New England GUILD
Wealth Management & Investment Advisors

Wealth Management Commentary

PROTECTING AND BUILDING YOUR FINANCIAL FUTURE

FALL 2012 (860) 236-3301 (800) 254-8453 www.neguild.com

Market Spotlight

Index	Returns			
	Qtr	Annual		
	3RD Qtr	YTD	3 YR	10 YR
Equities				
S&P 500	6.4%	16.4%	13.2%	8.0%
Russell 2000	5.3%	14.2%	13.0%	10.2%
MSCI AC World exUS	7.4%	10.4%	3.2%	9.8%
MSCI AC World	6.8%	12.9%	7.2%	8.6%
REITs	1.4%	16.6%	19.6%	10.5%
Barcap Agg. Bond	1.6%	4.0%	6.2%	5.3%
90 Day T-Bills	0.0%	0.1%	0.1%	1.8%

Although a myriad of concerns permeated markets during the past three months, risk assets generated strong performance. US equities, as measured by the S&P 500, rose 6.4%; international equities and emerging markets gained over 7%; high yield bonds were up 4.5% while emerging market debt returned 6.8%.

At the end of the quarter, the US equity market has gained more than 16% for the year. And during the month of August, the broad-based rally of June and July transitioned to one resembling typical market moves ahead of an economic recovery; (i.e. small companies outperformed large; aggressive sectors bested defensive sectors; and growth outpaced value). In addition, a "relief rally" was seen in major European markets after the European Central Bank pledged to do "whatever it takes" to save the euro. Still, dollars continued to flow from equity funds into bonds and cash as investors remain focused on what would happen if the world gets worse rather than if something goes right!

While specifics may have changed, the concerns and uncertainties of the past three years remain: US growth, the European crisis, and global growth. The US recovery continues along a subdued but positive trajectory, characterized by mild GDP growth as well as soft economic data. Corporate balance sheets are strong and earnings reports are generally positive; pent up demand remains for autos, housing and inventory; and monetary policy is highly accommodative. Yet weak consumer confidence reflects investor fear of possible global contagion or a "fiscal cliff" that could derail the recovery. Although Europe unveiled a sovereign bond purchase program to try to keep

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Investment Commentary: Navigating in a New Era

The economic and stock market meltdowns of 2007-2009 were the worst since the depression of the 1930's. It is a period that will long be studied by historians for its causes, effects and significance. It is likely as well to foster both reexamination of and innovation in financial theory and practice as applied to investment management. Important questions are being asked:

1. Are traditional asset classes and approaches to the management of investment portfolios now outdated?
2. Is diversification all that it's cracked up to be as 'the only free lunch in investing'?
3. Can we truly protect against 'Black Swan' events (unexpected happenings of devastating consequences)?
4. Where is alpha (the risk adjusted return over and above the return expected for the asset class) among the ruins (what opportunities will present themselves)?
5. What are the implications of an environment in which investors are highly risk averse, yet are in need of returns greater than money markets?

What makes these questions so intriguing and so difficult is that we won't know the answers for years to come. We are entering an era often described as a 'New Normal', facing economic circumstances that are outside of our nation's historical experience (aging demographics, globalization, accelerating technological innovation, massive public debt). It is not simply that we can study history and know what might work or not work in such an environment. Historical relationships and precepts may no longer apply.

So in the face of this, what do you do with investment portfolios? We tend to turn to the people and organizations which, we think, distinguish themselves by their resources, insights and innovation. Pimco, JPMorgan, AQR, Vanguard, and GMO are among these groups. Their responses might be as follows:

- For (1) and (2) they would say that traditional asset classes (stocks, bonds, cash) are not outdated, but must be defined more robustly. Pimco, JPM and AQR offer global, multi-asset portfolio strategies anchored in stocks and bonds but to which are added healthy portions of commodities, real estate, and less traditional bond strategies (high yield, emerging market, inflation-linked, variable rate), all in a global context. Each would claim that such portfolios lower overall risk because of their robust diversification characteristics, and improved opportunities for return because of the breadth of their span of mispriced assets. Time will tell.
- For protection against Black Swan risks (question 3) most of these organizations would say that protection comes with a cost (like insurance), and while this may provide peace of mind and avoidance of calamity, this comes at a long term economic cost (insurance companies make money). AQR and Pimco offer innovative strategies that place greater focus on balancing risk factors than on maximizing the return to risk relationship. Standard deviation as a measure of volatility or risk is less significant than is the weighted exposure of asset holdings to specific risk categories such as equity, interest, inflation or credit. The verdict is still out on the long-term effectiveness of these strategies, but there is evidence that correlations between risk factors are more stable than between asset class returns which would offer the potential to better control risk volatility.
- There is no easy source of alpha (question 4) despite what hedge fund managers would wish investors to believe. Jack Bogle, founder of Vanguard, and Bill Gross of Pimco both say that investors should expect lower returns than have been

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the debt in struggling countries from compounding faster than the economy, doubt remains as to whether problems can be solved without a banking crisis or dissolution of the euro. And outside the US and Europe, the former "growth darlings" known as the BRICs – Brazil, Russia, India and China – are showing signs of economic sluggishness.

We don't know how the various crises and concerns will evolve from day to day, but we do know that they present both risk and opportunity. We also know that history has taught that investors, driven by emotions of fear and greed, often do the wrong thing at the wrong time. So we continue to believe that having a carefully diversified plan for investing amidst ongoing uncertainty is an imperative strategy for navigating challenging markets.

QUOTE: *"I believe in the dignity of labor, whether with head or hand; that the world owes no man a living but that it owes every man an opportunity to make a living."*
— John D. Rockefeller

Excursion: A "shore" bet even in the winter! . . .

The Old Lyme Inn located in the heart of historic Old Lyme, CT has been fully renovated while retaining its original charm. The 19th century inn includes updated guest rooms and three dining areas; the main dining room, an elegant bar with fireplace and a seasonal outdoor patio. A welcoming fire pit near the front door provides opportunity for making s'mores after an evening of unique comfort food, cocktails and wine. In 2013, guests will be able to enjoy listening to acclaimed jazz musicians in an intimate Jazz Club. (860)434-2600 **oldlymeinn.com**

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achieved historically. This is because today's starting point for stock and bond yields are far lower than historic averages (and yields are a primary component of future returns). Further, future economic growth is expected to lag the historic average of 3.5% because of the need to de-lever debt.

- Consequently, the response for question 5 is that investors should remain diversified with moderate expectations for return. To fulfill long-term hopes, this means they must either assume greater risk in their portfolios (not a preferred choice) or increase their savings (i.e., reduce consumption).

To various degrees we have already adopted some of these ideas in portfolios. Others require more study and time. We anticipate that a rich flow of new ideas of investment options and strategies will continue and we look forward to the challenge of evaluating them and proposing them to clients if appropriate.

Our Team: Introductions and Farewells

Here at The Guild, we are committed to providing informed, comprehensive and timely response to the needs of each of our clients. We are dedicated to client satisfaction; and our approach is one of collaboration, where each member of our firm brings diverse capabilities to arrive at the best solutions for our clients. To that point, we are pleased to announce that we have added two new members to our team!

Bill Pfeiffer, Jr. joins us from GlobeOp Financial Services where he was the Senior Associate of Operations. Prior to that he was a Portfolio Manager with Apex Investment Services, an RIA in Hebron, CT. Bill is on the Board of Directors of Mary's Field Retreat Center and lives in Tolland, CT with his wife and daughter. He completed his undergraduate degree at Saint Anselm College and received his Masters of Science in Financial Planning from Bentley University.

Brendan Fitzgerald was formerly with Barclays Capital in New Jersey where he was an analyst for fixed income derivative operations. Prior to that he was an investment operations consultant with Wellington Management Company in Massachusetts. He has co-authored books for educational and recreational use in accordance with Major League Baseball official licensing requirements. He received a Bachelor of Arts Degree from Ithaca College and currently is finishing his MBA at the University of Massachusetts in Amherst.

We also want to share with you that, after 42 years in the investment profession, ***Eliot Williams*** has stepped back from day to day investment involvement at The Guild to spend more time with his wife, family and friends at their home in VT; to travel more, to pursue personal interests, serve on Boards and remain actively involved in the community. That said, we are very pleased that Eliot will remain an integral part of our Team, continuing his passion for research and writing on investment theory and application; and assisting with mutual fund due diligence and investment strategy formulation. He also will Chair our Advisory Group which will play an important role as we continue to expand the depth and breadth of our firm.

And finally, on a bittersweet note -as we welcome Bill and Brendan - we also are bidding farewell to ***Jen Stanley*** who has played a critical role in The Guild's success over the years. Jen is moving to Tennessee where her husband Gil has been offered a wonderful career opportunity. All of us will miss her; are grateful to her for her many contributions over the years; and wish her and her family many blessings and all good things.

QUOTE: *"Pennies don't fall from heaven – they have to be earned here on Earth."* — Margaret Thatcher

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

THE NEW ENGLAND GUILD TEAM

Harold L. Rives III, CPA | Susan M. Grayson | E. Patrick Logue, CPA
William R. Pfeiffer, Jr. | Brendan F. Fitzgerald | Claudia Flannery
Eliot P. Williams, CFA, Of Counsel