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THE ADVISOR

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Investing Doesn't Have to Mean Income or Growth

by John McCartin

We've all heard the old saying, "You can't have your cake and eat it, too." There's a similar notion that applies to investing.

The common belief is that if you invest for growth, you sacrifice income — and when it comes to the stock market, that adage generally holds true. Conversely, it is commonly thought that if you invest in non-stock market alternatives, designed to generate income through interest and dividends, you sacrifice the ability to grow your money.

Well, sometimes reality runs counter to clichés, especially when the reality is that we've been stuck in a secular bear market for almost 12 years. As I've mentioned several times in previous newsletters, history shows us that a secular bear market typically lasts 20 years or more, which means we could have another decade or so of zero market growth.

Now, here's another old saying you may have heard:

"Over the long run, the stock market outperforms most other asset classes." Obviously,

investors who believe that they are sacrificing income in favor of
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Economic Indicators: What Can They Tell You?

Sooner or later, every investor is curious to know if economic indicators can provide clues for investing. That's why financial institutions have economists on staff and why the latest government reports on this economic indicator or that make headline news.

However, the economy is a bit like the weather: forecasters are always talking about it, but what actually happens is quite often a surprise. All the same, it helps to know at least a little bit about what they're talking about, if only to begin to figure out for yourself what indicators you should pay attention to and how concerned you really should be when the indicators are announced.

With that in mind, here's a brief introduction to some of the most widely watched economic indicators. The organizing principle here is whether they're providing information about the past, the present, or the future.

Lagging Indicators

The family of "lagging" or "trailing" indicators gets its name

from the fact that they reflect economic conditions that have passed. Instead of predicting the future, they confirm what has already happened, so they tend not to cause sharp market reactions when they're announced — unless they diverge sharply from the consensus forecast of economists. Some of the major lagging indicators are:

- **Consumer Price Index (CPI).** This is the most-watched measure of inflation in America, measuring changes in the average price of a basket of consumer goods and services in the country's major metropolitan areas. Since 1945, the CPI has averaged just above 3% a year. Significantly higher rates are often associated with an economy that is growing too fast, which can lead to steps by the Federal Reserve to raise interest rates to curb borrowing and slow down the economy. *Issuer: U.S. Bureau of Labor Statistics. Frequency: monthly; mid-month, covering the prior month.*

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Income or Growth

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growth are *only* focused on “the long run” and willing to make that sacrifice for higher returns.

But if those same investors accept the lessons of history and the notion that we’re only half-way through a secular bear market, they must also accept that this “long run” is likely to be very long, indeed. Statistically, they won’t see the maximum return on their investments until the combined secular bear and bull markets have run their course. That — as regular readers know — takes about 35 years, according to history.

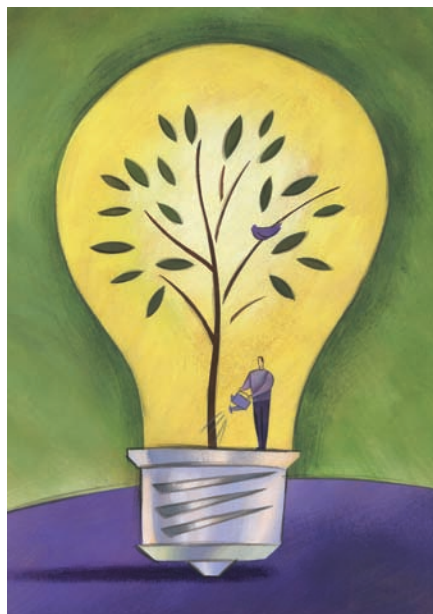
But many investors apparently *don’t* accept (or know about) the lessons of history. If they did, they might have heeded the warning signs of ballooning price-to-earnings ratios in the late 1990s that signaled the onset of this secular bear market and adjusted their investment strategies accordingly. Instead, they maintained the bulk of their assets in the market and may even have been reinvesting dividends ever since. Nevermind that the Standard & Poor’s 500 Index is down 24% from where it stood in 2000, and *still* down 6.8% even with reinvested dividends factored in.*

So, how is it that intelligent investors can *continue* to disregard history and remain loyal to the market even after 12 years of negative growth? Why are they content with an even smaller cake that they can’t eat?

Well, we can look to history yet again for that answer. As I’ve explained in this space previously, every secular bear

market since 1899 (and even before that) has been marked by almost non-stop volatility. Therefore, it’s not surprising that stalwart buy-and-hold investors have at least enjoyed the enticing thrill of temporary gains (twice, in fact) since this secular bear cycle began with a big drop in 2000. Starting in March 2003, the market climbed fairly steadily before a second big plunge began in October 2007. After bottoming out in 2009, it has trended upward more often than not, although — again — that rise has been marked by the kind of nerve-wracking bumpiness that has typified secular bear markets throughout history. And just to reiterate: the net result of all this chaos is a 24% decline in the S&P 500.*

If history continues repeating itself, committed market investors are likely to experience more of the same over the next decade as this secular bear slumbers on; more big drops, more slow rebounds, more volatility and, ultimately, zero growth — and even less than that when you consider inflation.



Now, think again about the idea that these investors are enduring all this because they’re more interested in growth than income, and then ask yourself: “What about the other guy? What about the investor more interested in security and income than growth, who heeded those warning signs in 2000 and shifted assets to a certificate of deposit offering a 4% return rate?”

Well, the fact is, that FDIC-insured CD could have been reliably generating that return annually for the past 12 years — to the cumulative tune of 58% with compounding! That’s money the CD holder could have reinvested to grow his money organically. Regular readers know this is what I like to call the “bird-in-hand” approach to investing, which is the alternative to crossing your fingers and toes and hoping for growth in the stock market.

My point is simply this: the numbers suggest that sacrificing income for growth may not only be unwise during a secular bear market, it may not even be necessary. Even if you need little or no income and are *only* interested in getting the highest possible return on your investments, conservative, non-stock market instruments may still be your best option in a secular bear market. By reinvesting smartly, with the help of your financial advisor, any number of alternatives might handily outperform your aggressive stock mutual funds over the next decade.

So enjoy your cake.

*Source: advisorperspectives.com/dshort
October 9, 2011

Economic Indicators

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- **Unemployment rate.** This measures the latest number of initial claims for unemployment insurance, as well as the number of people who are out of work as a percentage of the U.S. work force, defined as people who are already working or looking for work. This is considered a lagging indicator because unemployment continues to increase several months after the economy starts to improve. *Issuer: U.S. Department of Labor. Frequency: weekly; Thursdays prior to market opening.*
- **Consumer credit report.** This measures the dollar balances of consumer debt, including credit cards and bank loans, excluding loans backed by real estate. Since consumer spending accounts for 70% of the U.S. economy, rising levels of consumer credit reflect a strong economy, while declining levels indicate economic weakness. *Issuer: Federal Reserve. Frequency: monthly; five weeks after month's end.*

Coincident Indicators

Coincident indicators give a picture of the economy's current condition. These tend to cause more market volatility after their release than the lagging indicators. Some of the major coincident indicators are:

- **Gross Domestic Product (GDP).** This is the sum total of an economy's output of goods and services, measured in each nation's currency. The absolute number is less important than the change over time, expressed as a percentage. In the U.S., GDP growth has averaged between 3% and 4% annually since the end of World War II. Two consecutive quarters of negative growth is typically considered evidence of a recession. *Issuer: U.S. Bureau of Economic Analysis. Frequency: quarterly; advance release three weeks after the end of each calendar quarter; final report released three*

months after the quarter ends.

- **Retail sales report.** This indicator is very closely watched by both economists and investors. It tracks changes in the dollar value of big- and small-ticket goods sold in retail stores, by mail order, over the Internet, and in vending machines. It's taken as a sign of economic strength (again, because consumer spending accounts for such a huge percentage of the U.S. economy), as well as inflationary pressures and an indicator of whether the Federal Reserve is likely to raise or lower interest rates. *Issuers: U.S. Commerce Department and Census Bureau. Frequency: monthly; mid-month.*

Leading Indicators

Leading indicators are typically the ones used to help make key day-to-day decisions, because they tend to indicate economic conditions six to nine months into the future. As a result, these are the indicators with the greatest potential to move the markets noticeably when they're released.

- **Institute for Supply Management (ISM) index.** This index is based on a survey of purchasing executives at some 300 major industrial companies, reflecting their firms' activities aimed at future production. The index covers nine production factors, including new orders, production, employment, supplier deliveries, inventories, prices, new export orders, imports, and order backlog. Considered to be the single best barometer of conditions in the manufacturing sector, a value of 50 and higher signals economic expansion, and a value below 50 signals contraction. *Issuer: Institute for Supply Management. Frequency: the first business day of every month; covering the previous month's data.*
- **Consumer confidence index.** This indicator is a summary of interviews with some 5,000 consumers nationwide (for a random sample of Americans) on their

feelings about their own financial condition, the strength of the economy, and their outlook for the next six months. Historically, changes in this index have tracked the leading edge of the business cycle well, as it indicates how willing consumers are to spend more and make big-ticket purchases (like a car or a home). A strong report when the economy has been weak can spur a short-term rise in stock prices. Some economists look for an increase of at least five percentage points before calling for a change in the economic trend. *Issuer: The Conference Board. Frequency: the last Tuesday of every month; covering the previous month's survey.*

- **Housing starts and building permits.** This indicator reports on both the number of housing units on which construction has begun, as well the number of units for which permits have been issued. It's generally regarded as a good indicator of future home sales and consumer spending in general. Permits typically are a good indicator of housing starts three to four months in the future. *Issuer: the U.S. Census Bureau. Frequency: monthly; around the 18th of the month.*
- **Stock market prices.** Stock price trends are considered one of the most important indicators of future economic conditions, which tend to indicate future economic health some six to nine months into the future.

Only a portion of major economic indicators that economists and investment professionals watch on a regular basis have been reviewed. The truth is that all of the major indicators are meaningful, but tend to make the most sense when taken in context with each other. Even when they tell a clear story, what they can't tell you is whether you need to adjust your portfolio and how. To get the latest reading on what the economic indicators are saying and what they might mean for your investment strategy, please call. ■■■

Business Data

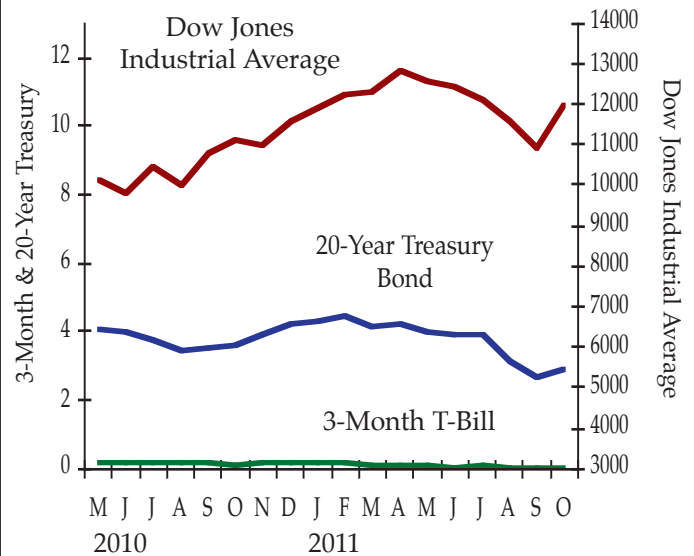


Indicator	Month-end				
	Aug-11	Sep-11	Oct-11	Dec-10	Oct-10
Prime rate	3.25	3.25	3.25	3.25	3.25
3-month T-bill yield	0.02	0.02	0.01	0.18	0.13
10-year T-note yield	2.17	1.87	2.20	3.37	2.54
20-year T-bond yield	3.13	2.68	2.92	4.23	3.56
Dow Jones Corp.	3.60	3.69	3.67	3.89	3.46
GDP (adj. annual rate)#	+0.40	+1.30	+2.50	+3.10	+2.60

Indicator	Month-end			% Change	
	Aug-11	Sep-11	Oct-11	YTD	12 Mon
Dow Jones Industrials	11613.53	10913.38	11955.01	3.3%	7.5%
Standard & Poor's 500	1218.89	1131.42	1253.30	-0.3%	5.9%
Nasdaq Composite	2579.46	2415.40	2684.41	1.2%	7.1%
Gold	1813.50	1620.00	1722.00	22.5%	27.9%
Unemployment rate@	9.10	9.10	9.10	-7.1%	-5.2%
Consumer price index@	225.90	226.50	226.90	3.7%	3.9%
Index of leading ind.@	115.90	116.20	116.40	4.6%	5.1%

— 1st, 2nd, 3rd quarter @ — Jul, Aug, Sep Sources: *Barron's*, *Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield May 2010 to October 2011



What Is Causing the Jobless Recovery?

Although the recession officially ended in June 2009, unemployment rates are decreasing slowly, the average length of unemployment remains at a historical high, and the unemployment rate is projected to remain above 7.8% until 2013. The concern is that we are again facing a jobless recovery, with economic activity growing, while the unemployment rate remains high. The prior two recessions, in 1990-91 and 2001, were also considered jobless recoveries, with the unemployment rate continuing to increase 15 months after the end of the recessions. However, the most recent recession has even more persistent and unusually high unemployment. What is causing this jobless recovery?

Many researchers consider a labor market mismatch as a significant cause for the persistently high unemployment. One study of employment opportunities over the past three decades found that employment growth has polarized into relatively high-skill, high-wage jobs and low-skill, low-wage jobs, while middle-skill

routine jobs have declined. Some middle-skill jobs have been replaced by technology while others have been outsourced overseas. During the most recent recession, employment in middle-skill and middle-wage jobs declined 7-17% (Source: *The Regional Economist*, April 2011).

Another study found that job opportunities have significantly reallocated between industries. During the recent recession, employment in the construction industry declined 20% and 6% in the financial industry. Between June 2009 and December 2010, employment dropped an additional 7% in the construction industry and 2% in the financial industry. Manufacturing and information service industries were also severely impacted (Source: *The Regional Economist*, April 2011).

During the recent recession, small firms lost proportionately more jobs than larger firms. Small firms accounted for approximately 10% of total net job loss despite their 5.3% employment share. They also take longer than large firms to rehire. FR2011-0614-0001



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