



MAY 2011 INVESTMENT UPDATE

Dear Friends and Clients,

Stocks had their best month of the year in April, as strong corporate earnings and the promise of continued low interest rates vaulted the Standard & Poor's 500 index to its highest close since July, 2008. But the purpose of this update is to discuss how inflation affects our investments.

Inflation, they say, is coming back. Well, this is not anything new to us because it never went away! We've been taking counter measures against the shrinking value of the dollar ever since we started our wealth management services in 2000 and we're still doing it.

It is curious how the public dialogue about inflation ebbs and flows. Sometimes consumers (and investors) rise up in arms over the dwindling purchasing power of their money – usually, after a spike in gasoline prices. Then the worries subside, fading into the background until the next energy crisis makes front page headlines.

The truth of the matter is the Federal Reserve has engineered inflation almost from the Fed's founding in 1913. Starting with World War I, the nation's Central Bank has repeatedly – and in recent decades, all but incessantly-financed government deficit spending by creating money out of thin air to pay Uncle Sam's bills.

As a result, the purchasing power of the dollar has steadily eroded through the years. I recently noticed a chart that reflected a dollar bill issued by the Fed in 1913 has lost approximately 96% of its value. All of this explains why, as long as there's a Fed, prudent investors must assume that inflation will continue. But the Central Bank's inflationary policies do affect different markets to different degrees at different times. So let us now discuss some strategies of how to protect our investments during inflationary time.

Hard assets are often touted as a classic inflation hedge – and with good reason. For centuries, gold and silver have provided a store of value for investors wary of depreciating paper currencies. At the same time, we recognize that every investment, to be successful, has to be purchased at an appropriate price. We were happy to buy gold years ago when it was \$400 an ounce or less. At \$1500+, though, we are a lot less eager.

Another inflation hedge is single-family real estate. With home prices deep in the doldrums in some hard-hit localities, it's possible to rent houses for a current cash yield of 10%-12%, net of taxes and upkeep. Plus, you are likely to enjoy substantial appreciation down the road, when buyers finally crawl out of their foxholes. According to a recent study by Deutsche

Bank, the 10 U.S. metro areas where rents will cover your after-tax costs by the widest margin are Atlanta (1.51X), Orlando (1.37X), Rochester, N.Y. (1.36X), Cleveland (1.33X), Tampa/St. Petersburg (1.32X), Las Vegas (1.25X), Jacksonville (1.23X), St. Louis (1.23X), Buffalo (1.22X) and Memphis (1.22X). Today's home prices may be presenting the best investment opportunity you'll come across for the next decade or more. Of course, not everyone is cut out to be a landlord.

For those of us who don't want to be landlords, we have been buying shares of a well-managed mortgage fund such as the Double Line Total Return Bond Fund (DLTNX), currently with a yield of 7.9%, based on the first three monthly distributions in 2011. In addition, we have increased our position in emerging market bonds and other investments that throw off a significantly higher yield than Treasuries.

Lastly, one of our biggest inflation hedge that we have invested since our beginning has been certain blue chip stocks that have boosted their dividends, over the long haul, at a rate far surpassing the cost of living.

Our investment strategy remains the same regarding our current allocations of Equity and Fixed investments of our portfolios. However, as we've noted in the past, we're gradually moving into a more defensive posture. For the short-term, we feel that these soaring share prices are due for a correction.

We want to thank all of you for giving our firm the opportunity to serve you. We thank you very much for the trust and confidence you have placed in our firm as it is always appreciated. Please contact me should you have any questions or comments. Also, we want to invite you to visit our website at www.farmandcpa.com for a quick Retirement Calculator, our latest firm news, and Market Commentary archives.