Toll Free: 888-557-3272
Fax: 888-852-3273
PersonalFinancial.com

California Office
5901 Christie Avenue, Suite 201
Emeryville, CA 94608

Hawaii Branch
4-1378 Kuhio Highway, Suite 202
Kapaa, HI 96746

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TRIALS, TRIBULATIONS, MARKETS & GROWTH AND A NEW SENIOR MANAGING ADVISOR

By Loren Kayfetz, President, CERTIFIED FINANCIAL PLANNER®

It would be easy to ask: what is not a problem right now? Strife around the globe continues with conflicts and protests erupting in many places this past quarter, most notably in Libya, Egypt, Tunisia and Yemen. The entire world watches and worries, about oil, about freedom and about the future. The European Union continues to work with their members whose finances are still dangerously over extended. In the United States, we have the specter of possible government shutdowns, gridlocked legislative forums, still falling housing markets, excessive debt (especially in the public sector), and sputtering growth.

Yet, despite these overhangs, our domestic stock markets have performed extraordinarily well. Elsewhere in this newsletter, we talk about benchmarks, but the narrow Dow Jones Industrial Average and US large cap based Standard and Poor's 500 index have been very profitable. While they look good for the last three months and one year, their three, five and ten year numbers are still between 1% and 4% a year. Since we look at our client's risk tolerance, allocating among different types of investments, and the long term, we are not focusing on just one economic indicator.

Indeed, our asset allocation methodology has consistently placed funds in forward looking places, which at the time of the initial investment, may seem unrelated to current events. Our emphasis on international and emerging markets investing has helped our clients obtain better results with their overall portfolio for 3, 5, 10 and longer periods of time. My travels to developing Asia and emerging Europe starting in the early 1990's set the stage for those allocations. We are now finding value and opportunity in what are being called Frontier Markets.

We do not expect to always "beat" a pure stock index (no one usually has an all stock portfolio.) It is true that when the markets are moving ahead, often an all stock index will do better. When we have retreats (or if you felt at the time like it was a rout in 2008), stock indexes are pushed much lower. So measuring every heart beat of performance activity does not make any sense. The future is more than just framing the present and projecting it forward.

At Personal Financial Consultants, we continue to look to the future as a company as well. I am pleased to announce that Nicole Hanson, CFP® has been promoted to Sr. Managing Advisor of our Emeryville office. To learn more about Nicole's qualifications, we have a special write up about her on page 3.

We will continue to keep you updated regarding our services each quarter, and remain available by telephone, e-mail and now video conferencing (via Skype) as needed.

MUCH ADO ABOUT INFLATION: ANSWERS TO COMMON QUESTIONS

By Erin Hadley, CERTIFIED FINANCIAL PLANNER®

What is it?

Inflation, by definition, is the increase in the cost of goods or services that we consumers all need to live our lives. Examples include commodities such as food, clothing, household items, and gas. as well as other services like a check up at the doctor, having your taxes prepared, or getting your house painted. When inflation rises, your purchasing power falls—meaning, one dollar buys you less.

How is it measured?

The Bureau of Labor Statistics (BLS) is the U.S. body charged with measuring inflation. It is measured using what is known as the "Consumer Price Index" or "CPI." The costs of a collection of different goods and services are averaged, the change in the prices of each are examined for a given period of time and then again averaged and further adjusted by region. The result is the CPI for that period.

Why do I hear news about the CPI *excluding* food and energy prices?

All human beings need to eat and use energy in some form (even those of us who don't have a car to gas up each week) so why wouldn't we want to include these two very significant components? Food and energy prices are volatile and therefore can skew the measurement; removing these can help us identify trends we might not otherwise be able to see. Having a sense of general price movement give us a better indication of what's going on and what to do about it.

Why is it important?

Slow and steady inflation is generally thought to be positive: it means our economy is growing: the risk arises when prices rise sharply and don't accurately reflect underlying values and this can lead to a bubble and the resulting aftermath when that bubble bursts. Our central bank, the Federal Reserve (the "Fed" for short) tries to ensure inflation stays within certain limits (typically 2-3% annually.) If they feel it is moving too rapidly in one direction or another, they will take measures to try to ameliorate what they believe to be an unsustainable trend.

When inflation is the concern, they attempt to tighten the money supply by raising interest rates, selling government securities (Treasury bonds) or increasing banks' reserve requirements. Each of these measures serve to reduce the free flow of money and thus, as former Federal Reserve chairman Alan Greenspan might say, reduce a situation that has become too "frothy."

The economy and markets are currently recovering from the burst of the real estate bubble and the subsequent ripple effects. Thus the problem of late has been not inflation but the opposite, deflation. When it comes to falling prices, the Fed takes measures to try to loosen the money supply to help our faltering economy. And the Fed has taken many steps to try to get people spending and lending money again: interest rates are at historical lows and they've pumped money into the system in various ways, most recently through "quantitative easing," an effort to encourage banks to lend more by buying government securities and increasing the amount of money flowing through the system.

What's the worry?

If deflation is the problem, why is everyone talking about inflation? The Fed's job is a precarious one: CPI is just one of the tools they use to try to evaluate what is going on in the economy (i.e. what is going on in the minds of individuals and institutions) to determine what strategies to utilize to keep things in balance.

Even if they do all the "right" things, they have to carefully gauge how much is enough and when to stop. While Alan Greenspan was revered for much of his 18 year tenure, he was blamed afterwards for contributing to the real estate bubble. Many believed he kept interest rates too low for too long and that the easy availability of money led consumers and companies alike to over- leverage themselves.

Right now, Ben Bernanke, our current Fed chairman, is in the difficult position of having to decide what to do next: keep rates where they are and risk another bubble in the long term, or begin to raise them and risk causing already fear-stricken consumers to put their wallets back in their pockets just as they were taking them out again for the first time in a long time.

Article continued on page 4…

ANATOMY OF A BENCHMARK

By Nicole Hanson, CERTIFIED FINANCIAL PLANNER®

What Are Investment Benchmarks?

The dictionary defines a benchmark as "a point of reference for measurement." This is the measuring stick we use to assess our portfolio performance over the long term.

Commonly Used Benchmarks

The most commonly quoted benchmarks are indices such as the Dow Jones Industrial Average, the S&P 500 and the MSCI EAFE. The Dow is composed of 30 large U.S. stocks, the S&P 500 of the large U.S. stocks and the EAFE is comprised of stocks from Europe, Asia, and the Far East.

Identifying the Appropriate Index

The appropriate index for your needs is not always easily identified by its name or popularity. For example, most people have heard of the Dow Jones Industrial Average because it is quoted in the news throughout the day. However, many people may not be aware that the Dow tracks only 30 stocks of America's largest companies — not a very reliable source for comparison if your portfolio is a diversified mix of domestic and foreign stocks and bonds. Since all of our clients have diversified portfolios, none of the often-quoted indices would make a good benchmark. For one thing they are all stock and do not hold any bonds.

As investment managers we not only want high returns for our clients but we want high, risk-adjusted returns. That is, we want our clients' portfolios to grow but in the least volatile way possible. To achieve this, we diversify our clients' holdings into both stocks and bonds. The result is a portfolio that doesn't fall as far or as fast as an all-equity index in a falling market. In a rapidly rising market our clients' portfolios will lag the all-equity index, however, due to our investment strategy, which includes a focus on international holdings including emerging markets, our clients have out-performed the S&P 500, Dow, and EAFE over the long-term. The bottom line is that your portfolio moves differently from common indices on a day-to-day basis so if you see that the Dow plummeted one day, your portfolio most likely did not fall as far.

How do we at PFC benchmark?

We use a hybrid benchmark which is a combination of both equity and bond indices and is based on your risk tolerance and time horizon. In addition, we benchmark individual funds against their own investment category to make sure they are competitive. From time to time you will see us switch out a fund in favor of a fund we feel will perform better over the long term.

NEW SENIOR MANAGING ADVISOR FOR PERSONAL FINANCIAL

We are pleased to announce that Nicole Hanson, CFP® has been promoted to Senior Managing Advisor of our Emeryville office. In addition to her continuing role as an investment advisory representative and Certified Financial Planner ™, she now oversees our personnel in the office, and is directly responsible for advisory and operational management.

We at Personal Financial Consultants Inc. are excited to have made this choice. Nicole is finishing her Master's Degree in financial planning and taxation at Golden Gate University this month. Nicole has nearly a decade of experience in the financial services industry and joined Personal Financial Consultants Inc. in 2008. Her prior experience includes being a Financial Planner for an independent advisory firm, a Financial Services and Risk Management Specialist for a Fortune 500 Company, and Financial Advisor for a Fortune 100 Company.

She completed the UC Berkeley Financial Planning Certificate Program with distinction in January 2004. The following year she earned designations as a Certified Financial Planner Practitioner™ (CFP®) and Chartered Life Underwriter (CLU). Nicole holds a bachelors degree in English and women's studies with psychology from Oberlin College and is working towards a master's degree in Financial Planning and Taxation at Golden Gate University.

Committed to understanding and providing best practices to clients, she is an active member of the Financial Planning Association (FPA) and serves on the conference committee of the FPA Northern California chapter.

Nicole and her husband, Jeff, live in Oakland. In addition to her financial planning activities and studies, she enjoys cooking, gardening, and making jewelry.

Much Ado About Inflation: Answers to Common Questions, *Continued*

(continued from page 2) Rates will have to be raised at some point, and with all the money the Fed has infused into the economy, it's hard to see how the cycle won't start again as consumers and businesses begin to feel more confident. It's a delicate balance to be sure and Bernanke won't know if these measures work until well after he employs them.

How does this affect me?

The most obvious way inflation affects consumers is the hit you feel to your pocketbook when you go to the grocery store or the gas pump, but inflation also affects your investments. When the Fed tries to stem inflation by raising interest rates, this can affect bonds in your portfolio. The risk of bond prices being hurt by these changes is known as interest rate risk.

Interest rates and bond prices have an inverse relationship: when bonds are first issued, their coupon rate is usually close to interest rates at that time. Because the coupon rate is fixed, if interest rates rise later, the bond price will fall. This is because the market is not willing to pay face value for a bond when newly issued bonds at the same price are paying higher coupon rates. While rising interest rates are generally bad for bonds, they affect different types of bonds differently: longer term bonds can be more significantly impacted than shorter term bonds.

What can I do to protect myself from the effects of inflation?

Lowering a bond portfolio's duration (a measure of bonds' sensitivity to interest rate changes) is one way to protect portfolios form rising interest rates. When we talk about interest rate changes, we are talking about changes in the US only; another way to protect a portfolio is by investing in bonds outside the US in addition to US bonds. Investing in commodities is another way to protect against inflation because it provides a hedge: as commodity prices rise, so does the value of a commodities fund. Investing in the market: while cash is fine for money you will be using in the short-term, it is not a fail-safe investment for the long-term because, as discussed above, inflation reduces purchasing power: $1 in the bank becomes worth less with every passing day that inflation is on the rise.

We continually monitor aspects of the economy that affect portfolio inflation sensitivity. Don't hesitate to call us at if you would like to have a more in depth conversation about inflation or other subjects related to your investments.

Quarterly Perspective

Newsletter

We are looking for people just like you!

The greatest compliment to us is a referral.