

Quarterly Comments

July 2009

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PERFORMANCE RESULTS

2009	2Q	YTD
<u>SP500</u>	15.9	3.2
<u>RUSSELL 2000</u>	20.7	2.6
<u>MSCI EAFE</u>	25.4	7.9
<u>BC AGG BOND</u>	1.8	1.9
<u>ML HIGH YIELD CP BB-B</u>	17.8	25.4

Shown as % return
 Data as of 6/30/09
 Source: Callan Associates, Inc.

Second Quarter 2009 Market Review

By Martha Post

The recovery that began in March catapulted equity markets to sizeable gains in the second quarter. The S&P 500 turned in its first positive return in seven quarters and its biggest gain since the fourth quarter of 1998. While the index closed the quarter 36% above its March low, it remained 41% behind the high achieved in October, 2007. The strongest sectors included small cap growth stocks, financials, industrials and technology. International equities, particularly in the emerging countries, performed very well, helped by currency effects.

As investors returned to equities, they also returned to riskier assets on the fixed income side, shunning the Treasuries that had benefited from the flight to quality during the financial crisis. The yield on the 10-year Treasury note rose almost a full percent (driving prices down), but the broad Barclays Capital Aggregate Bond Index was able to produce a 1.8% gain, helped by mortgage and corporate bonds snapping back to life as spreads to Treasuries tightened. The dollar's retreat also contributed to strong returns for U.S investors in international fixed income. In the U.S., high yield bonds continued to recover as the spread over Treasuries narrowed by 6%.

One of the most painful aspects of this financial crisis has been the decline of virtually all asset classes in lock-step, with no refuge from the storm. This quarter saw diversification proving its value once again, as nearly every asset class added substantial return over a traditional S&P 500/Barclays Aggregate portfolio, rewarding investors who chose to stick with their long term strategic allocations and not retreat to the perceived safety of Treasuries or cash. This is not to say the storm is over. It may or may not be, but maintaining a broadly diversified portfolio in line with long-term objectives and risk tolerance remains the best course.

The Birth of the Modern Part II

By Roger Hewins

One of the biggest developments in the world at large is the advent of the Age of the Emerging Markets Countries. Not to blow our own horn, but our clients have been investing in emerging markets (equity and bonds) all along, not as a matter of market timing or guesswork, but as a consistent allocation to businesses that represented, in aggregate, an excellent investment opportunity. These risky countries, which were forever debtors to the developed nations, are now the creditors. They are making a lot of money exporting to the developed world, especially to the U.S., and then they invest the profits, worth hundreds of billions of dollars, in U.S. Treasuries.

In his new book, *When Markets Collide: Investment Strategies for the Age of Global Economic Change* (2008), Mohamed El-Erian of PIMCO notes that this is likely to be a permanent change. We are moving from a world dominated by the U.S., Europe and Japan, to a world where major parts of the world's capital markets and economic activities are located in what used to be called "the third world." El-Erian expects that the massive imbalances, where America is buying and borrowing while the emerging countries are selling and lending, will not continue, and a more sustainable balance of trade and capital flow will develop. Hundreds of millions of desperately poor people are being lifted out of poverty and enormous new economic growth and opportunity is being created.

El-Erian asserts that people are slow to recognize major structural change, and thus the markets and the regulators failed to comprehend the impact these changes were having. For example, Alan Greenspan was baffled in February of 2005 because long term Treasury rates had dropped even as the Fed raised short rates by 150 basis points (1.5%). The traditional relationship was broken, and no one seemed to know why. Well, despite the low yields in Treasuries, all that emerging markets' money (their reserves) was flowing into the Treasury market and driving prices even higher (and yields down). Everyone missed it. Likewise, one prediction of inflation after another was proven wrong, as the massive impact of all that cheap labor (much of it educated and highly skilled!) from the emerging countries drove productivity higher and higher and kept wages low.

There is one fundamental fact that makes crafting flexible new strategies challenging. One can readily see that there are excellent growth opportunities all over the place, as well as major dangers. Volatility is historically high, and recent history warns us that our downside risks, the "tails" everyone loves to discuss these days, may be larger than they were until recently. There is considerable risk of major policy failures by governments who threaten to be far more deeply involved in economic activities than ever before, and these failures could have catastrophic consequences. Or not. But the fundamental fact is that the market is doing its best to put a price on all of the available investments that reflects all the opportunities and risks. *Continued on pg 4*

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Helping Donors Give: Scenario Planning

By Pat Brault

Across the nation, development staffs of non-profit organizations have felt the impact of the financial crisis on philanthropy. It's a perfect storm: endowments' asset values are down twenty-five to thirty percent, costs are rising and donor gifts are stagnating.

- Ninety-two percent of the nearly 100 non-profit leader respondents in a survey conducted in May by the Bridgespan Group said they were feeling the effects of the downturn.
- Eighty percent reported that their organizations were experiencing financial stress. In another study conducted in April by the Johns Hopkins University's Listening Post Project, forty percent of the respondents describe the stress as "severe."

More than eighty-five percent of all private donations in America are made by individuals representing a wide range of incomes and contribution levels. Significant gifts, especially repeatable ones, are typically made by individuals and families whose assets are equally significant.

It is no surprise that previously generous donors have pulled back in the face of financial uncertainty. Our firm provides financial planning and investment advisory services to wealthy individuals and families. Through a partnership with a well-known financial planning technology firm, we have introduced a technology-enabled, real-time scenario planning service that allows clients to consider a wide variety of real time, "what-ifs" examining the possible outcomes of a variety of different choices. One of the filters of the program looks at the impact of the timing and size of charitable gifts. Because these options are modeled interactively, clients are more able to make positive decisions about giving today because they can see the future impact of those gifts on their wealth over time.

By sharing our scenario planning service with non-profit organizations, our consulting team can be a strategic partner, helping development staff realistically address current donor concerns. Our non-profit clients and colleagues tell us that being able to introduce a visual way to consider gifting scenarios helps to restore gifting habits. For further information, please don't hesitate to contact us.

The financial crisis has impacted philanthropy and donors' gifts are stagnating.

Scenario modeling can help restore donors' confidence to make financial gifts to non-profits again.

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The Birth of the Modern Part II

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If you want return, you get exposure to risk. If you want to hedge risk, you pay a price. And if everyone knows that risk is high, the price of protecting against that risk is high. We hear, over and over, that people want some risk protection, flexibility, a nimble value-added strategy that captures the upside and protects on the downside.

There are many sad stories of people who invested with Bernie Madoff, the man who produced good returns and never lost money. People looking for magic solutions are often easy prey to snake oil salesmen. Don't be a victim of fear or greed. Don't look for magic. Take the right amount of risk, no more and no less, and find a way to live with it. You will never get better advice than that.

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