CAUBLE & HARRE WEALTH MANAGEMENT

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Market Note

I want to comment on the recent volatility in the markets. The markets will value common stocks differently over time. The values are based on both underlying fundamentals and the mood of the market. Over time, as good companies find ways to grow their operations, the market valuation will increase. The mood of the market, however, will change on a daily basis. This change in mood will affect market prices, and it can create a lot of volatility in prices. This volatility is around an increasing trend over time. In other words, history shows that companies have the ability to grow the fundamental value of their operations over time. The mood of the market will underprice and overprice this fundamental value in cycles.

The first line of defense in an investment portfolio is the asset allocation policy. Knowing that the mood of the market will change, mostly in an unpredictable fashion, one can put a limit on the aggregate exposure they have to the equity market. Ideally, this allocation will be linked to a spending policy or other financial plan. This is the case for our portfolios. Also note that with the correct asset allocation, investors can afford to experience some market volatility, even in retirement. In a typical portfolio, cash flow needs can be funded for 5 plus years from assets that do not exhibit much volatility. The equity assets (that create growth over time) can be held until the market is in a better mood.

In my January letter, I guessed that market volatility would continue into 2012, but that the market would produce higher highs and higher lows. So far, this has been the case. From January through last Friday, the S&P has ended close to where it began. In fact, the market today is about 1% higher than when it closed in 2010. Corporate earnings over this period have risen 15% (S&P 500 reported earnings for trailing 4 quarters). As of the end of May, expectations for the next four quarters were calling for another 18% increase.

There is little enthusiasm in the markets today, and a decent amount of concern and fear. In my experience, this bodes well for future returns. I do continue to monitor the markets, and I do believe that 2012 will be a better year than 2011.

Sincerely,

Peter B. Harre, CFA.