Manager Perspective

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TANDEM
WEALTH ADVISORS

SEPTEMBER 2011

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What happened to the markets in August?

The month of August was very disconcerting to investors. Wild daily swings pushed many to panic, instilling a sense of fear and dread. The stock market is a forward looking indicator and currently is suggesting a double-dip recession. We do not believe this to be the case. Coincident with the downdraft in equity prices this month has been a sharp rise in bond prices which has pushed yields to 50-year lows. These low rates help debtors (the American consumer, but also local, state and Federal governments). The ability to refinance mortgages to reduce monthly payments or purchase a car with lower payments will help those who have good credit.

Are we in another recession?

First of all, we would stress that this is not 2008 repeated. At that point there was serious concern the US banking system would fail due to the mortgage crisis. While there is still work to do, no large banks appear to be in any trouble and there is no current need for another bank bailout plan. Banks are much, much stronger than they were three years ago, the US consumer is in better shape having de-levered for the last three years, and corporate America is leaner and much stronger. The high unemployment rates and weak housing markets will not turn quickly and may linger for several more years. However, the balance sheet of corporate America (the stock market) is in very good shape – better shape than it has been in many years. Markets are places for long-term investing and we do not believe that daily swings of 4% or more accurately portray the economic and investing climate. There is no reason to believe US stocks are really worth 10% less than they were three weeks ago. Daily swings in individual stock prices of 20% or more exacerbate this concern. There is a large element of machine-driven trading causing this volatility. High-frequency trading by firms that have no care about what security they are buying or selling increases the intra-day volatility.

Now is not the time to panic and sell. At Tandem Wealth Advisors, we have a strong discipline which has worked for the past 30 plus years. The plan is to sell euphoria and buy panic. We are adhering to this discipline. Based on what we stated above, now is the time to cautiously and judiciously buy equities. Companies with strong balance sheets, rising earnings, and diversified customer bases should continue to do well in the next several quarters. We favor large, multinational corporations for their global reach and diversified product offerings.

It may feel like it is different this time, but during panics it usually does. We know from history that sharp declines in the market have almost always been excellent buying opportunities two to three years hence. If you had sold in 2008/2009, you would have missed the doubling in value that ensued over the next 24 months. We are not calling this a bottom, and admit there will be more churning and violent swings. However, we strongly believe that maintaining a disciplined investment strategy through this market volatility will benefit you in the long term.

What is your outlook and strategy on the portfolio?

Client equity portfolios have been positioned for this current economic environment since late 2010 when we modestly increased cyclical positions. Fixed income portfolios have remained very short and highly concentrated in the strongest credits. There has been no compelling reason to extend maturities as the yield curve has been flattening for nearly three years. As we head into the latter part of 2011 we expect to continue making minor adjustments to client portfolios to take advantage of the macro environment we are observing.

We see modest economic growth continuing, along with a healthier US financial system. Areas that seem best suited for this economic forecast are Technology, Healthcare, and multinational Industrial companies. We have increased our holdings in these areas during the past few months and expect to maintain this positioning into 2012.

2011 continues to look like a year with numerous potential headwinds facing investors although we believe a number of these issues will be solved to benefit long-term investors. Equities remain undervalued based on earnings multiples, cash flow yields and compared to most other alternative forms of investment. Our current forecast is equity returns over the next 12 months to approximate the long-term average of about 10%.

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