THE NEW ENGLAND GUILD, INC.

WEALTH MANAGEMENT COMMENTARY

PROTECTING AND BUILDING YOUR FINANCIAL FUTURE

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Market Spotlight

Index	Returns: Qtly 2nd Qtr	Annual 1 Yr	3 Yrs	10 Yrs
Equities				
S&P 500	-11.4%	14.4%	-9.8%	-1.6%
Russell 2000	-9.9%	21.5%	-8.6%	3.0%
MSCI EAFE (Int'l)	-14.0%	5.9%	-13.4%	0.2%
FTSE NAREIT	-3.7%	50.3%	-9.4%	9.4%
Bonds & Cash				
Barcap Agg. Bond	3.5%	9.5%	7.6%	6.5%
90 Day T-Bills	0.1%	0.1%	1.3%	2.6%

A confluence of softening global economic data coupled with news of a sovereign debt crisis in Greece spreading to European countries such as Portugal, Italy and Spain, resulted in a dreadful quarter for equity markets. Further investor concerns surfaced in May when a "flash crash" drove the DJIA down 1000 points in minutes before a sharp partial recovery. Stocks followed their 80% rally from March 2009 lows with a 16% loss since late April. This resulted in an 11.4% decline in the S&P 500 for the quarter, while foreign stocks fell even more sharply. Diversified portfolios benefitted from bond holdings as positive returns across most fixed income sectors helped to offset some of the equity losses. Renewed risk aversion reduced the yield on the 10 year Treasury to below 3%. Money flows into bond funds have now exceeded those into stock funds for 30 consecutive months.

Despite a significant market pullback, corporate balance sheets have strengthened, corporate profit growth has been favorable, inflation is subdued and interest rates remain low. At the same time however, unemployment remains stubbornly high, private sector job growth is slow, and compensation gains are meager. Retail and auto sales fell while housing numbers deteriorated as the home buyer tax credit expired in April. Tight credit continues to affect consumers and small businesses, restraining growth. Asset values, far below 2007, have left investors feeling less wealthy and more conservative about spending as they continue to reduce debt and save more. Threats of higher taxes and increased regulations, distrust of government, conditions of public finances, the potential for geopolitical shocks, longer term prospects of higher inflation and interest rates and the return of volatility to the global equity markets continue to fuel uncertainty. At the same time, fears of a double dip recession further adversely influenced market psychology.

Dr. David Kelly of JP Morgan offers historical perspective. He points out that since World War II, we have had 11 recessions and in only one period (1980-1982) did we experience a double dip. A major difference between that period and now was the massive tightening by the Federal Reserve which halted growth.

We're not sure where this all comes out, but we do believe that a self-sustaining recovery requires meaningful job creation in the private sector (versus public sector). Despite signs of their improved financial condition, however, many companies are holding back as they try to assess the impact from new regulations and legislative reform.

We are reminded of a quote from *The Psychology of Investing*; "Like a super tanker slowly rounding a bend, the economy's positive turn won't be noticed until long after the smoke is left on the horizon" (Chapman Marketline 1986). Clearly no one can be sure about the sustainability of this recovery. In the face of this, our investment strategy remains to make sure that sufficient assets have been set aside to meet future client needs for cash, and to hold a broadly diversified portfolio that can provide less volatile returns in unsteady markets.

Investment Commentary

NEW THINKING ON SPENDING POLICIES

With the volatility of markets over these past four years and uncertainty of future direction, clients are understandably apprehensive. Client questions center around what do we think about markets, what are we doing with portfolios. and what returns can they expect in the future. Unfortunately, our answers to these questions are boringly consistent. We think markets will continue to be volatile and replete with surprises. We continue to manage portfolios with careful attention to our clients' financial tolerance for risk and to their psychological willingness to take risk. We continue to believe in robust asset allocation as the best way to manage risk and diversification. And we believe that fund manager integrity and discipline are critical to fund performance success. Finally, we think investment returns of a balanced portfolio will be lower than the experience of the past 30 years in a range of 3-4% over inflation but with a very uneven pattern. All this is not as sexy as 'market timing', investing in hedge funds or limited partnerships, or picking 'hot stocks' that have been yesterday's winners.

Another key component of our process is **spending policy**, that part of the investment equation that addresses the question of how much can be drawn from the endowment assets each year without compromising the longer term objectives of the institution, a question as relevant for individuals as it is for institutions. The recent volatility of markets has shown that spending policies tied too closely to the shorter-term investment results of the portfolio can wreak havoc with financial planning.

The Commonfund, highly regarded for its work with educational endowment funds, has written extensively on this topic in white papers and in its semi-annual publication, *Mission Matters*. They note that "spending methodologies have failed to protect endowed institutions against excessive volatility in the financial support they expect from their endowments." According to their benchmarking study, three-fourths of all endowments use a spending policy based on a moving average (typically 3-5 years) of beginning period assets, a methodology developed in the 1970's. This policy worked fine in the tailwinds of rising markets through the 1980 through 2006 era. The market turmoil of the past four years, however, resulted in both greater than expected volatility in the endowment draw and added financial stress because this draw was lower at a time other institutional revenue sources were lower

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as well. Consequently, a Commonfund study suggests an increasing number of endowments are moving toward a "banded inflation" spending approach that bases spending on the previous year's spending level plus an inflation factor, often with an upper and lower band (e.g., low of 3%, high of 6%). The advantages of this 'banded' policy is that institutions will spend less during rising markets than with the moving average rule, they will spend more during down markets, and their annual draw will be less volatile and more predictable. Obviously its success depends on the level of initial spending (between 3% and 6% of assets) and on the sustainability of reasonable investment returns over time.

We think this methodology deserves careful consideration, not just for endowment funds, but for individual investors. Granted the dynamics of individual investors differ from those of endowment funds: individuals are mortal and therefore are not investing to perpetuity, nor do they typically have benefactors able to add to their funds over time. But individuals have been adversely impacted in much the same way as institutions through this turbulent market period, and the issues of how to invest and how much to spend must both be addressed thoughtfully and prudently.

EXCURSION

The term 'pleasant surprise' understates what greets first-time visitors to the *New Britain Museum of American Art*. Thousands of beautiful paintings, drawings, photography and other permanent works offer visitors a rewarding journey meandering throughout 50,000 square feet of well-planned exhibit space. Beyond the huge permanent collection that includes Rockwell, O'Keeffe and many others, the museum routinely borrows collections like the upcoming exhibit of drawings by M.C. Escher. From the exquisite collection, to great teaching and youth programs, to a bistro-style café, the museum has it all. Visit www.nbmaa.org for more info.

A Tribute to Jim Williams

The investment profession recently lost one of its more unforgettable characters this past May. Jim Williams (no relation) founded the Williams Inference Service. His obituary mentions that *Barron's Magazine* described him as a "One-Man think tank". He was more than this.

I came to know Jim in the early 1970's when I was Director of Research at the Travelers Investment Management Co (TIMCO). We were intrigued by his idea that careful observation and correct inference could help identify stock investment opportunities at an early stage. Jim would come into our offices looking, as he always did, disheveled with sunken eyes, jaundiced skin and emaciated frame. He would have with him an assortment of observations and inferences in manila folders filled with clippings from newspapers, journals, periodicals or whatever. In his halting, random way, seemingly unorganized, he would sort through his clippings, pointing out observations that suggested 'change' (a key word for Jim). Then he would offer his inferences:

Observation	Inference	Outcome
An obscure science magazine article mentions Defense Dept funding research for development of a quinine substitute to treat malaria in Vietnam servicemen	There must be a shortage of quinine, confirmed by follow-up research at Schweppes	*Quinine futures went through the roof*
An oil tanker is seen riding very low in the water in the Connecticut River near Hartford	Oil producers have so much oil they are storing it in old tankers out of the way upstream	*Oil prices soon peaked before falling precipitously*
A fashion magazine reports that 'black' is the 'in' color for Fall fashions	Black is a color of depression and therefore consumer sentiment must be turning negative	*Consumer spending fell dramatically in the late 1970's*

He also thought a great deal about the investment management process, believing that it should have four components: observation, analysis, decision and review. Each was equally important, but individuals who had strengths in one would not necessarily have strengths in the others. Jim was fascinated with research that observed the separate characteristics of the left and right hemispheres of the brain. This explained for him why some individuals would be better suited as 'observers' while others might excel at analysis and/or decision-making. Therefore, it was highly important to understand the strengths and weaknesses of each member of the investment group to assure that the team had diversity and balance with individuals psychologically and neurologically suited for their roles in the investment process.

After I retired from Travelers I continued to visit with Jim at his home in Longmeadow. We would sit at his large dining room table, clippings strewn about with newspapers, magazines, and file folders stacked on chairs and on the floor (he obviously lived alone!). We would have conversations about many things, usually related to investing. He was always provocative, informed and thoughtful. And always his love of the work, the process, and 'beating the market', came through.

We never measured exactly how much 'value-added' Jim brought to TIMCO's investment performance, but he sharpened our ability to observe change at an early stage and to contemplate its implications. This is his legacy. Those of us who knew him will always remember him with fondness and gratitude.

- Eliot Williams

QUOTE

"Do not let what you cannot do interfere with what you can do." *- John Wooden*

Our firm continues to grow by referrals from our clients. Thank you for recommending us.

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