

INTERIM REPORT - PORTFOLIO SUGGESTIONS

23th September 2011

Almost a year ago the FED initiated QE2 with a value of 600billion USD. They did so because the US economy was stalling and markets had reversed(S&P500 from 1120 to 1050). Historians would state...quite correctly...that the official date was 3rd November; however there was sufficient hints that QE2 was being considered to rally markets and in fairness to the FED continue the slow but evident growth in the general economy. In my 4th Qtr 2010 (Part one) Review I wrote...

"Therefore in many ways QE2 is the only available weapon in the USA's arsenal currently in play and as such is likely to be used... although I and many other economists...believe little benefit can be gained in the short term and if the eventual volume allocated, is as some expect, between \$1.5- 2Trillion USD over the next two years, then unless carefully handled has considerable downside repercussions."

My concern then was that QE2 would not stimulate a stagnant US economy; that mid term US elections would create a congress less willing to address difficulties outside of political dogma; that bubbles would occur within commodity/asset sectors and stronger currencies; that the Eurozone countries would be slow to address sovereign debt/ banking concerns. All of the above are still unresolved concerns.

As we write, the latter is to the front and centre. Sadly our present available programmes, financial strength and political credibility... needed to address the problems... has been dissipated over the past few years. Two years ago a concerted Eurozone programme to provide an "orderly default" in most of the piigs countries; a fully funded special rescue fund to support sovereign future borrowing and an overwhelming large enough banking fund to ensure liquidity within the system; was doable. Such an endeavor would have been difficult. Instead a "kick the can" down the road programme was instigated. It could be reasonably stated that the two years allowed many banks the time to repair and strengthen their beleaguered balance sheets. However, in step to this timeframe was an increasing level of public skepticism that politicians and other governance bodies had either the will or policies to correct the problems. A negative "groundswell" has been built up, which is battering greatly weakened defenses. It is quite appropriate that people living on low level land should move and take shelter. It is quite prudent for people living five miles inland to go and visit a friend while the storm lasts. A panic from those a hundred miles inland is neither prudent nor necessary. However, if the authorities were offering dramatically different weather forecasts and even stating that no storm was imminent; we would understand their nervousness and lack of confidence.

It will need a much higher level of evidence that a cohesive series of workable policies have been agreed to calm fears. However the question surely is "when" rather than "if".



Therefore our suggested "model portfolios" attempt to anticipate the long view with more than a light eye on current confidence levels. Notwithstanding our identifiable difficulties and the call for new solutions, I remain somewhat doubtful that...even under current pressures... more rhetoric than substance will ensue from G20 and other initiatives until they meet in November. I do however expect some new programmes to be discussed. An orderly default of Greece could be implemented if new programmes could be instigated to diminish the impact...especially to banks balance sheets... if the ECB decides to buy some of the Greek debt held by banks. This would reduce the "haircut" size and immediate pressure on the Greek government as to collateral. It would be less politically sensitive. It would not address the underlying difficulties, but if implemented in tandem with fully funded special rescue funds, sufficient in size to defend large countries borrowing needs; then confidence will be lifted.

An appropriate allocation spread must therefore be constructed to meet a number of very variable possibilities.

- The current lack of confidence;
- The likely positive reaction to any logical solutions presented by a reputable entity.
- Continued moderate to low overall growth rate expectations in the short term.
- Bubbles in Treasury Bills and commodity exporting countries Bonds values
- Constrained/reduced M&A and IPO activity

Therefore, we are forced to be more individual stock selectors than broader allocators when portfolios are large enough to facilitate the spread at the minimum \$8000USD entry point. When considering smaller sized portfolios then we are forced to use "sector" ETF's. They like most mutual funds have a large allocation of financials in their construction and as such could be more volatile in the short term while the Eurozone's banking sector is still unresolved. In addition I have changed the structural format to a less aggressive stance, using "Value"

rather than designated “growth” stocks/ETF’s and changed the percentage allocations to reflect a slightly more conservative approach. It would be much easier if the markets would test their lows (S&P500 at 1080). Sadly, circumstances are not always so accommodating and even if governments and Central banks continue their selfish log jammed programmes and/or fail to provide coherent well supported programmes; markets are...in normal time...forward looking(six months ahead) could rally on expectations. Therefore our selection must reflect both temporary and sustained growth, while minimising most of a downside if competence levels disappoint.

PORTFOLIO STRUCTURES.

PROFILE

- 1.) Select individual quality stocks with established Dividends as the major choice of equity exposure.
- 2.) TIPs should be used for bond exposure to protect against inflation.
- 3.) View High Beta stocks and/or ETFs are too risky.
- 4.) An emphasis on international equity exposure if necessary to protect against a weaker \$USD.
- 5.) To these I added an exposure to precious metals as they have retraces to below my short term valuation targets

My allocations were:

- 24% large value
- 7% Large core
- 7% Large growth
- 6% mid-cap

This is largely dictated by the choice of stocks.

- 8% Real Estate
- 6% commodities
- 5% gold- precious metals
- 10% International
- 5% Emerging markets
- 20% bonds
- 4% Cash

NOTE: Our clients mid to large size portfolios range between \$150K to many millions USD. Therefore to keep this suggestion profile pertinent our profiles are geared towards the lower sized portfolio within the ranges.

In early August we made some purchases and I create a list of Value/ beaten down investments which I believe have considerable upside possibilities in the mid term. They were many but I selected the following:-

BRK-B Berkshire Hathaway*; **E** ENI S.p.A. Common Stock; **MRO** Marathon Oil; **VIS** Industrial ETF; **CTB** Cooper Tire & Rubber Company Co; **HAO** Guggenheim China Small Cap Index ETF; **KWT** Solar ETF.

They all pay dividends with the exception of Berkshire Hathaway, although KWT and HAO are miniscule. The former has a stellar record over decades of quality value development and is at a discount level which puts it near a growth pick. Oil is demographically and devaluation driven. Some form of European stimulus programme coupled to a reduction in base interest rates as well as programmes to “kick start” the stubbornly moribund USA economy will be seen as a devaluation of currency. This should boost commodity prices again. In addition **E** ENI S.p.A is an Italian oil company owned in part by the government. It was affected by the loss of Libyan production, but it has invested in others and I see it rebounding on a better Libyan future and the need for the government to sell its shares to reduce is

fiscal deficits. **MRO** Marathon Oil will equally benefit from internal pressure and are well placed to develop US reserves and create jobs. **CTB** Cooper Tire & Rubber Company Corp I view as placement for today's economy. They manufacture both reconditioned and new tyres. Anything associated with consumer spending and cars in troubled economical time are traditionally oversold. They are therefore well place if the economy remains moribund and an economical solution for slightly better times. **KWT** Solar Index ETF; is a pure... highly volatile... growth option. Recent flooding of cheap stock and the Bankruptcy of a major funded USA based company, have hammered this sector. However future alternative energy needs must have solar as part of a balance programme for decades to come. **HAO** Guggenheim China Small Cap Index Addresses China's growing internal consumer development.

Therefore the following "Model Portfolios" are more diverse to spread downside risk and the "diversification" will probably impact "upside" possibilities. Never the less as you will see from the percentage fall from recent highs they still offer considerable upside' although not as much as the final chart with individual companies and sectors identified and assessed.

AGGRESSIVE (Small) PORTFOLIO \$100K

TKR	INVESTMENT	%	PRICE 23-9-11	FROM HIGH	1yr EST	%
VTI	Vanguard Total Market Viper Etf	20	57.74	-19.80	64	10.84%
VWO	Vanguard Emerging Markets Etf	20	35.80	-29.72	41	14.53%
VOE	Vanguard Mid Cap Value ETF	10	46.25	-21.30	52	12.43%
VNQ	Vanguard REIT ETF	10	50.73	-20.24	55	8.42%
VBR	Vanguard Small Company Value ETF	10	55.66	-24.30	62	11.39%
SCZ	Ishare EAFE Small Cap ETF	10	46.37	-26.44	51	9.98%
EFV	Ishare EAFE Value Index ETF	10	40.03	-29.48	46	14.91%
	Cash/ hedge position *	10				

CONSERVATIVE-MID PORTFOLIO \$100K

TKR	INVESTMENT	%	PRICE	FROM HIGH	1yr EST	%
VTI	Vanguard Total Market Viper Etf	10	57.74	-19.80	64	10.84%
VWO	Vanguard Emerging Markets Etf	10	35.80	-29.72	41	14.53%
RWX	Spdr DJ International Real Estate	10	32.36	-22.39	35	8.15%
VNQ	Vanguard REIT ETF	15	50.73	-20.24	55	8.42%
TLT	Barclays 20 Year Treasury Bond	20				
AGG	Barclay Agregate Bond	20				
EFV	Ishare EAFE Value Index ETF	15	40.03	-29.48	46	14.91%

AGGRESSIVE (Medium) PORTFOLIO \$150K

TKR	INVESTMENT	%	PRICE 23-9-11	FROM HIGH	1yr EST	%
VTI	Vanguard Total Market Viper Etf	14	57.74	-19.80	64	10.84%
VWO	Vanguard Emerging Markets Etf	14	35.80	-29.72	41	14.53%
VOE	Vanguard Mid Cap Value ETF	6	46.25	-21.30	52	12.43%
VNQ	Vanguard REIT ETF	7	50.73	-20.24	55	8.42%
VBR	Vanguard Small Company Value ETF	7	55.66	-24.30	62	11.39%
SCZ	Ishare EAFE Small Cap ETF	6	46.37	-26.44	51	9.98%
EFV	Ishare EAFE Value Index ETF	6	40.03	-29.48	46	14.91%
BRK-B	Berkshire Hathaway	5	67.20	-29.48	72	7.14%
E	ENI S.p.A.	6	33.87	-27.40	40	18.10%
MRO	Marathon Oil	6	22.94	-58.62	27	17.70%
CTB	Cooper Tire & Rubber Company Corp	5	10.82	-64.24	15	38.63%
KWT	Solar Energy ETF	5	5.22	-68.30	8	53.26%
HAO	Guggenheim China Small Cap Inde	5	19.23	-66.83	23	19.60%
VIS	Industrial ETF	5	54.32	24.47	61	12.30%
	Cash/Hedge fund	3				

CONSERVATIVE-MID PORTFOLIO \$150K

TKR	INVESTMENT	%	PRICE	FROM HIGH	1yr EST	%
VTI	Vanguard Total Market Viper Etf	8	57.74	-19.80	64	10.84%
VWO	Vanguard Emerging Markets Etf	8	35.80	-29.72	41	14.53%
RWX	Spdr DJ International Real Estate	8	32.36	-22.39	35	8.16%
VNQ	Vanguard REIT ETF	8	50.73	-20.24	55	8.42%
TLT	Barclays 20 Year Treasury Bond*	18				
AGG	Barclay Aggregate Bond*	18				
EFV	Ishare EAFE Value Index ETF	8	40.03	-29.48	45	12.42%
BRK-B	Berkshire Hathaway	4	67.20	-27.40	72	7.14%
E	ENI S.p.A	4	33.87	-58.62	40	18.10%
MRO	Marathon Oil	4	22.94	-64.24	27	17.70%
CTB	Cooper Tire & Rubber Company Corp	4	10.82	-68.30	15	38.63%
KWT	Solar Energy ETF	4	5.22	-66.83	8	53.26%
HAO	Guggenheim China Small Cap Inde	4	19.23	24.47	23	19.60%

NOTE:* The recent flight to safety has increased bond costs. At present the yields do not offer sufficient value to justify purchase. Both Funds have seen double digit growth. As market improve, money shall return to equities and prices will regain normal levels. Until then 36% shall be held in cash.

Larger portfolios have much greater flexibility by way of selection and as such the list/suggestions of August come into play. Notwithstanding the above I still believe that markets are likely to be roiled in the short term. I see nothing on the immediate horizon to convince me that better governance will be implemented easily. I do believe that some new initiatives are imminent and I am equally sure that policies will be implemented. However as long as the Eurozone is front and centre then the necessary fiscal decisions will be later than sooner in coming. Never the less last weekends IMF group meeting tends to support the view that the necessary solutions are not that far away. However the next few weeks are still vulnerable to outstanding issues.

In conclusion last week saw a \$1trillion USD drop in US equities and some of the target figures in our August list are close to reaching their buying/entry levels. The above "Model Portfolios" are more structured to individual opportunities rather than just broader spreads. While panic exists, all areas are affected whereas in reality some parts of the global economy are still quite buoyant.

SUMMARY

The above Models reflect current market conditions and are selected for the mid to long term. There is every possibilities that most of the sector ETFs could be available at lower levels than current valuations. We follow the markets with this possibility in mind. As they hit our "buying" values we shall assess whether a much better price can be achieved. However, the chances for a coordinated series of plans to assist in turning around low confidence levels seem more likely this week than last. No plan exists or seems imminent however we have come some way towards that goal; therefore some thought as to placement is pertinent. There will be a technical upswing in markets over the next few days/week. Whether this will be the point where a sustained rally is created will be determined by the how well the policymakers in Europe and the USA handle their current difficulties.

Greece will default. The uncertainty is whether the Eurozone in conjunction with the IMF and others can quickly create and implement the "overall" plans to handle all of the difficulties, rather than piecemeal solutions. If they can then a European recession is likely to be short lived. If they stumble or drop the ball then the current uncertainty will be exacerbated and their recession could be extended into years. It won't be a deep recession but it is likely to feel and

be viewed as much worse if they are forced to correct outstanding "zone" issues while addressing their own nation's individual economical and political needs.

My view is that a consensus is already being constructed...behind closed doors...to address the issues and that either willingly or dragged therein a process will finally be implemented. Currently there are legal, political and "Maastricht" contract difficulties which actively work against a simple solution. Until they are changed it is extremely difficult to see how a Greek default can be orderly. Next week their government has a vote to raise property taxes and reduce salaries by 30-40%. Without implementation the second tranche of "bailout loans" will be withheld. Even if passed confidence of actual implementation will be modest. Should we see a further run on their banks as Greek's take out their Euro's in expectations of some form of a "parallel Drachma" issue. Then contagion in Italy and Spain could occur.

Whether the “behind door” discussions and programmes are sufficiently progressed to quickly and effectively handle the situation remains to be seen. If so then a considerable boost of confidence and relief will be felt in all markets. If not then we test previous lows.

We are available to discuss the models and their alternatives and how best to timely apply them going forward. Europe could be improved quickly and the USA’s political “logjam” travails continue or the opposite. However I still remain very “Bullish” as to the longer term and recent events seem to support the idea that solutions are vigorously being sought.

Regards

Alan Lamb