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Some Thoughts on a Brighter Future

Since 1998 the US stock market has produced less than a third of its long term average return. From 1998 the index went on to a new high in 2001 but that was the tech bubble, not a market move with broad leadership. A litany of disasters has followed. Some disasters were external; the attacks of September 11, 2001, and some self imposed, the Fed holding down interest rates spurring the housing bubble. The 2008 election turned the country into a laboratory for Marxist and Keynesian economic policies. In a page out of "Das Kapital", auto companies were taken from creditors and given to workers. In the tradition of Lord Keynes we had the stimulus package, Quantitative Easing 1 and QE2. All of these measures have failed to revive our economy in our opinion. Today the entire planet is in a seemingly endless economic and political roil.

The ten year series of crises has brought us to the point where institutions and policies that we have depended upon in the past are no longer viable. We feel our government in an attempt to bring relief to all is now, or soon will, be in a position where it can bring relief to none.

The last "free lunch" has been served. Our $14.6 trillion in national debt and $7.5 trillion in agency debt pale beside the $78 trillion present value of our Social Security and Medicare obligations. In the same way that an individual cannot borrow their way to affluence, the country's ability to promise and deliver has come to an end.

Business is shackled by high tax rates and overwhelming regulation. Corporate taxes are higher in the U.S. than in Ireland, the U.K., Australia, and Switzerland. Boeing is being prevented by the National Labor Relations Board from opening a new plant in the right to work state of South Carolina[4]. We have, in our opinion, moved alarmingly away from being a free country.

The nightmare of central planning becomes obvious when we compare our 8,000 word U.S. Constitution with the 727,000 word Patient Protection and Affordable Care Act. For scale consider the Bible, written by forty authors over two thousand years, contains 783,000 words. Complying with regulation is a tremendous burden. We feel the Dodd-Frank Wall Street Reform and Consumer Protection Act in an attempt to protect us from the last crisis is creating a new one by paralyzing our financial system. Bank of America has recently announced plans for thirty thousand layoffs over the next few years. Given these circumstances companies move to friendlier ground. Jobs go overseas.

Now for some good news. The problems and the battles have reached a crescendo. Rather than blaming elected officials, citizens are getting involved at all levels and electing new ones. Our country is alive, our democracy is alive, and people are arguing passionately from all sides in the war of ideas and debating the proper role of government. As a country we have awoken to the reality of our civic responsibility.

Many solutions are obvious and the American people are demanding quick and decisive action. Change is already beginning and strong reforms are being implemented at the state level. For our federal government change will come slowly and grudgingly. Thankfully that is how our founding fathers designed it. When change comes we think the founders' ideals of individual responsibility, private property, and limited government will be the course for a successful future.

Imagine where stocks might trade once the imminent threat to business is alleviated and investors begin to see opportunity. We believe that the world's problems are priced into stocks. The trailing twelve month Price to Earnings ratio of the Standard and Poor's 500 Index is 12.5, a thirty percent discount to its twenty year average of 19.8[5]. Many companies are priced for years of no earnings in spite of the fact that S&P 500 earnings grew by more than five percent per year over the last tumultuous decade.

For the first time since the 1950's the dividend yield on large US companies is greater than the interest rate on ten year US Treasury Notes. Stock dividends generally grow over time. The interest paid on bonds does not.

The companies that we like today are high quality with low levels of debt and high amounts of cash on their balance sheets. These companies have been growing at a steady pace while they continue to innovate; of course, past performance is no guarantee of future results. Companies provide owners the opportunity to keep up with inflation. Large companies are buying back their own stock at a record pace. Stock repurchases for the second quarter of 2011 were forty one percent higher than a year ago[6].

We have navigated the period since 1998 with stock portfolios balanced by bonds. Bond prices have been going higher for thirty years and the ten year treasury yield is now below two percent.

What will we wish we had done today when we look back five years from now? We expect that increasing stock holdings or adding money to balanced accounts will bring some satisfaction over that period.

A key to successful investing is having the ability to anticipate change. History has shown time and again that by the time the coast is clear stocks have already made substantial gains. Now is the time to begin anticipating a brighter future for ourselves, our families, and our country.

Best Regards,

Bob

Robert W. Rathbone, CIMA
Managing Director - Investment Officer

[1] Wells Fargo Advisors did not assist in the preparation of this letter, and it's accuracy and completeness are not guaranteed. The opinions expressed in this letter are those of the author and are not necessarily those of Wells Fargo Advisors or its affiliates.
[2]There is no guarantee any forward looking statements will be attained and past performance is no guarantee of future results.
[3] Dividends are not guaranteed and are subject to change and/or elimination. While stocks generally have a greater potential return than bonds, they generally involve a higher degree of risk.
[4] Wall Street Journal, June 15, 2011
[5] Standard and Poor's Indices Market Attributes, August 2011
[6]Standard & Poor's Indices, September 20, 2011