Mentor Monthly Missive

August 2012 | Vol. No. 9 | Financial Planning News

More flavor, more fun

With foreign bonds making up an increasing share of the worldwide fixed-income market, most well-diversified portfolios should include them. Although it used to be difficult if not impossible to buy in to this asset class, today you can do it from the comfort of your easy chair.

But don't just dive in. There are three considerations you should make: First, why foreign bonds? For their yield or their ability to reduce portfolio risk?; Second, what flavor? Emerging markets or developed markets? High quality or junk? Sovereign or corporate?; And third, currency-hedged or -unhedged?

Foreign bonds right now generally offer more attractive yields than their domestic counterparts. For the 12 months ending July 31, the yield of all funds in the Morningstar world bond category averaged 4.32%, compared with 3.07% for the domestic category. Morningstar's emerging markets bond category did even better, with a 4.97% 12-month yield. The intermediate (domestic) government category yielded 2.48%.

As to the hedged or unhedged question: Research by Vanguard Financial Advisor Services shows that adding foreign bonds to a portfolio can help reduce volatility, assuming that currency exposure is hedged and that there is already a substantial domestic fixed-income component

"International bond prices respond to factors that have relatively low and varied correlations with factors driving U.S. bonds, implying a diversification benefit," Vanguard concludes. "To obtain this benefit, our research finds, investments in international bonds should be hedged. To do otherwise is to expose clients to more volatile currency risks rather than the lower bond risks associated with the underlying bonds."

contined on page 3

Meet our Wealth Managers

John S. Davis, CFP
President

john@mentoradvisers.com
630-530-1191
www.mentoradvisers.com

Mentor Capital Management Inc. was founded in response to the belief that a consumer's best interests are served when his or her financial planner is Fee Only. Advisors of Mentor Capital strive to provide objective, prudent and thoughtful advice to clients based on their personal goals and objectives.

John S. Davis is Mentor's founder, president and chief investment officer.   A graduate of the University of Missouri, Columbia, he is a Certified Financial Planner licensee and a Registered Investment Advisory Firm Principal.

Daniel B. Carey is vice president of Mentor Capital and a member of its board of directors. A graduate of the University of Notre Dame, he is a Certified Financial Planner licensee and a Registered Investment Advisory Firm Representative.

Monthly Market Commentary

Much of July consisted of market participants eagerly awaiting announcements from the U.S. Federal Reserve and the European Central Bank (ECB). The main expectation was for some form of concrete action to revitalize lackluster economies in the wake of the global slowdown. Markets soared after ECB chief Mario Draghi made strong statements, including how the ECB was “ready to do whatever it takes to preserve the euro,” but unfortunately fell sharply again when the ECB failed to actually provide any strong policy support to troubled Eurozone economies. Earnings season showed corporate earnings mostly came in better than expected, though revenue was mostly light as the European crisis continued to affect many companies.

GDP: Second quarter real GDP growth came in at an anemic, but not surprising 1.5%, down from a revised 2.0% in the first quarter. A slowdown in consumer spending and a rise in imports were the main causes of this deceleration. While many have questioned whether the U.S. might already be in a recession, the latest GDP results do not currently reveal that. At the same time, it is difficult to argue that the U.S. economy is booming.

Employment: Investors breathed a huge sigh of relief as 172,000 jobs were added in July, up from a revised 73,000 jobs in June. Most of the job growth came from business services, restaurants, health care, and manufacturing while government hiring shrank by 9,000. Unfortunately, the construction industry continued to contract from poor construction hiring in the commercial sector. The unemployment rate inched upwards slightly to 8.3%.

Housing: Housing data continued to show improvements, as July builder sentiment made its largest single-month increase in a decade. June housing starts set a new recovery high after rising 29% year-over-year, and June existing home inventories remained about 20% below year-ago levels. While low inventories have started to weigh on existing home sales, which fell 5.4% from May to June, lower inventory levels also caused a dramatic rise in median prices. Morningstar economists believe that while it is unfortunate housing is improving at such a slow pace, it still has a lot of room to expand and may drive the economy even higher as exports and manufacturing begin to slow.

Manufacturing: The purchasing manager reports in July indicated paltry gains for both U.S. and China manufacturing, while the Eurozone continued to show broad-based weakness with a 37-month low reading as European companies continued to cut employment and inventories in the face of further expected declines. More importantly, slowdowns in France and Germany suggest that further weakness lies ahead.

Auto: Auto sales were a big help for the economy in both the December 2011 quarter and the March 2012 quarter, but were essentially flat from March to June. With July’s vehicle sales of 14 million units, the auto industry continued to hold steady and will most likely not be a big help in the second half of 2012. Although sales did not accelerate, more sales were made to consumers instead of corporate fleets or rental car companies. It is worthwhile to note that consumer sales tend to occur at higher prices and are considered more indicative of economic strength.

Inflation: June’s CPI report showed that medical services and apparel prices increased, while overall energy and airline prices fell. Droughts in the Midwest continued, which could mean even higher corn and soybean prices that may further drive up the prices of items (such as pork and chicken) higher up the food chain. Unfortunately, this may hurt consumers, who were just beginning to get ahead of inflation.

More flavor, more fun - continued from page 1

The benefit of low correlation is a good one, and it's something we're always in search of. But it isn't always easy. Because of the global economy, asset classes that used to have little correlation now do. We used to be able to lower risk by blending foreign and domestic stocks. Today, the two asset classes tend to move in the same direction and at the same velocity.

Also because of the global economy, though, we can now efficiently invest in asset classes – like global bonds – to which we've never had access before.

Reducing volatility reduces risk, so the hedged foreign bond asset class adds value to a properly managed portfolio.

Contact one of the advisors with Mentor Capital for further discussion and guidance.

MENTOR CAPITAL

John S. Davis, CFP
President

Mentor Capital Management Inc.
105 S. York Street
Suite 450
Elmhurst, Illinois 60126

john@mentoradvisers.com
www.mentoradvisers.com

Tel:630-530-1191
Fax:630-530-1442