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THE BIG PICTURE

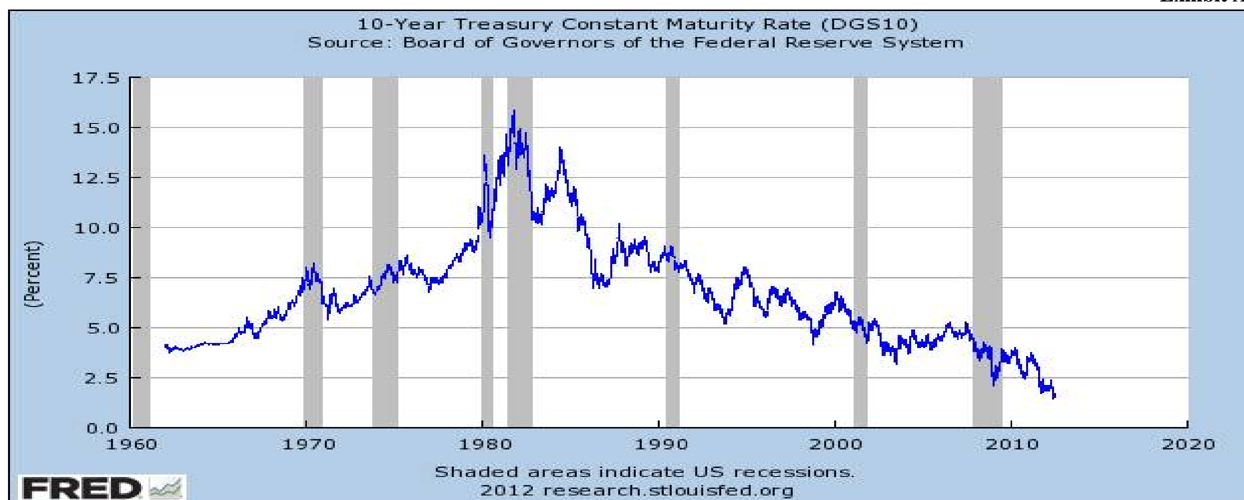
Investing is always a struggle between the realization of long-term returns (i.e. goals) and the navigation of short-term risk and volatility. For many quarters now, we have laid out our long-term view of higher inflation and, by extension, an overall increase in asset prices (including stocks, commodities, real estate, etc.) over time. The general thesis is that over-indebtedness in developed countries will be papered over with cheaper dollars and euros via a mix of stimulus (money printing) and extremely low interest rates. Further evidence of this global reflation playbook was provided on July 5th when the Peoples Bank of China, The European Central Bank and the Bank of England all announced further rate reductions and/or additional stimulus measures. Ultimately, more money means cheaper money which should have an inflationary effect on assets priced in the cheaper currency. While higher inflation is not necessarily a good thing, it is viewed as the lesser of two evils relative to deflation. Of course, the big loser in all of this is the conservative saver who is faced with negative real (inflation adjusted) rates of return on their CDs, treasuries and money market accounts. (See "Investing for Higher Income" below.)

Nevertheless, the road to reflation has been full of pot holes, providing a bumpy ride for investors. As allocators of our client's investment capital, we have sought to reduce these bumps via prudent diversification into investment grade bonds and other diversifying assets as well as tactically buying/selling various holdings from time to time. These tactical trades do not always work; however, we believe it is prudent to periodically harvest gains and/or cut losses as markets expand and contract.

INVESTING FOR HIGHER INCOME ~ PRESERVATION OF PURCHASING POWER

According to data from the Pew Research Center, nearly 10,000 baby boomers will reach retirement age *each day for the next 17½ years.* At the same time as this massive demographic wave is hitting retirement age, the ten year treasury is near all time lows yielding a scant 1.6% (Exhibit A). Retirees who had previously hoped to earn high single digits "risk free" in government bonds or CDs are finding that they are unable to earn enough on their savings. While yields on treasuries may be low, many blue chip companies are responding to increasing demand for income. Many of these stocks are generating yields above 4%, raising their dividends every year, offering potential price upside and providing an inflation hedge that bonds cannot offer. While everyone's retirement situation is different, in most cases we feel retirees and younger investors alike stand to benefit from holding at least some allocation to businesses that pay out a rising stream of dividend income.

Exhibit A



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(Investing for Higher Income cont.)

In order to capitalize on this opportunity, the conservative investor mindset needs to move away from "preservation of capital" and shift to "preservation of purchasing power". Holding all assets in "risk free" treasuries at current levels only guarantees a negative real rate of return after adjusting for inflation. Shares of dividend paying stocks, on the other hand, represent ownership in a business which provides investors with both income and the opportunity for capital appreciation. While these types of investments will fluctuate up and down from month to month and quarter to quarter, we feel strongly that the long-term holder of these stocks will experience a higher rate of return and generate more gross income than he/she may otherwise generate in a bond only portfolio.

Where We Are Investing Capital Now ~ Waiting For A "Fat Pitch"

The term "fat patch" is a baseball analogy that, when applied to investing, describes a relatively low risk (value) investment with strong upside potential. Since there are no called strikes in investing, investors have the ability to be patient and wait for a "fat pitch" before committing capital. While some efficient market theorists may refute the concept of a "fat pitch" on the grounds that the higher the potential upside the greater the risk, we believe fat pitches are a market reality, albeit a relatively infrequent one. A recent example of a fat pitch occurred during the 1st quarter of 2009 when at one point, after what seemed to be endless selling, a professional interviewed on CNBC commentated, in complete seriousness, that the Dow Jones Industrial Average would "go to zero". The U.S. markets bottomed within weeks, providing investors one of the best opportunities in a generation to invest in stocks. Unfortunately, fat pitches do not come along all the time, and in a low interest rate environment, investors need to generate some return on their capital. Still, we are always on the lookout for fat pitches; and currently, we believe that European markets may be approaching fat pitch territory. (See *Stocks* below for additional analysis.)

Below is an overview of where we are investing now across the three primary asset classes:

Diversifying Assets

Diversifying assets include investments (commodities, real estate, etc) with risk/return profiles that are different than stocks and bonds. We use the term diversifying since they generally provide a broader degree of diversification to a traditional stock/bond asset mix. In this category, we continue to provide exposure to investments tied to the Dow Jones Commodity Index and to our primary Gold/Silver position, The Central Fund of Canada (CEF). Both precious metals and other commodities like oil and gas are considered "hard assets" and should act well in an environment of rising inflation.

Bonds

Within our bond allocation, we are maintaining an extremely diversified posture in balanced and growth oriented strategies. Examples include funds that we believe offer attractive risk-reward trade-offs such as flexible and absolute return oriented fixed income funds that can pursue return and lessen the impact of potential rate increases by investing across a broad opportunity set of fixed-income securities such as short duration high yield bonds, floating rate securities, and emerging market / international bonds.

Currently, we continue to favor investing in a mix of high quality, shorter-term bonds as the core of a conservative portfolio. While rate declines are counter to our longer-term rate outlook, the potential for lower rates in the short-term has been, and remains, a risk that we are fully aware of and are willing to take in exchange for what we believe will ultimately be a much better buying opportunity in long-term bonds when rates do eventually rise. In order to add additional yield to a conservative allocation, we continue to include smaller positions in mortgage backed securities, floating rate notes, unconstrained bond strategies and emerging market / international bonds.

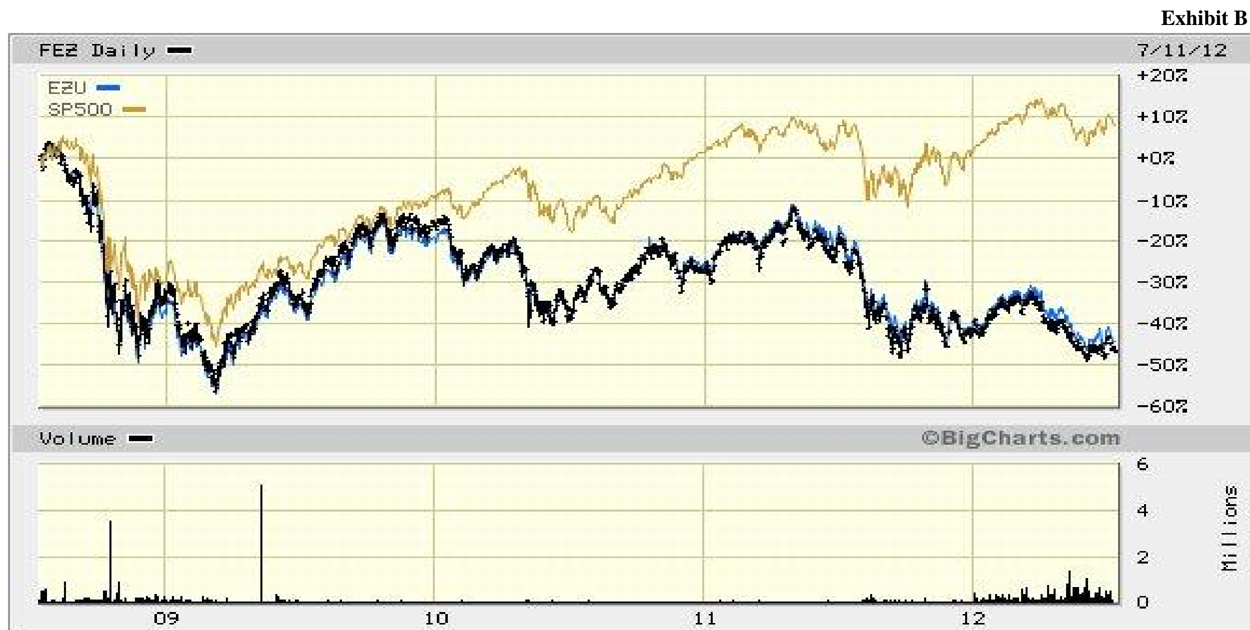
Stocks

We recently reduced stock exposure for the first time in more than a year across most asset allocation strategies. After a relatively strong first half of the year for U.S. stocks, there are several macro-economic factors that could cause a mild stock market correction (6-8%) as we approach the fall elections. First, the upcoming corporate earnings season could be tough as several major companies, including Proctor & Gamble, Texas Instruments & steelmaker Nucor, have already provided negative guidance related to their second quarter earnings estimates. Second, the upcoming election season and concerns about how the economy will respond to the "Fiscal Cliff" that is expected to hit the economy with more than $500 billion in combined spending reductions and tax increases will likely cause significant headline volatility regardless of the end result.

It is important to note that this kind of tactical trade is intended to both manage shorter-term market risk and provide a cash stash that can be used to invest at more favorable prices down the road, preferably a fat pitch. As mentioned above, we consider the broader European stock market to be a potential fat pitch opportunity and a candidate for the reinvestment of recently raised cash reserves. While most of our growth and balanced portfolios have some exposure to Germany via an exchange traded fund, the significant political and economic uncertainty on the continent has caused us to avoid adding additional exposure here. Nevertheless, European equities are now inexpensive relative to U.S. stocks with Germany, France and the U.K. all trading at less than 10 times forward earnings vs. 12.6 times for U.S companies*. Additionally, since the onset of the 2008/09 financial crisis, major exchange traded funds that track the European stock market (FEZ & EZU) have significantly underperformed the S&P 500 (Exhibit B). We will continue to follow these markets closely and may invest a larger portion of our client's stock allocation should valuation and market conditions warrant such a move.

**Source: JP Morgan Asset Management. Data as of 06/30/2012.*

Exhibit B



** Individual accounts will vary based on the client's stated objectives, risk tolerance, and time frame. We manage several different portfolio strategies, so not every client has exposure to the securities listed above. In addition to growth and/or income oriented asset allocation strategies, we also manage more concentrated equity portfolios that generally carry a higher degree of risk and volatility. Please contact us if you want to discuss your portfolio strategy or any of your investments in greater detail.*

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Year To Date Performance Review

Year to date through June 30th, the S&P 500 gained 9.5%, International stocks (EAFE) gained 2.9% and bonds (BarCap US Aggregate) gained 2.4%.

Should you have any questions regarding your investment accounts, or if there have been any recent changes to your investment and/or retirement objectives, please do not hesitate to contact our office.

As always, we thank you for entrusting AMM to help you achieve your investment and retirement objectives.

Your Portfolio Management Team

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Michael Moore
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Jim Rhodes, CFA
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