



## Global Overview

2011 was a turbulent year from the standpoint of volatility, turmoil, and angst with some of the most dramatic headwinds markets have seen in quite some time. No one could have predicted the Arab Spring or Japan's massive earthquakes/tsunami leading to nuclear meltdowns. And just a year ago not one economist in a hundred would have forecast the previously unimaginable downgrade in US Government debt paired with record low US government bond yields and mortgage rates. Events in Europe dominated the news, causing unprecedented market moves this past August. These "unknowable" events demonstrate the future is indeed uncertain.

Consider Ben Franklin's quote, "Certainty? In this world nothing is certain but death and taxes." And in this election year, even our tax policy is highly uncertain - will payroll tax relief continue past February and will the Bush tax cuts expire for some or for all? Fortunately, both taxes and investments can be strategically managed, resulting in greater after-tax wealth accumulation. Indeed, during 2011 clients profited from our strategic purchases of tax-advantaged investments including Steelpath MLP Select 40, Gateway and Eaton-Vance Tax-Managed funds, all of which produced highly tax-efficient returns. (Note that *HAS* clients also save 5.75% on purchases of Steelpath and Gateway due to our commission waiver that clients receive for all loaded funds; direct expense savings to clients resulting in higher returns - plus additional annual savings are created with low-cost institutional share purchases). During 2011 we also enhanced client portfolios with proactive sales (eg Calamos Convertible and Pimco Global) providing direct offsets to taxable gains and/or reduced taxable income. Briefly, to position investors for success in this world of uncertain outcomes, we recommend the relative certainty of broad diversification, protection against loss of purchasing power and an emphasis on predictable "all-weather" income.

## Executive Summary

- ◆ In this world of uncertain outcomes, we recommend the relative certainty of broad diversification, protection against loss of purchasing power, and emphasis on predictable "all-weather" income.
- ◆ The global investing environment will remain challenging and volatile; the European financial and banking crisis the biggest wildcard.
- ◆ Political dysfunction in Washington continues to loom over markets and the economy. However, despite the long list of failures by a deeply divided government, the economic recovery has persisted, and based on recent data, even strengthened.
- ◆ Unlike our government, US Companies are healthy with solid balance sheets and strong earnings which support higher stock prices.
- ◆ By employing risk-management strategies, including a strategic combination of investments, investors may be more assured of the success they desire, achieving their lifetime financial goals.
- ◆ Our portfolio design process takes into account four areas of concern for our clients: Broad Diversification, a Spending and Income cushion with bear-market protection, Portfolio Paychecks™ and Managed Risk & Opportunity Investing.
- ◆ Our primary objective is to help clients achieve their lifetime financial goals with less worry and effort.

*I don't make jokes. I just watch the government and report the facts*

—Will Rogers – actor, comedian social commentator (1879 – 1935)

## 2011 Looking in the Rear-view

Stocks swung within a 20% up and down range in 2011, finishing the year with slight declines in most U.S. indices. All eight of diversified Target Date Retirement Fund averages from 2011 thru 2050 posted negative returns, due in part to international stock losses. In terms of styles, “growth” stocks fared somewhat better than “value” stocks (which have a heavy financial weighting), and large company stocks fared better than small company stocks. In terms of market sectors, utilities (+10%) were the best performing sector as investors seemed to favor stability and dividends. Financials (-17%) were the worst performing sector for the year and remain down 60% over the last 5 years. International stock funds fared worse with declines in Europe (-15.2%), Pacific/Asia (-18%), and Emerging Markets (-20%). *HAS* portfolios benefited from profit-taking sales of international funds (First Eagle Global and Matthews Asian) which retain high long-term gains.

During chaotic times we focused on preserving and protecting client assets, while seeking consistent investment returns. Our “insurance-like” investments in Hussman Strategic Growth and Rydex Inverse both protected and profited during the market declines, and more recently, became a drag on returns as markets quickly rebounded late in December. During the past year our US-based growth & income investments fared well with the exception of convertible bonds (Calamos and Miller) which had posted considerable gains in prior years but had a down year in 2011. Likewise most of our domestic bond holdings contributed to returns, while international bonds detracted as the dollar strengthened.

Our belief to diversify and invest globally negatively impacted our returns in 2011, though our risk-managed investments that favored Asia did better than most.

Why have we shunned Europe and favored Asia these past couple of years? Because Asia (excluding Japan) doesn’t have deficit troubles, is growing faster, and also has significantly higher dividend yield and growth. Note that our primary fund, Matthews Asian Growth & Income, has provided protection during tough times, declining less than half the benchmark. Although this fund is officially closed to new investors, *HAS* clients are privileged to be able to make new purchases.

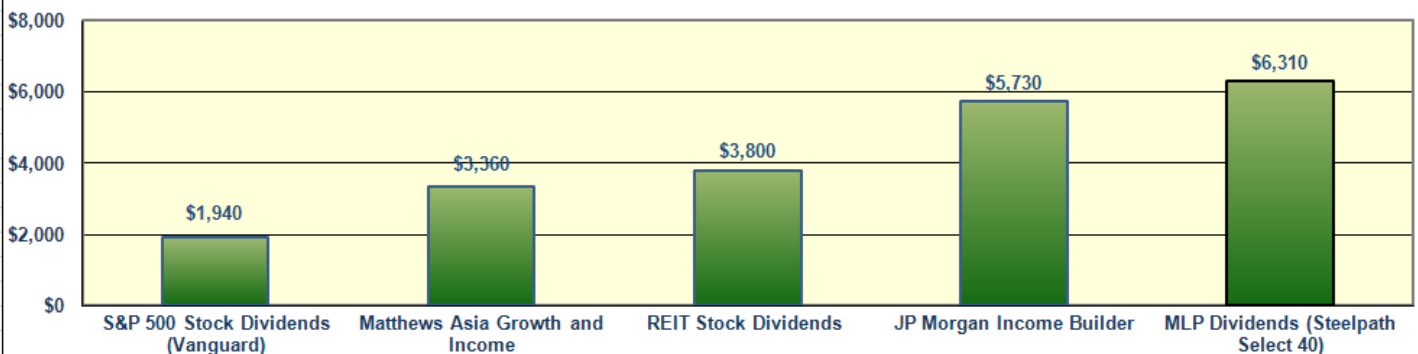
**Managed Risk & Opportunity Investing:** we trimmed more volatile investments while adding to reduced risk growth and dividend paying investments. Our opportunistic purchases of Eaton Vance Tax-Managed Funds during the August panic helped by earning mid-teen returns on average. (Similarly, during the panic in 2008 we made substantial purchases of the Cohen & Steers Closed-end Opportunity Fund which roughly doubled in a two-year period.) For more information on our “Managed Risk & Opportunity Investment” Strategy, please take a look at our Summer 2011 Newsletter (<http://haswealth.com/pages/newsletter.asp>). We intend to make additional purchases of these opportunistic investments, especially in the event of a market panic which creates excellent buying opportunities.

In a difficult year for natural resource investments (the average fund declined 13.9%), our largest investment Steelpath MLP Select 40 gained +6.7% while our other modest holdings of natural resource investments detracted from returns. Our limited partnership investments in natural gas (MAP and Kriebel Wells) also contributed to returns.

## Looking Ahead—Real Assets

Due to deficits, debt and demographics, we intend to

**Annualized Income per \$100,000 Investment as of November/December 2011**



add selectively to real assets over time. This asset class should benefit from favorable economic and demographic trends, including world population growth from 7 to 9 billion over the next twenty years. Similarly, about \$40 trillion is expected to be spent on global infrastructure over the next two decades. Many investments will receive favorable long-term tailwinds as a result of these trends.

**Food, Water and Energy:** both agriculture and water-related investments should post outsized returns. We expect that the food supply will become a huge global problem over the next decade, and that agricultural companies will be the greatest beneficiaries. The emerging markets (especially South America, China, and India) have seen huge increases in demand for more expensive protein-based foods (meat, fish, poultry). These foods are becoming a staple and even a necessity for the rapidly-growing middle class in emerging markets. We also expect that cleaner, greener, cheaper energy including natural gas (less than half the emissions of coal) will benefit from growing demand. New oil/gas technologies are changing the global energy map with the US projected to become an even larger oil producer than Saudi Arabia during this decade. This sector is also generating the highest US job gains in 30 years.

**Gold and Gold Mining Stocks:** the primary rationale for owning gold remains intact: massive sovereign debt, leading to debasement and inflation of paper currencies. Additionally, gold and some other “real assets” can provide protection in down markets, also serving as an inflation hedge.

With growing deficits and “money printing” by central banks in fashion throughout the developed world, the price of gold bullion could move significantly higher. Eventually, the stocks of gold miners, which are very cheap, will follow, probably in explosive fashion. Our

most disappointing investment on a short-term basis was the Tocqueville Gold (Mining) Fund which has an excellent manager and stellar 10 year track record with 24.1% average annual gains). We replaced Tocqueville with the less volatile SPDR Gold Trust which closely tracks the price of gold (each share of this investment represents about one tenth of an ounce of bullion at current market prices). We were able to make our Gold Trust purchase at \$154/share, roughly a 17% discount from its 52 week peak.

## Good News Here At Home

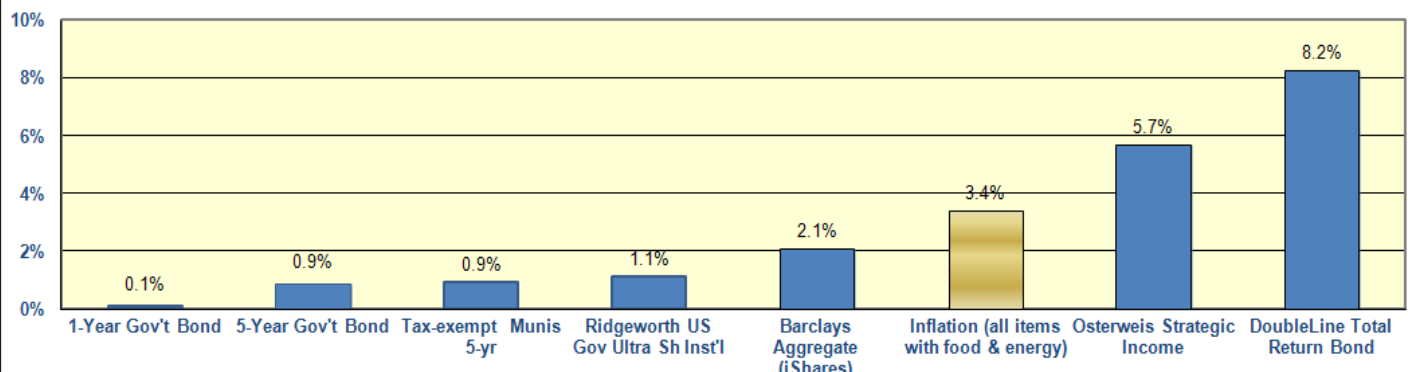
Most companies have solid balance sheets and productivity remains high. Unlike governments with their extreme deficit spending, corporations took advantage of the 2008 financial crisis to become fiscally lean and mean, adapting to current economic reality. In 2011 US corporate earnings rose a healthy 12%. US corporate balance sheets are rock-solid with record levels of cash. Even though the S&P 500 return is nearly flat for a decade, corporate earnings have grown 121% during the same period.

The inflation rate over the last 12 months (including energy and food) increased 3.4%. Note that the yield on a 1-Year Government bonds is a paltry 0.1% (one-tenth of one percent) and a 5-year government bond yields are 0.9%. As you can see from the graph on page 3 and below, most *HAS* bond, income, and growth & income funds outpace inflation, protecting purchasing power.

## Why do we invest in world markets?

By investing globally, we intend to boost investment returns, gaining access to faster markets and economies. Broad international diversification also helps smooth

**Fixed Income Yields as of November/December 2011**





out returns since gains in one country (or currency) can offset losses in another. Importantly, global investors are also able to earn much higher dividend distributions that also serve to provide more consistent returns.

The graph above shows equity dividend yields for major world markets along with corresponding 10 year government bond yields. Yields on many distressed European countries are off this chart (Italy is at 7% compared to 2% for the U.S.)

## Summary & What's Coming

The global investing environment will remain challenging. In a world of uncertain outcomes, we recommend the relative certainty of broad diversification, protection against a loss of purchasing power, and emphasis on current "all-weather" income.

Of course many risks still remain in the global economy. So that our clients may be more assured of the lifelong success they desire, *HAS* employs a variety of strategies designed to protect on downside and our more conservative portfolios have significant buffers of low and moderate risk investments. Our portfolio design process takes into account four areas of concern for our clients: Broad Diversification, Spending and Income cushion with bear-market protection, Portfolio Paychecks™ and Managed Risk & Opportunity Investing.

These strategies combined are intended to produce the highest risk-adjusted returns over a market cycle. In addition to receiving generous income from our Portfolio Paychecks™ retired or lower risk clients may also benefit from a 6 – 10+ year living expense buffer, comprised of low and reduced risk investments.

Looking ahead to 2012 and beyond, we will expand our specialized Big Picture service offerings to include enhancements in our Portfolio Paychecks™ Process, New Personal CFO Services and New "Ideal Rest-of-My-Life" Planning Services.

As always, we encourage you to call anytime with questions or to apprise us of changes that may affect your financial objectives. Once again all of us here at Hillegas Advisory Services, Inc. wish you and your family the very best in 2012.

*Past performance is no guarantee of future results. All content in this newsletter is intended as general information, not specific advice. Performance data listed is for illustrative purposes only. Portfolios are personalized and often consider many variables, including investment objectives, age, time horizon, risk tolerance, client requests and tax variables. Information contained herein has been obtained from sources believed reliable, but not guaranteed.*

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