JVL Associates, LLC

NEWSLETTER

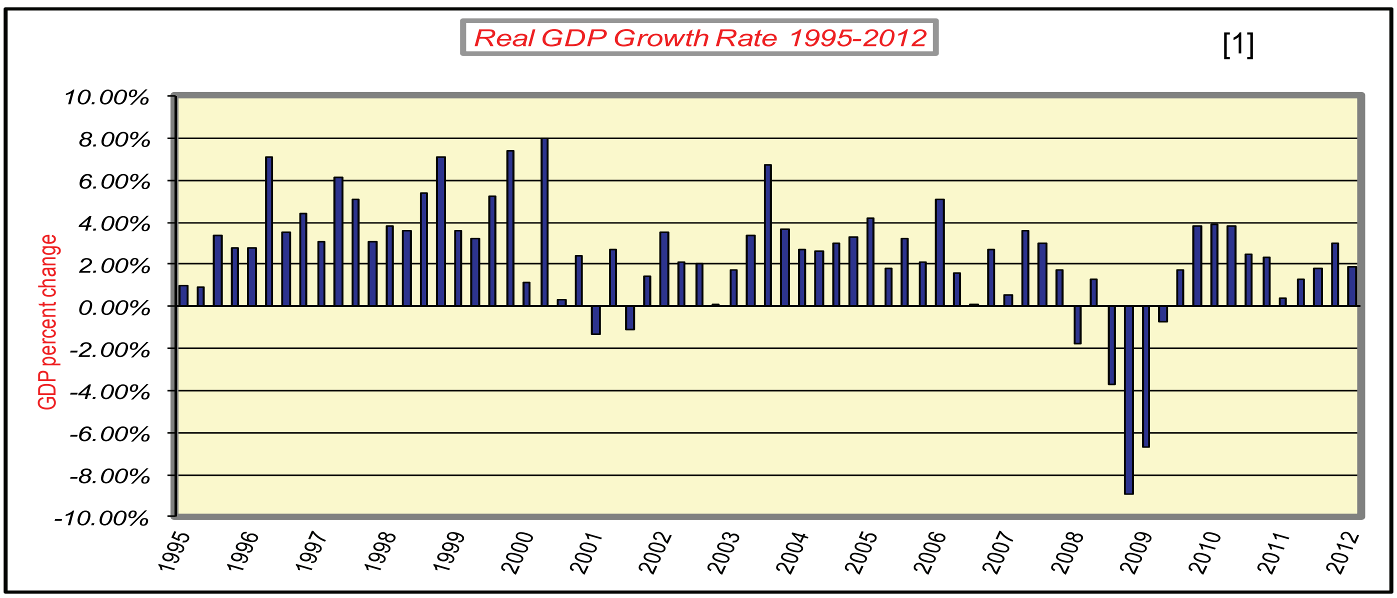
June 2012

FIRST HALF REVIEW – 2012

THE U.S. ECONOMY:

GDP Growth:

All indications point to a slowing of the U.S. economy. While quarterly numbers continue to show growth (11 consecutive quarters through March, 2012), the trend has been downward. From the fourth quarter of 2009 to the end of 2010 the GDP grew over 2% per quarter in 5 consecutive quarters. However, since the beginning of 2011, growth has been less than 2% in 4 of the last 5 quarters. Estimates for June, 2012 (data not available at time of publication) are for growth between 1% and 2%.



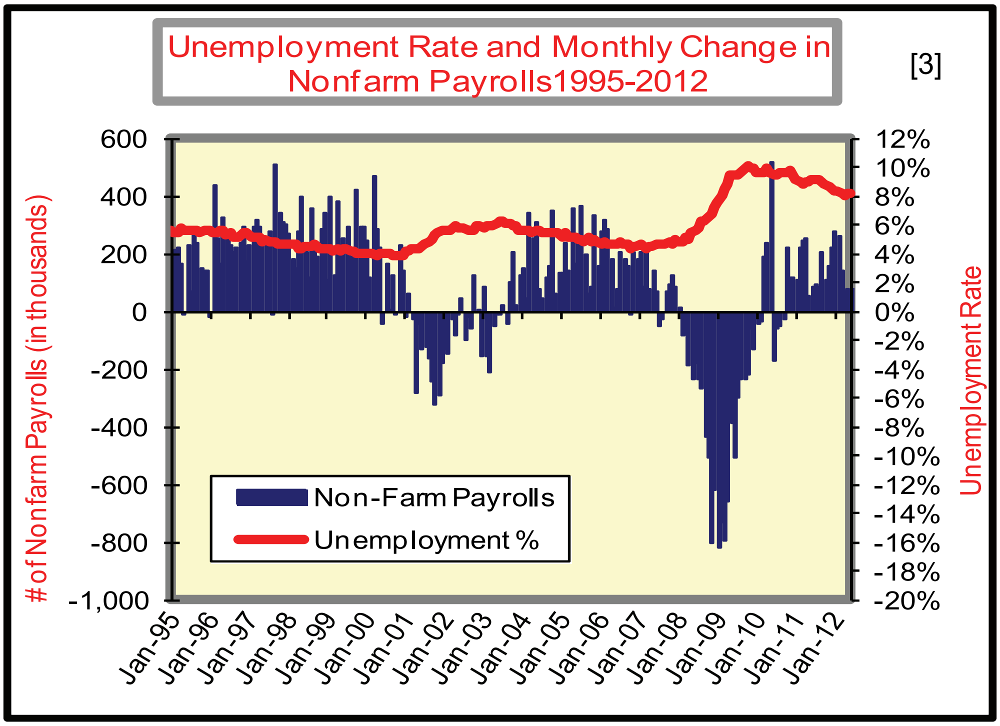
Employment:

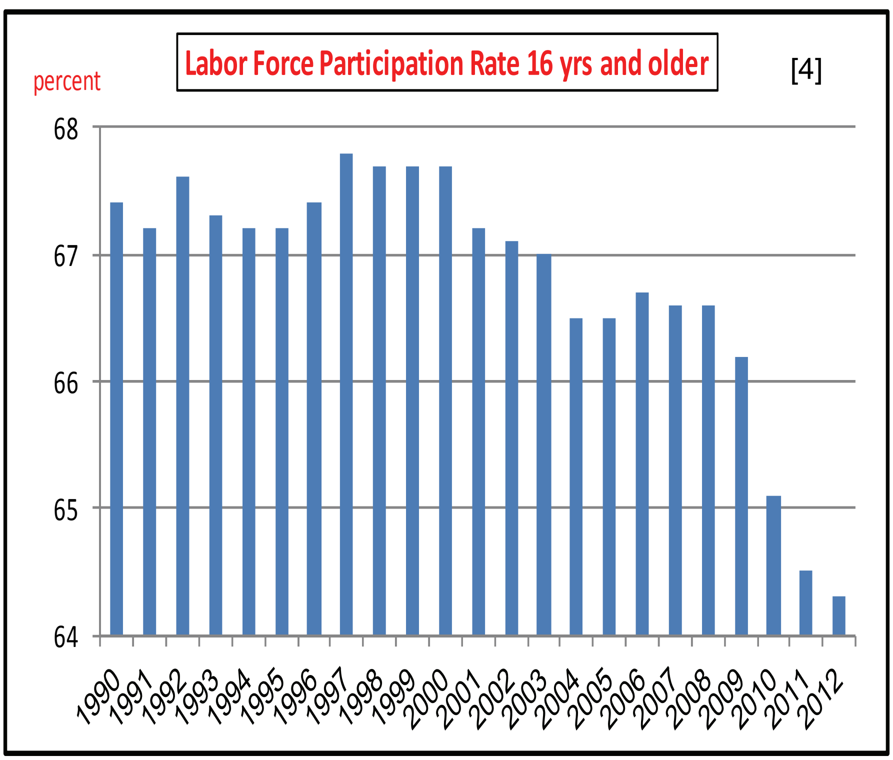
The employment situation is a major driving force in the economy. The only way to accurately understand the employment situation is to peel back the many layers that make up the data.

As of June, 2012 there are 12.7 million persons listed as officially unemployed. In addition, there are another 8.2 million persons who are working part time but would like to find full-time work (underemployed). An additional 2.5 million persons “wanted and were available for work” but were not counted as officially unemployed because they had not looked for employment in the prior 4 weeks. And finally, there are 820,000 persons classified as discouraged because they “are not currently looking for work because they believe no jobs are available for them.” Added together that totals over 24 million persons who are either unemployed or underemployed. Of the 12.7 million persons listed as officially unemployed over 40% had been out of work for over 27 weeks. (2)

The official unemployment rate for teenagers (age 16 – 19) is 23.7%. Broken out by race, the unemployment rate for whites is 7.4%; for African-Americans 14.4% and for Hispanic or Latinos 11.0%. Broken out by education, the unemployment rate for persons age 25 or older without a high school diploma is 12.6%; for those persons with a high school diploma but no college experience it is 8.4%; for persons with some college experience it is 7.5% and for those with a Bachelor's degree or higher the rate is 4.1%. (2)

Looking at the published data, the rate of job creation is slowing dramatically. During the first 3 months of 2012, employment grew at an average of 236,000 per month while over the next 3 months it slowed to an average of 75,000 per month. During the last recession the U.S. lost over 8 million jobs of which only 3 million have returned leaving 5 million persons still without work.



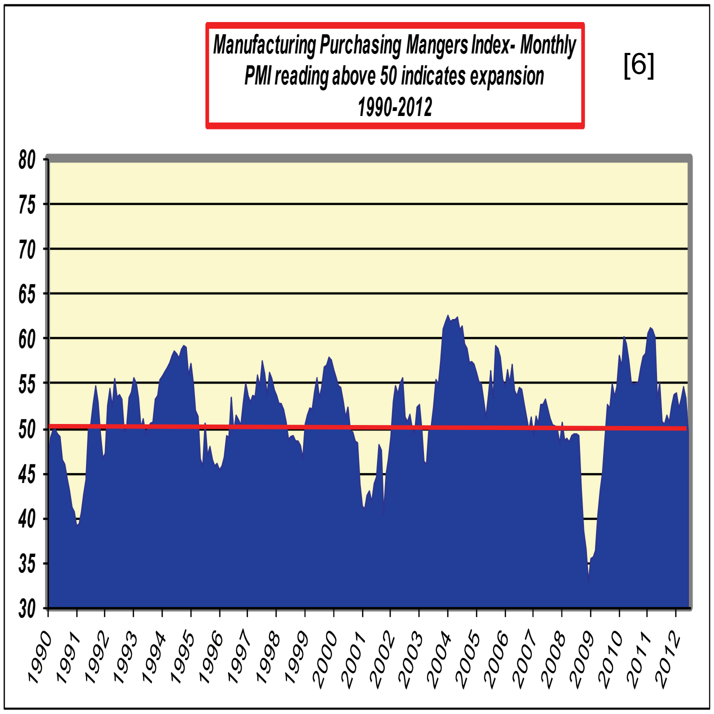


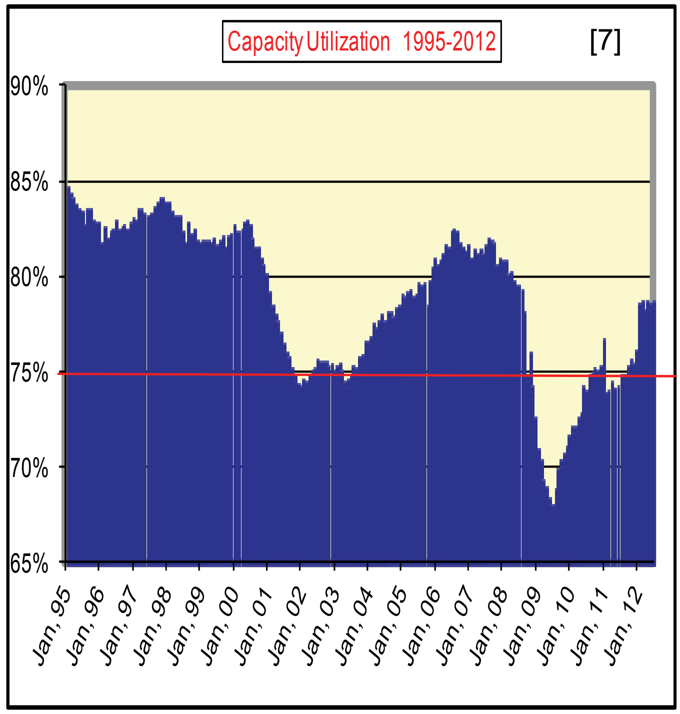
Peeling back the many layers in the data reveals that from 1990 to 2012 the U.S. population age 16 and over increased by 54 million persons. During that same time period the number of persons actually employed increased only 23 million. While there may be many differing reasons for the large disparity it emphasizes that the percentage of persons age 16 and over working today as a percentage of persons age 16 and over who desire to work has dropped from 67.4% to 64.3%. (5)

Manufacturing:

The Manufacturing Purchasing Managers Index (PMI) dropped below the magic 50 mark in June. This signifies contraction in the manufacturing sector and will be watched closely over the next few months. It is the first time the reading has been below 50 since 2009. The PMI is a forward looking reading.

Plant capacity utilization readings remained strong (over 75%) for the first half of 2012.





Home Sales:

New residential housing starts have averaged 727,000 on an annualized rate for 2012. This is up from an average of 554,000 in 2009; 585,000 in 2010 and 612,000 in 2011.

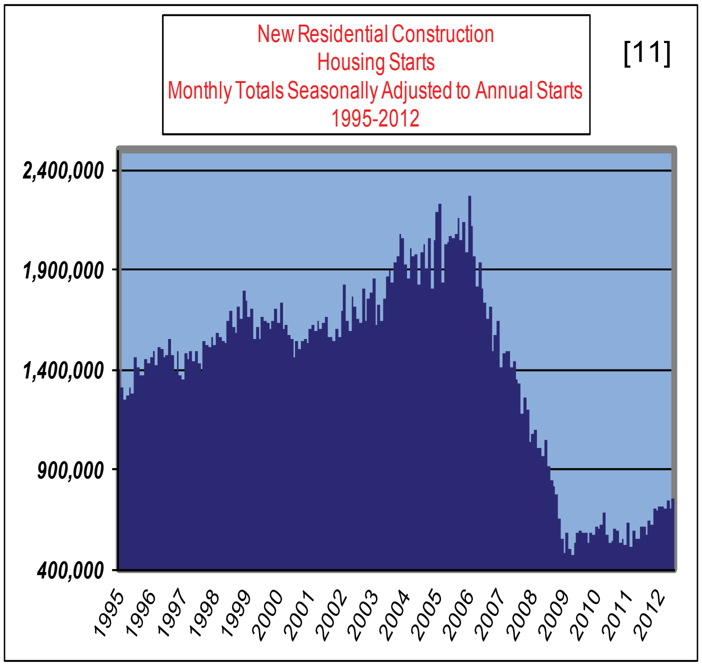
Sales of existing homes have averaged 4.5 million homes on an annualized rate for 2012. This compares to 5.2 million in 2009; 4.8 million in 2010 and 4.3 million in 2011.

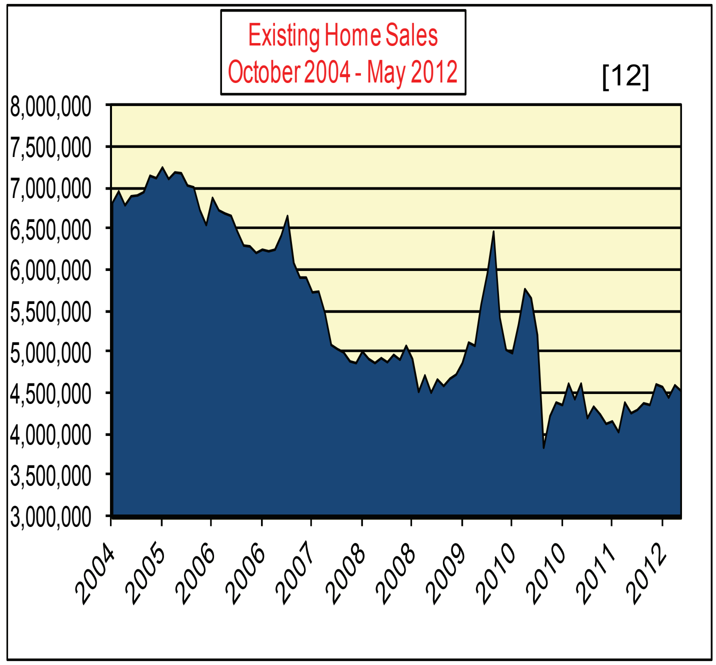
Home values have hit a plateau for the time being according to the S&P / Case – Shiller Home Price Index. While home prices remain 33% below their July, 2006 highs and continue to show year over year declines, they are beginning to show month over month increases. This may create a bottoming of valuations for the time being. (8)

The two big unknowns affecting the housing market are the number of homes in the foreclosure process that have not yet hit the market (supply) and the impact of future interest rate hikes in the mortgage markets (demand).

According to data from RealtyTrac there were 311,000 properties that had foreclosure processes started in the second quarter of 2012. That is up 9% from first quarter, 2012 and up 6% from second quarter, 2011. (9) As the foreclosed homes hit the market the supply increases and prices may decline.

Recently, Freddie Mac announced 30 year mortgage rates at 3.53% and 15 year rates at 2.83%, a new all time low. (10) These interest rates make purchasing attractive, but what happens to demand when interest rates begin to increase?

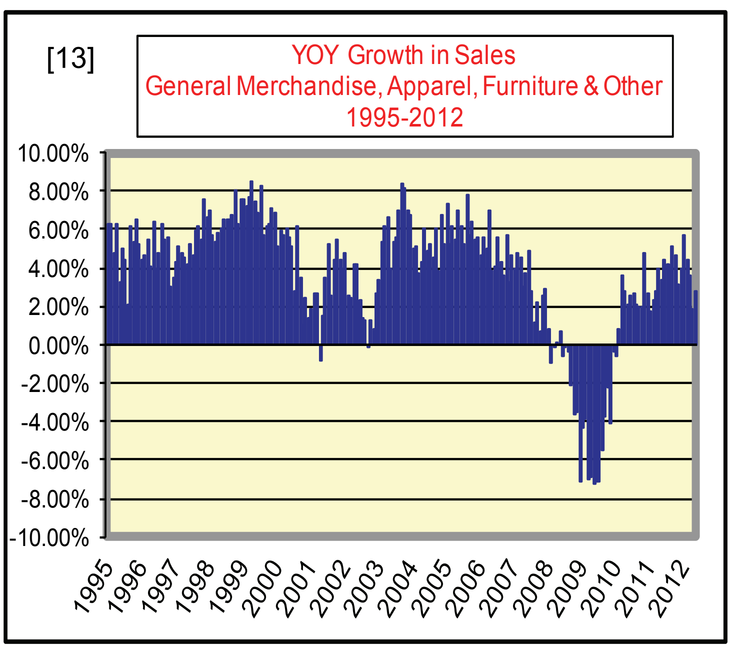


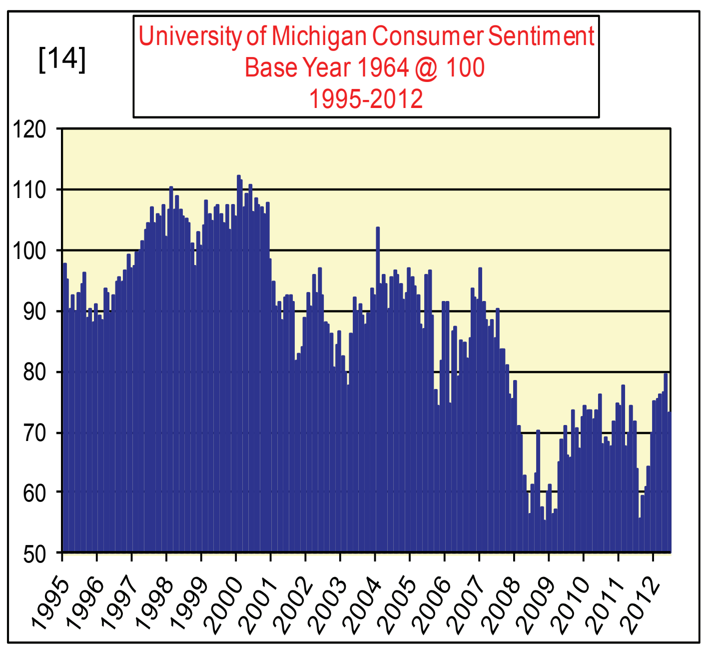


The Consumer:

The consumer represents over 70% of the U.S. economy. While year over year sales have continued to remain positive, retail sales (in dollars) peaked in February, 2012 and have declined since.

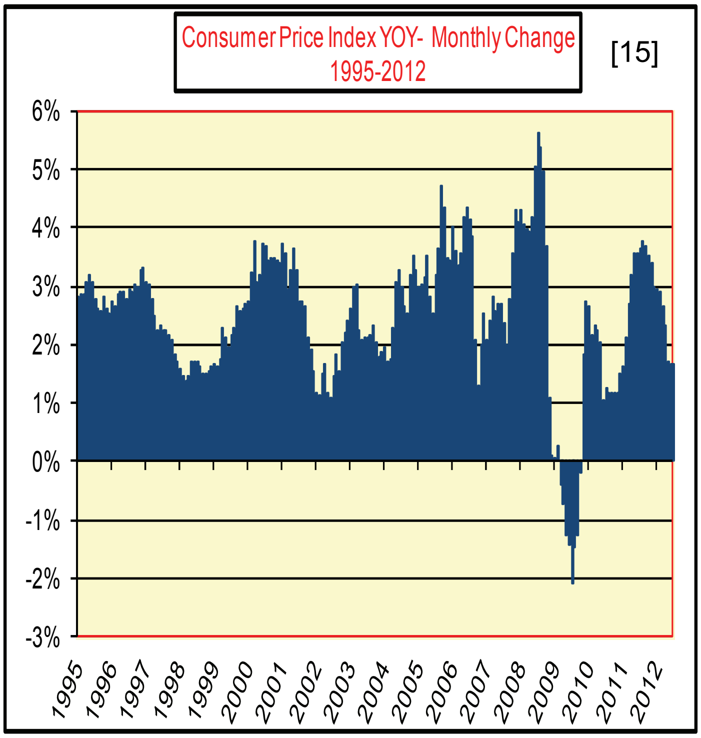
The University of Michigan Consumer Sentiment Survey has remained in the 75 range for 2012 which is above the readings of fall of 2011 but still well below their long term averages.

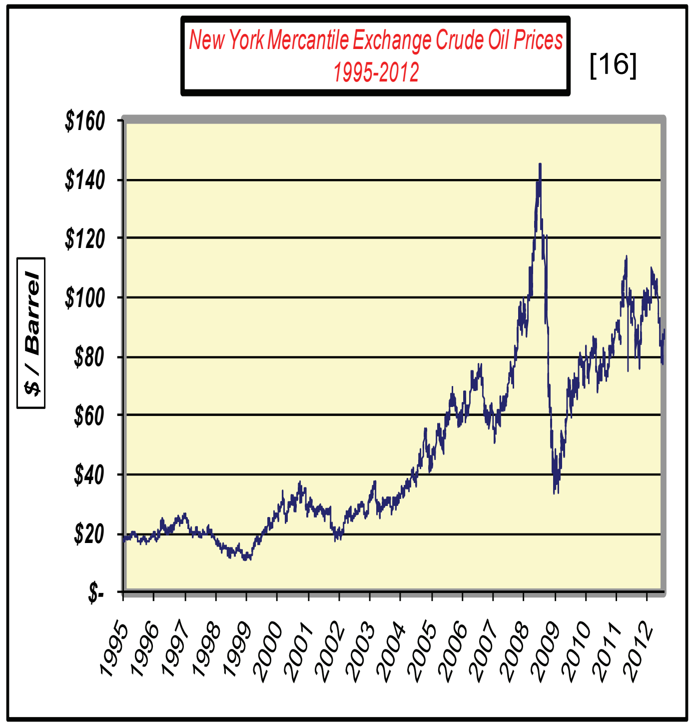




Prices:

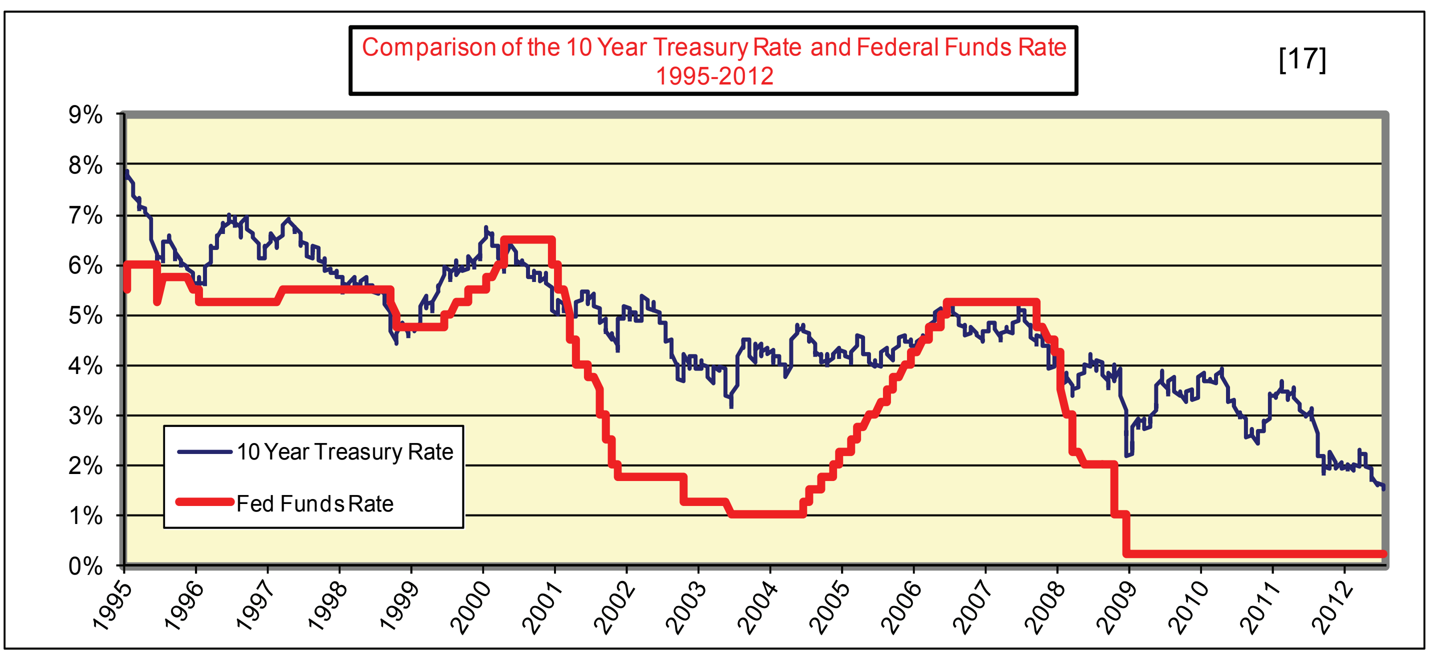
Inflation, as measured by the Consumer Price Index, has remained in check during the first half of 2012. Helping keep the rate of inflation low is that energy prices have been decreasing as the price of a barrel of oil has dropped from its March highs.





Interest Rates:

Interest rates continue to remain low – helping borrowers but punishing savers. The Federal government is paying 1.64% on their 10 year notes – meaning that bond holders are actually losing money after inflation is computed.



THE STOCK MARKETS:

The Stock markets bounced around during the first half of 2012. The Dow Jones Industrial Averages (DJIA) reached its peak on May 1, 2012 before giving all of the gains back during the month of May. June was strong as the Dow ended the half up 5.4%

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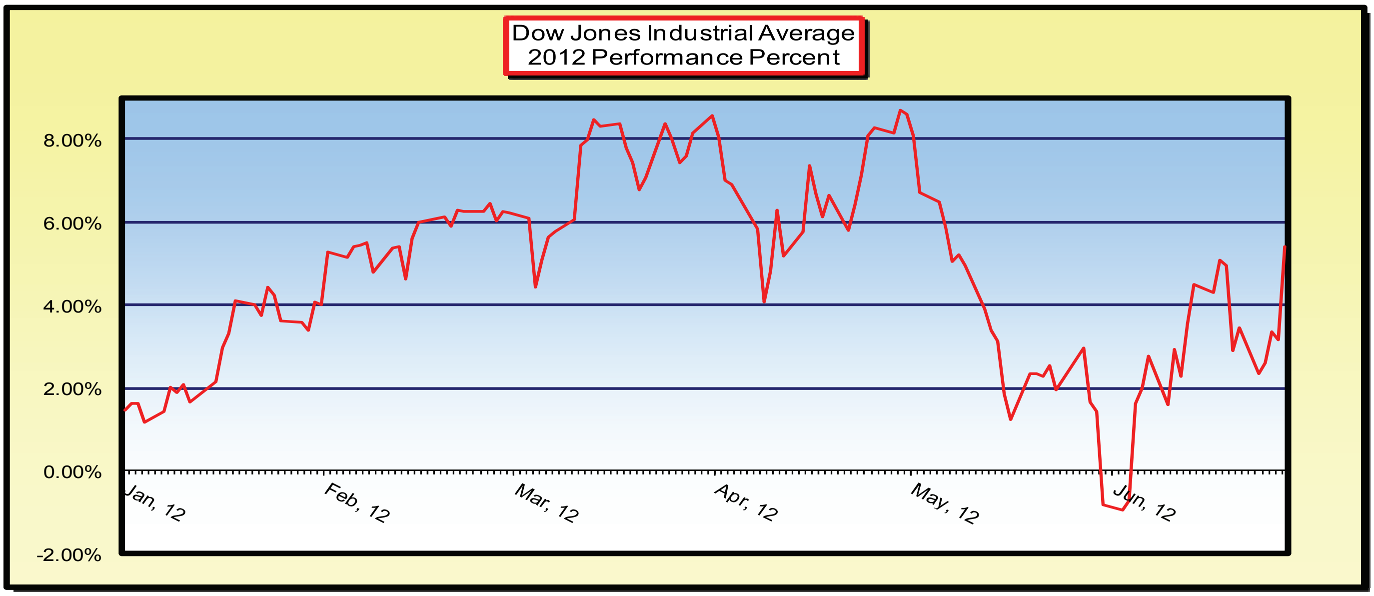


Looking at a longer term picture we see that the stock markets reached their highs in October, 2007 before falling to their lows in late 2008 and early 2009. The chart below shows the differing stock markets highs, lows, and status as of June 30, 2012. While each market has rebounded from their lows, none have yet reached their 2007 high points.

Equity Markets

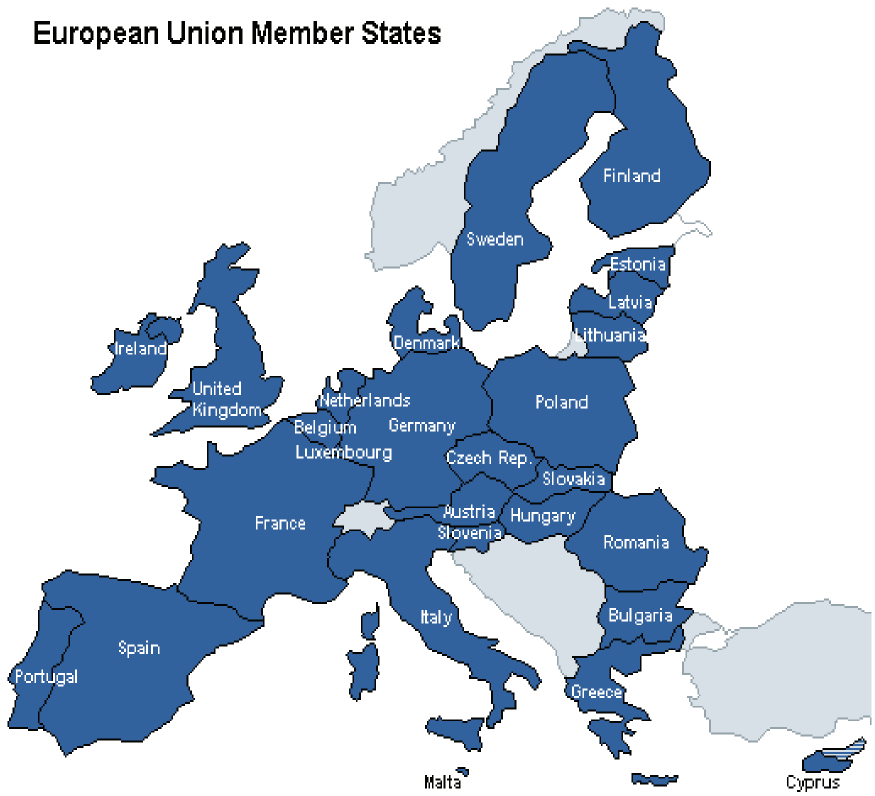
Market Highs / Lows / Current Values [19]

	2007 High		Bear Market Low		Bear Market	June 30, 2012	Increase	Decrease
Equity Market	Date	Value	Date	Value	Decrease	Value	From Low	From High
U. S. - Dow Jones Industrial Average	10-09-2007	14,164.53	03-09-2009	6,547.05	-54%	12,880.09	97%	-9%
U. S. Large Cap - Standard & Poor's 500	10-09-2007	1,565.15	03-09-2009	676.53	-57%	1,362.16	101%	-13%
International Developed - EFA	10-31-2007	86.10	11-20-2008	35.73	-59%	49.96	40%	-42%
International Emerging - EEM	10-31-2007	54.26	11-20-2008	18.26	-67%	39.13	114%	-28%
Real Estate Investment Trusts - ICF	10-05-2007	98.52	11-20-2008	28.33	-71%	78.64	178%	-20%

MACRO VIEW LOOKING FORWARD:

The macro issues continue to drive the markets. The new term “risk on / risk off” seems to play out on a daily basis. The headline news seems to dictate “up days” from “down days”.

The largest threat facing the markets is Europe. Europe is complicated – it is very different from the U.S. There are 27 independent member nations in the European Union. Of the 27 member nations 17 are part of the Euro zone and only 14 actually use the Euro as its national currency. Each nation is sovereign and separate from the others. Each country has both national interests to protect while benefiting from the use of the Euro currency in world trade transactions.



The disparity in the national finances of each country has resulted in a need for the economically stronger countries to bail out the economically weaker countries. This has been done on numerous occasions for Ireland, Greece, Portugal, and now Spain. Thus, stronger countries like Germany are providing money to the European Central Bank (ECB) who loan it to European banks who in turn are loaning those funds to the struggling countries. In exchange for the funds provided, the stronger countries are requiring the weaker nations to cut their national spending as a condition of the bail out. Since much of the national spending is for retirement benefits to former employees, cutting these expenses is politically unpopular. Political unpopularity has caused civil unrest and resulted in new leaders being elected in Greece, France and Italy.

Meanwhile the national debts continue to grow. Greece, Italy, Portugal and Ireland all have national debt over 100% of their respective GDP. This has resulted in rising interest rates that prohibit borrowing in traditional markets and thus has forced countries to submit to bail out funds to keep their countries operating.

On top of the national issues, the European banking system is in trouble. European banks are much larger than U.S. banks because European banks are the primary lenders to the individual countries. U.S. banks hold $12.4 trillion in assets while European banks hold $42.6 trillion. (20)

If countries cannot pay back their debts, many banks may fail.

And, nothing is getting fixed. The band-aids that are being applied serve only to prolong the agony for a short time. I am of the belief that Europe will not survive in its present form. The process will take time and be painful before we come out the other side.

And, the U.S. is joining the fiscal mess. Years of massive spending have resulted in national annual deficits exceeding $1 trillion each year. Not only are the amounts unprecedented but the deficits as a percentage of our GDP are unsustainable.

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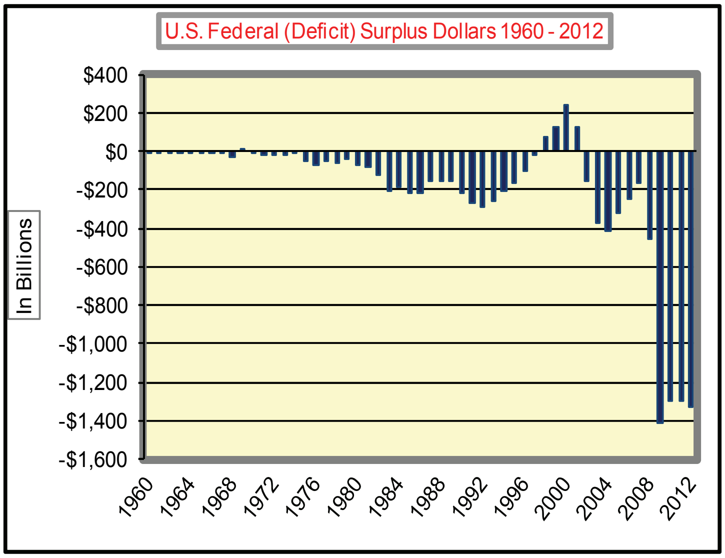

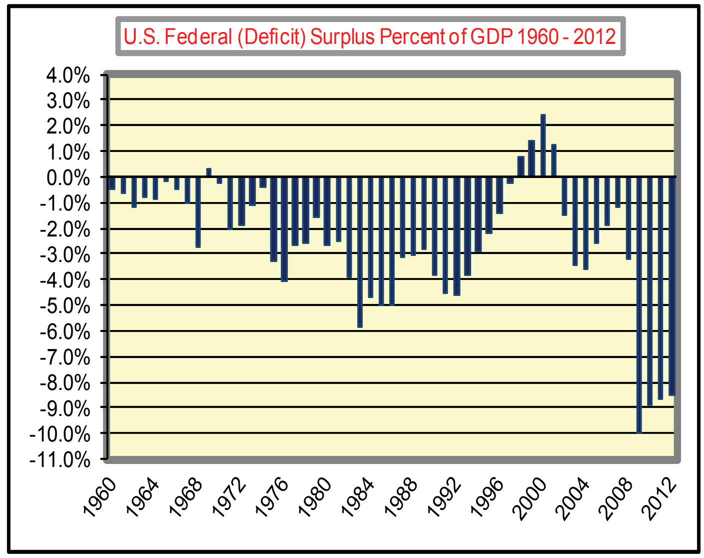

My March, 2011 newsletter (archived on our website at www.jvlassociates.com) asked the question *"Do we have a lack of will?"* The answer is emphatically YES!! Politicians argue over nickels and dimes when the problems are in trillions of dollars.

As of June 30, 2012 the U.S. national debt is $15.8 trillion pushing up against a debt ceiling limit of $16.4 trillion leaving less than $600 billion before it all hits the fan again. (22)

Will the debate be any better this time?

Compounding the U.S. fiscal problems are the many uncertainties facing U.S. taxpayers. All current individual tax rates expire on December 31, 2012 and revert back to 2001 tax rates. In addition, the Obama passed health care tax surcharges kick in on January 1, 2013. Compounding the problem is that all current estate and gift tax rates expire as well. Nothing creates more chaos than uncertainty and I do not expect to see resolution prior to the elections in November.

TIME TO LAND THE PLANE:

We are in a sustained period of uncertainty as countries try to resolve their debt issues while avoiding drastic budget cutbacks that could further slow economic growth. Growth is hard to achieve in the current environment. Traditional investment philosophies need to be reviewed, analyzed, tweaked, and in many cases challenged.

I recently returned from a week in California with my son Josh (age 17). We spent time back-packing and camping in the Sierra Nevada Mountains just outside Yosemite National Park with other dads and their sons. One of the days was spent rock climbing to the top of a 200 foot rock face where we repelled to the bottom. Josh and I had never repelled before and the thought of walking off a 200 foot cliff with your life in your own hands was exhilarating. Josh and I walked backwards off the edge, hung in the air for 200 feet as we let ourselves down with the rope in our hands – what a rush! After everyone had repelled we sat around and talked about the experience. Some said they were apprehensive or nervous as they walked backward off the cliff while others experienced fear as they hung in mid air with the rope in their own hands.

I have to say that I never felt fear or anxiousness. At first, I attributed it to naivety, never having repelled, maybe I didn't know I was supposed to be scared! But as I thought in more detail I now attribute my lack of fear to confidence in the harness, the carabineers (hooks for you non-repellant types) the ropes, and the very professional guides who set us up at the top of the rock.

Investing in today's uncertain world is not much different. By placing our trust in the process we can reduce our fears of the unknowns. At JVL Associates, LLC we take the time to research, study, analyze and implement investment strategies that take all these factors into account. We think globally in our investment analysis. We utilize strategies that blend many differing types of fixed income, equity, real estate, precious metals and commodities into portfolios that can endure the ups and downs of the markets. We use our abilities and talents so that you can walk confidently off the cliff.

If you know of someone who could benefit from our services please let us know. You can learn more about us on our website.

We are looking forward to the remainder of 2012.

By: Jerry VanderLugt CPA CFP®

Web site www.jvlassociates.com

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