Pacific Crest Financial Advisors, LLC

Dear Clients and Friends,

Stocks and other risk assets surged in the first quarter, continuing the strong run that began in the fourth quarter of last year. In each of the past two quarters, domestic stocks gained vigorously, marking one the strongest runs over the October-March span going back to the 1920s. Developed foreign stocks increased nearly in-line with the domestic market, emerging-markets stocks gained even more, small-cap U.S. stocks were also up for the quarter. In contrast, the core investment-grade bond index was flat, as Treasury bond prices declined and yields increased.

The level amount of debt in the developed world continues to drive our expectations about the years ahead. Most of the developed world struggles to dig out from under their debt loads, all options involve economic pain that is compounded by political uncertainty. Thus we have been deliberately reviewing all portfolios to ensure they have an allocation in the emerging growth economies. We see this allocation as an investment into an economic region that does not have the significant debt burden that overhangs the developed economies.

The market rally in global equities over the last several months is due to a multitude of factors that drive financial markets over the shorter term, but from a fundamental perspective we'd highlight the following as among the key positive developments in recent months.

- The receding fear of a European debt contagion/financial crisis due to a combination of the European Central Bank's long-term refinancing operations, or LTRO, as well as other stimulative global central bank actions taken in late 2011 and early 2012.
- In late December and again at the end of February, the European Central Bank (ECB) undertook the LTRO, whereby they offered essentially unlimited three-year loans to European banks at a 1% interest rate and with easier collateral requirements. In total, over one trillion euros ($1.3 trillion) was borrowed by more than 800 financial institutions across Europe and the United Kingdom in the two LTROs. The December LTRO slowed, if not fully stopped, the adverse feedback loop of forced deleveraging among European banks that was gaining momentum last winter. The LTRO also had the effect of supporting the peripheral European sovereign bond markets (e.g., Italy and Spain), where interest rates had been rising sharply. Because the banks were no longer being forced to sell assets, and other market participants understood that the cycle of forced deleveraging had been halted by the ECB, the price of government debt rose and yields fell, reducing these countries' borrowing costs. This is critical, as a country's borrowing costs (the rate it pays on its sovereign debt) can have a huge impact on its ability to continue to finance its deficits and ultimately reduce its overall debt/GDP ratio. Italian and Spanish 10-year government bonds that had been yielding around 7% in late November were yielding 5% or less in early March. (However, the yield on Spanish debt moved sharply higher in late March/early April on renewed concerns about the government's ability or willingness to meet previously agreed-upon deficit reduction targets.)
- The successful Greek debt restructuring in March, in which Greece was able to write off 107 billion euro of debt to private lenders, was another positive for sentiment about the European debt situation.
- There are positive U.S. economic data points including nonfarm payroll employment rose by an average of 245,000/month during the three months from December through February, the largest gains since 2006; the unemployment rate has dropped from 9% in September to 8.3% in February, and; new claims for unemployment insurance recently hit a four-year low.

- The results of the Federal Reserve's latest banking stress tests, in which 15 of the 19 institutions passed, gave the domestic market, and financial stocks in particular, another boost.
- A slowdown in the rate of inflation in China, which will allow the country's rulers to take additional measures to support growth (e.g., by further easing monetary policy), boosting hopes they can engineer the hoped-for "soft landing" for the economy.

These are all positive developments, but they don't signal an "all clear" to us because our time horizon is not the next month or the next quarter, but the next five years.

While the long-term refinancing operations (LTRO) and Greek debt restructuring appear to have taken the disorderly default risk and European debt contagion risk off the table for now, it does nothing to solve the fundamental structural problems of the Eurozone. We have seen mostly short-term solutions that have not addressed the long-term problems of the Eurozone. The LTRO provides the countries some additional time and space to try to implement necessary but extremely painful and difficult economic and political reforms.

The new Greek debt is currently trading at roughly 20 cents on the dollar, indicating the market is pricing in a high probability of yet another default/restructuring. Greece's exit from the Eurozone remains a significant risk that could lead to contagion across the Eurozone.

With respect to the recent positive U.S. economic numbers: New York Federal Reserve President William Dudley recently noted that roughly half the decline in the unemployment rate was due to a decline in the labor force participation rate. Dudley also noted that while GDP growth of 3% in the fourth quarter was "stronger," most of that growth was due to inventory accumulation, while final sales-growth was weak, which bodes poorly for first quarter 2012 GDP growth. He also pointed out that the unusually mild winter weather this year likely caused a temporary boost to overall economic activity, pulling forward spending and hiring that would otherwise have happened in the spring.

The looming U.S. "tax shift" is here. In his recent congressional testimony, Fed Chairman Bernanke stated, "Under current law, on January 1, 2013, there's going to be a massive fiscal cliff of large spending cuts and tax increases." That is when the Bush-era tax cuts, the temporary payroll tax cut, and extended unemployment benefits are due to expire, and $1.2 trillion of automatic spending cuts begin to kick in—the result of last year's Congressional super-committee's failure to reach consensus. The impact would be a roughly 3.5% hit to GDP next year. It seems unlikely that it will actually play out that way without any modifications, but policy changes are likely coming regardless of the party in the White House.

We continue to not try to out-guess the market, but rather stick to a long-term asset allocation policy that is individual for each client with assets spread between fixed income and equities and across many industries and regions.

Thoughts for those Approaching Retirement

We have been approached by a number of clients about the benefits of delaying Social Security benefits. By delaying you will get an 8% delayed retirement credit for each year you delay those benefits up to age 70. Plus, your benefit would be adjusted upward for any cost of living boost that you would have received if you had taken your benefits. One final point that is not mentioned much is once you claim your benefit at 70, all subsequent cost of living adjustments will be based on the higher benefit. If you can delay Social Security retirement benefits, we advise most clients to do so if there are sufficient resources to support the family's needs in the short-term.

Gifting to Grandchildren

It is better to teach someone how to fish rather than just handing them a fish. In that same thought pattern, it is better to teach your children or grandchildren how to save than just to hand them the cash. Consider offering to match your children or grandchildren's earnings with matching contributions to Roth-IRAs during their teen years and early twenties. You would be teaching them to save, a habit that could benefit them for decades to come.

Financial Records Retention

We often get the question from clients asking how long should clients keep their financial records? Our answer is to keep all your financial records for three years if not directly related to your tax returns. All financial records directly supporting your tax returns should be kept for seven years. Please note that Schwab provides historic tax reports and monthly statements for the prior ten years for current accounts available at Schwab's password protected website.

Personal Activities

Alec took a spring vacation with his two daughters to introduce them to Yosemite National Park. We could not have timed the visit better than we did. We had sunny days with a dry valley floor but all the peaks were snowcapped. The waterfalls were close to their peak for the year. It is a magical place to visit. The sign of a successful trip is when my daughters said this is the second best vacation they have ever had.

Darron has begun his coaching position again for his daughter's (Indigo) soccer team. Thus, he is now busily chasing after nine eight year-old girls while trying to teach them the philosophy of the game. Aside from that he remains busy tending to the yard and enjoying the Spring weather.

Sincerely,

Alec

Darron

Alec Williamson, CFP®
Managing Director

Darron Kuehn
Managing Director

3002 Colby Avenue, Suite 305
Everett, WA 98201
Tel: 425-609-3797
Free: 888-576-1352

601 Union Street, Suite 4200
Seattle, WA 98101
Tel: 206-428-6012
Free: 888-576-1352