WealthTrust

Arizona Quarterly

Summer 2011 Edition

Learn how the end of **QE2** could affect your portfolio

Deflation or Inflation:

Where Should You Redirect Your Money?

Spend some time with **Michael Bowen**

PLUS: Educational Workshops coming soon

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Letter from WealthTrust-Arizona's CEO

Dear Clients and Friends of WealthTrust-Arizona,

I think you will agree it is an understatement to say we live in interesting economic times. The past few years we have all seen just about anything you can think of thrown our way – be it the housing meltdown, Wall Street bailouts and scandals, a recession reminiscent of the Great Depression, and government bailouts of some of America's largest corporations.

While many claim to see the light at the end of the proverbial tunnel, others are not as optimistic about the turnaround and eventual recovery of our nation's economy. Recent unemployment and job creation figures do not bode well, and with last month's end of the Federal Reserve's policy of quantitative easing (QE2) even more uncertainty is hanging in the air, as we all wait to see what the long and short-term effects will be.

I want to assure you that, no matter what the future brings, my colleagues at WealthTrust-Arizona and I are constantly immersed in all things related to the economy and the impact it may have on your wealth. We share the common goal of making the most analytical, reasoned, clear-headed decisions we can, utilizing the best information available to us, regarding our client's portfolios.

In this edition of the WealthTrust-Arizona newsletter, we discuss fixed income: the basics of bonds, their relation to interest rates and how they are impacted by inflation. We elaborate on the QE2 policy I mentioned above, explaining the basics of quantitative easing and discussing possible scenarios of what might happen, now that the Fed has backed away from QE2.

We will provide our perspective on the question of deflation versus inflation – and how you can be prepared for either one. We have a profile on Mike Bowen in this quarterly newsletter. Mike is one of our many talented senior advisors.

In addition, I would like to remind you that your second quarter financial statement for 2011 should be arriving in the mail soon. This is the first look at the statements from our new portfolio accounting system and is a direct result of our clients asking for more user-friendly information. Your financial advisor is available to answer any questions you may have.

From the entire WealthTrust-Arizona team, we wish you continued financial prosperity and offer a sincere "Thank You" for partnering with us to further your financial future.

Best,

Holly D. Deem
Chief Executive Officer
WealthTrust-Arizona

What is Quantitative Easing, and How Could Its Ending Affect You and Your Portfolio?

Quantitative easing is the electronic equivalent of firing up the Fed's printing presses to create money for buying financial assets in the market, which in this case are long-term U.S. Treasury bonds. The Fed had pledged to buy $600 billion worth of treasury bonds, in an effort to keep interest rates low and help spur economic growth and lending.

There is disagreement in the economic community as to whether QE2 worked. Fans of quantitative easing say the U.S. economy is better off because of the program, while inflation hawks say it has propped up asset prices across the board, and that the markets will react now that it has ended.

Here are some scenarios which could play out, post-QE2:

Bond yields could continue to rise. With QE2 in place, treasury yields started to move lower, albeit slowly. On average, the Federal Reserve has been buying about $75 billion in bonds a month since last November. Now that it has come to an end, it is unlikely there will be a QE3.

Stock prices could take a hit. Since November, the S&P 500 has risen about 6 percent. Financial assets become more valuable when interest rates are low – while conversely, when interest rates are high, they are not so valuable. If investors are worried that yields are now going to start heading up, that could be a negative for the stock market. As a rule, higher yields are associated with an economic recovery, but a sudden jump could negatively impact stocks. Some say the stock market has already factored in the effect of the end of QE2, and that stocks are poised for higher gains.

> "QE2 ending does open the door for higher interest rates but it does not mean that the economy is actually ready to walk through the door."

Rally in commodities slows. The prices of commodities have seen a benefit from the quantitative easing program, with gold and silver continuing to perform well.

The professionals at WealthTrust-Arizona have been watching the QE2 program for months, and carefully analyzing the situation. "QE2

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ending does open the door for higher interest rates but it does not mean that the economy is actually ready to walk through the door," says Brent McQuiston, a Vice President and Senior Financial Advisor with WealthTrust-Arizona, who added, "As a result, it is not time to panic but it is time to pay attention to how well a portfolio can withstand different scenarios. Those who panic and sell each time the markets get a little scary typically experience poor investment returns."

McQuiston concludes that savvy investors should not necessarily be concerned with what happens after QE2, saying, "We have found that a well-thought-out portfolio strategy that is diversified within and across global asset classes is the secret to winning over full market cycles." **WTAZ**

Deflation or Inflation?

Be Prepared Either Way

Just like politics, there is no shortage of opinions out there when it comes to the economy and where things are headed.

Is inflation – a general increase in prices and fall in the purchasing value of money – headed our way? Or is it more likely we will be facing the opposite – deflation – and its decline in general price levels, often caused by a reduction in the supply of money or credit?

While our country has gone through bouts of inflation (most notably in the 1970s, when President Gerald Ford declared inflation was "Public Enemy Number One" and rolled out the Whip Inflation Now (WIN) program), we have not seen deflation on any real scale since the Great Depression. At least one observer thinks that could change. Economic consultant A. Gary Shilling says, "We could see annual economic growth of just 2% over the next decade, as well as significant deflation." Conversely, others foresee high inflation in our future, caused by high levels of government borrowing in the wake of the financial crisis. With $12 trillion in debt, they predict an inflationary spiral is just around the corner.

So, what is an investor to do? Here are some areas of investment WealthTrust-Arizona recommends for our clients, to help protect them either way the economy goes.

Stocks with pricing power

Both deflation and inflation can have adverse effects on the economy. When prices are falling, consumers put off purchases, in anticipation of even lower prices in the future. When prices climb, household purchasing power goes down. In either case, we consider leaning your portfolio towards firms which make or sell products which consumers buy no matter what happens with the economy, such as medicine or groceries. By sticking with dominant players in those areas – companies which are stable enough to pass along price increases to customers without hurting sales – portfolios will contain companies which can maintain earnings growth under most economic conditions.

Cash-rich blue chips

If deflation occurs, portfolios should include shares of large companies which have extensive cash reserves and little or no debt. This is a better strategy than being invested in firms which borrow

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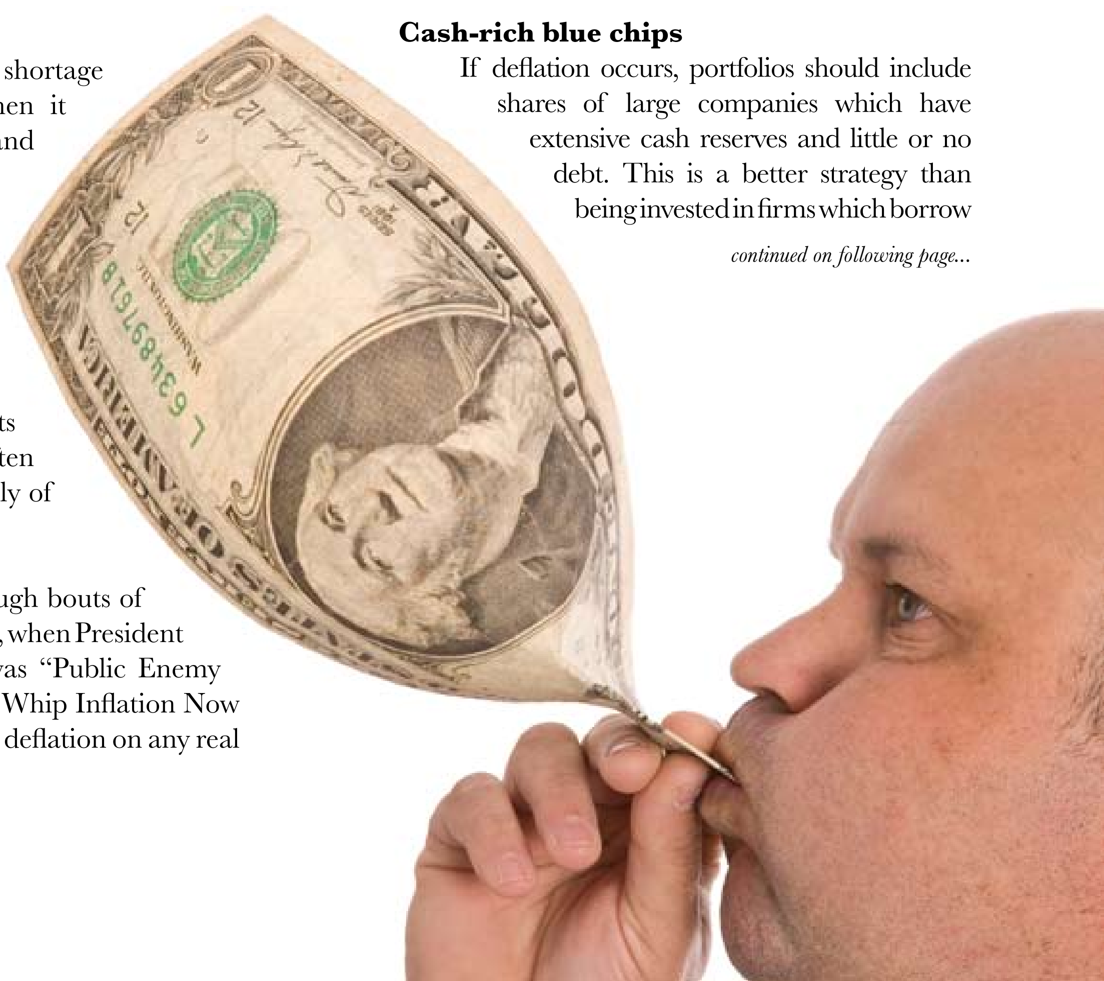

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heavily, because it can be hard for firms to refinance or secure loans in difficult economic times. Also, during times of deflation, companies would be paying back loans with dollars which are increasingly valuable.

It turns out that being invested in cash-rich, blue chip stocks might also be a good hedge against inflation, because they are currently trading at better valuations than other shares, including those of smaller companies.

Emerging-markets stocks

In the event of deflation, developing markets can provide diversification, because fast-growing nations – such as China and India – are likely to keep growing, in part based on rising domestic demand, even if the U.S. remains stagnant. The Chinese economy is forecast to grow around 8% or more every year for the next decade. Developing nations are leading producers of commodities and raw materials – whose prices tend to keep up with inflation.

Foreign bonds

One potential hedge against inflation is to own international bonds, from both developed and emerging markets. Many of them allow investors a shot at higher yields than investors can find in U.S. bonds.

When investing in foreign bonds, investors are also making sure that all of their investments are not exclusively held in U.S. dollars. It is hard to predict how the dollar will perform in the event of extreme deflation or inflation, in part because so much depends on how bad the situation is here, relative to overseas. By keeping at least a portion of a bond portfolio in international securities, investors can protect themselves if the dollar falls because of either deflation or inflation.

Commodities and real estate

Although there can be long periods where physical assets like commodities can be stagnant, or actually lose money, they can offer good protection against high inflation over short periods of time. That is because when inflation is high, natural resources such as raw materials, food and oil go up in price, as well.

For example, between 1973 and 1981, inflation climbed at an annual percentage rate of 9%, while the Goldman Sachs Commodity Index had a return of 12.1% a year.

During deflationary times, real assets tend to fall in value, which adds to their risk. It can be argued that this is less of a concern today when it comes to one hard asset – housing – because residential real estate had already been going down in value for years.

The bottom line is whether we are dealing with inflation or deflation, the best reason to invest at least a small portion of portfolio in real assets is to increase diversification. If investors can accomplish that goal, no matter what is happening in the economy, they will be a step ahead of the game. **WTAZ**

> "Whether we are dealing with inflation or deflation, the best reason to invest at least a small portion of portfolio in real assets is to increase diversification."

A Minute With...Mike Bowen

Vice President - Senior Financial Advisor

Q: ***Why did you become a financial planner?***

A: I have always been interested in investments. In my last career all of my fellow employees came to me for help with their 401(k) accounts. When I finished my M.B.A. at Keller Graduate School of Management, I decided I should become a financial planner.

Q: ***What is the best part about your job?***

A: The best part of my job is being able to make personal connections with my clients by learning about their families and what is important to them. A lot of my clients are juggling saving for retirement with the costs of educating their children. I have parallel goals as well – I hope that my son will follow my path to Brophy and ASU but like my clients, I know it takes a plan.

Q: ***What was your best experience with a client?***

A: My best experience was when a client came to me and thanked me for finding a Long-Term Care policy that they could qualify for because they were hard to insure. A few years after they got the policy something unfortunate happened and they had to start receiving benefits, which they will be receiving for many, many years. They were very appreciative for this because the benefits will help to preserve the rest of their portfolio.

Q: ***What is the biggest issue, facing clients today?***

A: I believe the biggest issue facing clients today is the news. There is so much of it out there that it can be difficult to navigate. It tends to really scare them. I understand the tendency to react because my son is on his second tour of duty in Iraq and it is hard for my wife and me to separate fact from fiction when reading the news reports.

Q: ***What are you doing to help them overcome that issue?***

A: I always offer to discuss any questions with my clients and to give them our thoughts on the economy and markets. It also helps to remember that we are in it for the long run. The very reason we create a plan when a client first comes on board is for those difficult times. It is no different from a flight plan; at any given time it can look like the pilot is off course, but in actuality he is following a specific plan.

Q: ***What is one thing a client should know about the WealthTrust-Arizona team?***

A: The one thing that all clients should know about the WealthTrust-Arizona Team is the diverse education, certifications and years of experience the team brings to the table.

Q: ***What is one thing everyone should know about you?***

A: The Boys and Girls Club has always been a big part of my life. I am an active member of The Boys & Girls Clubs of Greater Scottsdale and serve on the Board of Directors. My goal is to inspire and enable young people to reach their full potential by supporting the club in any way possible. **WTAZ**

WealthTrust-Arizona Will Be Announcing the Fall/Winter Educational Workshops Schedule Soon

At WealthTrust-Arizona, we are committed to help shape and manage your financial future. In an effort to continuously provide you with information that could impact your portfolio, we have developed an ongoing educational workshop program designed to help educate and inform you about issues that have affected or will affect your financial future.

These events are one of the ways we grow our firm. We welcome guests of our clients who may benefit from the material provided to attend our workshops as well.

We will be announcing our schedule soon on our website at wealthtrust-arizona.com and via e-mail – stay tuned.

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