



This summer edition examines both the randomness of investment returns along with three economic scenarios that may unfold in coming months. Importantly, the newsletter then takes a close look at one vital risk reduction strategy, namely Portfolio Paychecks or the income component of total investment returns.

We are grateful for the valuable input received in our first detailed *HAS* Client Survey conducted by independent survey firm Advisor Impact. The goal of the audit was to gain a better understanding of client needs and interests and to ensure that the service we provide meets or exceeds your expectations. We have begun to implement service enhancements suggested in the survey including a more client-friendly website and personal portfolio report enhancements. We are especially honored that *HAS* clients awarded us an overall rating of 5.0 out of a possible 5 points on service!

Randomness of Returns

The graph produced by Vanguard Investments (view the exhibit on page 5) illustrates just how random short term stock and bond market returns really are. Before looking at the graph, answer the following question. The average annual return for the S&P 500 from 1926 to 2009 was 9.9%, over this period of time how many times did the annual returns for the S&P 500 fall within 2% of the 9.9% average? The answer is shockingly low at only 6 out of 84 years or roughly 7% of the time. As the Vanguard graph clearly demonstrates, it's the rule, rather than the exception for the stock market to exhibit a very wide range of annual returns.

You'd think that bond market returns being much less volatile in the short term would frequently fall within 2% of their average return on a year by year basis. This does turn out to be the case but not as often as one would think. As you can see from the graph on page 6 this occurred in only 20 out of 84 years or roughly 24% of the time. Even bond market returns are prone to a fairly wide, dispersed range.

In spite of being fully aware of our inability to predict the short term direction of the financial markets and economy, we believe it is both helpful and important to create a game plan ahead of time for various short-term scenarios that may unfold.

Future Economic Scenarios

Longtime newsletter readers are familiar with Jeremy Grantham who offers well-reasoned insight into the economy and the markets. In Grantham's most recent April quarterly letter he discusses three short-term scenarios.

The first scenario shows a 30% chance the economy will experience a strong and sustained recovery, interest rates will rise and the stock market will fall and basically all will be well. How can all be well if the stock market falls? Grantham's fear is that the market is already overpriced but not terribly overpriced (he feels fair value for the S&P 500 is near 875 and we are currently around 1,000 as of 7/6/10) and if the market does not fall in the shorter term it could become severely overpriced and precipitate a market crash. If the market falls in the shorter term, he thinks this will put us back onto a more balanced track from which the economy and the stock market can grow in a sustained manner.

If this scenario unfolds, we would hold onto most existing growth-oriented equity positions and strategically add to equities as they become cheaper.

Grantham gives a 70% probability to the economy bumping along in fits and starts with the Federal Reserve (Fed) keeping interest rates low in an effort to both reduce unemployment and increase economic growth. If this happens, he believes there is a one in two possibility that the market would become extremely overvalued, setting us up for a significant downturn that might have severe consequences for the economy. He thinks this is an unlikely scenario since in October we enter the third year of the Presidential Cycle. Since 1932 there has never been a serious decline in Year 3.

Grantham emphasizes to not think for a second that a very stimulated market will go down in year 3 just because it's overpriced...even badly overpriced. So far it has had 10 tries to go down since 1932 and has never pulled it off. He feels the market could move back to the old highs, say, 1,500 to 1,600 on the S&P, accompanied by an equivalent gain in most risk measures, followed once again by a very dangerous break. He goes on to say if that happens, interest rates will still be very low and thus the Fed will be unable to employ rate reductions to stimulate or jumpstart the economy, as has been the case over the past couple years. In short, the Fed will not have its normal interest rate tools to

stimulate the economy. If this scenario were to unfold we would take profits in more volatile growth-oriented investments as the market climbed, while adding to lower and reduced risk investments.

Grantham's third scenario is that the economy bumps along, rates stay low but some poor economic data or crisis breaks the animal herd instinct, sending the market lower and avoiding a longer-term major bubble. He sees this as a positive outcome as well since even though the market would fall in the shorter term, it would restore us to a more balanced economic foundation from which the stock market could grow in a sustained fashion.

If this scenario unfolded, we would follow a similar strategy as Grantham's first scenario, by retaining most existing equity positions while opportunistically increasing select equity positions as valuations became more attractive.

It's interesting to note that Grantham's article was written before the most recent stock market correction. Presently we are closest to the third scenario. Time will tell which scenario or combination unfolds.

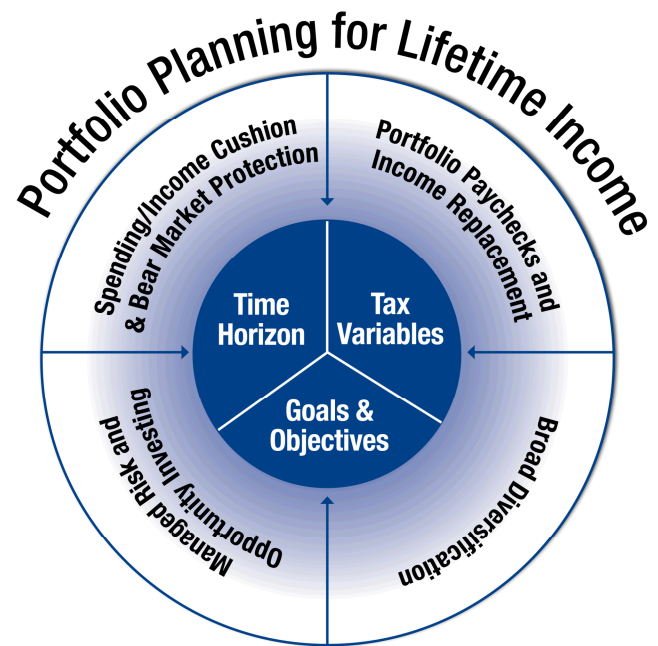
In any case, our broadly diversified portfolios are constructed to perform well in a variety of environments, balancing the needs for capital growth with capital preservation and income. Currently portfolios are more defensively positioned emphasizing capital preservation and income. We intend to continue making incremental investments in natural resource equities and equities of faster growing countries as valuations become more attractive.

The balance of the newsletter will address another vital personal portfolio ingredient, namely the income generating component.

Portfolio Planning for Lifetime Income

Meeting one's lifetime spending goals is the primary need of most investors. To this end in the fall of 2008, we formally introduced our Portfolio Planning Process for Lifetime Income. *Portfolio Paychecks* and Income Replacement is one of the four components of this integrated process. The other three components include broad diversification, a spending/income cushion, and risk-opportunity investing. In keeping with the income theme, we revisit the *Portfolio Paychecks* component in this newsletter. Later in the year, we'll review all four components complete with current illustrations (the

interested reader may refer to the Fall 2008 Portfolio Planning issue on our website).



Portfolio Paychecks & Income Replacement

Think of how much money you need to handle your routine living expenses. Now imagine that you are retired and your portfolio produces an amount sufficient to cover your expenses with predictable monthly portfolio distributions, including dividends and interest. How much of a relief would it be to know you could depend on a steady *Portfolio Paycheck*, regardless of the market's gyrations? Clients at or near retirement experience priceless peace-of-mind knowing that most of their income needs for living expenses are handled by *Portfolio Paychecks*.

Even if the market is flat or declines for years, portfolios can generate substantial income. This income helps to both offset declines and also provides generous cash flow. Furthermore *HAS* creates added value through our tax and investment expertise, proactively monitoring many variables that increase after-tax returns.

The *Portfolio Paychecks* component will vary depending upon one's age, spending needs, and investment objectives. For example, young and middle-age investors who are building their nest egg will be more focused on growing their portfolio over the long term; therefore the strategies of broad diversification and risk-opportunity investing perform a more vital role. However, investors

who are near retirement are typically more interested in generating both income and inflation-adjusted growth to last a lifetime.

For retired clients or others with regular cash needs for living expenses, income planning and cash flow management is an important ongoing need. Hence *Portfolio Paychecks* naturally play a greater role. These cash flow management and portfolio distribution services are carried on “behind the scenes.” As a result, it is difficult for a client to assess the value of this service until the client actually gets to the point in life when it becomes a primary life issue. As wealth managers we employ a variety of strategies suited to clients’ stages of life (accumulation, retirement, etc.) and the applicable investment objectives during these different life stages. We are pleased to offer this lifestage expertise to our clients.

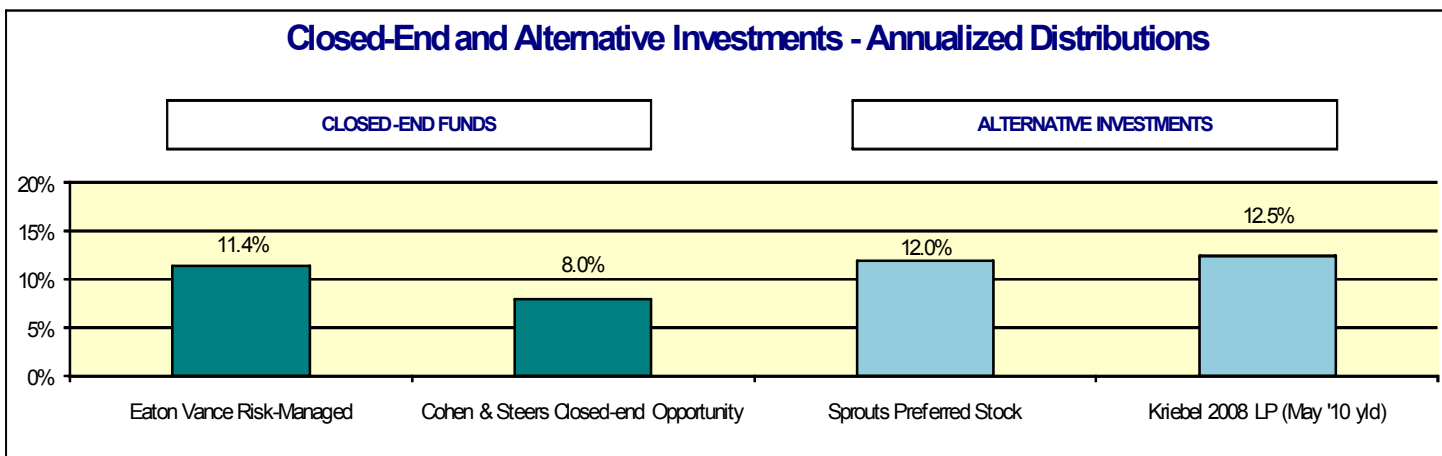
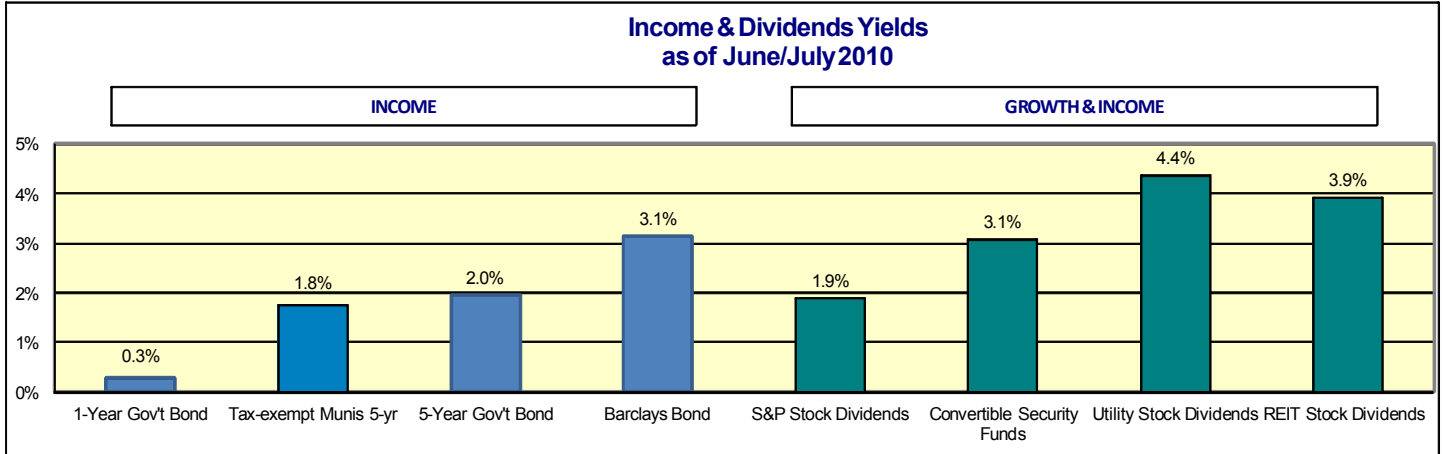
The Income Component of Total Investment Returns

Investment returns come from two components: capital appreciation (a rise in price) and income. Some

investments like Bonds, CDs, money market funds and other fixed-income investments are designed to pay interest without potential for price appreciation.

For example, an investor who buys a ten year \$1,000,000 U.S. Treasury Note today, earns \$29,500 each year with the current 2.95% interest rate. After 10 years they receive the million dollar principal back. Upon closer examination, this \$1,000,000 investor receives \$1,647/month after tax (assuming a 33% tax rate). Moreover, due to inflation, the investor should expect to lose significant purchasing power over time. To overcome the double whammy of taxes and inflation, most investors desire higher tax-efficient income and growth to meet their future expenses. This is especially true for the typical retiree-investor who can plan on thirty or more years of retirement.

Fortunately, some investments offer both income and growth and make regular cash dividend or interest payments, typically on a monthly or quarterly basis (see the Income & Dividends chart below). These investments include convertible bonds, various reduced risk growth funds, closed-end funds, and dividend paying stocks. Mature cash-rich companies and industries (telecom, financials and utility stocks) often



pay much higher dividends than the average company. This predictable cash flow is a helpful component of total investment returns and enables investors to reap cash rewards during bull and bear markets alike. And as part of a diversified portfolio, income paying investments help reduce risk, while providing more consistent returns.

Closed-end funds offer both generous distributions and the potential to provide substantial additional returns, especially during market panics. During turbulent times these funds are often “on sale” at a 10% or greater discounts to current market values of their underlying investments. Many also offer 10%+ cash distribution yields. During the panic in October 2008 some of these funds were temporarily on sale at never-seen-before levels approaching 30%. We used this as an opportunity to buy the Eaton Vance Risk Managed Fund at very large discounts that subsequently transitioned to an 8% premium which provided a “tailwind” return of about 30%, excluding additional returns from the underlying investments. We’ve since sold most of the Eaton Vance Fund and have made substantial investments in the Cohen & Steers Closed-end Opportunity Fund which has gained over 40% in the last 18 months. In the event of another panic or discounted buying opportunity, we intend to make more opportunistic investments in various funds.

Finally, at *HAS*, we are also able to offer alternative and private equity investments that can provide distribution rates of 10% or more. Alternative investments are not appropriate for everyone; in general, investors must be accredited (\$1m total portfolio) and willing to accept additional risk, including illiquidity (no public market to liquidate or sell). Please contact us should you wish to learn more about these alternative investment options.

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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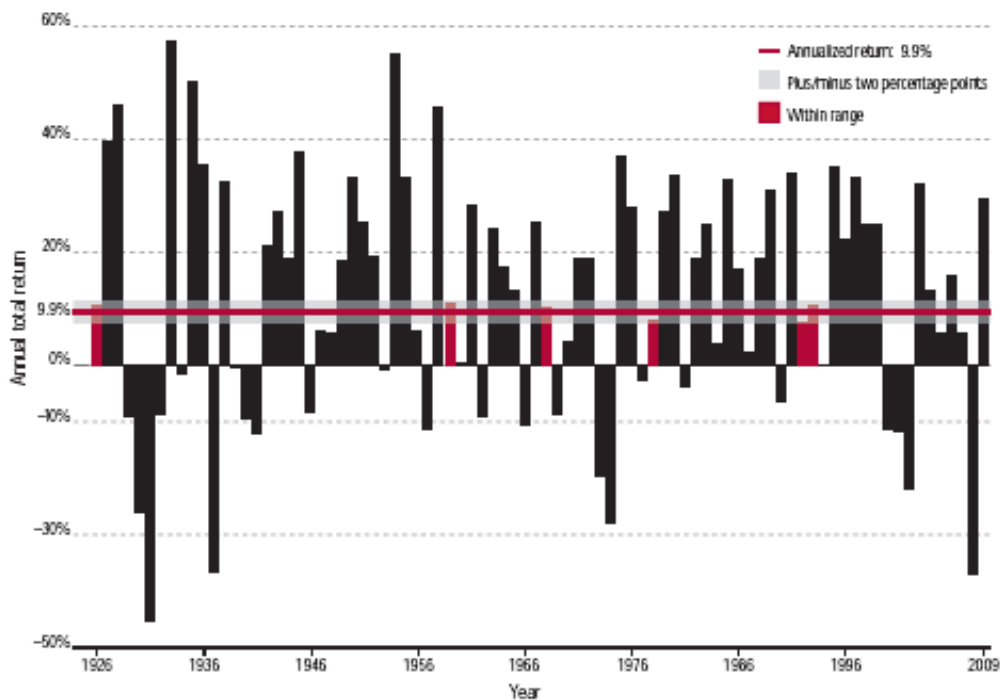


When will we get back to average market returns?

INVESTOR | education

U.S. stock market, 1926–2009

Returns fell within two percentage points of the annualized return of 9.9% in only 6 out of 84 years.



U.S. stock market returns based on S&P 500 Index for 1926–1970 and on Dow Jones Total U.S. Stock Market Index for 1971–2009. Assumes all distributions were reinvested. Past performance is not a guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Sources: Standard & Poor's, Dow Jones, and Vanguard.

Average total returns in the stock and bond markets are often cited in financial circles, perhaps giving lay investors the false impression that these returns are the norm. In reality, there have been few years when either stocks or bonds delivered returns that are even close to market averages.

Financial markets, particularly stocks, are inherently volatile over the short term. To benefit from long-term market performance, investors should temper their expectations and stay the course.

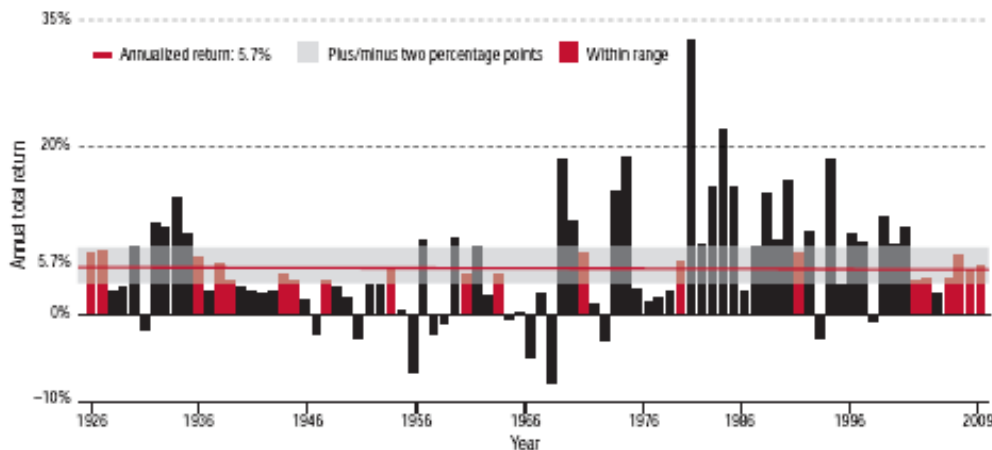
What does this mean to me?

Temper your expectations. As rare as it is for either the stock or bond markets to deliver returns near their historical averages, it's even more rare when both stocks and bonds have done so in the same calendar year. In fact, that's happened only three times (1926, 1968, and 1992). Investors should never expect the average return in any given year or even over intermediate time periods.

Understand the risk/return trade-off. The higher the return potential of a given asset class, the higher the risk. Investors who understand this will make more appropriate asset allocation decisions based on their goals, time horizon, and risk tolerance.

Stay the course. While volatility is the norm, market fluctuations tend to cancel each other out over the long term. While there is no such thing as a guarantee in the financial markets, staying invested over the long run gives you a higher probability of capturing the markets' long-term averages, which may help you meet your financial objectives.

U.S. bond market, 1926–2009
Returns fell within two percentage points of the annualized return of 5.7% in 20 out of 84 years.



U.S. taxable investment-grade bond market returns based on intermediate-term government bonds data from Ibbotson Associates for 1926–1976 and Barclays Capital U.S. Aggregate Bond Index for 1977–2009. Assumes all distributions were reinvested. Past performance is not a guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Sources: Ibbotson Associates, Barclays Capital, and Vanguard.

All investments are subject to risks. Investments in bonds are subject to interest rate, credit, and inflation risk.

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