Financial Management Group
Building and Preserving Client Wealth Since 1989

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2011 Economic & Investment Outlook

As we expected and forecasted, the massive economic stimulus packages by the central governments world-wide since the financial crisis occurring in 2008 has created an economic environment enabling positive investment returns in 2010 for the second consecutive year. The following are the major index performances for 2010:

Index	Dec-10	QTD	YTD	Description
S&P 500 Index	6.68%	10.76%	15.06%	Large-cap stocks
DJIA	5.33%	8.04%	14.06%	Large-cap stocks
Nasdaq Comp.	6.29%	12.34%	18.13%	Large-cap tech stocks
Russell 1000 Growth	5.51%	11.83%	16.71%	Large-cap growth stocks
Russell 1000 Value	7.89%	10.54%	15.51%	Large-cap value stocks
Russell 2000 Growth	7.59%	17.11%	29.09%	Small-cap growth stocks
Russell 2000 Value	8.31%	15.36%	24.50%	Small-cap value stocks
EAFE	8.10%	6.61%	7.75%	Europe, Australasia & Far East Index
Barclays Aggregate	-1.08%	-1.30%	6.54%	U.S. Government Bonds
All returns are estimates as of December 31, 2010.				

FMG's proprietary in-house economic forecasting influences the present moment investment decision-making for client portfolios.

Since our founding 22 years ago, we have advocated and focused on asset allocation as being the most important investment decision. We utilize proprietary in-house economic analysis and forecasting methods extending out up to 24 months to anticipate how the asset classes might behave, then make present moment tactical asset allocation decisions accordingly. This has benefited our clients during the numerous economic and investment cycles that have transpired over the years.

We do not profess to have secret ways to forecast investment behavior, which is typically irrational and unpredictable, nor do we attempt to *time* when to get in and out of the markets. Rather, we subjectively *tune* the portfolio asset class weightings within preset limits using a commonsense, macroeconomic interpretation of economic indicators, while diversifying the portfolios sufficiently enough to be forgiving in the likelihood that the portfolio adjustments are not made perfectly.

Guided by this investment approach, we defensively positioned client portfolios in advance of the 2008 economic crisis, and were able to successfully buffer them from experiencing the full brunt of the traumatic market declines. Our approach also guided us to reposition the portfolios for equity growth in advance of the current uninterrupted bull market run, which started in March 2009. As a result, our managed diversified portfolios fully participated in the rebounding markets occurring in 2009 and 2010 subsequent to not losing nearly as much in 2008. This exemplifies how our "win by not losing" approach preserves and builds wealth.

The outlook for 2011 appears promising for continuing investment growth with the strongest gains expected to occur internationally.

FMG has been a leading proponent for increasing foreign exposure in *both* the equity and fixed income portions of investment portfolios. The result of our heavier foreign allocation, relative to most investment advisors, has proven beneficial, and we expect this trend to continue going forward. Today, over half of the world's equity assets are outside the U.S. and this percentage will continue to increase as the foreign economies grow more rapidly. The 2008 global financial crisis demonstrated for the first time that emerging market economies could weather a global downturn financially stronger and healthier than the U.S. economy and, therefore, the financial risks associated with foreign investing are lessening, further validating our advocacy of global diversification in portfolios.

Global economic growth for 2011 appears promising as the U.S. and major developed foreign economies are continuing their recovery fueled by low interest rates and the huge money stimuli being provided by the central governments. We foresee interest rates starting to increase very modestly sometime during the latter part of the year whenever the Federal Reserve and other global central banks determine it is economically safe to remove some of its liquidity support. However, in general the U.S. and Western European governments will be forced to maintain a relatively dominant fiscal and monetary presence in order to offset the diminished consumer spending.

Meanwhile, the faster growing emerging market economies, will be experiencing just the opposite scenario. Most of the developing countries, including China, have already raised interest rates in order to control inflation and high internal growth rates. The diversity of the FMG portfolios will benefit from these varying economic momentums. However, this requires our vigilant global economic monitoring and an intelligent active tactical asset allocation approach in order for productive investment decision-making to occur.

Close monitoring of global economic behavior will be required during 2011 in order to make beneficial tactical shifts in portfolio asset class weightings.

The worst performing calendar decade (2000-2009) ever experienced for the equity markets worldwide is now behind us. As mentioned, the global economic recovery occurring in 2010 should continue throughout 2011, and this maintains our expectation for the foreseeable future that equity performance will be more normal and typically outperform that of fixed income. This will be assisted by money inflows into equity investments from monies that are currently being hoarded in less risky, low yielding fixed income investments.

Tactically, we anticipate our asset allocation shifts in 2011 to be, as in 2010, less dramatic than those we performed in 2008 for defensive purposes, and in 2009 for capturing growth. Accordingly, our strategy throughout the year will be to stay the course, peel away gains in the higher achieving asset classes to lock in profits, and to rebalance opportunistically towards the lesser achieving ones which we expect to subsequently perform better. In essence, we'll be implementing a rebalancing sell high, buy low, "tuning" approach.

What are non-traditional alternative investments and what are the specific asset allocation benefits achieved by FMG adding them to the traditional investments in client portfolios?

After extensive research and due diligence, FMG began in 2007 to add various forms of alternative investment strategies within larger portfolios in order to further build and preserve client wealth. Normally available only to institutional investors, we have arranged to provide these alternative investments to our clients in order to supplement the traditional forms of equity and fixed income investments within the portfolios. These alternatives include asset allocations to investment vehicles such as structured notes, hedge funds, and private investments. The specific benefits derived are increased diversification, lower performance correlations, and diminished portfolio volatility, which reinforce our overall "win by not losing" investment approach. Our clients particularly benefit from these portfolio attributes during stressful bear market periods as was the environment during the financial crisis in 2008.

What indicators will FMG be watching that could alter our Economic and Investment outlook for 2011?

Most importantly, we will be monitoring the behavior of the economies throughout the world and the resulting monetary and fiscal policy responses performed by their central governments. The economic issues and challenges differ amongst countries. For example, the Far East countries such as China, India, South Korea, and Indonesia have a burgeoning middle class, clamoring to spend more money. These developing countries have been raising interest rates in order to control inflation and high internal growth rates. In turn, this creates a dilemma for them because the higher interest rates create incentive for speculators to overflow money into the developing economies and possibly creating unwanted speculative internal bubbles.

Economic powerhouse China in particular is facing the need to shift its focus from exports to serving its huge and growing middle class. It is uncertain whether the government can smoothly manage this transition, especially with inflation on the rise, real estate currently in a bubble, and a demographic profile that increasingly resembles an inverted pyramid created by the strict one-child policy.

Meanwhile, the U.S., Europe, and Japan have an aging population that has been financially wounded and is now spending less money. Moreover, despite all the current efforts of the governments and central banks to stabilize short-term economic problems, there remain long-term problems yet to be solved. The U.S. housing market is still an economic concern. Numerous European governments are struggling and require painful austerity measures and wage restraints in order to become stabilized. Many of the banks globally are fundamentally weak and require more capital. Moreover, the rescue packages provided to date have not been sufficient to calm the investment community, and this is being exacerbated because the sense of urgency to co-ordinate solutions for the global financial problems has diminished.

Differing country demographics and economic conditions dictate varying policy responses and create elements of uncertainty for the global economic behavior. Along the way there are intelligent monetary and fiscal policy decisions required which, if erroneous, could negatively affect investment performance. In turn, this makes our global economic and business cycle forecasting challenging, but it is necessary in our opinion for investment success. Importantly, even if our forecasting might be less-than-perfect, our diversified investment approach is more forgiving to possible forced errors than one that is not.

Should investors be concerned about the U.S. sustaining an economic recovery in 2011?

Politics aside, the massive fiscal stimulus programs, combined with the monetary quantitative easing and the surprise approval by Congress to extend the reduced tax levels has lessened uncertainty and actually boosted our forecast for economic growth in 2011. Inflation should not be a concern at this time because it occurs when the economy becomes overheated, scarce resources are in high demand, and production capacity is being fully utilized. In fact, we anticipate just the opposite currently with the economy in its early recovery stage, and the demand for goods and services is relatively low. Resources are now plentiful and production capacity can be increased without it being inflationary, and we do not foresee this changing during 2011.

The Federal Reserve is currently more concerned about reducing the high unemployment rate, than about inflation. Accordingly, we expect interest rates will only increase modestly in 2011 due to the Federal Reserve’s easy monetary policy until the unemployment rate shows signs of consistent decline. As a result of the Federal Reserve and congressional actions, our forecast for when reduced unemployment will occur has been accelerated to begin in the latter part of 2011.

While the U.S. economic outlook for the short-term appears positive, it is clear as the economy recovers that the large budget deficit problem for the medium to longer term needs to be addressed. The spending and taxes in 2011 are essentially now locked in, so changes will not occur until 2012 and beyond. In the meantime, there will be plenty of political arguing about how to reduce the budget deficit, and this uncertainty will cause investment decision making to be more challenging in 2012.

Experienced wealth building and preservation go beyond investment management.

Since our founding in 1989, FMG has advocated that investment management be done as part of a comprehensive, coordinated financial plan whereby specific goals are set, and progress is monitored along the way as life events evolve, and economic and investment scenarios change. In our opinion, wealth building and preservation must include not only investment management, but also financial planning activities such as cash management, debt management, tax planning, college funding, retirement planning, and estate preservation. For this reason, we have assembled a financial planning team to work together cooperatively with our investment management team in order to build and preserve wealth for our clients throughout all the stages of economic and investment cycles.

FMG welcomes referrals for new clients to assist.

Today, many people are searching for a knowledgeable and trustworthy advisor to assist them with their current financial management concerns. FMG is a fee-only advisor with a proven 22 year track record of success and an experienced staff of professionals prepared to advise new clients seeking the comprehensive financial planning and investment advisory services.

Our firm has the capacity for accepting new clients and the most important resource for us to grow and enhance the value of our services is satisfied clients and professionals who are willing to refer others to us. We offer with no charge or obligation an introductory, get-acquainted consultation to determine if and how we might be able to assist others with our services. For additional information, please view our Internet websites www.fmgonline.com and www.quietmillionaire.com or telephone us at 513-984-6696.