PENCE WEALTH MANAGEMENT
Planning for Your Dreams

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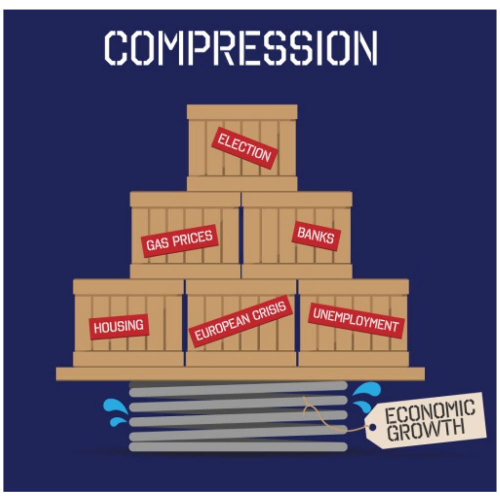
PENCE PERSPECTIVES - *September 2012*

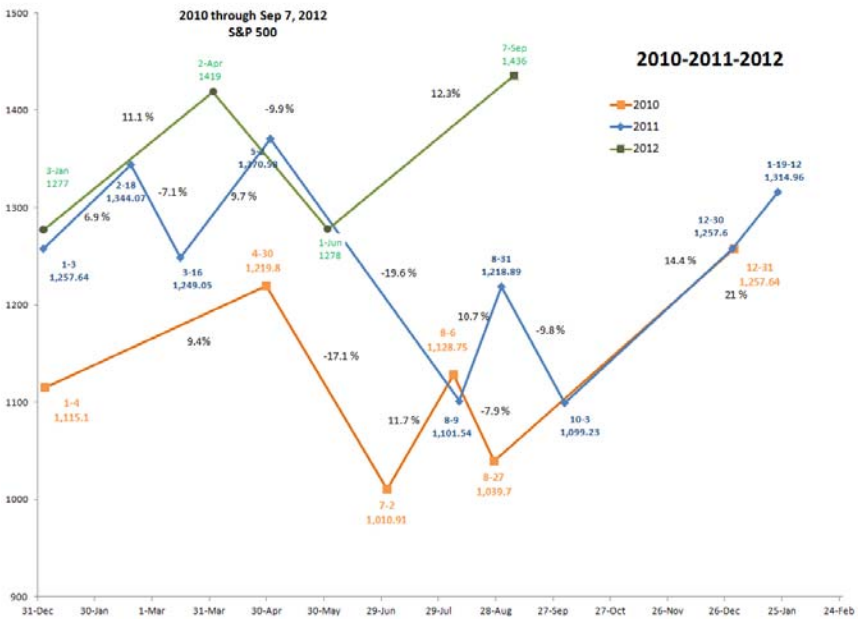
Bottom Line Up Front:

If you attended our annual client Luncheon on May 5th 2012, you know that our predictions for both the economy and the markets for this year have been pretty much on target. We had a market peak in April, followed by an adjustment, followed by continued volatility and then a slow slog back through the summer to near annual highs. The question is now what? If the playbook continues to follow the same pattern, we may be due for another adjustment sometime soon. Even as fundamentals are improving, today's markets seem to be driven by headline risk. Currently, the two headlines we watch the most are unemployment in the U.S. and bond purchase programs by the European Central Bank (ECB). At this time, we are cautious and defensive, yet opportunistic.

The way we see it:

We think the economy will continue to create private sector jobs between 100,000 – 200,000 per month for the next year. Any number above 200,000 will move the market upward, whereas any number below 100,000 will move it downward in the short run. If our math is correct, we expect our economy to create 1.5 to 2 million private jobs each year for the next 3 years, which will bring the unemployment rate down to around 7%. We call this the new natural rate of unemployment for the next decade. We stated in May, as we still believe now, that what is going on in both the economy and the market is a phenomenon called **COMPRESSION**. The economy is growing slowly and getting stronger but it is being held back by uncertainty, headline risk, and policy risk which, all together, are weights that are impeding a more robust recovery. There are significant issues that cause uncertainty in our economy and our markets. Until clarity is obtained and some of those issues are resolved, the economy will stay in low growth mode and our markets will continue in the same two steps forward, one step back or up-ten, down-seven cycle for a while. The good news is, the underlying strength of the economy is much better and clearer than it was 18 to 24 months ago. In the intermediate term the key thing to remember is that some of the factors of compression are likely to get better with time. The election will be over in November. Regardless of its outcome, businesses will have more clarity over the next four years. The housing crisis is getting better as the excess supply is being soaked up by the increasing natural housing demand. The banking crisis is abating. Highly accommodative policies have allowed banks to repair their balance sheets. As they rebuild their capital structure, their ability to lend returns. So, the Election, Banks, and Housing all become less of a weight as the clock ticks. Gasoline prices, the European Crisis and Unemployment are all issues more tied up in policy than in economics. Gas prices are volatile but range bound and as the US natural gas and energy production comes more in line, we will be less exposed to international risk and less energy dependent on imports. Europe is a basket case, but they continue to muddle through. Finally, after exhausting all other options, they are trying to do the right thing. I would need an entire newsletter devoted to Europe to spell out the end game. However, just plan on a constant stream of headlines for the next year. Though the skies are not clear and the sun is not bright, it is not pouring rain either. We believe the underlining fundamentals of the US economy are strengthening. While we wait and move forward slowly, we think it is still possible to do well in this current low-growth environment with diligence, caution, and cash flow. This is the third year of the same type of pattern by which you can almost set your calendar (see chart next page). This is one reason we are both cautious and opportunistic at this time. When we see a market adjustment, it will be a great opportunity to buy solid dividend paying companies with strong balance sheets and income streams while they are on sale.





This is why we have allowed our cash positions to rise above the normal 2%. We want to take advantage of potential opportunities as they present themselves.

The Big Knowable Themes:

The US is still the best house in a bad neighborhood. Corporate profits and balance sheets are better than ever. The uncertainty that plagues us now will be getting clearer over time. The real risk is the Fiscal Cliff. It is something that is in our power to address. The Fed states that it will continue to be accommodative until 2014, if not until 2015. However, after that, there is a significant risk in the bond market. These are the key elements that will guide us in the short and intermediate term.

Actions:

For our clients with Strategic Asset Management accounts (SAM) where we manage with full discretion, depending on your individual situation and account, we are still clearly focused on cash flow, dividend paying stocks and high yield bonds. Cash positions will increase well above the normal 2% level as we seek to balance two issues:

- One: seeking to limit risk if we see the market get toppy and
- Two: taking advantage of volatility to buy solid companies we like when their price is at what we feel to be of good value.

For our clients who hold brokerage accounts, if you are interested in similar treatment please contact your advisor.

If you are not yet a client, and are interested in learning more about our services, please contact Lanae King (949) 660-8777 ext 100 or lanae.king@lpl.com to schedule an appointment.

I strongly encourage you to attend our annual client luncheon next year on Saturday, April 27th, 2013. It is at this annual event where I lay out our key thoughts for the entire year and those clients and potential clients who attend always find it rewarding and informative. If you would like to receive an invitation please email abigale.jasinsky@lpl.com.

As Pence Wealth Management embraces the digital age, we encourage you to like us on Facebook, follow us on Twitter and check our daily blog on our website www.PenceWealthManagement.com/blog.

For our clients, friends and prospective clients we wish to remind you that, once again, we have been recognized by Barron's Magazine as one of the top Financial Advisors in the Nation (Barron's criteria: based on assets under management, revenues generated by the advisor and quality of their practices).

We are accepting new clients, and the greatest compliment or gratitude that you can show us is the referral of a friend or family member. If you would like a hard copy version of this newsletter to pass on, please contact Anne Godfrey anne.godfrey@lpl.com or (949) 660-8777 ext 116.

We appreciate your trust and the opportunity to be of service.

All the best, ❖

E. Dryden Pence III, CPM®, AIF®

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To receive email communication from Pence Wealth Management:
Please make sure to add no-reply@salesforce.com and anne.godfrey@lpl.com in your email address book