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Turmoil in the Middle East
As the Saying Goes, It's Always Something

A quarterly publication may not be the ideal medium to cover a situation as fluid as the ongoing political upheaval roiling a string of North African and Middle Eastern countries. But there are certain abiding factors and implications for investors to consider.

Global markets were pretty quiescent as ruling regimes were toppled in Tunisia and Egypt with very little violence and limited threat of economic disruption. But then the situation in Libya moved in the direction of civil war and raised the likelihood of significantly curtailing that nation's oil production. This brought two critical issues to the fore: the prospect of much higher oil prices and possible investor flight from risk assets in general.

Of course oil prices had climbed steadily over the past two years as the global economy picked up steam. And Libya accounts for only 2% of world output. The accompanying table shows the U.S. sourcing much of its crude oil and other petroleum imports from our own hemisphere, and U.S. domestic production is responding to price signals as well.

But oil trades in a global market. Significant supply disruptions *anywhere* affect price *everywhere*. Economic models generally suggest that a $10 bump in the per-barrel price of oil can trim economic growth by 0.1% to 0.2%, so the recent rise is not that worrisome. But a spike like we saw in 2008 would be.

As the Libya situation appeared to worsen, unrest in Algeria, Bahrain, and Yemen, representing another couple percentage points of global supply, further rattled investors. If a larger producer such as Iran, representing 4.6% of global supply, gets brought into the mix, or if transport through the Strait of Hormuz is threatened, the impact could escalate significantly.

Such worries helped trigger a nervous two weeks just ahead of this *Quarterly* publication date. After the strong rally of the past two years, it had the feel of an overdue correction. It seems we never go too long without a sobering reminder of the global economy's reliance on a key resource concentrated in a chronically unstable region. ■

Bringing In the Oil

Source of U.S. oil imports, December, 2010, in thousands of barrels per day

Country	Crude Oil Imports	Total Petroleum Imports
Canada	2,064	2,713
Mexico	1,223	1,365
Saudi Arabia	1,076	1,087
Nigeria	1,024	1,070
Venezuela	825	917
Iraq	336	336
Angola	207	319
Brazil	271	295
Algeria	262	N/A
Colombia	220	231
Ecuador	192	192
Russia	158	514
Kuwait	125	125
United Kingdom	124	236
Argentina	85	N/A
Virgin Islands	N/A	191

Source: *U.S. Department of Energy*

Few Things More Basic Than Food

The wave of unrest across the Middle East has highlighted pressure points both political and economic. The latter include a big runup in food prices in countries where their daily bread commands a much larger share of cost of living than in the developed world.

The global economic recovery has been most robust across emerging economies with millions of people moving toward a middle-class standard of living. Those higher living standards translate into more consumption of meat which in turn raises the demand for feed grain.

Global grain production has not quite kept pace. The U.S. Department of Agriculture has warned that corn inventories may fall to levels of the mid-1990s. Record amounts of acreage are being planted, but weather and other disruptions have hurt production. USDA statistics indicate that global harvests have fallen short of rising consumption in seven of the past 11 years.

Prices have nearly doubled this past year in one of the tightest corn markets since the 1970s. The situation is exacerbated by the fact that about 40% of the U.S. corn crop is now used to produce ethanol. China may have huge opportunities to dramatically expand its production, but at least for this year China is forecast to import as much as five million tons of corn.

Worldwide prices for wheat, soybeans, cocoa, and other grains have surged as well. But booming grain markets are just one of the recent stars of the bullish commodity cycle covered in these pages from time to time. Among widely traded commodities, the 2010 gains

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Prospects for Extending a Two-Year-Old Bull Market

This issue of the *Quarterly* coincides with the second anniversary of the very deepest point of the sell-off that started tentatively in early 2008, then grew into a full-blown global financial crisis. On March 9, 2009, the Standard & Poor's 500 Index closed at 676, completing a wrenching decline from a high of 1561 in October, 2007. It took real intestinal fortitude to hang on to one's equity positions two years ago, and only the bravest were putting *more* money into stocks.

As we swung into 2011 investors appeared to be taking on risk across a range of assets including global equities, high-yield bonds, and commodities. In February the S&P 500 broke through the 1300 level. But what has driven that optimism, and does the argument for the upside still hold water?

Equity boosters cite a global economic expansion continuing to drive higher earnings, coupled with reasonable valuations for stocks under that scenario. In the U.S. some housing markets have stabilized while others remain soft and continue to feel pressure from a backlog of foreclosed properties. But the management of this process over the past 18 months suggests that housing needn't be a major drag from current levels of activity.

Consumers retrenched significantly through the recession. Households eventually brought their spending down below income levels and are currently saving at about a $630 billion annualized pace. That's equal to nearly 5% of outstanding liabilities, and it may position consumer spending to grow in line with any income gains.

In a role-reversal from past expansions, this recovery is being led by the developing (less-indebted) world along with resource-rich players such as Australia, Canada, and several South American countries. A slack labor market and a decade of relative dollar weakness have given U.S. producers a price advantage on a range of high-value products. Exports have grown at double-digit real rates the past two years. That could prompt a feedback loop of expanded domestic capital investment.

There's always the question of how much of tomorrow's story is already discounted in today's stock prices. The S&P 500 is currently trading at roughly the average earnings multiple of the past 30 years. That valuation measure has actually lagged corporate earnings growth since the deep trough of 2009. Aggressive cost-cutting in the recession has given companies significant top-to-bottom-line leverage from their existing plants and personnel as business has recovered.

Companies in the S&P 500 garner about half their revenues outside the U.S., so sustaining the broad global expansion is key. One potential pothole is the balancing act central bankers must play to provide sufficient liquidity to the system without igniting general inflation. Inflationary pressures still appear to be relatively muted in the U.S. and Europe, but they have assumed headline status in faster growing emerging economies.

China has been tightening credit controls in an effort to contain rising prices and prospects of a real estate bubble. On the other hand, China continues to guard against the kind of rapid appreciation of its currency that might trim exports and curtail the high growth rate it needs to maintain stability.

Longer-term yields on U.S. Treasury securities had edged higher even with the Fed holding short rates near zero. This has been tough on savers but a boon to banks that have enjoyed an extended window to "borrow" from depositors at rock-bottom short rates, then buy high quality longer maturity bonds and pocket the big yield spread. Now the debate is heating up over whether Fed policy is sowing the seeds of a broader inflation.

Developments in the Middle East present yet another challenge to investor confidence (see accompanying article). But at this writing the bull market hasn't really cracked, and cautious optimism is the operative phrase – perhaps with the accent on the cautious. ■

Investment Performance Review	**TOTAL RETURN *** **(dividends and capital gains reinvested)**			
Selected Mutual Fund Categories *	**--- Annualized thru March 4, 2011 ---**			
	1 yr.	***3 yr.***	***5 yr.***	***10 yr.***
Large-Cap Stocks (Core)	17.5%	1.6%	2.3%	2.4%
Mid-cap Stocks (Core)	25.8	5.7	4.2	6.5
Small-cap Stocks (Core) †	27.1	7.4	3.6	7.9
Foreign Stocks (multi-cap) †	18.2	– 1.5	2.5	6.0
Emerging Market Stocks †	18.6	– 0.2	7.9	14.8
Natural Resources	35.9	0.5	6.8	10.3
Real Estate related	31.6	2.6	1.2	10.2
Flexible Portfolio	14.1	3.5	3.8	4.8
General Bond	5.7	4.1	4.7	6.4
Int'l Fixed Income †	7.2	4.6	6.5	6.6
High-Yield Taxable Bond †	15.9	9.6	6.9	6.7
General Municipal Debt	0.4	3.4	2.5	3.6

* Source: Lipper, as reported in the *Wall Street Journal*, March 5, 2011. **Past performance is NOT indicative of future results.**

† Small-cap stocks and high-yield (lower rated) bonds pose more risk and price volatility than those of larger, established companies. Securities of companies based outside the U.S. may be affected by currency fluctuations and political or social instability to a greater extent than U.S.-based companies.

Checking the Rules on Inherited IRAs

Individual Retirement Accounts have been around a long time. Each year thousands of IRAs are passed to heirs, and some of those beneficiaries get tripped up by the distribution rules for inherited IRAs.

Anyone inheriting a traditional IRA can take withdrawals, subject to income tax but with *no* 10% penalty. However, if a beneficiary wants to extend the IRA's tax-deferral, the choices and withdrawal requirements depend on several variables.

Inheriting the IRA of one's *spouse* offers the greatest flexibility, including the option of rolling it into the spouse's own IRA. But a younger surviving spouse may prefer to keep the inherited IRA separate in order to take pre-age-59½ withdrawals without penalty.

A *non-spouse* beneficiary must keep an inherited IRA separate. Distributions may be spread out based on the beneficiary's life expectancy, but those distributions must start by December 31st of the year after the original IRA owner's death. If the beneficiary delays starting distributions beyond that date, the entire balance must then be withdrawn within five years of the original IRA owner's death.

If the deceased was subject to *required minimum distributions*, there may be a distribution due by December 31st of the year of death.

If there are multiple beneficiaries of the IRA, it is generally advantageous to establish separate inherited IRAs before the end of the year *following* the year of the original owner's death. Otherwise those beneficiaries must *all* take withdrawals based on the life expectancy of the *oldest* beneficiary.

Inheriting a Roth IRA has some parallels and some differences. Distributions are tax-free as long as the assets giving rise to the withdrawal were in the Roth IRA at least five years. A spouse can roll the inherited Roth into his or her own Roth IRA. A non-spouse beneficiary is subject to the same distribution requirements as with an inherited traditional IRA (see above).

This summary does not cover every scenario, such as IRAs inherited through a trust or inheriting assets from a qualified retirement plan. Under whatever circumstances you inherit an IRA, be sure to consult with a financial or tax advisor regarding your options. And in a pinch IRS Publication 590 provides a wealth of IRA information. ■

The *Found* Weekend

No, they're not bringing Ray Milland back for a sequel to *The Lost Weekend* (1945). But the IRS is giving you an extra weekend to file your 2010 tax return. Friday, April 15th, is Emancipation Day, a holiday in the District of Columbia, so the filing deadline is moved to Monday, April 18th. That goes for those 2010 IRA contributions as well.

Those who *still* can't get a return together can file for an extension giving them until October 17th. But that does *not* extend the deadline for a 2010 IRA contribution.

By the way, there's no law that you *have* to spend April 16th and 17th poring over tax forms. Get your return out of the way early and make plans for a little emancipation of your own that weekend. ■

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Few Things More Basic Than Food

for corn and wheat trailed only palladium and silver. But in 2009 they were well down the list, and 2008 was negative for nearly every major commodity except gold.

That kind of volatility is common with pure commodity plays. But the trends outlined above do have inherently positive implications for the U.S. as one of the world's most efficient and prolific agricultural producers. Portfolio managers looking to incorporate this theme more broadly have a host of U.S.-based companies that are global leaders in plant research and bio-engineering, food processing, agricultural machinery, fertilizers, specialty energy services, transport and logistics.

Protests in the streets of Middle Eastern capitals may focus on political freedoms long denied. But food is basic, and seeing its cost soar beyond people's wherewithal has been a primary trigger of revolution before. Fortunately agricultural innovation to feed a growing population is also one of history's longest running economic stories; a hallmark of human progress itself. ■

Fed Chairmen Are Rarely Voted Down

If it seems like the financial press hangs on every utterance from Federal Reserve Chairman Ben Bernanke, maybe there's good reason. In theory Mr. Bernanke simply *presides* over the Federal Open Market Committee (FOMC) with members free to dissent from his monetary policy recommendations. In practice, it has been 25 years since a Fed Chairman was actually outvoted in an FOMC meeting.

On February 24, 1986, the Committee rejected the recommendation of Chairman Paul Volcker who many consider the pivotal figure in turning the tide against inflation in the early 1980s. Mr. Volcker was succeeded in 1987 by Alan Greenspan who served 18½ years without ever being outvoted by the Committee.

During Mr. Bernanke's five years as Chairman he has yet to be outvoted and has experienced just 23 dissenting votes in the course of 42 FOMC meetings. As debate intensifies over this long run of highly accommodative monetary policy, the suspense attached to those FOMC meetings may grow as well. ■

More Nervous, Yet More Generous

A recent survey of wealth managers conducted by Merrill Lynch indicates that even the affluent investors with significant portfolio holdings are worrying more about their retirement. Rising concern showed up among Americans with $250,000 or more in investment assets. Even those with over $1 million are reconsidering their investment approach and retirement readiness.

Despite strong markets the past two years, persistent low interest rates are prompting a recalculation of the capital needed to comfortably support a given level of retirement income. Affluent investors are skirting risk, saving more, even working longer. Apparently individuals exhibit rational responses to new realities even if governments don't.

Notwithstanding those concerns, it appears that American investors boosted their charitable giving in 2010. Two of the industry's largest donor-advised funds, sponsored by Fidelity and Charles Schwab, reported big increases in new contributions, up 42% and 100% respectively over 2009.

There is a strategic timing aspect to such contributions. By late 2010 investors had more in the way of unrealized gains in their portfolios than had been the case for a couple years. Transfers of appreciated securities are an especially tax-efficient way to give. Donor-advised funds allow one to transfer assets when it's strategically attractive while retaining significant control over eventual grants to favored charities.

Clearly the trends noted above are not in conflict. Rather they are paired examples of investors' seriousness about long-term financial challenges and responsibilities. ■

And On the *Lighter* Side...

Russian President Dmitry Medvedev announced recently that Russia would eliminate "winter time" (our "standard time") next fall. Russians will "leap forward" an hour this March and then just stay on "summer time" permanently. But if they leap forward this spring without ever falling back, doesn't that short Russia's 2011 by an hour?

That's something to ponder for a nation with one of the shortest average life expectancies in the developed world. But Mr. Medvedev says that staying on summer time will "reduce stress and illnesses associated with the semiannual time change." Last year he eliminated two of Russia's 11 time zones to "enhance economic efficiency." Some eastern regions that were affected by that change now go dark at mid-afternoon in the winter time.

Whatever the merits, Mr. Medvedev's announcement should dispel the notion that the real power in Russia is still wielded by Vladimir Putin. After all, what's more impressive than excising a whole hour from the calendar? ■

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