



# FINANCIAL MANAGEMENT GROUP, INC.

"...to place our clients' interests first, to provide comprehensive financial planning and investment management, and to be a premier provider of innovative and timely strategies that ensure every client meets their established lifetime objectives."

## FMG Economic & Investment Outlook First Quarter 2010

The worst performing calendar decade (2000-2009) ever experienced for the equity markets worldwide is now behind us. In fact, the past decade's performance results for the equity indices were such a significant departure from the historic average long-term norm of 9.8% that, based upon the rule of averages, it is a reasonable statistical expectation that future investment performance during the upcoming ten years will revert to more normal rates of return.

As the below major index performances reflect, the momentum for a regression toward more normal investment performance started in 2009 which was the best performing year for equities since 2003, and one of the best ever, rallying from 2008 which was one of the worst years ever.

Index	Dec-09	QTD	YTD	Description
S&P 500 Index*	1.8%	5.5%	23.5%	Large-cap stocks
DJIA*	0.8%	7.4%	18.8%	Large-cap stocks
Nasdaq Comp.*	5.8%	6.9%	43.9%	Large-cap tech stocks
Russell 1000 Growth	3.1%	7.9%	37.2%	Large-cap growth stocks
Russell 1000 Value	1.8%	4.2%	19.7%	Large-cap value stocks
Russell 2000 Growth	8.6%	4.1%	34.5%	Small-cap growth stocks
Russell 2000 Value	7.6%	3.6%	20.6%	Small-cap value stocks
EAFE	1.5%	2.2%	32.5%	Europe, Australasia & Far East Index
Lehman Aggregate	-1.6%	0.2%	5.9%	U.S. Government Bonds
Lehman High Yield	3.3%	6.2%	58.2%	High Yield Corporate Bonds
All returns are estimates as of December 31, 2009. *Return numbers do not include dividends.				

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

Since the founding of FMG 21 years ago, we have advocated and focused on asset allocation as being the most important investment decision and we utilize proprietary in-house economic analysis and forecasting methods extending out up to 24 months to anticipate how the asset classes might behave and then make present moment tactical asset allocation decisions accordingly. This often makes us appear contrarian to the current on-going market and economic commentaries, and 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

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10979 Reed Hartman Highway  
Suite 209  
Cincinnati, OH 45242

phone 513.984.6696  
fax 513.984.9270  
www.fmgonline.com

135 Garfield Place  
Unit 101  
Cincinnati, OH 45202



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 of last year. As a result, our managed portfolios outperformed the rebounding markets in 2009 subsequent to not losing nearly as much in 2008. This is a perfect example of how our “win by not losing” approach builds wealth.

**What anticipatory portfolio asset allocation shifts did FMG specifically make *before* the 2009 investment recovery?**

As we expected and forecasted, the massive economic stimulus packages by the central governments world-wide jump-started the global economic and market recoveries. Beginning in late 2008 and early 2009, we tactically rebalanced the portfolios back to their strategic equity asset target levels. Moreover, in rebalancing the portfolios, we correctly anticipated that the small company asset classes would lead the early stages of the U.S. economic recovery, and that the emerging markets would lead the rebound outside the U.S. The result was that FMG client portfolios outperformed the equity indices in 2009 during the recovery just as they did in 2008 during the financial crisis.

**The outlook for 2010 appears promising for continuing investment growth, but with downward adjustments occurring and more modest gains than those in 2009**

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. Moreover, every major foreign market except Japan outperformed the U.S. in 2009, further validating our advocacy of global diversification in portfolios.

Global growth prospects in 2010 are good. The U.S. and major foreign economies are in the early stages of recovery and we forecast the global economic expansion to be relatively strong in the first half of 2010 as a result of low interest rates and the huge money stimuli being provided by the central governments worldwide. The expansion should continue during the second half, but at a less robust pace and maybe with some additional government stimulus programs being required to sustain the recovery.

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 countries will be experiencing just the opposite scenario, and the diversity of the FMG portfolios will benefit from these varying economic momentums. This requires proactive investment decision making, and the past decade has reconfirmed that buy-and-hold investing is not as successful as an intelligent active tactical asset allocation approach.

**2010 will require close monitoring of global economic behavior in order to make beneficial tactical shifts in portfolio asset class weightings**

As mentioned, the U.S. and global economic recovery should continue throughout 2010, and this is combined with the fact that the equity indices are still below their highs of 2007. Therefore, we expect less volatility in investment performance during 2010 than that experienced in 2008, but relatively more than experienced in 2009.

Tactically, our asset allocation shifts in 2010 are expected to be 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 strive to implement a sell high, buy low, rebalancing approach.

**What indicators will FMG be watching that could alter our Economic and Investment outlook for 2010?**

Most importantly, we will be monitoring the behavior of the major 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 young middle class clamoring to spend more money, while the U.S., Western Europe, and Japan have an aging population that has been financially wounded and is now spending less money.

Differing country demographics 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 for 2010 that the U.S. government's spending spree will cause inflation, higher interest rates, derail the economic recovery, and sabotage positive investment performance results?**

Domestically, the massive spending and stimulus programs could generate an array of problematic issues to be addressed such as inflation, higher interest rates, increased taxes, imbedded costly government intervention, increased regulations and government spending financed by debt. However, we are not concerned about these issues being a problem in 2010 for several reasons.



First, inflation occurs when the economy becomes overheated, scarce resources are in high demand, and production capacity is being fully utilized. In fact, we are looking at just the opposite right now. The economy is still sluggish, unemployment is high and the demand for goods and services is relatively low. Resources are plentiful and production capacity can be increased without it being inflationary. We do not foresee this changing until 2011 and beyond.

Second, the Federal Reserve is currently more concerned about reducing the unemployment rate than about inflation. Accordingly, we expect interest rates will continue to be kept relatively low intentionally by the Federal Reserve's monetary policy until the unemployment rate shows signs of decline. In our opinion, this will not occur until a later stage of the economic recovery occurring in 2011.

Third, legislation to increase taxes is on the horizon, but even if passed this year the full effects will not take effect until 2011. Accordingly, our tax reduction planning strategies for 2010 consider the real potential for higher taxes in the future. Therefore, we have aggressively harvested tax losses in the taxable investment portfolios we manage in order to reduce the potential harmful impact of increasing capital gains tax rates.

At this time, we expect 2010 to be a modestly fruitful year for the investment portfolios, but with a moderate correction or two occurring. We will remain alert and plan for a potentially more difficult year in 2011.

### **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 21 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](http://www.fmgonline.com) and [www.quietmillionaire.com](http://www.quietmillionaire.com) or telephone us at 513-984-6696.