Pettinga Insights and Outlook

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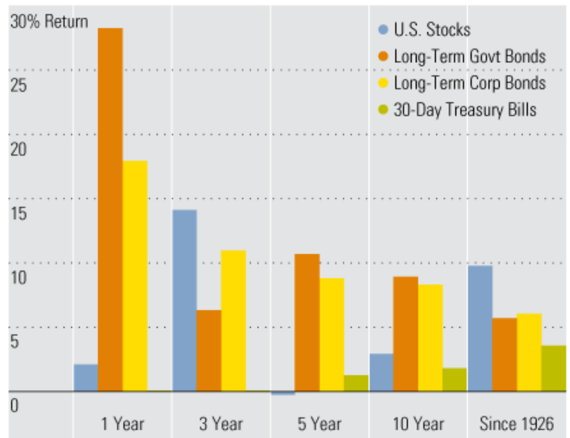
Recent Bond Performance Explained

For investors, it comes as a surprise that bonds have recently outperformed stocks. Investors often assume that stocks offer higher returns compared with bonds. Recent market conditions, however, have proved otherwise. The image shows that while stocks have outperformed other asset classes from a return perspective since 1926, they have struggled over the last 10 years. Don't be surprised at the higher bond returns in the past 1-, 5-, and 10-years. Besides the dot-com bubble and subprime mortgage crisis in the past decade, several unique events in 2011, such as the Arab Spring, U.S. credit downgrade and the sovereign debt crisis, led to a flight to safety into government bonds. Under these circumstances, investors are advised to stick with their long-term investing strategy and be aware that asset class characteristics may deviate in the short term based on current market conditions.

Unusual Stock and Bond Behavior 1926–2011



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. U.S. stocks are represented by the Standard and Poor's 90 index from 1926 through February 1957 and the S&P 500 index thereafter, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general, long-term government bonds by the 20-year U.S. government bond, long-term corporate bonds by the Ibbotson® Long-Term Corporate Bond Index, and 30-day Treasury bills by the 30-day U.S. Treasury bill. Government bonds and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than the other asset classes. With corporate bonds an investor is a creditor of the corporation and the bond is subject to default risk. Corporate bonds are not guaranteed. Returns are compound annual returns.

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Our Firm

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How Safe Is Your Cash?

Cash Alternatives.

- Rather than maintaining large positions in cash, we suggest clients consider a combination of high quality bond funds and ETFs. These positions can be established with relatively little risk, and significantly greater return potential. Further, these funds do not run the risk of "breaking the buck" as money market funds can.

Investors often ask the question, “Are money-market funds FDIC insured like certificates of deposit and savings accounts?” The short answer is no, money-market fund holders don't have the same guarantees that holders of CDs, money-market deposit accounts, and checking and savings accounts have. However, money-market fund investors were accorded extra protections when the financial crisis happened in 2008. At that time, a large money-market mutual fund, the Reserve Primary Fund, "broke the buck," meaning its holdings dropped in price, which in turn caused the fund's net asset value to drop lower than $1. That event created panic selling among some holders of money-market funds, prompting the Treasury Department to start a new program, similar to FDIC insurance, for money-market funds. Under the Treasury's program, investors who owned money-market funds before Sept. 19, 2008 (the date that the Treasury introduced the program) were guaranteed to be "made whole" if their funds' net asset values dropped below $1. The Treasury's program expired a year later, however, meaning that the Treasury, FDIC, or any other entity do not currently insure assets in money-market mutual funds.

That said, the fact that money-market funds aren't insured doesn't mean you should automatically eschew them. Yields on nearly all cash-like vehicles are low across the board right now, but at other points in time, money-market mutual funds might provide better yields than you'd obtain with other cash products. In addition, money-market funds also offer daily access to your money, which is not an option for CD holders. Finally, there's the convenience factor: If you frequently move money into your long-term investments from your cash accounts, holding a money -market fund with your investment provider can make these transfers seamless.

Since the introduction of the first money-market fund 40 years ago, there have been a very small number of funds that have broken the buck; all the rest have maintained stable net asset values. And following the financial crisis, the Securities and Exchange Commission, which regulates money-market funds, imposed more stringent standards, instituting new requirements for liquidity, credit quality, and maturity.

If you do opt for a money-market fund for your cash holdings, take a common-sense approach to ensure that you don't get stuck with an outlier. As with all investments, be on high alert if a money-market fund offers an appreciably higher yield than competing funds and does not have ultralow expenses; that can be a red flag that it's taking more risks than its peers.

It can also make sense to stick with money funds offered by very large providers with extensive operations outside of the money-market fund business. Thus, in a worst-case scenario in which a money-market fund's NAV falls below $1, the provider could contribute the cash to make investors "whole." Finally, if you have a lot of cash on the sidelines, it may be worthwhile to spread your positions among multiple providers for diversification purposes; you might also consider splitting your cash assets among accounts that offer FDIC protection as well as those that do not.

An investment in a money-market vehicle is not insured or guaranteed by the FDIC or any other government agency. The current yield quotation reflects the current earnings of the money market more closely than the total return quotation. Although money markets seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in them. Before investing in a money-market fund, you should carefully read all of the fund’s available information, including its prospectus and its most recent shareholder report.

Monthly Market Commentary

Avoid Market Timing Your Portfolio.

- The market has sold off since reaching a multi-year high in October. The selloff accelerated in November following the election because of investor fears that Republicans in the House would not reach an agreement with President Obama over the "fiscal cliff" matter. We urge our clients to maintain a longer -term perspective, and not to make drastic changes to their portfolios in response to the volatility.

Markets in October and early November were mostly distracted from the positive economic news in the U.S. by poor earnings reports, election jitters, and Hurricane Sandy. The earnings reports have not been pretty, with negative news from slowing emerging markets, a weak Europe (and, to a lesser degree, China), and large currency swings. Although the U.S. won't remain immune to the rest of the world forever, and our fiscal situation remains in disarray, there still are a few factors that will help the domestic economy. These include Boeing's ongoing ramp-up, a nicely improved and stable auto industry, increased oil production, a relatively stabilized banking industry, and a lumbering housing industry that has finally begun to recover.

GDP: Third-quarter real GDP grew by 2%, ahead of the second quarter's 1.3% rate. Much of this improvement was due to a very strong consumer, an improved housing market, and strong government spending. Consumption, which represents about 70% of GDP, is always the most important factor, because if consumers continue to spend, businesses will have to invest in plant and equipment, inventory, and most importantly, employees.

Employment: In October, 171,000 jobs were added, sharply exceeding expectations. While this was great news, Morningstar economists believe that at the current pace of job growth, an additional 23 months is still required to recover pre-recession jobs. Employment recovery across sectors has not been consistent. The overall service sector is nearly back to pre-recession levels, while good-producing sectors (mining, manufacturing, and construction) have only recovered 15% of the jobs lost. Furthermore, massive efficiency gains in manufacturing have moved industrial production levels to near pre-recession levels, even as manufacturing has regained a measly 25% or less of the jobs lost. The unemployment rate inched upward to 7.9%.

Housing: Despite the arrival of fall, which typically brings a drop in real estate activities, home prices, new home sales, and pending home sales all showed improvement. On a year-over-year basis, the August Federal Housing Finance Agency (FHFA) Home Price Index was up 4.6%, with all nine regions in the U.S. showing positive growth. While almost always moving in the same direction, pending sales (contract executed but not closed) have exceeded closed sales by a large margin for many months, as below-market appraisals and mortgage denials caused many contracts to not close. Recently, the gap between growth in pending and closing sales has narrowed to about 2% from as much as 6%, which Morningstar economists believe points toward an improving housing market.

Manufacturing: October's manufacturing data showed gains in new orders and an increase in employment, which suggested that the manufacturing sector in the U.S. may have bottomed and is now recovering. Auto sales in October were better than a year ago, but slumped from 14.9 million units in September to 14.2 million units in October. Hurricane Sandy was most likely the cause of this shortfall, as a large portion of auto sales occur on the last few days of the month, and the area hit by the storm accounted for 20%-25% of all auto sales. Outside of the U.S., China showed meaningful improvement between September and October as the Chinese construction market continued to show signs of bottoming. Europe's manufacturing, on the other hand, continued to contract and is currently at its lowest level in 40 months.

Election results: With President Barack Obama narrowly beating out Republican challenger Mitt Romney to win a second term in office, all attention has now turned to global woes and the looming fiscal cliff. If nothing is resolved by the end of 2012, massive spending cuts and across-the-board tax increases may occur. Markets reacted negatively on Wednesday November 7th, falling by as much as 2.73%, with energy and banking sectors among the hardest hit.

We Are Thankful!

Thanksgiving turns our attention to those things for which we give thanks. Our priorities are clear; we give thanks to our Lord for our families, our health, and our friends.

We also give thanks for our firm's clients, as they are the people we are privileged to serve, and who enable us to provide for our families. Thank you! Further, we give thanks to those professionals, attorneys, accountants and others, who refer their clients to us. Thank you, as well!

The economic and political times in which we live can, if we allow, take our focus off our priorities. Thanksgiving is an opportunity for us to step back, reflect, and rededicate our attention to the things that matter most. Maintaining the proper perspective aids not only in a happier personal life, but also keeps members of our firm on track with the longer-term objectives of our clients.

The election is over (for that we are MOST thankful), and the markets have sold off in response (for that we are NOT thankful, but we understand the reaction of investors). It is easy to get down with all the negative news surrounding the election (regardless of which person you supported), and the subsequent market selloff. We are still blessed, however, with the best country to live in, and in which to earn a living and invest. For that we, as individuals and as financial advisors, remain very thankful.

We wish all of our clients and friends a Happy Thanksgiving. Keep your eyes on your priorities, and the big picture, and we believe you will find much to be thankful for as well.

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