Market Commentary

Second Quarter 2011

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we'll get there together

The second quarter of 2011 was a challenging one for investors. The benchmark S&P 500 index was essentially unchanged during the quarter, rising by a scant 0.1% including dividends. The quarter began with equity markets continuing to rally in April, furthering the rise that began last July. However, during May and June, profit taking – led by economic and fiscal concerns – brought equity prices down to finish the quarter almost where it began. There are signs that the spring sell-off may have ended as equities began a rally during the last week of June and continued pushing higher during the first few trading days of July.

Fixed income markets showed mixed performance with long-term US Government bonds moving slightly higher in price during the quarter (yields move inversely to price). The benchmark 10-year U.S. Treasury note saw its yield decline modestly from 3.47% at the beginning of the quarter to 3.18% on June 30. With all the turmoil surrounding the debt-limit and the potential for a US government default, bond investors continue to shrug off this possibility as rates continued to move lower during the first half of July. At Tandem Wealth, we are focusing on shorter-term, higher quality debt instruments to help protect against principal fluctuations. Rates are likely to move higher from here and we do not want to risk principal for the sake of a slightly higher yield.

Our Outlook

We believe the earthquake and tsunami in Japan earlier this year caused far more reaching supply disruptions than most economists and strategists initially expected. These disruptions caused a good deal of the economic soft patch we witnessed during the past three months. There are numerous signs the economy is beginning to bounce back from this short-term lull. While the employment situation remains bleak, we note that unemployment has always been a lagging indicator. Companies squeeze as much productivity out of current staff before committing to new hiring so employment may remain weak for several months into an economic pickup.

It has become clearly evident over the past few months, that the twin natural disasters in Japan earlier this year caused far greater supply chain disruptions than most had anticipated. We believed it would put a temporary restraint on global growth and remain convinced that the spring slowdown in both the US and international economies is largely due to these disruptions. As more of Japanese factories come back on line, parts shortages are waning and this should lead to increased global GDP growth in the second half of 2011.

The European debt crisis has been with us since late 2009 and has grabbed headlines again recently. While Greece is clearly in the worst financial position of the EU nations, Ireland, Italy and Portugal also face significant fiscal issues. The Europeans are struggling with the challenge of having a unified currency without having unified fiscal policies. Ultimately, the Germans will decide the fate of the weaker EU nations, due to its economy's disproportionately large size within the EU.

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While nothing has yet been done to resolve the US budget deficit issues, we believe the President and Congress will come to some sort of agreement to increase the debt limit and prevent the US government from entering default. There is a great deal of fear mongering occurring in the weeks leading up to the August 2 deadline. In the remote chance a deal is not reached before August 2, Social Security checks would still be paid and a great deal of governmental activity would be able to continue. What would change is the ability of the government to borrow 40 cents for each dollar it spends. This would cause a number of short-term disruptions and would likely drive fixed income yields higher and equity markets lower. We do not believe Congress and the President would allow this to happen.

Portfolio Positioning

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. As we head into the second half 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.

Conclusion

Tandem Wealth Advisors was founded with the knowledge that client trust is earned each day. We believe that a firm rooted in ethics and based upon a healthy interaction between our investment team and client base benefits both parties. We strongly believe that our primary role is to protect client assets that are entrusted to us. Additionally we endeavor to earn healthy returns without taking unnecessary levels of risk. We strive to outperform the benchmark indices over full-market cycles which smooth out temporary distortions caused by investor psyche or short-term disruptions in fundamental valuation analysis.

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. Yields on fixed income securities should remain low in a historical perspective for the next several quarters at least. While hurting income investors, these low rates help debtors including local, state and Federal governments. Equities remain undervalued based on earnings multiples, cash flow yields and compared to most other alternative forms of investment. Our current forecast is for full year returns approximating the longterm average for equities of about 10-12%.

In closing, we thank you – our clients – for the trust you place in us at Tandem Wealth Advisors. We believe in striving to earn your trust and loyalty every day. If you have any questions or comments, please do not hesitate to call or email us.

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