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By: Scott Walker, CFP

We hope this finds you well and enjoying the summer. It was a bit of a roller coaster last quarter with stocks cruising higher through the end of April, and then came a seven week downturn, followed by a strong rally during the final week of June. Bonds posted price gains across the board benefitting from a flight to safety as renewed concerns about a possible Greek debt default and contagion fears shook equity markets. Gold hit an all-time record high price today of $1,568 an ounce.

We believe in a global asset allocation strategy to reduce the risk of being blindsided by something unexpected. Utilizing individual stocks and bonds, along with low-cost exchange-traded funds (ETF's) and actively managed no-load mutual funds we build all-weather portfolios that allow you to sleep well at night with peace of mind. Given the balanced conservative nature of our managed assets, we posted a gain of 1.06% net after fees for the quarter. Year-to-date we are up 3.90%. Our more conservative accounts with a higher percentage in bonds had the best returns last quarter; however, the moderate and aggressive portfolios with a larger equity weighting hold an edge year-to-date after an exceptionally strong first quarter. Your individual portfolio performance may be found on page 3 of the quarterly report package. Individual holdings and prices paid will vary based on your objectives and inception date.

The economy continues to slowly recover. Unemployment remains elevated at 9.2%, as many companies have learned how to make due with fewer full-time employees. One company that's still hiring is Google which recently opened an Irvine location and received 75,000 job applications for 75 positions. Those fortunate enough to have a job are deleveraging by paying down debt and boosting retirement savings. There is a big debate going on in Washington as the Democrats and the GOP try to negotiate a deal on increasing the $14.3 trillion federal debt ceiling. Any realistic compromise must include a combination of spending cuts and tax increases. Bipartisan support is growing for a tax holiday for multinational firms. In 2005, Congress allowed multinational corporations to repatriate foreign earnings back to the U.S. at a 5.25% tax rate. Billions of dollars flowed back to the U.S., so why not do it again?

U.S. Stocks and Dividends – Corporations added $30.2 billion to their first-half dividends. That was more than the $26.5 billion for all of 2010. Dividend increases are a sign that the board of directors has confidence in a companies' ability to continue to generate higher cash flow in the future. Here are our favorite cash flow kings that have boosted shareholder payouts this year: **Chevron**, **ExxonMobil**, **International Business Machines**, **JP Morgan Chase & Co.**, **Nextera Energy**, **Proctor & Gamble**, **Pricesmart**, **Sempra Energy**, **Target**, and **Wells Fargo & Co**. Annualized dividend yields range from a low of 1.0% for retailer Pricesmart to a high of 3.8% for utility Nextera. Dividends are paid quarterly and add to our total return, but capital appreciation is the primary reason for owning most common stocks.

Cloud computing is the next stage in the Internet's evolution. The "cloud" refers to an offsite secure data center that houses computer hardware and software which is networked to the internet. Companies can reduce information technology costs by moving applications to the cloud. Our cloud plays are **Google**, **Apple**, **IBM**, **Microsoft**, and a new holding **Juniper Networks** (JNPR). Their company mission is to connect everything and empower everyone. Juniper offers high-performance network infrastructure products that facilitate cloud computing and the faster flow of information over the internet. The company has partnered with IBM in its cloud computing offering. Two new key executives have been hired this year from Cisco. The stock is 30% off the high, with no debt and $6/share in cash. Network demand will only go up.

A recent dip in the price of **Deere & Co.** (DE) offered a reasonable entry point for those underexposed to equities. Global population and income growth are the macro tailwinds behind Deere's agricultural and construction equipment solutions. Last month, the company unveiled a bigger, more powerful line of tractors. They also are investing $100 million to expand a manufacturing facility in Pune, India to meet growing demand. Deere has increased their dividend three times in the last fourteen months.

U.S. Stock Funds / Exchange-Traded Funds (ETF's) – Last quarter we took profits and sold the Vanguard Capital Opportunity Fund due to weak performance versus its benchmark, the S&P 500 index. The fund has a large position in Research in Motion, which manufactures the struggling Blackberry. They have been losing market share to smart phones powered by Google's Android operating system and Apple's iPhone. A portion of the sale proceeds were redeployed into the **Rydex S&P 500 Equal Weight ETF**. The Rydex strategy has worked and gives us equal exposure to the top 500 companies in America, via a low-cost ETF. Another ETF that's done its job is the **SPDR Gold Trust** (GLD), which holds gold bullion and tracks the price of gold. Continued economic and political uncertainties have kept a strong underlying bid under gold prices. We are content to hold what we have but reluctant to add more at current prices.

International Holdings – Taking a global perspective and holding up to 25% of our money in foreign stocks and bonds provides diversification and the opportunity for higher returns and lower risk versus a strictly domestic portfolio. We own two conservative international equity funds that are focused in the most dynamic growth area in the world, the **Matthews Asia Dividend** (MAPIX) and **Matthews Asia Growth & Income** (MACSX).

For bonds, the **Templeton Global Bond Fund** (TGBAX) is a champ. The fund has maintained a defensive duration while still producing a current yield of 4.5%. The managers favor South Korea, Australia, Norway, Sweden, and Poland. The **CurrencyShares Australian Dollar Trust** (FXA) is a recent new addition. This ETF is designed to track the value of the Australian dollar and pays a respectable 4% current yield.

Domestic Bond Update – Bond prices surged across the board last quarter as long-term interest rates moved lower. We lightened up and sold our long-term treasury, high yield and emerging market bond ETF's to lock in gains and preserve capital. We continue to recommend a laddered approach to individual bonds with no current buys past a 2018 maturity date to limit interest rate risk.

We own two actively managed funds for their specialized expertise, defensive nature, and generous payouts. The **American Century CA High Yield Municipal** (BCHYX) has a large position in land-backed bonds that supports the current yield of 5%, which is free from federal and state income tax.

Our core taxable bond fund is the **Doubleline Total Return Bond Fund** (DBLTX), managed by Jeffrey Gundlach and his mortgage specialist team in Los Angeles. They comb the secondary market for mispriced mortgage-backed securities. The housing and credit crises devastated many of these securities, but there are gems amidst the rubble and Doubleline digs them out. They are assuming further weakness in housing with more delinquencies and defaults. They have a large weighting in prime mortgage-backed paper, versus lower quality Alt-A, or sub-prime mortgages. Current yield varied last quarter between 7.5 – 8%. Warren and I closely monitor the daily prices of these funds and will not hesitate to sell if there is a problem that we judge would lead to a sustained drop in the share price. We are not married to any of our holdings.

Splitting our exposure between individual bonds and bond funds provides the best of both worlds. Individual bonds have the certainty of semi-annual interest payments with a return of principal on the maturity date. Bond funds and ETF's provide more diversified exposure and more frequent cash payments from the monthly dividend.

Schwab Money Market Funds – Given the recent developments in Europe, we checked to see if the Schwab money funds have any holdings in European financial institutions. Schwab reports that their money funds have no direct holdings in Greece, Spain, Italy, Ireland or Portugal. The funds do hold securities issued by financial institutions in various other European countries that are high quality with a maximum weighted average maturity of 60 days or less. We are confident that all money fund holdings will pay full principal at maturity.

Your asset allocation is the key driver of volatility and returns. We are ever mindful of the downside risk, but take comfort in the overall high quality of our holdings. If you have any questions or comments regarding your portfolio, or any changes in your personal situation, please call or email. Thank you for your continued trust and confidence.

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