

# QUARTERLY REPORT

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## BEING THERE 2009

*"In a garden, growth has its season. There is spring and summer, but there is also fall and winter. And then spring and summer again..."* Chance (Peter Sellers) in "Being There"

The stock market has finally been kind to investors again. Optimism abounds that the U.S. economy will exit the recession by the end of 2009 or early in 2010. Federal Reserve Chairman Ben Bernanke is commonly cited for using the term "green shoots" to describe nascent signs of regeneration in the U.S. economy.

Chairman Bernanke's turn of phrase brings to mind the 1979 Oscar-winning satirical film "Being There." In the film, Chance (played by Peter Sellers) is an illiterate gardener, whose simple TV-informed catch-phrases are misconstrued as wisdom by the powers-that-be.

In our current real 2009 world, it appears that the polar opposite has occurred: the simple catch-phrase "green shoots", uttered by the highly intellectual and accomplished Fed Chairman Bernanke, has been mistakenly accepted as economic profundity by some semi-literate cable television talking heads, who see in it the beginning of the next raging bull market.

The term has given birth to vociferous, heated debate between economic pundits, economists, investment analysts, business leaders and politicians as to the shape of the impending recovery. Will it be L-shaped, a long flat Japan-style stagflation? A V-shaped sharp rebound,

having already seen the bottom? A W-shaped ride.... with the economy and the markets now at the top of the first V, ready for a new descent? Or, a gently upward sloped, saw-toothed economic rebound, up two steps, down one, but heading up in the medium-to-long term?



We do see some "green shoots" in the economic garden. We are mindful, however, to view this as a sobering positive development; the *pace of decline* in economic conditions is moderating and is now safely distanced from the near-freefall scare of late 2008.

## KEY FACTS FOR 2009

- Annual gift exclusion \$13,000
- Estate tax exemption \$3.5 million
- Highest marginal estate tax rate 45% in 2009
- IRA contribution limits \$5,000, plus another \$1,000 for those over fifty
- SIMPLE IRA and 401(k) contribution limits \$11,500, plus another \$2,500 for those over fifty
- 401(k) contribution limits \$16,500, plus another \$5,500 for those over fifty
- SEP IRA contribution limits 25% of compensation, max. of \$49,000
- Top Federal tax rate is 35% on income over \$372,950

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## BEING THERE

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At Wimmer Associates, our investment leitmotif is safety: return of capital is more important than return on capital. Accordingly, we invest in high quality bonds only, and our equity portfolio is dominated by a diverse blend of well-capitalized companies that we believe can weather an extended business downturn, without being adversely affected by unstable lenders. We have been especially mindful to avoid poorly capitalized or highly leveraged companies over the past few years; the reward has been the avoidance of horrendous losses in investments in banking, autos and housing.



We are confident that the recession will end at some point (we are guesstimating sometime in early 2010) and economic growth and corporate profits will recover. We do not project a vigorous recovery and regrettably believe that unemployment will linger with only a gradual return to full employment. Our thesis is that the U.S. economy became highly dysfunctional over the past decade. Homes became grossly overvalued while individuals over-borrowed on a false premise that interest rates would remain low and consumption was a right rather than a necessity. The deleveraging of the American consumer is an ongoing challenge and will take years rather than months to fully recover to a healthy state. Yet, the healing process has begun and the worst is now behind us!

We will offer our thoughts on the markets in our second quarter review below and conclude the newsletter with some timely information on how to recognize the signs of a stroke and what course of action to pursue should it become necessary. We have a “dog in this fight.” We were recently personally rewarded by the quick thinking of a family member who recognized the signs of stroke in a loved one and took the right steps immediately. Thanks to a rapid response, the effects of the stroke were essentially reversed in a one-time, three hour window of opportunity. Please read and be well!

Cordially,

Kathy Wimmer CFA, CIC  
President

## SECOND QUARTER 2009

Second quarter GDP fell by 1% which is a vast improvement from the 6.0% declines registered in the fourth quarter (2008) and first quarter 2009. Unemployment has risen to 9.5% nationally, with California suffering even more so with nearly a 12% rate. Unemployment is projected to continue to rise through the end of the year as companies seek to maintain profitability by cutting variable (labor) costs. We remain concerned that unemployment will lead to additional problems in the housing market as borrowers lose their livelihoods and refinancing becomes more problematic without gainful employment.

The housing sector has shrunk from 6% of GDP at the end of 2007 to only 2.6% today reflecting a souring economy. We have long held that residential real estate must stabilize before meaningful economic expansion can

proceed. There are now strong signs that the residential real estate market has found its bottom. After 34 months of consecutive price declines, the May results of the Case-Shiller home price index covering 20 metropolitan areas showed a 0.5% price rise! Additionally, new home sales climbed 3.6% in June for the third month in a row. Finally, the inventory of unsold homes declined from 10.2 months supply to 8.8 months. This is still an ample supply of unsold homes but it is now at the lowest level seen since October 2007. Some of the rise in home sales can be attributed to first-time buyers who took advantage of a one-time federal tax credit which expires soon, but we think that lower supplies, favorable interest rates and affordability are the main drivers behind the improvement in the housing market. Should the housing market continue to recover, we should expect a welcome boost to GDP

growth.

The stock market enjoyed its best gains in six years as the S&P 500 index rose 15% in the second quarter. The weakest, most damaged sectors of the economy including finance, autos and real estate led the way in price gains during the quarter as investors increased their risk appetite. The valuation of the S&P 500 index remains at the historical average of 16 times operating earnings, which seems high considering the state of the economy. Technology stocks, which comprise 14% of our portfolio, rose 20% in the second quarter on the hope that companies will invest in technology to improve productivity. Technology companies generally are cash rich and debt shy which will hold them in good stead through the recession.

Short term interest rates remained microscopic in the second quarter as the Federal Reserve maintained a federal

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## SECOND QUARTER 2009

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funds rate targeted at 0-0.25%. The ten-year Treasury bond, which drives the price of thirty year mortgages, rose from 2.7% at the end of March to 3.5% at the end of June as investors became concerned with future inflationary expectations. The Federal Reserve policy of flooding the banking industry with reserves through loose monetary policy has no immediate inflation impact as banks are lending less and simply parking excess reserves at the Fed for a risk-free return. This may help banks heal their balance sheets but does nothing to increase economic activity as a whole. Federal Reserve Chairman Ben Bernanke recently wrote that "economic conditions are not likely to warrant tighter monetary policy for an extended period." Should the Federal Reserve fail to tighten monetary policy in a

timely fashion so as to negate inflationary expectations, interest rates will climb and the value of the U.S. dollar will be debased.

And as for the U.S. dollar, the monetary unit saw its first decline in a year as market turbulence subsided which lessened the greenback's status as a "safe haven". The long-term prospects for the dollar are questionable as massive deficits will require a record issuance of U.S. Treasury debt which has led foreign investors to question the safety of the dollar as the world's reserve currency. Unless the Federal Reserve tightens monetary policy (at the risk of choking off economic recovery) in time, investors fear that inflation will be pursued as a policy in order to cheapen the value of U.S. debt outstanding. In response, investors have recently exited dollar holdings in favor of commodities

in the belief that "things" such as gold, copper and oil will hold up in value in the face of incipient inflation. Investors have also sought to diversify their holdings outside of the U.S. as a further hedge against a weakening dollar. Emerging markets enjoyed a strong rally in the second quarter as China rose 25% only to be lapped around the course by India's 49% gain. Aside from Eastern Europe, emerging economies have sidestepped subprime lending and over-leverage and are



## THIRD QUARTER PROSPECTS

We believe that the housing market is nearing a bottom which should lay a cornerstone for future growth in the economy. Unemployment is expected to rise through the end of the year and could adversely affect the nascent recovery in housing. The deleveraging of the debt-strapped American consumer will continue to impede economic growth both domestically and internationally.

We think enthusiasm over the rebound in financial stocks is mostly overdone. Having stared into a financial abyss in late 2008, the banking industry has seen an unprecedented level of support from policymakers. FASB suspended mark-to-market accounting so that bad loans wouldn't have to be written down to true value, the U.S. Treasury offered

cheap equity infusions to hundreds of banks to shore up under-capitalized balance sheets, and the Federal Reserve offered risk-free returns to national banks on excess reserves. Oh, yes, the FDIC provided federal guarantees to corporate debt, while the Federal Reserve bought up questionable assets (loans) in the trillions of dollars from banks. Yet, we do not see a recovery in bank lending. In fact, bank lending shrank by 2.8% in the second quarter! It is also an ongoing concern that massive government borrowing will "crowd out" borrowing in the private sector. There will be definite winners in the financial sector but we have to question the industry's true earnings power for the next year or two as governmental subsidies must still be rid from the sector.

International economic growth should benefit from dynamic growth in the BRIC (Brazil, Russia, India and China) countries. China is currently growing at an 8% annual rate through massive infrastructure programs which are meant to offset the loss of foreign demand for Chinese products. China's rapid growth in monetary supply (M2 up 28.5% in June) is an inflation concern and could lead to problems in their banking sector as industry overcapacity may limit borrowers' ability to repay loans. We recognize that there are tremendous long-term opportunities in emerging markets but remain cautious as to their valuations after this year's large run-up! Overall, we think equity valuations need to take a pause or even a slight retreat before earnings growth once again becomes the long-term catalyst for rising equity prices.

# WIMMER ASSOCIATES

Investment Counsel

350 West Colorado Blvd, Suite 200  
Pasadena, California 91105  
626-683-3150

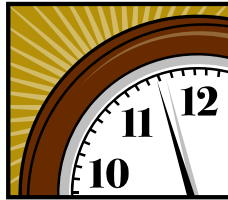
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[www.wimmerassociates.com](http://www.wimmerassociates.com)

We strive to optimize our clients' financial well being by coordinating investment decisions with other professionals in the fields of taxation and estate planning.

## WARNING SIGNS OF A STROKE

According to the American Stroke Association, strokes are the third highest cause of death in the United States. There are two kinds of stroke with *ischemic* or blood clot accounting for 85% and *hemorrhagic* or weakened blood vessel ruptures making up the balance. Ischemic strokes occur when a blood clot forms and blocks the flow of blood to the brain. Hemorrhagic strokes occur when a broken blood vessel floods the brain with blood causing undue pressure. Both strokes are treatable with time being of the essence for a favorable outcome.

Prompt response to stroke symptoms can allow for a nearly complete reversal of stroke damage if treated in the first three hours of the onset of a stroke. Sadly, only 3 to 5 percent of patients seek appropriate treatment in time.



The acute treatment for ischemic strokes is the intravenous administration of tPA (tissue Plasminogen Activator) a blood clot busting agent that can dissolve a blood clot within five minutes of treatment. Hemorrhagic strokes are treated with either surgery or an endovascular procedure where either a clip or a coil is introduced to prevent the rupturing of blood vessels.

Recognizing the signs of stroke is a prerequisite for a healthy outcome. The American Stroke Association cites sudden numbness in the face, arm or leg, confusion or inability to understand or speak clearly, loss of normal sight, loss of balance and severe headache.

There is a simple four part procedure which laymen can use to diagnose stroke:

1. Smile to see whether there is balance on both sides of the mouth
2. Talk to see whether a simple sentence is clear or mangled
3. Raise both arms out and then straight up to check for mobility and loss of feeling
4. Stick out the tongue to see if it is straight (good) or crooked (bad)

If any one of the above signs is prevalent, immediately call for an ambulance and get to a hospital for acute treatment. Remember, appropriate treatment within the first three hours of a stroke can be the difference between a full recovery or a lifetime of paralysis and/or loss of sight and speech.

*Disclosure: "Be careful about reading health books, you may die of a misprint." Mark Twain Keep that in mind as you read these articles. We obtain data from sources we believe are reliable but they should not be relied upon for making life-changing decisions.*