

GV FINANCIAL ADVISORS



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Investment Insights

Mid 2011 Outlook

GV Capital Management



Mid 2011

GV Financial Advisors

GV Capital Management, the investment management arm of GV Financial Advisors, is pleased to present perspectives on the current state of financial markets.

GV is one of the premier wealth managements firms in Atlanta, recognized for its disciplined approach to research and investment management. As a caring partner and a conscientious steward of its clients' assets, GV has a long-standing commitment to an open and thorough research process and attention to detail that we like to call "the ruthless execution of investment fundamentals."

Members of GV's Investment Committee bring great breadth and depth of knowledge as well as years of experience to their tasks of setting asset allocation targets, constructing the firm's model portfolios, and selecting and monitoring money managers. In addition to the proprietary research conducted in-house, GV also has access to research and insights from outside experts and money managers.

In this article, the GV team explores current and emerging trends in the local and global economic landscape, the present state of financial markets and the potential impact these economic and marketing conditions may have on various asset classes.

For more information about GV Financial Advisors, please visit:

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Insights and Outlook: Mid 2011

With the first half of 2011 officially behind us, it is time to consider what risks and opportunities may lay ahead for investors the remainder of the year. In this Market Commentary and Outlook, we take a brief look back at the first six months and explore some of the economic themes and data which form the basis for 2011 tactical adjustments to our asset allocation strategy.

Recap of the First Half of 2011

At the halfway point of the year, it is interesting to look back at the first six months. The equity market climbed the proverbial “wall of worry” in the first half of 2011 (1H), as there were no shortage of concerns on which investors could fixate: Japan’s tsunami and nuclear crisis, the fast-approaching U.S. debt ceiling, continued unrest in Middle East and North Africa, ongoing European sovereign debt issues and the tenuous future of the Euro zone. Despite all these concerns, the equity markets ended the 1H up a robust 7.57%, as reflected by the S&P 500. Momentum that carried stocks higher through the first four months of the year fizzled in May given the concerns of the slowing economy. A look at the performance returns of various asset classes by their benchmark indexes (indicated by italics) reveals that most asset classes were higher at midyear:

- **U.S. stocks outperformed bonds and cash.** The *S&P 500* returned 7.57% outperforming the *Barcap US Aggregate Bond Index*, which returned 2.6% and *Citi Treasury 3-Month T-Bill* which earned just 0.79%.
- **U.S. stocks also outperformed International stocks and Emerging Markets.** The *S&P 500* returned 7.57% in comparison to the *MSCI EAFE*’s 3.51% and the *S&P Emerging Index*’s flat 0.02% return.
- **Growth stocks outperformed Value stocks.** The *Russell 3000 Growth* earned 8.52%, as compared to the *Russell 3000 Value*’s 7.34% return.
- **Large Cap Stocks had nearly identical performance as Small Cap stocks.** The *Russell 1000* returned 7.94%, while the *Russell 2000* returned 7.83%.
- **High Yield debt led the fixed income returns in the first half of the year, and was Fixed Income’s best performing sector.** At midyear, the *BofA/ML US High Yield Master II* was up 5.08%, while the overall bond market, as represented by the *BarCap US Aggregate Bond Index*, returned 2.6%.
- **REITS (Real Estate Investment Trusts) also continued their run-up becoming one of the top asset class performers.** The *Wilshire US REIT Index* returned 12.95%, while Commodities, as reflected by the *Dow UBS Commodity Index*, returned -3.36%, following the sharp correction in the commodity prices in April and May.

Data Source: Morningstar. All data is for the first half of 2011 and as of June 30, 2011.

Key Themes for the Second Half of 2011 (2H)

As we look ahead, we remain cautiously optimistic about the economy. The global economy is in a soft patch that we believe will give way to stronger data in 2H; nonetheless, we believe the global recovery may remain “below trend,” constrained as it is by the gloomy consumer. The good news is that we do not expect a double-dip recession given the stabilizing (or declining) oil prices and the strong corporate earnings we have seen. The bad news is that the economic growth rate is slowing and may remain at a pause until we see a sustained recovery in the troubled real estate, labor and banking markets.

We believe that the increase in inflation in the 1H was temporary, as the core CPI continues to undershoot expectations. Although we expect the recovery to persist, it remains restrained by lingering headwinds from the bursting of the housing and credit bubble. The economy continues to suffer from a housing hangover, the ongoing effort by consumers to reduce their debt, still high unemployment rates, the unresolved European sovereign debt crisis, probable spending cuts, and possible tax hikes, to name just a few of the challenges we face. These headwinds are ebbing only slowly, keeping growth well below that which we have seen in prior recoveries from deep recessions and below that needed to repair the damage done by the recession.

In setting our asset allocations for the second half of 2011, our Investment Committee considered a wide variety of economic and market data. Outlined below are a few of the key factors we considered and whether we concluded each to have a positive, negative or neutral effect:

POSITIVES AND POTENTIAL OPPORTUNITIES

Theme	Commentary
Corporate Earnings	We continue to believe that corporate earnings are one of the strongest tailwinds present today. While the rate of growth of corporate profits may moderate in 2H2011, given tight control on expenses by businesses and improving revenues, there might yet be further room for corporate earnings to grow.
Manufacturing Activity	As the Japan supply chain disruption effect fades, we believe that the global manufacturing activity will continue to expand and may even pick up toward the end of the year. As an example, according to ISI Group, U.S. vehicle production in July is scheduled to surge nearly 24% month-over-month due to the recovering supply chain from Japan. <i>Source: Charles Schwab.</i>
Fiscal and Monetary Policy	To date, government policies have been supportive of continued growth. We believe that the Fed will maintain its accommodative policy over the near term in order to fulfill its dual mandate of promoting full employment and stabilizing prices. We expect favorable monetary policies to continue in the near to mid-term and the Fed will be ready to introduce more stimulus if deflation risks materialize. As we had thought, the end of the Fed's second round of quantitative easing was greeted mostly as a non-event, largely due to the Fed's transparency in telegraphing its intentions early. The bond market has been adjusting to life without QE2.
Low Interest Rate Environment	Inexpensive credit allows businesses to invest in equipment, materials and manpower to fuel future growth. We believe that the current historically low rate environment will continue to benefit businesses and consumer households. The steep yield curve may prove beneficial to equities.
Oil Prices Down	High oil prices that tethered the economy in the first half and likely contributed to the slowdown in economic growth have come down substantially. Lower oil prices free up resources for other purchases.
High Cash Balances/Business Investment	Corporate cash balances continue to be at or near record levels. We continue to believe that capitalism ultimately will prevail; these companies eventually will stop hoarding money and start deploying their idle cash in search of additional profits, which could have a positive impact on jobs, capital expenditures, and economic productivity. Through the beginning of May 2011, \$1 trillion of global M&A deals have been announced, up 24% from the same period in 2010, and \$419 billion of these were U.S. deals that were announced, up 41% from last year. This jump in mergers & acquisitions activity is a bullish sign for equities. <i>Source: KPMG.</i>
Soft Landing of China's Economy	If China is able to orchestrate a soft landing of its economy and quell fears of a hard landing, a soft landing has the potential to improve market sentiment. The current credit tightening cycle as inflation increases has been a primary cause of the Commodity and Emerging Markets correction.

NEUTRAL

Themes	Commentary
Growth is Slowing	The U.S. and global economies remain in a subpar growth cycle and currently appear to be in a slowdown phase looking at the incoming economic data. Some of the reasons for the slowdown appear to be temporary, such as the impact of the Japanese Tsunami on supply chain disruptions, the spike in commodity prices, and bad weather. Given the transitory nature of these factors, we are expecting a better second half of 2011, but weather remains unpredictable.
Consumers tuckered out?	The June retail sales demonstrate that consumer spending has paused after declining 0.2% in May. Tepid confidence, weak labor markets, and heightened oil prices continue to hamper the potential of consumers. This cloud on consumer spending may improve as oil prices fall.
Credit Environment	We continue to believe that credit still remains relatively tight given the higher loan standards and modest demand for loans by households and small businesses.
U.S. Dollar	The end of the Fed's QE2 program has coincided with the recent appreciation of the much-maligned U.S. dollar. Given the negative correlation the dollar to the equities, this might not be good news unless the stronger dollar is associated with positive U.S. policy news such as a credible U.S. debt deal. A weak U.S. Dollar may be beneficial for exports, but it can hurt imports. The dollar may continue to be weak relative to the emerging currencies given the twin deficits, the large U.S. output gap and the aggressive monetary policy.
Inflation	We continue to believe that inflation is low and any rise in the 1H is likely to be transitory. However, the ability of the Emerging Markets to transport inflation to the Developed world given the governments adopted policy measures to curb growth and minimize inflation remains unknown.
Volatility	Uncertainty in the global economy and markets may create volatility.

NEGATIVES AND POTENTIAL RISKS

Theme	Commentary
Unemployment	We continue to expect unemployment to have a negative impact on the economy over the mid-term. The recent rise in the unemployment rate to 9.2% may peak out with slight improvement in the jobs growth in the latter half of the year; however, stubbornly high rates may mean we are experiencing structural unemployment which could take longer to resolve. The elevated unemployment rate remains a drag on the economy. Source: U.S. Bureau of Labor Statistics
Sovereign Risks	The European Union's piecemeal response to Greece and Ireland's debt crises has not calmed investors. We also see potential for the debt crisis to engulf other EU countries, specifically, Italy, Portugal and Spain. The highly valued Euro could pose additional risks.

Political Gridlock	We need to see a credible deficit reduction plan from Washington for long-term improvement of the U.S. economy. Gridlock between the Republicans and Democrats regarding raising the debt ceiling continues to add unwelcome volatility and noise to the markets. We believe that the structural problem with our debt and deficit will remain unresolved and not seriously addressed at least until after 2012 elections. We believe that any political drama that fails to raise the debt ceiling (unlikely scenario) will prove catastrophic for the markets and the global economy in the short term. The good news is that we finally have Washington talking about spending cuts which we believe will have long term economic benefits.
Weak Housing Market	We continue to believe that home prices will be held back by high inventory levels; however, there might be light at the end of the tunnel as delinquencies pause. Some pundits believe that we may see a gradual recovery, but when and by how much remains uncertain.

To summarize, our economic and market outlook have not materially changed since the beginning of the year; however, volatility has increased in response to the disappointing economic data and renewed fears of the European sovereign debt crisis. We continue to believe that the economy will continue to grow, although at a slower rate (more like a pause), and that a high proportion of companies will continue to meet or beat their earnings estimates. A low- growth environment, with volatile prices and limited pricing power, will continue to provide a rationale to differentiate between high (risk-off) quality companies and stocks of the low (risk-on) quality companies. Valuation of the market plays a small role in determining the short-term direction; however, equity valuations appear to be in a fairly valued mode. Our Investment Committee believes that we will continue to experience an ongoing recovery in the economy and the markets.

Asset Class Implications

GV Financial Advisors remains committed to making investment decisions based on empirical data and rigorous analysis. For the remainder of the year, we have made some tactical adjustments to our model portfolios in an effort to seize upon opportunities suggested by the themes and economic and market conditions outlined above. Our Mid 2011 Outlook for various asset classes is outlined below:

GV Financial believes ...	Outlook for Mid 2011
Bonds	<ul style="list-style-type: none"> ▪ We continue to reduce our bond allocations with a long-term view that there are other asset classes that can also act as a hedge and counterbalance to equities and provide income while maintaining the overall risk profile of the portfolio. ▪ While we believe that the U.S. debt ceiling debate may cause near-term headwinds for the risk assets such as high yield debt, this issue may result in only temporary volatility. ▪ Any fiscal tightening is likely to affect growth negatively, keeping the Fed on hold for longer, further steepening the yield curve. We recommend staying diversified across the yield curve versus targeting the short end of the curve. ▪ US state fiscal austerity will be positive for high quality municipal bond issuers. ▪ Credit-sensitive bonds may continue to provide value in this low yield environment as the economy improves and the default fears subside.
Equities: Domestic and International	<ul style="list-style-type: none"> ▪ Domestic and International stocks offer value, although our analysis of valuations do not seem to favor one asset class over the other. ▪ Emerging Markets is a long-term secular theme, given the rising consumers that have healthy balance sheets. ▪ Expensive Emerging Market valuations, inflation and tighter government policies may present risk and increased volatility in the short term.
Equities: Large Cap and Small/Mid Cap Equities	<ul style="list-style-type: none"> ▪ Large-cap companies may benefit from the following tailwinds: a weak U.S. dollar, better access to capital in the tight credit environment, greater global exposure, higher dividend yields, and cheaper valuations. ▪ Small-cap companies may benefit from Mergers & Acquisitions as many companies have high cash balances. However, their valuations appear to be more inflated now than six months back. Small-cap stocks may suffer from lofty earnings expectations and equity managers that are already fully invested and have low cash levels. ▪ We believe staying diversified with a large-cap bias may offer value.
Equities: Growth and Value	<ul style="list-style-type: none"> ▪ Increased capital expenditure towards technology is a key factor favoring Growth stocks over Value stocks. Value stocks tend to be driven by financials which still have lingering issues from the 2008 credit crisis and increased regulations. ▪ Growth equities may offer opportunity due to greater global exposure, weaker dollar, higher than normal dividend yields and cheaper valuations. Growth appears to be historically undervalued based on multiple valuation criteria such as forward

	<p>Price/Earning, Price/Book and Price/Sales ratios.</p> <ul style="list-style-type: none"> Historically speaking, Growth stocks tend to do better as the economic cycle becomes mid-cycle.
Commodities	<ul style="list-style-type: none"> Over the long term, we believe that Commodities have the potential to help hedge overall portfolio risk while also providing opportunities for investment growth. Commodities are all about supply and demand. If the global economy slows in a short term, we may expect increased volatility to continue in this asset class. The compelling trend is certainly more mature now than it was two years ago from a cyclical standpoint.
Alternatives	<ul style="list-style-type: none"> We have added a sub-asset class that we believe has the potential to provide a hedge, low correlation to the equity markets and downside protection. Previously, we used only Real Estate and Commodities as the historically low correlated asset classes. Given the recent increased correlation of Commodities and Real Estate asset classes to the equity markets, we believe the Alternative allocations should help provide a more effective hedge. <p>Cash could be considered such an asset exhibiting the traits of a low correlation. This may allow us to take advantage of potential opportunities in the future.</p>

Final Words

At GV Financial Advisors, we believe successful long-term investing stems from thorough research of the available data and careful analysis of its implications, not emotionally charged decisions. Should you have any questions, please feel free to contact us at GV Financial.

On behalf of all the Advisors and Investment Committee, we thank you for your interest.

Sincerely,

Aradhana Kejriwal, CFA
Portfolio Manager

Matthew Geller
Chief Operating Officer

[Please see the important disclosures that follow.](#)

Wealth Management at GV Financial Advisors



A Three-Part Program for Wealth Management

THE GV APPROACH

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