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Monthly Investment Outlook

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Northern California
4040 Civic Center Drive
Suite 200
San Rafael, CA 94903
415.690.8547

Southern California
11622 El Camino Real
Suite 100
San Diego, CA 92130
858.461.8547

info@MeritasAdvisors.com
www.MeritasAdvisors.com

Strength and Stability in Volatile Times

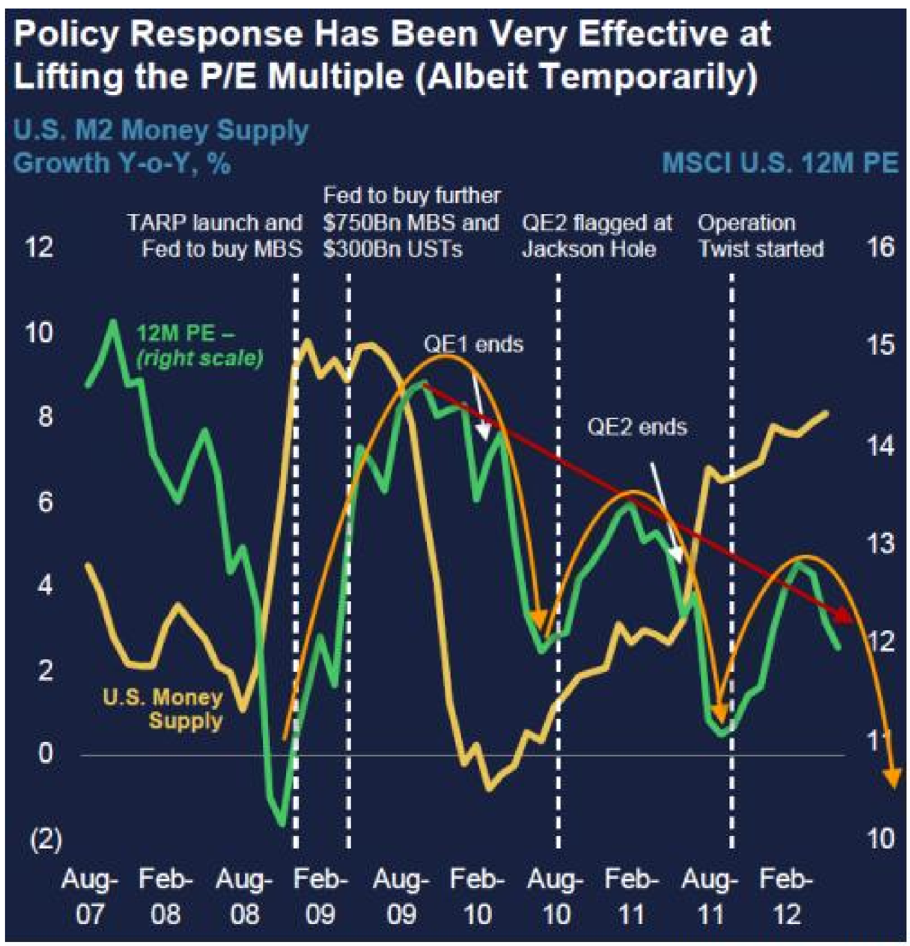
Our mission is to generate stable real returns, regardless of the direction of the economy, while providing the highest level of service and exceeding expectations in performance, planning and communication.

We seek to generate returns from market movement, rather than being dependent on a particular market direction. We utilize the strongest performing investments across a wide range of sectors and strategies that when combined seek to optimize opportunity, while minimizing downturns.

Dear Clients and Friends: We hope you are all enjoying a wonderful summer with your families and friends, feeling the warmth of the sun, laughing as much as possible and remembering the joy found in the simple things like building a sandcastle and playing belly bump with the ocean waves.
Lenore Hawkins, MBA, Principal

Domestic Economy

Sometimes a picture really is worth a thousand words. In our July newsletter, we predicted that GDP growth would slow in the second quarter, and indeed it did from a revised 1.9% in Q1 to 1.5% in Q2. Shortly after the data release, markets around the world rebounded on hopes that both the European Central Bank and the Federal Reserve would engage in another round of monetary stimulus based on the lackluster growth here in the States and continued recessionary trends in Europe. Despite the market fervor over another round of proverbial money printing, the actual impact of each successive round of quantitative easing on stock prices has been weakening, as the chart below illustrates.



Source: Morgan Stanley

This next chart, from those snarky and endlessly entertaining fellows at Zero Hedge, gives you an even more impressive view as to just how excited the markets get about a potential money printing promise coming out of the FOMC (Federal Open Markets Committee) meeting. This is when all the Fed mucky mucks get together to talk about and then announce their next action or inaction.

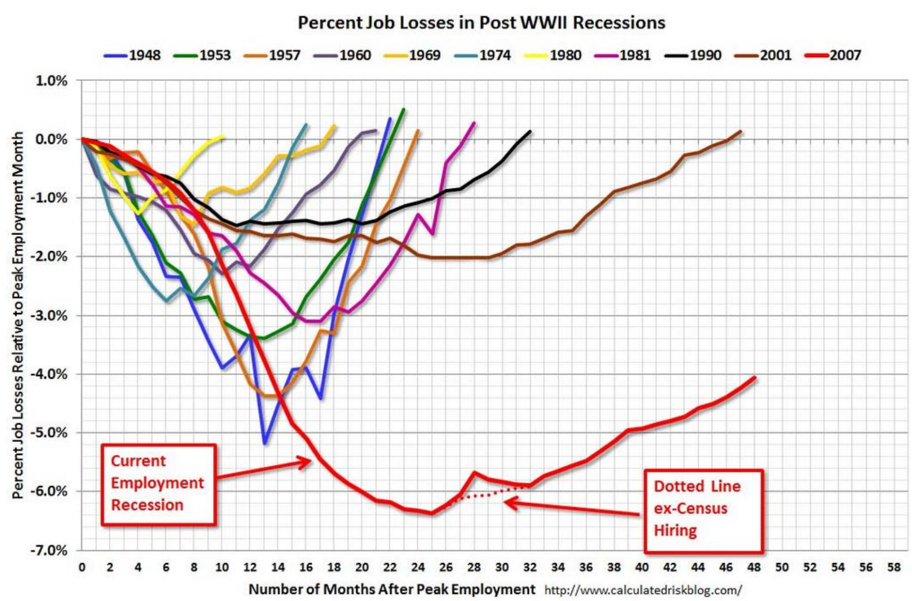
Talk about the tail wagging the dog, with rumored monetary stimulus acting like a brief espresso hit for the markets every few months!

With the slowing U.S. market and worsening conditions across the pond in Europe and in China, expectations are growing for debt monetization out of the European Central Bank (ECB) and for more balance sheet expansion from the U.S. Federal Reserve as well as the Bank of Japan (BOJ). A good deal of quantitative easing is already priced in, making the likelihood of a pullback fairly high if reality doesnôt quite measure up to expectations. Todayôs markets need continual reassurance from governments. One is reminded of one of those cautionary teenage romance movies on the Lifetime channel, full of endless codependent angst.

All this focus on additional monetary stimulus seems short-sighted and ineffective as it repeatedly has had only a temporary affect, like a Kardashian marriage. Europe continues to believe that the problem of too much debt will be resolved with yet more debt. Until the real problem is addressed, that many developed nations around the world have too much debt relative to their economyôs capacity to service the debt, the problem will only temporarily appear to be resolved. This is akin to having a mortgage that the family's income simply cannot afford. Paying for daily expenses using a credit card doesn't change the fact that the mortgage is just too big.

Employment

On Friday, August 17th the Bureau of Labor statistics reported that for July, forty-four states recorded an increase in unemployment, with two states and the District of Columbia reporting decreases and four states reporting no change. Civilian employment as a percent of the population bottomed out in December 2009 at 58.2%, improved to 58.7% earlier this year then dropped 0.3% by July 2012 to stand at 58.4%. Today the percent of people with a job in this country is only 0.2% higher than at the depths of the recession. The chart at right illustrates just how grim the job recovery has been relative to previous recessions.



Household Wealth

It should come as no surprise that household net worth has also suffered to an unprecedented degree. There has never been a time in recorded history in which household net worth has contracted over a five-year time span. In this chart at right this is reflected by the first-time drop below the line at zero. This will have a lasting impact on the biggest driver of U.S. GDP, the consumer, which accounts for a full 70%!

Housing

Amid all this gloom, there are a few bright spots worth noting. According to an August 9th report from the National Association of Realtors, prices for single-family homes climbed in most U.S. cities in the second quarter and values nationally jumped the most since 2006 as real estate markets stabilized. The median sales price increased from a year earlier in 110 of 147 metropolitan areas measured. In the first quarter, 74 areas had gains. U.S. housing prices are beginning to lift off the bottom after the worst housing slump since the 1930s as buyers compete for a tight supply of available properties. At the end of June, 2.39 million previously owned homes were available for sale, 24% less than a year earlier. One remaining area for concern is the magnitude of the "shadow inventory" of delinquent properties that have yet to enter the market.

The Markets

Recall that the S&P 500, which as of Friday's close stood at 1,418, first crossed 1,380 on July 1st, 1999. Since that date it has crossed this level 60 times on a daily closing basis, while gold has risen about 515%, the 10 year Treasury total return index is up nearly 160% and the 30 year Treasury total return index is up almost 215%.

On August 20th, we saw a rally in Spanish bonds, with yields dropping to a six week low. There was a corresponding selloff in German bunds and U.S. Treasuries based on a claim in the German newspaper Der Speigel that the ECB is planning to take an aggressive stance to keep bond yields for the troubled periphery countries low. The Bundesbank has already issued a public rejection of this claim, but the bond market is choosing to believe the rumor and ignore the officials.

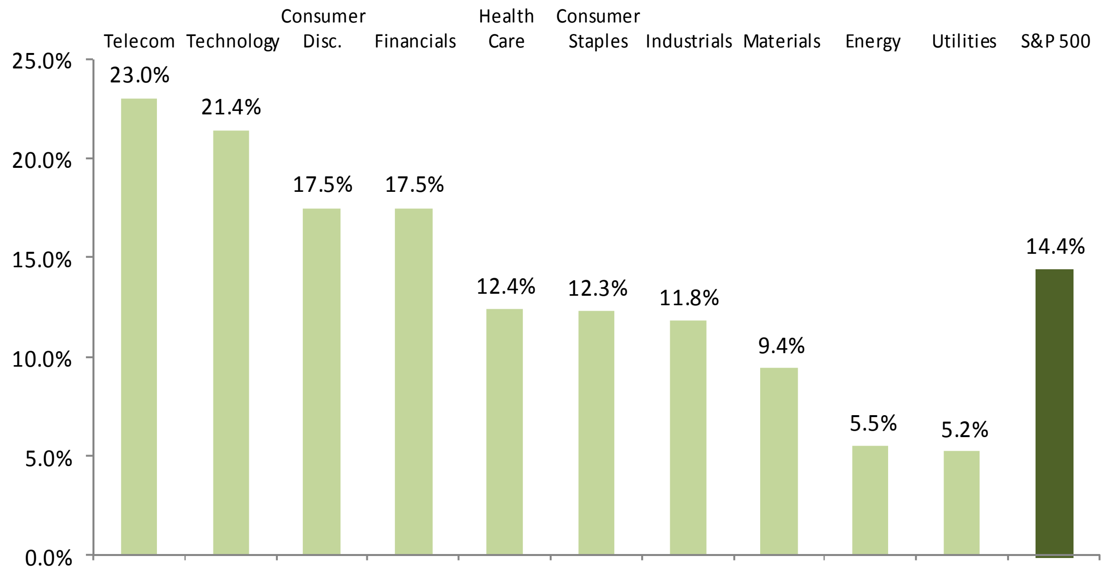
We've seen various markets rally again and again based on market rumors of central bank action. Why? This highlights one of the most important realities of the investing world.

> *The markets are primarily driven by institutional investing, thus one needs to understand the motivations of institutional investors. Their biggest fear is missing a rally, thus any hint of central bank action that could drive prices up and they have to hop in.* ***It is much worse for them professionally to miss a rally than to take a big hit along with everyone else in a downturn, putting their professional incentives at odds with those of most individual investors.*** *For the individual investor, long-term performance and peace of mind is often best served when sufficient focus is placed on limiting losses and generating sustainable long term gains rather than seeking to maximize temporary short term gains.*

Market Recap

Index Levels	**Close 08/17/12**	**Year End 12/30/11**	**Year Ago 08/17/11**	**Commodities**	**Close 08/17/12**	**Year End 12/30/11**	**Year Ago 08/17/11**
Dow Jones 30	13,275	12,218	11,410	Gold	1,614.75	1,531.00	1,790.00
S&P 500	1,418	1,258	1,194	Crude Oil	96.01	98.83	87.58
Nasdaq	3,077	2,605	2,511	Gasoline	3.72	3.26	3.60
Russell 2000	820	741	704				
Bond Rates				**Index Characteristics**	**P/E Forward**	**P/E Trailing**	**Dividend Yield**
Fed Funds Target	0.25	0.25	0.25	S&P 500	13.10	15.81	2.23%
2 Year Treasury	0.29	0.24	0.19	Russell 1000 Value	11.74	13.67	2.59%
10 Year Treasury	1.82	1.87	2.17	Russell 1000 Growth	15.34	17.65	1.63%
10 Year Municipal	2.22	2.45	2.87	Russell 2000	17.73	22.36	1.45%
High Yield	6.88	8.36	8.32				

Year-to-Date Returns by Sector
(As of 08/17/12 - Source: JP Morgan)



Wrap Up: Overall the economic data is still soft, while not quite as gloomy as earlier this summer. There are reasons to hope that we've finally hit bottom in the housing market, which would give consumers a real boost of confidence. However, the European situation is far from resolved, the degree of slowing in China, (which has been the global growth engine since the great recession) is not yet clear and the U.S. economic and political situation is tenuous. The equity markets have priced in a lot of hope, and we believe they are rather overpriced, even though we see some potential for increased optimism in the economy. Enjoy these waning days of summer and take some time to enjoy a cool lemonade and a lazy afternoon with those you love.

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