



August 2009 Hot Topics

Looking for a Recovery in Odd Places

The business world loves a good economic indicator. Chief executives, budget planners, small-business owners, and others who must make assumptions about the health and direction of the economy take a keen interest in popular indicators such as consumer confidence, gross domestic product, housing starts, stock prices, employment data, and even the price of gold.

Economic indicators may take on extra significance when the nation is in a recession and anxious for signs of a recovery because the national psyche plays a key role in business cycles. People who are not experiencing any personal financial problems may nonetheless rein in their spending or alter the timing of major purchases when the news is telling them that the national economy is in difficult straits.

Right on the Kisser

When investors and economists anticipate that the economy is approaching a turning point, they may look in some unusual places for early indications of a shift in consumer behavior. After all, someone who can identify a recovery or a downturn before everyone else may gain a competitive advantage. Over the years, this has given rise to a number of odd economic indicators, although some are more valuable as entertainment than as a basis for financial decision making.

Keeneland thoroughbred sales: The epicenter of the world thoroughbred horse market is Keeneland, a horse auctioneer near Lexington, Kentucky. Business columnist Daniel Gross suggested that the prices of thoroughbred race horses at Keeneland might be a good indicator of how the ultra-rich feel about the global economy. Race horses are highly speculative investments. When the rich are feeling their oats, they bid up pony prices. When their appetite for risk declines, so does their willingness to spend big. For example, from 1993 to 2000, a time when the economy was flourishing, Keeneland's sales rose for eight straight years. But Keeneland's sales dropped sharply in 2001 and 2002 as the global economy went into recession and the stock market plummeted.¹ Gross receipts for

Keeneland's January 2009 Horses of All Ages Sale were \$32.8 million, down from a year earlier.²

Lipstick sales: Leonard Lauder (the son of Estee Lauder and chairman of Estee Lauder Companies) found that his lipstick sales increased during tough economic times. He reportedly coined the term "lipstick index" during the 2001 recession, but the idea that cosmetics sales flourish during a tough economy goes back at least to the Great Depression, when cosmetic sales increased by 25%. One theory is that women are more likely to give up expensive luxuries such as designer shoes and handbags before they would consider cutting back on cosmetics (which they consider more essential), and that they may reward their own frugality with less expensive luxuries such as lipstick. In autumn of 2001, during the aftermath of the terrorist attacks on September 11, 2001, lipstick sales increased by 11%. Therefore, according to this theory, when lipstick sales are up, it may be a sign that consumers are feeling negative about the economy, although lipstick sales have increased during prosperous times as well.³

Scrap metal sales: This was a favorite of former Federal Reserve Chairman Alan Greenspan. Scrap metal is a significant source of raw material for industrial production. Greenspan believed the market for scrap metal was a leading indicator and that rising prices were an early signal of an economic recovery.⁴ Scrap metal prices are down so far in 2009 but remain relatively high compared with historical numbers.⁵

Skirt length theory: According to this one, skirt lengths reflect stock market direction: short skirts reflect an up market; long skirts reflect a down market. The explanation is that short skirts tend to be in vogue during bull markets because consumers are more optimistic and may spend freely, adding to corporate earnings. When confidence wanes and the outlook for stocks is gloomy, the theory goes, hemlines head downward.⁶

² Austin Business Journal, January 19, 2009

³ The Economist, January 22, 2009

⁴ The Wall Street Journal, June 12, 2009

⁵ Scrap Price Bulletin, June 15, 2009

⁶ Investopedia, 2009

¹ Slate.com, December 2, 2005

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Men's underwear sales: Greenspan once said that he also paid close attention to the sales of men's underwear. His theory was that when men are feeling truly pinched by a tightening economy, underwear is one of the first purchases they will postpone because almost no one sees a man's underwear. Therefore, because sales of men's underwear tend to be fairly level, Greenspan took an interest when sales dipped. Conversely, pent-up demand can cause men's underwear sales to be among the first signals of an economic recovery, indicating men are confident enough to replace their worn-out underwear.⁷

Cardboard box sales: This indicator is used by some investors to gauge industrial production. An estimated 75% to 80% of all nondurable goods are shipped in cardboard packaging.⁸ When cardboard sales go up, it could be a sign that companies are shipping their goods in greater volume.

It's important to remember that even though these offbeat indicators may be an interesting diversion, they shouldn't supplant financial fundamentals and your long-term investment goals. When it comes to your investments, you should rely on a carefully considered strategy, not on whether consumers are wearing old jockey shorts or purchasing more lipstick.

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Stalking the Mighty Consumer

Key Surveys Provide Insight into Economy's Largest Engine

What group can claim credit for being the driving force behind the world's largest economy? *Hint: You are probably a member of this group.*

The answer is U.S. consumers, whose spending is responsible for more than 70% of U.S. gross domestic product (GDP).⁹ As we've seen in recent years, when consumer conditions are bad, the effects can be widespread. If consumer spending falters, it affects business income and tax revenues. If revenues fall far enough, the effects can include increased unemployment, which in turn exaggerates the problem because the unemployed have reduced incomes and tend to make fewer purchases.

Economists, traders, investors, and policymakers all take great interest in the financial health of consumers and

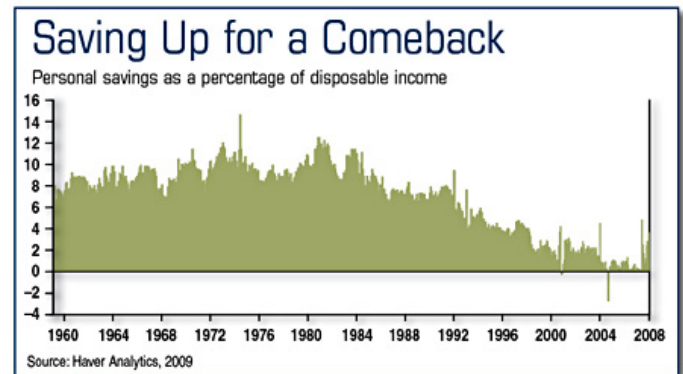
⁷ The Economist, May 27, 2009

⁸ Investopedia, 2009

⁹ Haver Analytics, 2009

what they may do next. Here are some popular indicators of consumer behavior.

The **Monthly Retail Trade Survey** is conducted by the U.S. Census Bureau, which mails questionnaires to about 12,500 businesses. The Census Bureau uses the data to estimate the dollar value of total national retail sales, the value of month-end retail inventories, and the ratio of retail inventories to sales.



The Monthly Retail Trade Survey results are used by the Bureau of Economic Analysis to help calculate GDP and by the Bureau of Labor Statistics to calculate the consumer price index and productivity measurements. The White House uses them to analyze current economic activity. The Federal Reserve uses them to detect trends in consumer behavior. And the private sector uses them to measure economic trends.¹⁰

The Bureau of Labor Statistics **Consumer Expenditure Survey** comprises two separate surveys that collect information from about 7,000 households. The weekly Diary Survey asks participants to document their expenditures for food and beverages, nonprescription drugs, tobacco, and other personal care products. The quarterly Interview Survey asks about larger monthly expenditures such as housing, clothing, transportation, entertainment, and health care.¹¹

The Consumer Expenditure Survey is noteworthy for the ways in which it links the data collected with the respondents' household characteristics. Characteristics measured include the amount and number of incomes in the household; how long they have lived in their homes; as well as their age, gender, education, race, and other details that might illuminate consumer behavior.¹²

Perhaps the best-known consumer survey is the **Consumer Confidence Index**, which measures

¹⁰ U.S. Census Bureau, 2009

¹¹ U.S. Bureau of Labor Statistics, 2009

¹² U.S. Bureau of Labor Statistics, 2009

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consumer attitudes rather than behavior. Each month, The Conference Board polls 5,000 households about their assessment of business conditions and the outlook for their regions.⁵ The rub is that the CCI does not appear to predict consumer behavior. Consumer spending has increased every year, regardless of the direction of consumer confidence. Dips may occur from one month to the next, but spending has increased on an annual basis as far back as available records go.¹³

Consumer behavior can be a good source of clues about the direction of the economy and the financial markets. Keeping a close eye may help with decisions about your portfolio.

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It's Not Too Late to Consider Life Insurance

Most Americans believe that it's important to provide for their families after they are gone.¹⁴ But what if your children are grown and/or you have substantial assets? Should life insurance still play a role in your overall financial picture?

Results from one survey suggest that confidence in financial security tends to increase as life insurance coverage increases.¹⁵ Although your life circumstances may have changed significantly since the days when you bought life insurance to protect dependent family members, you may still have some compelling reasons to consider owning life insurance.

Retirement for Survivors

A surviving spouse who is suddenly faced with a smaller income may be tempted to cut back on retirement contributions. Proceeds from a life insurance policy can help ensure that the survivor has enough money for a comfortable retirement.

Quick Cash Infusion

Life insurance proceeds typically are not subject to probate or income taxes. As long as everything is in order, beneficiaries usually can expect to collect the death benefit in a matter of weeks. The money might even serve as a lifeline if significant medical expenses are looming just as the family's income ceases.

¹³ Haver Analytics, 2009

¹⁴ MarketWatch, September 23, 2008

¹⁵ Journal of Financial Planning, December 2008

Money to Pay Debts, Expenses, and Taxes

The primary reason to own life insurance is to cover expenses that would otherwise fall onto dependents that may not have the means to pay them. Even if they have the means, you may not want to leave expenses or debts behind for others to pay out of their own pockets. Life insurance proceeds can be used to help pay any estate taxes and probate costs, as well as final expenses and any outstanding debts.

LIFE AND DISPARITY

77%

Adults who believe it's important to provide for family members after they are gone

34%

Don't have life insurance

Source: MarketWatch, September 23, 2008

Family Legacy

Life insurance proceeds represent an opportunity to make a significant charitable contribution or leave an inheritance for loved ones. The money can even go toward higher-education costs for children or grandchildren. You might also find that it makes sense to leverage money you had earmarked for a donation by using it to purchase a life insurance policy with the charity named as beneficiary.

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. Before implementing a strategy involving life insurance, it would be prudent to make sure that you are insurable.

As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications. Before you take any specific action, be sure to consult with your tax professional.

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Exchange-Traded Funds Can Be for Conservative Portfolios, Too

Exchange-traded funds have enjoyed a rapidly growing popularity throughout the investing public, except among one key group: investors who are wary of the risks associated with equity investments.

Because the universe of exchange-traded funds, or ETFs, is expanding, several new bond-based ETFs have come on the market. At the end of 2008, there were 60 ETFs tracking bond indexes, up from six in 2006.¹⁶

If you avoided ETFs because they were predominantly composed of stocks, the growing availability of bond ETFs might warrant a second look.

Bonding with the Stock Exchange

An ETF is a portfolio of securities that is assembled by an investment company and sold in shares that trade like stock. The investment company holds the underlying securities in trust and sells ownership of them in shares. The underlying securities typically track an index, a sector, or a group of securities that share a common thread.

The value of an ETF share may be only loosely related to the value of the underlying securities. Supply and demand for the shares themselves may cause them to trade at a premium or a discount relative to the value of the underlying shares, although their prices tend to track the underlying value most of the time. ETFs are subject to investment risk and their value will fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost.

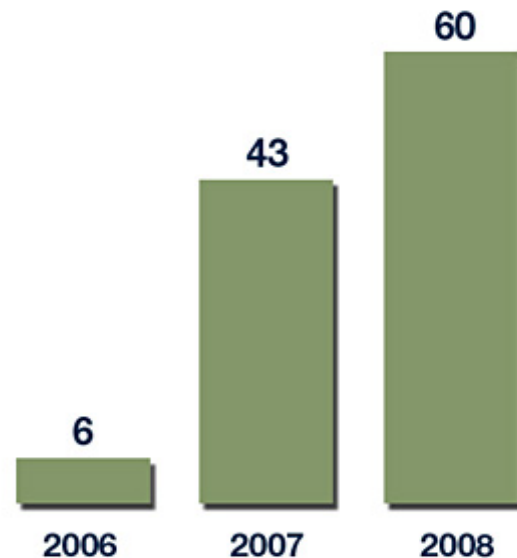
Why not just buy the underlying securities? ETFs enable investors to target almost any index, sector, country, or other specific market segment and still achieve a level of diversification that might be cost-prohibitive for some individual investors to achieve. This is especially true of bonds, which typically carry face values in multiples of \$1,000. This ability to be selective can help investors structure portfolios that better fit their style allocations. Bond ETFs are subject to the same inflation, interest-rate, and credit risks associated with their underlying bonds.

Why an ETF instead of a traditional mutual fund?

Depending on your situation, ETFs may not be able to replace the role that mutual funds may play in your portfolio, but they can serve a complementary role. ETFs are passively managed, which means they don't have a

professional manager who can respond to changing conditions. ETFs tend to offer lower expense ratios and greater tax efficiency. There are no sales loads or minimum investment amounts. However, investors typically need a broker to buy ETFs and therefore must pay a commission. Investing in ETFs should be based on an investor's goals, time horizon, and risk tolerance. Past performance is no guarantee of future results.

GROWTH OF BOND ETFs Domestic exchange-traded funds that track bond indexes



Source: Investment Company Institute, 2007–2008

Exchange-traded funds and mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

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Navigating the Bond Market

Bonds are fixed income investments. In other words, a bond (purchased individually or via ETF or mutual fund) is a debt security. In effect, you are loaning money to the government, a municipality or a company in the expectation of receiving monthly, quarterly or semi-

¹⁶ Investment Company Institute, 2007-2008

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annually interest payments, in addition to return of the principal.

Bonds are subject to their own set of investment risks including reinvestment risk, interest rate risk and purchasing power (inflation) risk. These risks affect all forms of corporate, government and municipal bond issues. Government bonds however are not subject to default risk, that is, the risk that a creditor may seize the underlying collateral of a bond (if any) and sell it to recoup the principal. Also, government bonds do not have credit risk which is the risk that the issuer cannot make interest and principal payments.

The credit risk of a bond issuer can be determined by reviewing the credit rating assigned by the bond rating agencies, most notably the private firms of Standard & Poor's and Moody's. Both firms rate a corporate bond issue as either Investment Grade or Non-Investment Grade (Speculative) grade. The grade assigned is a judgment call so it is recommend you (or your investment advisor) do your own due diligence on the issuer.

An alternative to individual bonds are bond ETF or mutual funds. A bond ETF/Mutual funds is a portfolio of individual bonds that have similar credit ratings. For example, the Dodge & Cox Income fund (DODIX) has an Average Credit Quality of AA (high grade) and Yield of 5.72%¹⁷. On the other hand the Vanguard High-Yield Corporate mutual fund (VWEHX) has an Average Credit Quality of BB (Speculative) with a Yield of 8.40%.

You will notice with these two examples that the less the quality of the bond, the higher the yield. This is because for a lesser creditworthy company to sell its bonds, it must offer an interest rate high enough to attract a buyer. Contrast the two examples with the iShares Barclay 1-3 Year Treasury ETF (SHY) with a yield of 3.16% but no credit risk.

Bonds should be a portion of every investor's portfolio regardless of age. The only variables being level of acceptable risk and percentage of portfolio. As the investor ages, shifting toward a larger allocation of bonds along with a move toward less risk in the bond allocation is necessary.

Bond Options

Municipals Bonds – Issued by state and city governments who use the money to build schools, sewers or other high ticket items. Most municipal bonds are free from federal income taxes and state tax (if the

¹⁷ All stated yields are as of July 15, 2009

investor lives in the state that issued the bond. Because of the tax advantage, munis have historically offered much lower yields than Treasury bonds. The **SPDR Barclays Capital Municipal Bond** (TFI – 3.88%), **Fidelity Municipal Income** (FHIGX – 4.31%) and **Vanguard Interm-Term Tx-Ex** (VWITX – 4.00%) are three funds in this classification..

Government agency bonds – Ginnie Mae, Fannie Mae and Freddie Mac issue bonds backed by the payments from mortgages. Since the federal takeover of Fannie and Freddie, their bonds are effectively guaranteed. Ginnie Maes are also government backed. The yields tend to be higher than Treasuries. The **Vanguard GNMA** (VFII - 4.61%), **Payden GNMA** (PYGNX – 4.88%), **Fidelity Ginnie Mae** (FGMNX – 4.65%) and other funds can provide exposure.

Treasury bonds and TIPS – The interest and principal are guaranteed by the government. The downside is the safety is paid for with lower yields. The yields on Treasury Inflation Protected Securities (TIPS) are designed to float with the inflation rate. **iShares Barclay TIPS Bond** (TIP – 4.68%¹⁸) and **SPDR Barclays Capital TIPS** (IPE – 3.38%) are two ETFs that invest in TIPS.

High-grade corporate bonds – Corporate bonds generally have higher yields when compared to Treasuries. They are not risk-free but the bondholders are ahead of stockholders if the company runs into financial trouble. **RidgeWorth Investment Grade Bond** (STGIX – 4.28%) and **iShares Barclays MBS Bond** (MBB – 3.85%) are two plays in these bonds.

High-yield bonds – Often called 'junk bonds', these riskier cousins of high-grade corporates are issued by companies that have to pay higher interest rates to attract investors. These funds can be tempting because of the high yields, but remember they are paying higher yields for a reason. Two funds in this agenda are **SPDR Barclays Capital High Yiled Bond** (JNK – 13.25%) and **T. Rowe Price High-Yield** (PRHYX – 8.32%).

As with any investment, always read the prospectus and make sure you understand all the fees and expenses associated with a bond or bond fund purchases. High fees may cut into your returns.

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¹⁸ Due to the market volatility of the past year, the yields shown may no represent a true picture of the yields available with this class of bonds.

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- **Stalking the Mighty Consumer** – Key surveys provide insight into economy's largest engine
- **It's Not Too Late to Consider Life Insurance** – Should life insurance play a role in your overall estate planning picture
- **Exchange-Traded Funds Can Be for Conservative Portfolios, Too.** – ETFs are enjoying a rapidly growing popularity with the investing public
- **Navigating the Bond Market** – With bonds, you are loaning money to the government, a municipality or a company in the expectation of receiving monthly, quarterly or semi-annually interest payments

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