

Volume 3, Issue 11



The (not so) Almighty Dollar

November 16, 2009

Monthly Newsletter and Update

Greetings,

Discussions at two events I attended last week sparked some thoughts.

At the monthly meeting of the Investment Round Table at The Nassau Club our excellent speaker from Henderson Global distributed an interesting chart. Over the last ten years the United States stock market has delivered a mediocre to poor performance every year compared to other nations.

At a dinner with high school classmates, all of whom except me exhibit symptoms of advancing age, there was a fair amount of pessimism expressed about the economic prospects of our country and the possibility that our children could do better than we have from a materialistic point of view.

My clients are tired of hearing the reasons why I have a greater part of their equities in companies trading on overseas exchanges. Apart from the three quarters ending March of 2009 my view has been profitable for them. This has generated in me an unpleasant mixture of *schadenfreude* and foreboding about the future of our country. Although I am optimistic about the short to mid-term economy of the U.S. I remain convinced that the rest of the world is a better investment. I wish it were otherwise.

Sincerely,

Jeff Sprowles, CFP®



Mid Quarter Update

- S&P 500 – domestic large cap
 - 9/30 to 11/13 3.70%
 - Trailing 1 year 29.43%
- BarCap Intermediate Gov Bonds
 - 9/30 to 11/13 0.47%
 - Trailing 1 year 5.17%
- 90 Day U.S. Treasury Bills
 - 9/30 to 11/13 0.03%
 - Trailing 1 year 0.23%
- MSCI Emerging Markets
 - 9/30 to 11/13 5.47%
 - Trailing 1 year 88.79%
- Jeff's Current Stock Outlook
75% of target



Next Month:

Thinking about acquiring a new pet? Perhaps a dog, or a seemingly cheaper rabbit?



Next month we discuss what has happened to the cost of owning a pet as veterinarian medical ability has increased at a faster rate than our investment portfolios.



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Market comments

Our stock target has been reduced from 100% to 75% of target. The price/earnings ratio of the S&P 500 Stock Index has gone over 20. This negative sign is not definitive. There are long periods when stocks have gone up after the P/E has exceeded 20.

On the other hand, it is unwise to make decisions based on only one indicator. In the case of P/E, especially as applied to an aggregation of companies, there are several factors that temper whatever it indicates. Unless clearly indicated otherwise, P/E usually refers to "TTM" (Trailing Twelve Month earnings). Earnings reported in December, 2008 do not have a lot of relevance to the present earnings of most companies.

Further, different tracking entities calculate the earnings of an index in different ways. Some use market capitalization to weight the earnings within the index. Others do not include companies that have not earned a profit when calculating the overall P/E.

Arguments may be made that domestic stocks have a lot of room for growth. Earnings of stocks are still attractive compared to interest rates. There is still a lot of cash on the sidelines and not a lot of places to go.

On the negative side, in addition to the P/E indicator, stocks have had a significant run up in the first year of the presidential cycle. Economic indicators for the near future are mixed. Finally, a client recently told me that he was anxious to get into stocks because he felt as if he had missed the boat. That kind of talk is usually a surefire indication that we are going to have a major correction.

THE SOAP BOX: A closer look at Exchange Traded Funds (ETFs)

Individual investors owe John Bogle a debt of gratitude for co-founding The Vanguard Group. Vanguard continues to follow his principles of low cost investment vehicles including the first widely available index funds.

Although retired from Vanguard, Mr. Bogle is an active advocate for responsible investing. Most of his opinions are easy to espouse. He inveighs against greed in the investment community and cautions against rampant speculation. He is also a visible critic of the proliferation of exchange traded funds (ETFs).

In the October 2009 issue of *Journal of Financial Planning* Mr. Bogle advises against using ETFs that track a small or artificial index, a point on which I agree, but then says "Across the board, ETFs lag their targets by four or five percentage points a year, no matter the sector."

It is possible he was misquoted or I misunderstood his point. The ETFs I use certainly do not have that large a tracking error. This table uses data from Morningstar Associates.

Major ETF Performance vs Indices as of 9/30/2009

Source Index	One Year			Three Year			Five Year		
	Index	ETF	Diff	Index	ETF	Diff	Index	ETF	Diff
Domestic									
Russell 1000	-6.1%	-6.1%	0.0%	-5.1%	-5.2%	0.1%	1.5%	1.4%	0.1%
Russell 1000 Val	-10.6%	-10.6%	-0.1%	-7.9%	-7.9%	0.0%	0.9%	0.8%	0.1%
Russell MidCap	-3.6%	-3.6%	0.0%	-4.1%	-4.2%	0.1%	3.9%	3.8%	0.1%
Russell 2000	-9.6%	-9.4%	-0.2%	-4.6%	-4.5%	-0.1%	2.4%	2.4%	0.0%
Russell 3000	-6.4%	-6.4%	0.0%	-5.1%	-5.1%	0.1%	1.6%	1.5%	0.1%
International									
MSCI EAFE	3.2%	3.1%	0.1%	-3.6%	-3.7%	0.1%	6.1%	5.9%	0.2%
MSCI EEM	19.1%	17.0%	2.1%	8.0%	8.3%	-0.3%	17.3%	17.2%	0.1%
	9/30/2009	9/30/2008	↑						
EEM size (millions)	35,452.5	19,000.0	187%						

The only difference that was greater than that enjoyed by a typical Vanguard index fund was earned by the one year emerging markets ETF result. This happened in a year when its assets grew by 187% because of a combination of deposits and price increase. Many money managers will grant that it is more difficult to track a benchmark if there is a large influx of cash in irregular intervals.

Much as I admire Mr. Bogle I will continue to use ETFs as long as they are large enough (I use \$200,000,000 as a threshold) to avoid the likelihood of being orphaned and their tracking characteristics remain reasonable.



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FINANCIAL FABLE

Why starting a Roth IRA is good for a college freshman

Philip Kunkelman has been looking for a way to give money to his grandchildren without running the risk of upsetting their parents who do not approve of large sums of money being made available to their progeny.

Mr. Kunkelman has two motives for wanting to give something to his grandchildren. His attorney has advised him that it is likely his assets will be subject to federal estate tax after he and his wife die. Mr. Kunkelman feels that a life of hard work and prudent living should not be punished by having to fork over a chunk of his estate to the government just because he and his wife are unsuccessful in their search for immortality.

The other reason is that he is extremely fond of his grandchildren. He would like his grandchildren to remember him and his wife in a positive way.

What should Mr. Kunkelman do?

Their financial advisor suggested that they work with their children and grandchildren to open Roth IRA accounts for any grandchild who has earned income from a summer or after-school job. The Kunkelmans could deposit cash to the Roth IRA up to the amount of the earned income or \$5,000, whichever is less.

There are tax penalties if the grandchild takes the money out before they retire. Making a \$2,000 gift in 2009, 2010 and 2011 and letting it sit for 40 years at 8% in stocks would provide a nice supplement to retirement plans of about \$120,000 in 2049 which may be withdrawn tax-free as the grandchild needs it. They will think about grandmother and grandfather every time they look at the statement.