First Quarter 2011
2011 Annual Economic & Capital Market Forecast
Volume VIII
Issue #1

Happy New Year to all of our Clients and Friends!

In an effort to be more efficient we have decided to combine our annual Economic and Capital Market Forecast with our Q1 investment newsletter. We think this will better allow us to "wrap up" the previous year and share some of our thinking with you about the year ahead in one email versus two.

Before we get to our forecast and commentary, I would like to take this opportunity to briefly touch on our name change from Planning Resources to Matrix Wealth Management, as well as our move to our new location in downtown Portland. We decided to rebrand the company under Matrix Wealth Management because we felt like the new name and logo better represented our firm's overall comprehensive wealth management capabilities. Wealth Management (the way we practice it) is a relatively new concept. Many clients may have experienced some type of "Wealth Management" but usually this is simply their insurance representative trying to cross-sell them investments or their stock broker trying to cross-sell them insurance. While these products are all necessary and important, our approach relies on experienced professionals working together as your team. It is our philosophy that no one person can be all things to all people and still do quality work. This is one way we differentiate ourselves from our competition.

Our new address is 1001 SW 5th, Suite 2175. If you need to come visit us at our office please feel free to park across the street in the parking garage (entrance on 6th) and bring your parking pass with you to the office. We will be happy to validate for one hour of free parking. There is ample shopping and dining opportunities within walking distance and the Nike Town store is one block away from our front door. So, if you find yourself at our offices here in downtown we hope that you will also enjoy some of the amenities while you are in the area.

We would also like to take this opportunity to introduce to you the newest member of our team, Brad Walker.

Brad's experience in the insurance industry began in 2003 while working in the health care industry for Anthem Blue Cross/ Blue Shield in Louisville, KY. In 2008, after working for his family's business, Brad and his wife Sarah moved to Portland, OR where he began his career in Risk Management with Allstate Insurance Company.

In January of 2011, Brad joined Matrix Wealth Management and began managing the Property and Casualty business within the firm. He is currently a licensed Agent in Oregon and Washington providing Home, Auto, Liability, and Business Insurance.

Brad enjoys spending time near the water and outdoors along with playing tennis, visiting family, and traveling.
We are very proud to have Bradley as our newest member of the team.

If you would like Brad to review your current insurance coverage, then please feel free to contact him directly at 503-227-7744 or email bwalker@matrixwealthmanagement.com.

2011 Economic & Capital Forecast

As a reminder, while we do forecasting as part of our investment process, the purpose is not really to try and divine the future but better understand the current environment. We feel this type of process gives us a better chance of finding the best investments possible in the right sectors of the economy.

Gross Domestic Product (GDP) – In 2009 we forecasted that 2010 GDP would be up to around 2.22% as companies replenished their inventories, continued to cut cost and benefited from an overall weaker dollar. According to the Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters as of 1-1-11 it now looks like 2010 GDP will come in around 2.7%.

For 2011 we are expecting GDP to be in the area of 2.5%. We are now more or less in line with the official forecast but up slightly from our 2010 forecast.

Jobs – Most experts (except those that work for Uncle Sam) seem to now agree that real unemployment for 2010 was around 17%. Our forecast for 2010 predicted the number would peak at around 20%.

Looking forward to 2011 we are expecting this number to stay about the same. The good news is that we think the government is going to throw everything it can at this problem in anticipation of the upcoming Presidential election cycle. While we are pleased to finally see the jobs problem on the front burner (so to speak) we still don't believe that any real net improvement in family wage jobs will be realized. Besides the misery many of our fellow citizens have found themselves dealing with, investors may not escape the fall out many in government are hoping. We believe that if the employment problem is not solved that stock investors will eventually suffer. Companies have been able to increase profits as a result of various cost containment policies and in some cases the weaker dollar has been a big help, but sooner or later the top line must also grow as further bottom line efficiencies will be harder to come by. We have said this before and will take this opportunity to say again, we do not believe that you can have a sustainable jobless recovery. The key metric is, has been, and will be the jobs picture.

Taxes – We were wrong in believing that the Obama administration would not extend the Bush tax cuts, somehow wisdom prevailed, at least for now. It is fantasy to believe that you can have real deficit reduction without decreases in spending and tax increases. At some point we believe that most taxes must and will go up.

While it looks like the fed will stay put for now the situation with the states is a very different and worrisome. Many states are in serious economic distress and are faced with not only cutting their budgets, but raising taxes just to meet basic budget requirements.

Muni investors should be reviewing their portfolios as we are seeing an increase in both credit risk and interest rate risk. This could end up being a double whammy for muni's and could affect bond fund investors in a much more serious way than those investors that own individual bonds. If you are unsure about your bond portfolio, then please feel free to contact us for a portfolio review. We will look at your credits as well as the duration on the portfolio. If you own a bond fund we will also look for any leverage in the portfolio. If you don't already know these things then you should speak with someone soon.

So for 2011 we expect taxes to go up. As a result, tax policy will remain more favorable for stocks than for bonds or other income streams that would be taxed at ordinary income levels for many investors.

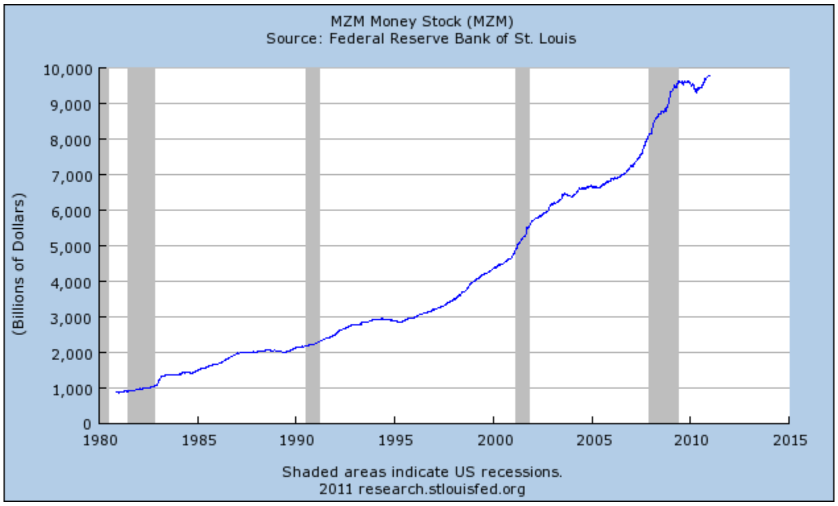
Inflation – There should be no doubt in anyone's mind at this point that the Fed loves to print money. Foreign governments like China and others have publically stated their concerns about our monetary policy and with good reason. The Chinese are our largest foreign debt holder (held in the form of U.S. Treasuries) and if I were them I would be worried about my investment too. In an article published in The Wall Street Journal on January 13, 2001 both Moody's and S&P have cautioned the U.S. on its credit rating, expressing concern over a deteriorating fiscal situation that they say needs correcting. The bond market did nothing on this news. If we were in an environment where reality actually mattered then the bond market would have been slaughtered on such a revelation, but instead it did nothing! This reminds me of something a client said to me recently, "with the government so involved in everything, it's hard to know what anything is really worth". I wish I had said that.

We do know one thing for sure (because the Fed publically said it), that they intend on reflating the economy. This makes some sense from the government's perspective, because it's one way we can restructure our enormous debt, by allowing us to pay back our creditors in currency that is worth less in the future.

We are very worried that someday this policy will catch up to us and the price will indeed be high.

The market (as measured by the S&P 500) went up about 10% or so last year; cotton, a commodity used in most of the clothing we buy went up over 98%! I guess you could say that means that your underwear outperformed the stock market! What it really means is that the price of everything has gone up: oil, clothing, groceries, etc. Many of our most commonly used commodities (things used in everyday life) have gone up at least 50% or more. And the government still wants to believe that there is no inflation?

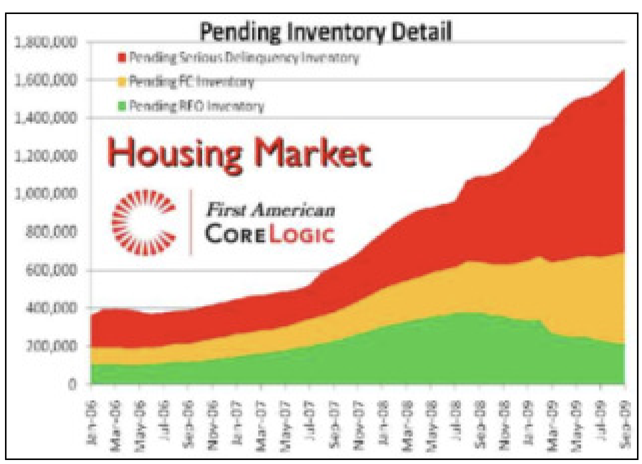
So far, the Fed has injected $1.85 trillion into the money markets, under its QE-1 and QE-2 interventions, which in turn have fueled huge rallies in commodities and stocks. The Fed argues the QE is not inflationary, because the electronic money supply is sitting in the hands of the Oligarchs and isn't circulating in the general economy. If you're a small business trying to access money from the bank to grow your business, you already know this.



The facts simply do not jive with Mr. Bernanke's defense of QE. The fact is (see above chart from St Louis Federal Reserve) that the money supply (as measured by MZM) has mushroomed in size by over 450 billion in the last six months – that's the equivalent of 3% of GDP. MZM is defined by Wikipedia as the total amount of money available in an economy at a particular point in time. The way I think of this is as the measurement of money available for spending. MZM can be immediately redeemed without suffering a penalty or a capital loss.

Our outlook for inflation remains very bearish as long as the Fed continues to print more and more paper currency. We expect inflation to be well north of 10% in real terms for 2011. In 2009 we said that inflation, perhaps even hyperinflation would be the next fiscal crisis we faced in 2010 and if not, in 2011. Unless something major changes we still expect this to be the case.

Housing – With little reprieve the housing situation has shown very little sign of a sustained recovery. For example, according to the Wall Street Journal in an article published on August 24th, 2010 home resales dropped a record 27.7% to an annualized rate of 3.83 million in July. This was a 27.2% drop while at the same time inventories rose to a staggering 12.5 months from 8.9 months in June. Again, until the jobs picture starts to meaningfully improve housing will remain weak.



As you can see from the above chart, the situation has not only failed to improve, but has actually gotten much worse when you take into consideration housing inventory that is seriously delinquent. Until, the inventory overhang issue is resolved, which in our opinion won't be until the jobs issue is resolved, we expect housing to be weak. True, we may see one time shots in the arm like we saw last May with the tax credit of $8,000, but I think it is noteworthy to understand that as soon as this program closed mortgage applications dropped off a cliff.

These types of stimulus programs do nothing to "fix" the problems and only serve to kick the can a little further down the road.

The Dollar – As we expected, the dollar was weak not only in real terms, but in almost every currency comparison that you can make. When the situation in Greece and in other parts of Europe got worse, the ensuing panic in Europe caused the dollar to strengthen, but only as a result of a temporary flight to quality trade. Sooner or later we think investors will wake up to the fact that in many ways the economic and fiscal situation in the U.S. is a bigger house of cards than anywhere else in the world.

We expect the dollar to become even weaker and therefore make other currencies and precious metals increase in value. Remember, we currently see precious metals as an alternative currency and not as a "trade". So as long as the dollar and for that matter other currencies like the Euro, remain weak on a fundamental basis, we see the case for gold to go higher to remain intact.

Commercial Real Estate - As we expected, the commercial real estate market made available some tremendous buying opportunities for savvy investors with access to capital. Our in-house Commercial Real Estate professional (Greg Baldwin) feels that 2011 will be about the same with some moderation as prices have climbed. While we saw the makings of some great buying opportunities in 2010, we were wrong in our expectation that excessive leverage would be the next big shoe to drop on the banks. What we did not fully appreciate was the extent that the accounting and reporting standards would be "modified" to allow the banks to escape most of the carnage (at least for now).

If you would like to discuss how to diversify your portfolio with real estate or if you are considering a 1031 exchange, please contact Greg Baldwin directly at 503-227-7744 or gbaldwin@matrixwealthmanagement.com.

Our Portfolios

It seems nothing can scare the bullish stock market these days. Weak job growth and rising unemployment, a 1% upward surge in Treasury yields, crude oil heading towards $100.00 per barrel, not even the threat that the U.S. may lose its AAA rating sounded any alarm bells! Instead, all that matters is the explosive growth of the MZM money supply, and the amount of high powered money that the Fed seems willing to plug into the markets.

When stock market bulls collide with bearish bond vigilantes, it's called a "Dangerous Divergence" and can go on for many months. But if the bond vigilantes jack up interest rates to dangerously high levels, it could bring the whole house of cards down.

Our outlook for stocks in 2011 is bullish and our outlook for treasury bonds is bearish. Therefore, we are long stocks and short bonds. Our current approach to stocks is to focus on the large multinationals that pay good dividends and have had a history of raising those dividends over time.

We also are still big believers in commodities. We are very mindful of the big run up in prices. Our approach to the commodity market has been to be net long most commodities, but with the ability to go short as prices reach even higher and higher levels. The only commodity that we do not intend on shorting any time in the near future is oil.

As our readers know, we increased our price target in Q3 of 2010 for gold to $1,400 per ounce which gold saw before the current pullback. For now, we do not see any meaningful long term pullbacks in precious metals until such time as the US dollar and other major foreign currencies regain some fundamental strength. We are currently neutral on the price of gold but would look for any meaningful pullback to initiate new positions and/or increase our investment. We want to emphasize that we are not "gold bugs" and we would prefer to own an asset that has the ability to earn like a stock. So, as soon as it looks like things are getting better for the dollar we hope to be long gone from our position in gold.

We remain bullish on the emerging markets. Many emerging market economies are dependent on the ability to export raw materials. Much of this export takes place to China and India. It is very important to keep a close eye on these economies as any perceived slowdown in real terms could spark a major sell off not only in the emerging markets but the commodities they export.

Our view on China and India is that they will continue to grow their respective economies at a low double digit pace and that they will continue to exercise good judgment as they manage that growth. As a result, we will be looking for opportunities to add to our investments in this area.

We also remain bullish on the M&A space and will be looking to go long potential takeover targets and short potential acquirers.

In summary, we clearly underestimated the strength of the U.S. stock market in 2010. As a result, in many cases our clients' portfolios have underperformed the S&P 500. While portfolio returns were positive for the year our hedges while limiting the downside risk also had in effect limited our upside capture ratio as well.

On a composite basis, I think this might very well prove to be the case in 2011 as well. We cannot in all good judgment throw caution to the wind and jump into the pool with everyone else. The fact that many money managers are all over the tube and in the press "talking their book" makes us especially suspicious that a top may be forming as many investors look to unload expensive stocks on late comers.

If our outlook proves to be more right than wrong in 2011, our clients could be very big beneficiaries of any further downside volatility or worsening of the economy and the capital markets.

As always, a very special thanks to all of our clients for their continued confidence and trust.

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