



Fee-Only Portfolio News

A Quarterly Summary of Events and Changes July 2008

Historical Recessions and the Stock Market By Peyton

The stock market does not REFLECT current economic conditions, but rather FORECASTS conditions, typically 6 months or more, into the future. So the stock market's poor performance is indicative of what?

According to the National Bureau of Economic Research, a recession can be defined as **"a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion. Expansion is the normal state of the economy; most recessions are brief and they have been rare in recent decades."**

Looking back on the last 9 recessions (since 1953) provides valuable clues as to how this current one may play out. The average recession lasts 11 months. Stocks begin their descent 6 months earlier, and lasts 6 months into the middle of the recession. During this period the average return on stocks was a negative 21%.

Then, as the markets discounts economic recovery, the returns turn positive, and the upward slope for stock prices averages a +36% return. Through the entire "recession cycle", investors have averaged +8%

The worst return, pre-recession to post-recession, since 1953, began in 2000, when the dot-com bubble burst, the 9/11 attacks occurred, and corporate accounting scandals were headlines. Investors suffered a loss of 30% pre-to-post-recession, then in 2003 they enjoyed a gain of 28.5%. The next worst was Nov '73 to March '75, a loss of 22%, during OPEC price-quadrupling, Watergate scandals, and Vietnam War spending.

From June 2007 through June of 2008, the S&P 500 has lost 18.25%. So we may have more time and further stock price reductions. Or not. The problem is that these things are not predictable. But we do know that patient investors average 8% from pre to post-recession, on average, if they simply weather the full market cycle. Also, well-allocated investors reduce the peak-to-trough impact by owning bonds, which typically perform well when interest rates decline.

-Sources include: Jennison Dryden

TIME IN THE CORNER

LIFE at \$5.00.99/gallon

The US Energy market was once large enough to command respect in the world. The fear of American energy conservation measures was enough that Big Oil always made sure the price never got high enough to keep us from driving our SUV's to work.

The expansion of China and India has changed the calculus, and our power to influence the price has faded. SO...high gas prices are here to stay, it appears. What can, or should, we do?

For most of us, this is about our personal economy. Yes, the price of oil at \$140 does make alternative fuels more feasible, and that's good, but it's really about our family's budget, isn't it? About making smart decisions to respond to the new fuel costs?

DO NOT trade in the gas-hog for a fuel-sipper, and spend \$15,000 doing it...it will be years before the fuel savings reward your "smart" decision. Make only lateral moves to a smaller car, and don't spend any more than your current vehicle's value.

Car-pooling with your co-workers puts money in your Pocket *next week*, so start there.



Peyton, Rhonda, and Russ

Your house may be an energy pig, so turn down the temp on water heater, put new windows in, insulate, get an energy efficient furnace, and enjoy the available tax credits for it. Take excess weight out of your car, stop running errands to excess, be a "hyper-miler" by slowing down, and keep your tires full of air.

Most of all: **Keep things in perspective.** We have enjoyed artificially low prices for fuel for many years. The commuter earning \$75k, making a 60 mile round-trip commute, was spending 2% of his income at \$2.00 per gallon. At \$5.00 per gallon he is spending 5%. His weekly costs have increased by \$90, but it's neither the end of the world nor an excessive percentage of his working income if you **keep it in perspective.** We must all make changes, but they are good changes in the long run. Our kids and grandkids need a planet too, after all. Don't spoil the joy that today brings by framing things in a negative light. Slow down and enjoy it! Deepen your relationship with your co-workers on the drive in. Plant a garden with your granddaughter. Walk and enjoy it more.

Russell Hawkes Portfolio Design: What is behind it all?

As fee-only investment advisors, we do things differently when assembling and maintaining your portfolio. First, we use only “No Load” mutual funds that neither charge you, nor pay us, for inclusion in your portfolio. Also, we are on-going managers of your account...we re-evaluate both the investment allocation and manager choices we made initially, to make sure your account contains our current best thinking...always.

There are two important elements to portfolio design: the amount in each asset class and the mutual fund managers selected.

Research shows that the asset allocation policy (how much stocks, bonds, and which kind of each are used) is the most important decision, and has the biggest impact, on investment success. It is for this reason that we consult various outside experts to help us design the portfolios. Litman-Gregory is our main source of wisdom on this matter. Their role is to ascertain for us, based on historical benchmarks, the optimum asset allocation for 4 places on the risk spectrum, ranging from low to high risk. This is referred to as the neutral portfolio stance, where diversification is thorough and deep, and where risk is minimized in all market environments.

A second level of research is on-going, adding a tactical element to our portfolios. Markets are volatile, and tend to overreact to the news of the day. Occasionally we identify what we call “fat pitch” opportunities, when the valuations within a certain asset class are so low relative to historical norms that they warrant special attention, and added allocation, within our strategies.

Once the asset allocation decision had been made for the quarter, mutual fund managers need to be selected. There are over 20,000 mutual funds out there, so this is no easy task.

The advantage we have is that virtually ALL funds are available to us, so our work creates an “All-Star” manager stable which draws on the best talent to work for our clients.

Shopping the list of top-performing mutual funds is only the beginning of our process. Numbers are important, but they don’t tell the whole story, and they do NOT predict tomorrow’s best mutual funds...in fact half of today’s winners will fall below median in the next cycle. What can we do to improve our odds...to give us “an edge”?

We believe that well run, stable organizations are the most likely to replicate good results.

And this applies to mutual fund organizations as well. That’s why our research includes visits to many of the mutual fund companies we use in your portfolio. Future success, while not guaranteed, is at least probable when quality of organization is a big part of the selection process.

Some of the best mutual funds are “institutional”...they have large minimum purchases to deter all but the largest entities from using them. Also, some of the best funds are “closed to new investors”, so they do not become unmanageably large.

Because our investors accounts are combined into one large (Omnibus) account, and then partitioned electronically, we are able to buy true institutional shares on a preferred basis.

So our client funds are placed in hand-selected mutual funds that are monitored for quality, enjoy pricing that is 20-30% cheaper than retail buyers, incurs NO trading charges, and can buy closed funds!! Because we are “fee only”, commissions and other incentives do not draw our allegiance away from YOU, the client.

You get only the best here at Russell Hawkes Associates!!



Characteristics of Neutral Allocations

| PORTFOLIO TYPE | RISK LEVEL | | INVESTMENT ALLOCATION | | | |
|------------------------|-----------------------|-------------------------------|-----------------------|------------------|------------------|----------------|
| | 1-Year Loss Threshold | Probability of Violating Loss | INV-GRADE BONDS | LARGE-CAP STOCKS | SMALL-CAP STOCKS | FOREIGN STOCKS |
| Conservative Balanced | -5% | 2.2% | 60% | 30% | 5% | 5% |
| Balanced | -10% | 1.4% | 40% | 40% | 8% | 12% |
| Equity-Tilted Balanced | -15% | 0.9% | 25% | 50% | 10% | 15% |
| Equity | -20% | 1.2% | 0% | 65% | 15% | 20% |

Asset Class Allocations as of June 2008

| PORTFOLIO TYPE | Investment Grade Bonds | Multi Sector Bonds | Emerging Market Bonds | Large Cap Growth Stocks | Large Cap Blend Stocks | Large Cap Value Stocks | Small Cap Stocks | Intl Stocks | Global Funds | Commodity Futures |
|-----------------------|------------------------|--------------------|-----------------------|-------------------------|------------------------|------------------------|------------------|-------------|--------------|-------------------|
| Conservative Balanced | 34% | 11% | 13% | 11% | 12.5% | 12.5% | 1% | 5% | 0% | 0% |
| Balanced | 19% | 9% | 9% | 12.5% | 22% | 12.5% | 1% | 8% | 7% | 0% |
| Equity-Tilted | 9% | 5% | 8% | 16.5% | 25% | 16.5% | 1% | 10% | 9% | 0% |
| Equity | 0% | 0% | 0% | 21% | 32% | 20% | 3% | 14% | 10% | 0% |



“Patience is required and rewarded, each more so as your portfolio is positioned in stocks.”

It is important to note that returns can vary significantly. For instance, from 1/1/70-12/31/07 the best and worst returns for a “balanced” neutral allocation portfolio for the following time periods were as follows:

| Period | Best Return | Worst Return |
|---------|--|---|
| 1-Year | 44.8% <i>(for the period ended 6/30/83)</i> | -23.6% <i>(for the period ended 9/30/74)</i> |
| 3-Year | 27.7% <i>(for the period ended 7/31/87)</i> | -6.3% <i>(for the period ended 3/31/03)</i> |
| 5-Year | 24.3% <i>(for the period ended 7/31/87)</i> | 0.6% <i>(for the period ended 3/31/03)</i> |
| 10-Year | 16.4% <i>(for the period ended 8/31/87)</i> | 5.08% <i>(for the period ended 3/31/08)</i> |

Registered Investment Advisory



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The National Association of Personal Financial Advisors (<http://www.napfa.org>) is committed to the fee-only business model, to eliminating the conflicts of interest, and to offering an alternative to traditional financial sales.

Russell Hawkes Associates is a proud member of NAPFA.

Fee-Only Portfolios are designed to provide cost-effective asset management to investors of all stripes. Russell Hawkes Associates Inc is a fee-only advisor to the Portfolios. They use only no-load products, and are never driven by the incentives that commissions offer.

Huntington National Bank is retained as the custodian/trustee to the Fee-Only Portfolios. An Omnibus Account is in place to aggregate all accounts and buy institutional shares at a low cost to investors. On-Line Access is provided.

Using a system of quality control, the best mutual funds are selected for use in the Fee-Only Portfolios.. Litman-Gregory provides independent counsel to the Portfolios.

Portfolios can be assigned to each investor through a simple self-administered needs test, or a full financial plan prepared by the Advisor.

You can't ignore the **Fund-amentals**

Mutual Fund Internal Expenses: How important are they?

Before you are shown the value of your mutual fund shares, they have been reduced by the "internal" expenses of the mutual fund. These expenses include the portfolio manager and his research staff, trading costs, and administration costs. The amount of these "internal" costs does not appear on your statements, but it's no mystery...every fund must disclose them...and they're usually in the neighborhood of .25%-2.25%. Overseas funds are expensive, bond and index funds are less expensive. This makes sense if you compare the cost of searching the globe for stock op-

portunities, versus sifting through U.S. government bond offerings, for example.

So research costs money, and good research costs good money, but I dare say it is worth every penny.

That is why we, in our selection of mutual funds, are conscious of costs but not governed by them. If a mutual fund has shown excellent results, does it really make sense to throw them out of the running because those results came from a well-paid staff?

In our view, active managers are in place to separate the wheat from the chaff in the stock and bond markets. We

want them to provide the expertise to make smarter moves in both bull and bear markets, so why would we hire the cheapest manager and cheapest staff, just for the sake of saving hard-dollars? If a good mutual fund manager demands expensive research and produces superior net results, why would we question his cost structure? We wouldn't, and we don't.



Mutual fund managers often hold large cash positions if they don't like the market prices. Here is the actual positions of our managers as of 5/31/08:

| | Cash | Bond | US Stck | Foreign Stck |
|--------------------------|------|------|---------|--------------|
| Conservative Portfolio: | 43% | 18% | 22% | 17% |
| Balanced Portfolio: | 25% | 13% | 44% | 18% |
| Equity-Tilted Portfolio: | 19% | 7% | 53% | 21% |
| All Equity Portfolio: | 11% | 0% | 44% | 45% |