Fama Fiduciary
WEALTH LLC

Website: www.famawealth.com *E-Mail: andrew@famawealth.com*

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"The greatness of America lies not in being more enlightened than any other nation, but rather in her ability to repair her faults."*—Alexis de Toqueville, Democracy in America, 1835*

To our clients and friends:

This quarter's newsletter is being published later than usual—I was in California last week, sightseeing and visiting friends. One of my dearest friends (and my old college roommate) is a physician and faculty member at the University of California. He is also an environmentally-conscious sort. One of the highlights of my trip was being able to drive my friend's brand-new Tesla Model S electric car on the outskirts of Silicon Valley one evening. For a photo of the car, please see home page: http://www.teslamotors.com/.

My experience driving the Tesla brought to mind a number of comments made by Warren Buffet and which I've so often alluded to in these newsletters—namely, that America continues to confound its critics. The above quote from Alexis de Toqueville is also a good reminder.

Just when we feel as a nation that we've given up on trying to solve our problems—for example, because of our dependence on foreign oil, or due to our perceived lack of ambition in encouraging entrepreneurship—we have an individual like Elon Musk, the original founder of Pay Pal, step up and make positive change happen in our country by founding a company like Tesla Motors. This is precisely the type of thing that Buffett writes about on a regular basis. As you'll recall, he showed great courage and commitment during the throes of the financial crisis by sticking to his positive message.

First Half Review

In late May, the U.S. stock market indexes (except the Nasdaq) reached all-time highs. Then on May 22, Federal Reserve Board Chairman Ben Bernanke quietly implied that a stronger outlook for U.S. economic growth might lead to a gradual reduction in bond purchases (which is what had helped keep interest rates low). The prospect of an end to the record-low interest rates shocked markets, leading to declines in the coming weeks of almost 7% in the S & P 500 and much more in the non-U.S. global markets.

Time Frame	U.S. Total Market	Europe	Emerging Markets	World Markets
1/1/13 to /21/13	18 %	16 %	3 %	19 %
5/22 to 6/30/13	-4 %	-8 %	-7 %	-8 %
Entire 1st Half	14 %	7 %	-4 %	10 %

Source: MSCI returns **including the price gains plus dividends**, all returns in local currency

The strength evidenced by this chart in the U.S. market signals a continuation of the trend of the past three and one-half years. Since the beginning of 2010, the U.S. market is up 32%, compared to 14% for international markets outside the United States. Therefore, investors who weighted their portfolios in favor of U.S. markets as opposed to international markets have done very well since at least 2010.

By some measures, in fact, U.S. stocks have been outperforming *emerging market* stocks for more than five years running. Yet, few investors seem to recognize that a "great rotation" is underway from global equities to U.S. equities. In some cases, and in keeping with the theme of this newsletter, the U.S. is even a better growth story than are the emerging markets. We really have to look no further than the California-based Tesla Motors to see evidence of this dynamic trend.

The consensus in much of the financial media here in July 2013 seems to be that the U.S. economy is on the brink of a serious slowdown. However, both *asset class* performance during the first half and U.S. *sector performance* among domestically-focused companies do not support that consensus view.

Will the U.S. pick up the global growth baton?

With Europe's economies facing continuing challenges and with slowing growth in China and other emerging markets, the United States is once again being looked to as the driver of global growth.

That's why it's important to step back and look critically at prospects for the American economy. The spotlight on the U.S. is nothing new – the opening quote for this newsletter was drawn from a book by 19thcentury French historian Alexis de Toqueville, written after traveling across America. His insights on America's resiliency and can-do spirit caused a stir among European politicians, many of whom at the time still saw the United States as an uncivilized outpost.

And, in addition to Alexis de Toqueville, we have Warren Buffett. If Mr. Buffett is to be believed, then we should all continue to express confidence in the resiliency of American business, just as he himself did in the famous New York Times article written in the fall of 2008 and entitled "*Buy American—I am".* We should remember that this article appeared at a moment in time which was very close to the stock market bottom. It was also written amidst great uncertainty and in the immediate aftermath of the global financial crisis.

Earlier this year, Buffett addressed the uncertainty that preoccupies many members of the media and which has dampened the willingness of American business to invest. He pointed out that uncertainty has been a constant in the United States since 1776. The only variable is whether people ignore the uncertainty (which typically happens in boom times) or fixate on it (which seems to have been the pattern recently).

A Positive Perspective on America

Like every other country in the world today, the United States faces serious issues. A recent *Wall Street Journal* article by Harvard economist Niall Ferguson made a bearish case for the United States by focusing on our country's political dysfunction, burdensome regulation and slipping competitiveness.

However, a more positive perspective comes from *The Economist* magazine. Published in London, *The Economist* is broadly respected for its objective analysis of global trends. In April, it published a special report on American competitiveness.

The author of the piece urged readers to look outside of Washington political entanglements to the more positive progress and developments being made within the U.S., namely:

- The shale oil and gas revolution is changing the dynamics of the energy industry and providing America with the prospect of energy self-sufficiency;
- Sweeping reforms are taking place at the state and municipal levels to create accountability and greater focus on *results* in the public education system;
- America's innovation engine is once more operating at full speed – research and development as a percentage of the economy has set the previous record set during the space race (e.g., Tesla Motors);
- In a world where technology is playing a growing role, the United States is home to 27 out of the world's top 30 universities for scientific research.

None of this is to say that the United States doesn't face issues involving regulation, infrastructure, education and entitlement spending. But as we look forward, there is a strong case that the United States recovery will help fuel economic growth around the world – and with that growth we should expect to see the prospect of solid performance by stock markets, particular here in the United States.

A Word about "Recency Bias"

From a psychological point of view, investors continue to make mistakes in their assessment of markets. For example, those investors who have remained on the sidelines during the past three years are demonstrating a cognitive bias known as the "recency effect."

Because of the severe declines in 2008 and 2009 (which are these investors' most recent experiences), they fail to grasp the fact that *over the long term* markets will revert to the mean. The importance of objectivity is lost on investors suffering from recency bias.

This bias rears its head whenever we place exaggerated importance on what has just happened, downplaying the significance of historical data. It's a common problem, and this is why it's so important to always subject our hunches to more rigorous statistical scrutiny and to consciously try and avoid investing on an emotional level.

The Plight of Fixed Income

Following is a quote from a publication called *The Bank Credit Analyst.* The editor is Martin H. Barnes and his website is www.bcaresearch.com. Mr. Barnes wrote recently:

"A persistent shortage of safe assets continues to be a key driver of global markets. Ironically, this shortage has created a perverse dynamic in which investors bid up the prices of assets that they perceive to be safe to such an extent that they cease to be safe".

The point Mr. Barnes is making is that investors have (until very recently) become so greatly enamored with bonds and fixed income, that they have failed to realize that asset class performance moves in cycles, and that many times following the herd is the wrong course of action.

I've pointed out in previous newsletters that often something perceived to be safe actually turns out to be more risky, and vice-versa. This is essentially the same principle that drives the logic behind the concept of the old adage: "buy low and sell high". Rather than following that basic tenet, emotional investors will do just the opposite. This kind of behavior often results in irreparable harm to their plans for a secure financial future.

If one bears in mind the risks inherent in those investments which have outperformed significantly over a long period of time (currently bonds and fixed income), then one is less likely to jump on the proverbial bandwagon and march over the cliff.

Conclusion: Focus on Dividends and Cash Flow

My final comment relates to the role of cash flow from investments. Amidst the uncertainty surrounding economic growth and equity returns, we continue to place priority on the cash yield from investments. While the headlines talked about U.S. markets hitting new highs in May, investors who reinvested their dividends saw their account values exceed the 2007 peak significantly earlier than others who did not do so.

Dividends continue to make certain investments attractive. We must be increasingly discerning, however, because some traditional high-dividend investments that generate portfolio income may now have become expensive by historical standards.

Thank you for allowing me to be of service to you.

Sincerely,

Andrew J. Fama, JD, RFC, MHA, Registered Fiduciary

Principal, Fama Fiduciary Wealth LLC

Registered Investment Advisor

Past performance is no guarantee of future results

Nothing contained in this quarterly newsletter should be construed as investment advice