# Investor Insights

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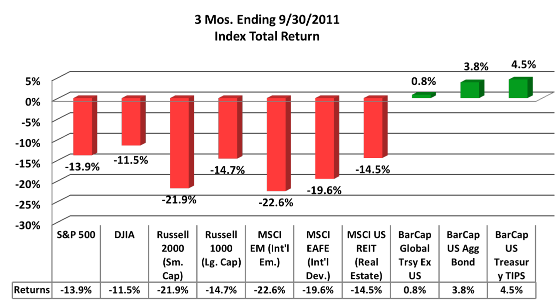
## Quarterly Review

Performance for the quarter was dismal for stocks in the U.S. and around the world. In the U.S., bigger was better. The DJIA, which includes 30 of the largest U.S. companies, was down 11.5% compared to the Russell 1,000 Large Cap stocks at -14.7% return and Small Caps down 22%. International developed countries lost 20% as Europe struggled with a debt crisis. Emerging markets plummeted 22.6% with the BRIC's losses weighing heavily on the index. Brazil was down 28%, Russia off 31%, India losing 20%, and China down 26%.

As stock returns took a dive, bond returns were up 3.8% in the U.S. with international sovereign debt up almost 1%.

U.S. commercial real estate (REITs) rose 5% from July 1 to July 22, only to end the quarter with a 14.5% loss.

Index Returns provided by Morningstar. Past performance is not a guarantee of future results. Thankful for that.




| | S&P 500 | DJIA | Russell 2000 (Sm. Cap) | Russell 1000 (Lg. Cap) | MSCI EM (Int'l Em.) | MSCI EAFE (Int'l Dev.) | MSCI US REIT (Real Estate) | BarCap Global Trsy Ex US | BarCap US Agg Bond | BarCap US Treasury TIPS |
|---|---|---|---|---|---|---|---|---|---|---|
| Returns | -13.9% | -11.5% | -21.9% | -14.7% | -22.6% | -19.6% | -14.5% | 0.8% | 3.8% | 4.5% |

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### Advisor Corner

Golden Hills Financial Group is a fee-only registered investment advisor. We offer unbiased professional money management services at a low overall expense.

# European Union Herds Cats

The U.S. economy has been experiencing slow growth as it has battled economic hurdles for the past several months. One obstacle to our recovery is a troublesome and wide-spread financial crisis in Europe that has been evolving, rattling U.S. markets and making headlines daily. The epicenter is the European Union (EU). The big question is "Why is the EU slow to implement much needed change?"

A brief history is helpful to understand the current situation. It all began following WWII when six European countries united economically and politically in order to secure lasting peace. In the subsequent 60 years, 21 European countries were added to the EU. Borders opened to a free-flow of trade, the Euro became the currency of 17 countries in what is called the Eurozone, passports were no longer needed at the border, and a general collaboration on environmental policies took hold.

Today, the European Union has its own flag, currency (for some members), and law-making abilities. However, each of the 27 member states (countries) retains its own culture, politics, and financial obligations. A solution to the current debt crisis that began with Greece, Portugal and Ireland, relies upon the cooperation of economically strong EU members to provide the troubled countries with financial support.

While the EU has reaped considerable economic strength and prosperity through size, it now faces a monumental challenge to manage and instill EU wide changes needed to maintain a cohesive economic region and to save the Euro and ultimately the EU.

Just how influential is the EU economically? Its prominent role in the world's economy rivals that of the U.S. both in production of goods and services and in population. The figures below compare the population and economic horsepower the EU holds relative to the U.S.

2010 GDP

* U.S. - $14.5 trillion (Bureau of Economic Analysis)

* European Union – $16 trillion (CIA World Factbook)

2010 Population

* U.S. – 312 million

* EU - 500 million

The EU is a major economic power. Its future relies on the ability to unite 27 independent countries in its quest to speak as a single market.

Co-writers: Rita Janaky and Brian Janaky

Map Source:

http://www.nationsonline.org/oneworld/map/small_europe_map.htm

# Destination Correlation

**Correlation Explained**

- This is a key concept in modern portfolio theory. I have been asked, "Wouldn't one be better off just investing in stocks when they're going up, rather than owning some bonds that might be declining?" That would be ideal, if one knew to buy before stocks started rising, and then sold at the peak. Unfortunately, the stock market isn't predictable, especially in the near-term.

"Correlation" and "correlated assets" are mainstay expressions in the jargon of investors and financial professionals, and while the concept of correlation can be confusing to novice investors, a quick explanation can clarify why correlation is a key factor in portfolio construction.

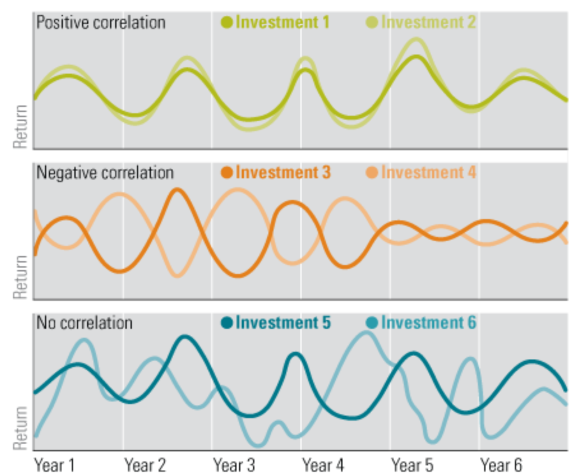
Let's say you or your financial advisor are trying to choose two investments in the construction of a portfolio. Would you prefer investments that are similar (move in the same direction) or investments that are dissimilar? Think about it this way: If you are going on vacation to an unknown island, what type of clothes will you put in your suitcase? If you only take summer clothes and the island nights turn out to be cold, or if you only bring winter clothes and the climate is tropical, your vacation will probably end in tears. It's the same with investing: You're better off diversifying than putting all your money in similar investments.

In order to create a truly diversified portfolio, the investments in the portfolio have to compensate for each other's shortcomings. If investment A declines in value, ideally you would want investment B to increase in value, or at least decline less than investment A. In order to achieve this, you need two investments that behave differently, meaning they have a low correlation.

Correlation is a statistical measure designed to quantify the interrelationship of two investments (again, investment A and investment B). By taking into account the characteristics of the two investments, a mathematical formula calculates a number between –1.00 and +1.00. This number is called the correlation coefficient. If this coefficient is negative (for example, –0.81), we say the two asset classes are negatively correlated. This simply means they tend to move in different directions: if asset class A declines in value, asset class B is likely to increase in value, and vice versa. If the correlation coefficient is positive (for example, +0.34), the two asset classes tend to move in the same direction: they are positively correlated. A correlation coefficient of zero means the asset classes are completely uncorrelated; their movements in relation to one another are random.

Adding investments with low correlation to a portfolio can soften the impact of market swings because the investments do not all react to economic and market conditions in the same manner. For example, building a portfolio with large, small and international stocks would probably not be such a good idea because stocks are generally highly correlated to one another—if large stocks go down, the other stock categories will probably go down, too. The same logic applies to a portfolio with only bonds. However, combining stocks and bonds in a portfolio could provide a significant diversification benefit because these two types of investments do not tend to move together (they have a low correlation).

## Various Levels of Correlation




Past performance is no guarantee of future results. Diversification does not eliminate the risk of investment losses. Investment returns shown and correlation numbers mentioned in the text are based on hypothetical data. Government bonds and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds.

# This is Bull


Financial news often refer to a "bull market" (when the market is doing well) or a "bear market" (when the market is doing...not so well). These terms may have originated from the animals' styles of attack. A bear mauls (downward movement), while a bull thrusts its horns (upward movement).

Whether you're reading news about a bull market or a bear market, always be mindful of the source. There are many financial wizards out there who are ready to promise you 20% returns, so it's best to always check the credentials and reliability of a financial professional or information source.



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