CPS Investment Advisors
Steady as You Grow

2011 Market Update

Provided by: Chas P. Smith, CPA/PFS

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CPS in the News

Events this quarter

"**CPS First Thursdays**:

- Basic Auto Maintenance
- Identity Theft
- Centurian Fitness

CPS Investment Advisors
1509 S Florida Ave
Lakeland, FL 33803

11:30 am—Lunch Provided

Contact us for more dates

Stock Market Set For Higher Returns in 2011

While we never make predictions we are optimistic about a continued recovery in the stock market for a number of reasons.

Reasons for Optimism for stocks

- U.S. Corporate profits hit a record in the third quarter of 2010. Earnings for the fourth quarter and 2011 are projected to continue climbing. Corporate cash reserves are the highest on record enabling increased stock dividends and stock buy backs.
- Interest rates in the U.S. and global economies are very low which has enabled corporations to either refinance existing debt at lower rates or borrow new funds at below market rates.
- The panic from the 57% decline in the S& P 500 in 2008-09 is over.
- Money should begin flowing away from bonds into stocks. For the first time in three years bond investors have seen small losses in their bond portfolios in November and December. The safety, low volatility and liquidity of bonds caused demand thus driving prices higher and yields to reach 30 year lows in 2010. Even though stocks were climbing from their March, 2009 lows, 14 times as much money went into bond funds during the last twelve months as stock funds.
- Money market funds and CD's are currently earning investors very nominal returns. The latest estimates are reflecting between $3 and $4 trillion in money market funds earning virtually zero. Eventually, a portion of those funds will come back to the equity markets.
- Price to earnings ratios for the S&P 500 are currently 12 to 13 times 2011 forecasted profits. Historic norms are 15 to 16 times one year's earnings. Many market gurus estimate the U.S. and global markets are undervalued by 20% or more.
- Ample liquidity in the markets has calmed the stress from the 2008 blood letting. Banks are lending, albeit modestly.
- Extension of the Bush Tax Cuts and an administration more friendly to Wall Street has encouraged investors to return to the stock market.
- Retail sales have jumped 7.3% from a year ago.

Sources: Wall St. Journal, Barron's and Investors Business Daily

Dividends

No other single factor has a greater effect on your total return from stocks than dividends. The latest study reinforces our earlier reports that over 42% of the total return from the stock market is from dividends. The remaining portion is from appreciation. Further, all academic studies reflect that a portfolio of dividend paying stocks is much less volatile than a portfolio of non-dividend paying stocks. The meltdown of 2008-2009 clearly reinforced that research. In reviewing our portfolios, only two core holdings do not pay dividends. Those two holdings are loaded with cash and have the ability to pay dividends but choose to invest their excess cash reserves in acquisitions.

Lower Price to Earnings Ratios-Value Investing

The academic research also reflects that lower P/E stocks generally outperform the higher P/E stocks. This of course makes sense as individual stock prices rise and the P/E rises the likelihood of further price appreciation is diminished.

Bond Investors Beware

Interest rates are so low that it will take 36 years to double your money in 5 year U.S. Treasuries!

While we continue to preach the importance of asset allocation and diversification including fixed income for a portion of your portfolio, there are numerous storm warnings on the horizon for intermediate and long term bonds. The thirty year bull market in bonds probably ended in November, 2010 after the Federal Reserve announced QE II (the purchase of an additional $600 billion of U.S. Treasuries). The Fed has been purchasing U.S. Treasury notes, bonds and agency debt during this fiscal crisis. It is now the largest holder of U.S. debt instruments surpassing mutual fund investors, China and Japan. Where does the Fed obtain the funds to buy the debt issued by the U.S. Treasury? It merely prints the money on its printing press and buys the debt at the periodic auctions if outside investors fail to buy our debt.

The Fed is playing with fire in our view and the view of many economists. Eventually, interest rates are going higher. With the global economy recovering and the demand for money increasing, interest rates will be increasing. Higher interest rates are the enemy of bondholders, in particular, intermediate and long term bonds which are very sensitive to rate increases and move in an inverse relationship to rate changes (when rates go up, bond prices decline).

Municipal Bonds-Facing Hurdles

Local and state governments are facing headwinds with ever decreasing tax revenue and increased pension and healthcare costs mandated by employee contracts. Investors are scrutinizing the underlying ability of municipalities to meet their obligations. California in particular is in the headlines daily as it faces the largest state wide budget deficit in the country. Again, we emphasize diversification, safety and shortening maturities wherever possible to mitigate principal losses due to higher interest rates or default. On the flip side, we will probably see buying opportunities when Wall Street and investors over due it by selling municipals across all maturities and investment grades.

CPS' Strategy on Fixed Income for 2011

In reviewing your November and December statements you have seen a number of changes we made in our managed portfolios to mitigate potential declines in our fixed income allocation. We captured profits in a number of areas and added to high yield, convertible securities, international bonds and floating rate bonds. These positions are complimented with short term bonds and short term bond mutual funds.

Conclusion

There will be continued volatility in the markets, it is the nature of the beast. However, volatility can be a friend of the investors providing us opportunities to buy when everyone else is selling. Happy New Year and have a great year in 2011. ***Thank you for the many kind referrals. Referrals are a vote of confidence and we appreciate them.***