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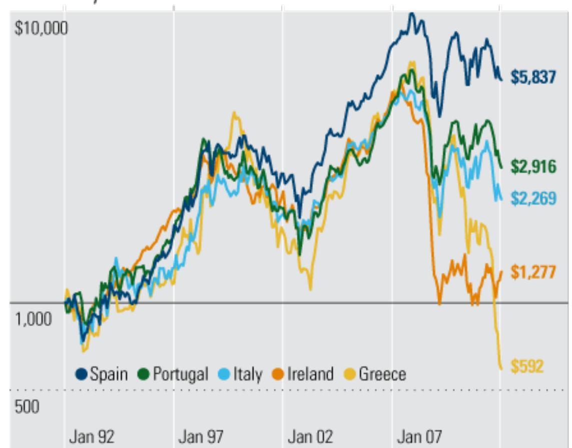
PIIGS Performance

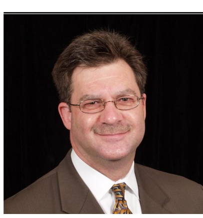
The “PIIGS” acronym refers to the economies of Portugal, Ireland, Italy, Greece, and Spain. The term became popular during the European sovereign debt crisis in highlighting the weaker performance of these economies coming out of the economic downturn. As shown in the image, the PIIGS economies have yet to fully recover from the 2007 financial crisis and the subsequent European sovereign debt crisis. In fact, an initial $1,000 invested in Greek stocks at the start of 1992 would have yielded a mere $592 by the end of 2011 (a 41% decline in value).

If an investor desires to invest in international markets, it is important to remember to diversify across not just asset classes, but also country exposure. Diversification may minimize the financial impact to your portfolio if a specific country or region ends up in financial distress.

Growth of $1,000
January 1992–December 2011



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Greece, Ireland, Portugal, Italy and Spain are each represented by the corresponding Morgan Stanley Capital International Index. Returns in U.S. dollars are based on the exchange rate over the selected time period. Returns and principal invested in stocks are not guaranteed. The 1992 start date for this analysis was chosen in order to analyze the most recent 20-year time period. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards. Diversification does not eliminte the risk of experiencing investment losses.



Louis E. Conrad II, CFA
President

lconrad@compassinvest.com
(978) 828-5681
www.compassinvest.com

More about COMPASS Wealth Management, LLC

COMPASS Wealth Management, LLC is a client-focused wealth management firm dedicated to providing superior advice to individuals, families, and corporate retirement plans.

Our wealth management services include investment management, retirement and gift planning, education funding, and other advisory services.

We take pride in offering you expert financial advice along with personalized service. Assisting you in reaching your financial goals is our business and we take that responsibility very seriously.

For details on the selection criteria used to determine the recipients of the FIVE STAR Wealth Manager award, please visit our web site.

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The Emergence of the Emerging Markets

By Louis E. Conrad II, CFA

- The emerging markets have evolved in recent years to become an economic juggernaut and creditor to the developed world.
- Though investors accept additional risks when investing in the emerging markets, they should also benefit from the emerging markets' superior return potential, as well as diversification benefits.

The emerging markets have dramatically improved their position within the global economy from numerous perspectives. Many countries have enhanced their circumstances to such an extent that they could be considered to have emerged from their previous less developed status. This month we review how the emerging markets are defined, the extent to which their place in the world economy has evolved, and the investment opportunities that are available.

Emerging Markets Defined

The emerging markets are those countries with economies that are considered to be still developing and have not yet reached a more mature phase of growth. These nations are proceeding through the industrialization process and expanding the ranks of their middle class as incomes improve. Typically, most areas of the former Eastern Europe, Russia, the Middle East, Asia (excluding Japan), Central and South America, and Africa are considered to be emerging markets, though the most underdeveloped of such regions have been labeled "frontier" markets, such as Kazakhstan, Vietnam, and Nigeria. According to the World Bank, China, India, Indonesia, Brazil, and Russia are the largest emerging markets.

The Evolution of the Emerging Markets

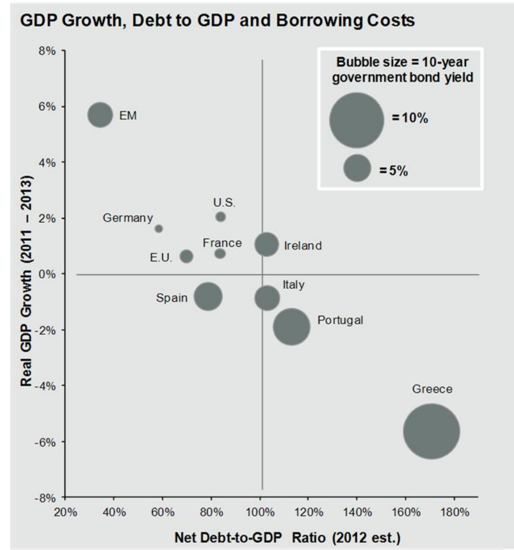
Previously, the emerging markets were the bastion for politically unstable and heavily debt-laden nations, but many have transformed themselves over the past 10 – 20 years. In fact, emerging market economies are now the fastest growing in the world, outpacing the world's developed leaders, the U.S., Europe, and Japan. Trade balances have shifted, transforming the emerging markets from net exporters of historically commodity-based goods to net importers of goods needed to drive their industrialization and emergence of middle class consumers.

The relative economic growth experienced by the emerging markets has increased their proportional share to more than one-third of the world's gross domestic product (GDP). At the same time as their economic fortunes have improved, so too have their balance sheets. The world's engine of growth is now also the creditor to the economically mature, increasingly debt-laden U.S. and Europe. China is now the largest foreign holder of U.S. Treasury securities.

In the graph on the next page from J.P. Morgan Asset Management, the economic growth and debt levels of some notable developed nations are plotted with the emerging markets (EM). The countries with the greatest economic growth lie toward the top of the chart, while those with the least amount of debt relative to their GDP are to the left. The emerging markets possess both preferred qualities—faster-paced growth and lower government debt. The size of the circles in the graph indicates the yield on each country's 10-year government bonds. Despite the emerging markets' better growth and lower debt, their government bonds yield as much as the bonds of developed nations that have had, or are undergoing, meaningful financial hardship, such as Italy, Spain, Ireland, and Portugal.

[Continued on next page.]

The Emergence of the Emerging Markets, continued



Source: IMF, BLS, J.P. Morgan Asset Management
Growth and debt data based on the October 2012 World Economic Outlook. Bond yields as of 12/31/12.
Data are as of 12/31/12.

Investment Opportunities

Despite the emerging markets' successes, their capital markets are still considered to be riskier than markets in the developed world. Though some emerging markets have less stable political infrastructures and less liquid capital markets, they also offer potentially greater opportunity.

As indicated above, emerging market sovereign and corporate bonds present one avenue for investment. The credit rating for the sovereign debt of many emerging market nations has reached the investment-grade tier, reflecting their improved circumstances and strong financial position. However, due to their overall higher risk profile, emerging market bonds offer superior yields versus comparably rated debt in the developed world as outlined previously. Emerging market debt is issued in either U.S. dollar-denominated or local currency form. Investors who believe that the superior economic growth of the emerging markets and their fiscal discipline will persist can select bonds denominated in the countries' local currencies in order to benefit from their potential appreciation relative to the U.S. dollar.

The emerging markets' superior economic growth should lead to better underlying earnings growth of companies operating in their jurisdictions and, consequently, better relative stock appreciation than in developed markets. Emerging market stocks are also generally more attractively priced than in the developed world, which supports the potential for future appreciation. The expanded opportunity set also provides the risk-reducing benefits of diversification through less correlated returns.

Though COMPASS constructs investment portfolios based on the needs of each client, most client portfolios have representation of both emerging market stocks and bonds. Clients can expect to benefit from the expanded opportunity set offered by such investments, as well as higher potential returns.

What's Next for the Stock Market?

By Louis E. Conrad II, CFA

- The U.S. stock market performed well last year and has continued that streak into the second quarter of 2013.
- Though COMPASS would not be surprised to see a correction on the order of 5 - 10%, which is a common and natural occurrence, we continue to believe that the U.S. economy will continue to plod along and a correction should not cause clients to abandon their strategy.

Following a 16% total return last year, the S&P 500 Index, considered to be a good yardstick for the U.S. stock market, increased another 10.6% during the first quarter, ending at a record high. The year-to-date gain is better than many had expected for all of 2013. Consequently, what's next for the U.S. stock market given its recent appreciation and the risks it faces?

Market Environment

Despite several head winds facing the stock market, it has not suffered from a correction of more than 3% since November 2012. These head winds have included a deceleration in corporate earnings growth and anemic economic growth, the fiscal cliff at year end, a payroll tax increase of 2%, as well as higher rates for higher earners, the ongoing European debt crisis as witnessed by recent challenges in Cyprus, and geopolitical concerns, especially Iran and North Korea.

On the other hand, the Federal Reserve's ongoing purchase of Treasury and mortgage-backed securities has helped keep interest rates near all-time record lows. Low interest rates have allowed for the recovery of the housing market, which has seen declining inventory levels and rising prices. A rebounding housing market should aid economic growth this year.

Market Valuation

Although the stock market has enjoyed a meaningful rally recently and more significantly since the market bottom in March 2009, from a valuation perspective the stock market is not expensive. Whether viewed from a price-earnings multiple, dividend yield, or other valuation metrics, the S&P 500 is currently trading near its long-term historical average on these measures. Given the low interest rate environment, it could be argued that the stock market should be trading at meaningfully higher levels, especially if some of the uncertainty from U.S. fiscal policy and the European debt crisis were to clear.

Alternatives

When viewed from the perspective of other types of common investments, stocks remain a compelling choice. For example, the safest type of investments, such as cash equivalents like money market accounts and certificates of deposit, pay minimal rates of interest, generally far below the current rate of inflation. Bonds too are suffering from low levels of interest income, but also are susceptible to a decline in value if interest rates increase should economic activity improve and the Federal Reserve reduce its bond purchases.

Market Outlook

So while the U.S. stock market has performed well recently, it is still not expensive from an historical valuation perspective. However, given the lack of a meaningful correction over the past four months and the uncertainties facing market participants, a correction on the order of at least 5 – 10 percent should not be a surprise. In fact, based on data compiled by J.P. Morgan Asset Management, intra-year corrections are commonplace. Over the past 33 calendar years, the S&P 500 has experienced 14.7% intra-year declines on average, though many are between 5 – 10% (the average is dragged down by infrequent, larger declines like those seen in 1987, 2001 – 2002, and 2008). The challenge for investors will be to maintain composure during a market sell-off given the heightened nervousness felt by many over the past several years.

Monthly Market Commentary

Recovery, full steam ahead? It would appear so. The stock market returned 11.02% during the first quarter of 2013, and the U.S. economy continues to grow at a slow but steady pace, despite apparent volatility and instability displayed by most major economic indicators.

GDP: For starters, real GDP growth rates have been highly volatile from quarter to quarter; for example, from 3.1% in Q3 2012 to only 0.1% in Q4 2012. However, it's important to keep in mind that the data includes some measurement and seasonal-adjustment issues that may blur the big picture a little bit. Morningstar economists forecast that GDP will grow at a slow, but sustainable 2.0%–2.5% rate in 2013, very similar to 2011 and 2012.

Employment: The private sector added only 95,000 jobs in March (compared with 254,000 in February). At first glance, this number is discouraging, and the lowest in nine months. However, similar to the case for GDP above, month-to-month data is volatile, influenced by weather and other seasonal factors, and often subject to revisions. Three-month average employment growth (YOY), a more reliable data point, does show slow erosion, but no catastrophic decline (2.1% in December, 2.0% in January, and 1.9% in February and March).

The Big Four: Given all the fiscal scares, Hurricane Sandy, volatile gasoline prices, and new taxes, the U.S. economy is doing surprisingly well, according to the Big Four economic indicators (private employment growth, retail sales, manufacturing, and real disposable income). Private sector year-over-year employment growth has been steady at 2% for almost two years, while retail sales growth (adjusted for inflation and excluding autos and gasoline) has been in the 2%–3% range for almost as long. Even U.S. manufacturing data hasn't been particularly volatile, especially if weather events are removed. Of the Big Four, only real disposable income has been very volatile, and most of that volatility is due to ever-shifting inflation rates (with food and energy showing the most volatility) and changes in government tax policy, not changes in wages.

Consumer: Consumer spending continues to drive the economy, constituting about 70% of GDP. Unfortunately, consumers were severely hit early in 2013 with soaring gasoline prices, a higher payroll tax, and delayed tax refunds. On the other hand, they also have a lot going for them, including lower inflation in many categories, better employment prospects, increasing home prices and related construction activity, and a much higher stock market and related wealth effects. While consumer spending is not as robust as it once was, it is clearly not falling apart in the middle of all the economic headwinds, either.

Quarter-end insights: A lot of fiscal issues were at least temporarily "settled" this quarter, helping to reassure both consumers and businesses. The fiscal cliff negotiations and the March sequestration resulted in a total deficit reduction of about $300 billion slated for 2013. The Fed plans on maintaining a relatively loose monetary policy, assuring investors that low interest rates and bond buybacks would continue to fuel further growth. As slow as this growth may be, the U.S. economy is better positioned and growing faster than many other developed economies. Some of the factors providing a longer-term advantage include newfound supplies of oil and gas, low electricity prices, more available land for building, and an improving auto industry.

In Europe, however, the situation isn't getting better, even when excluding the effects of the Cyprus situation. The Chinese economy seems to have bottomed, and future Chinese growth (if any) will likely be lower than previous peaks, and more likely to be consumption based than focused on infrastructure. Last, but not least, U.S. corporations are starting to invest for growth again (capital spending and acquisitions), which could prove to be an effective engine for further stock market appreciation.

Risk, Not Volatility, Is the Real Enemy

- This short article reminds us that the real financial risk that we face is falling short of our financial goals.
- While the value of our portfolio will experience volatility, this should be expected.

What would you do if your investments lost 10% in a single day? A) Add more money to my account. B) Hold steady with what I've got. C) Yank my money; I wouldn't be able to stand any more losses.

If investors buy the right investments but sell them at the wrong time because they can’t handle the price fluctuations, they may have been better off avoiding those investments in the first place. Most investors are poor judges of their own risk tolerance, feeling more risk-resilient in up markets and more risk-averse after market losses. However, focusing on an investor's response to short-term losses inappropriately confuses risk and volatility. Understanding the difference between the two and focusing on the former is a potential way to make sure you reach your financial goals.

Volatility encompasses the changes in the price of a security, a portfolio, or a market segment, both on the upside and downside, during a short time period like a day, a month, or a year. Risk, by contrast, is the chance that you won't be able to meet your financial goals or that you'll have to recalibrate your goals because your investment comes up short. So how can investors focus on risk while putting volatility in its place? The first step is to know that volatility is inevitable, and if you have a long enough time horizon, you may be able to harness it for your own benefit. Diversifying your portfolio among different asset classes can also help mute the volatility. It helps to articulate your real risks: your financial goals and the possibility of falling short of them. Finally, plan to keep money you need for near-term expenses out of the volatility mix altogether.

Investing in securities always involves risk of loss. Diversification does not eliminate the risk of experiencing investment losses.

Louis E. Conrad II, CFA
President

COMPASS Wealth Management
Post Office Box 250
Lexington, Massachusetts 02420

lconrad@compassinvest.com
www.compassinvest.com

Tel:(978) 828-5681
Fax:(781) 862-7030