stock prices already reflect the worst case scenario or something close to it, downside risk is limited and any normal surprises on the upside will lead to significant gains. So even though the economic news is currently not very good, we believe it's a lot better than what today's stock prices reflect.

De Ja Vu all over again...

Investor overreaction to bad news has repeated itself for centuries, in virtually every economic downturn we've ever experienced. In fact, investor overreaction is one of the few areas in the academic literature where there is near total agreement. We all know emotions like fear and greed can drive financial markets to extremes over the short run—and we also know that these emotions have an uncanny way of making investors repeat the same mistakes over and over and over again. So as long as there is still significant fear in the air, stock prices will remain muted and it bodes well for stock investors going forward. At present, we think stocks are cheap for long term investors who can remain patient and we also believe we have rampant (and in some cases irrational) pessimism to thank for it.

How Cheap is the Market?

According to International Monetary Fund estimates, the global economy should grow 4.8% in 2010 and is forecast to grow another 4.2% in 2011. This is slower than the 5%-plus rates we saw just prior to the recession but well above the

global average since 1980 - and well above the current and near-term forecast growth rates of our domestic economy - around 1.5%. There is a lot of evidence that many investors are using the domestic economic growth rate to forecast future cash flows and stock prices. If the global economy drives our stock market, these estimates are incorrect and too low.

Stocks also look cheap relative to government bonds (remember our discussions on the bond bubble?) and high-quality corporate bonds. Large cap domestic stocks are expected to pay dividends in 2011 that equate to a yield of 3.2% based on current stock prices. Given bond yields of just 3.4% and the growing realization that the 20-year bull market run in bonds is finally at an end, a great deal of money appears poised to flow out of bonds and into stocks over the next few years. Again, this is bullish for stocks.

Finally, accommodative monetary policy in many countries risks creating inflation. Since stocks typically thrive during inflationary periods, while bonds falter, stocks should be favored by a wide margin should fears of widespread inflation come to pass.

Risks Still Remain

Of course, there are still risks that investors need to be cognizant of. First, firms have cut costs dramatically and this could impinge on their ability expand quickly enough post-recession. Second, U.S. profits as a share of GDP are close to their pre-crisis peak, according to UBS. Third, we still have a long way to go in terms of the restructuring of personal balance sheets, which will continue to inhibit consumption for some time. Fourth, the mortgage and housing markets both have a long way to go before they get back to anything we would even remotely recognize as “normal.” Finally, some believe policy makers are running short of ammunition to deal with fresh economic problems that may emerge.

However, given strong corporate balance sheets, healthy profits, continued global growth and a continuing pessimistic outlook by investors, it is hard for us to be pessimistic about the prospects for global stocks. At this point, the upside potential for stocks appears to outweigh the downside potential by a substantial margin.

In Closing

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 any time. 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.

Wishing you and yours a very Happy Holidays!

- **Joe & the Gang at KWAG**

KIELY GROUP ADVISORS & OFFICES

Asheville, NC

Joe Kiely, PhD

jkiely@thekielygroup.com

828-350-8681

Sunset Beach, NC

Brownie Cordell, RIS

bcordell@thekielygroup.com

910-579-8075

Greenville, NC
Scott Below, PhD
sbelow@thekielygroup.com
877-366-5623

This e-mail is confidential and may well be legally privileged. If you have received it in error, you are on notice of its status. Please notify us immediately by reply e-mail and then delete this message from your system. Please do not copy it or use it for any purposes, or disclose its contents to any other person. To do so could violate state and Federal privacy laws. Thank you for your cooperation. Please contact Kathryn Burr at 336-298-4316 or e-mail katie@thekielygroup.com if you need assistance.

Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable. Past performance may not be indicative of future results. Please remember to contact Kiely Wealth Advisory Group, Inc. if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services. Please also advise us if you would like to impose add. or modify any reasonable restrictions to our investment advisory services. A copy of our current written disclosure statement discussing our advisory services and fees continues to remain available for your review upon request.