Rinehart Wealth Management
Greater Trust

Second Quarter Economic Overview

We would like to thank all of you who joined us for our first quarter economic overview webinar in May. Given the positive feedback we received, we hope even more of you will join us next time. As a reminder, each quarter we will host a similar webinar with the aim of providing professional colleagues and clients with a way to navigate the news and the implications for the stock market. The next webinar will be August 4th at 11:00 am.

Despite continued concerns over the economy, we have reasonable expectations for the remainder of the year. The market exhibited a much needed correction in the second quarter, which has us feeling better about appreciation potential going forward. We continue to monitor the credit situation and the ramifications of the unwinding of unprecedented monetary stimulus; however, we remain constructive on large capitalization equities that could increase or initiate dividend payments.

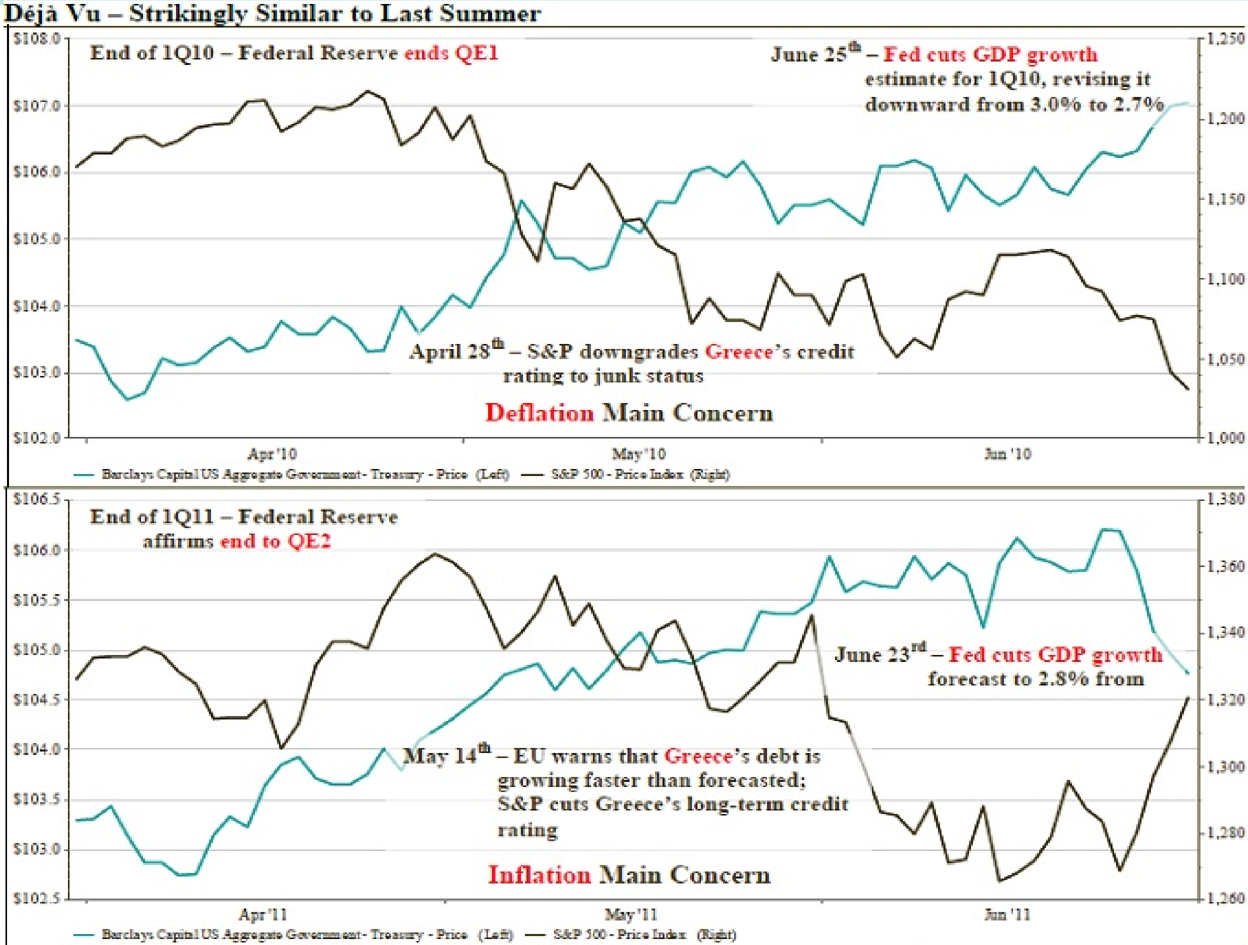
Market Dips After Unsustainable 1st Quarter Performance

Consistent with our expectations for the first quarter, large cap stocks outperformed as high quality, less risky assets exhibited leadership. A number of the risks we highlighted last quarter, such as downward revisions to GDP due to high commodity costs, continued pressure on housing prices and stubbornly high unemployment, emerged as performance drivers of a volatile second quarter. In addition, investors moved away from risky assets as concerns over Greek sovereign debt, Middle East tension, QE2 ending and slowing GDP growth resulted in a “flight to quality” – a move to less risky, highly liquid assets. The subsequent fixed income and equity performance were so similar to what we observed in the second quarter of 2010 that we experienced a sense of déjà vu. Below we highlight the quarterly performance of the major equity indexes in the second quarter 2011. Additionally, the graph below depicts the similarities between second quarter 2010 and second quarter 2011.

Equity Index Performance in 2Q11						
S&P 500	DJIA	NASDAQ	Russell 1000	Russell 2000	MSCI - EM	MSCI - World
-0.4%	0.8%	-0.3%	-0.4%	-1.9%	-3.6%	-1.4%

As you can see, the S&P 500, represented by the black line in both charts, experienced a notable mid-quarter correction while bond prices, represented by the green line in both charts, experienced a simultaneous rally. The charts outline the timing and striking similarity of the events responsible for performance. One of the main differences between 2010 (top chart) and 2011 (bottom chart) is that the market rallied into the end of this quarter. Furthermore, while deflation was the taboo word circling in 2010, the 2011 quarter was more focused on inflation.

Déjà Vu – Strikingly Similar to Last Summer



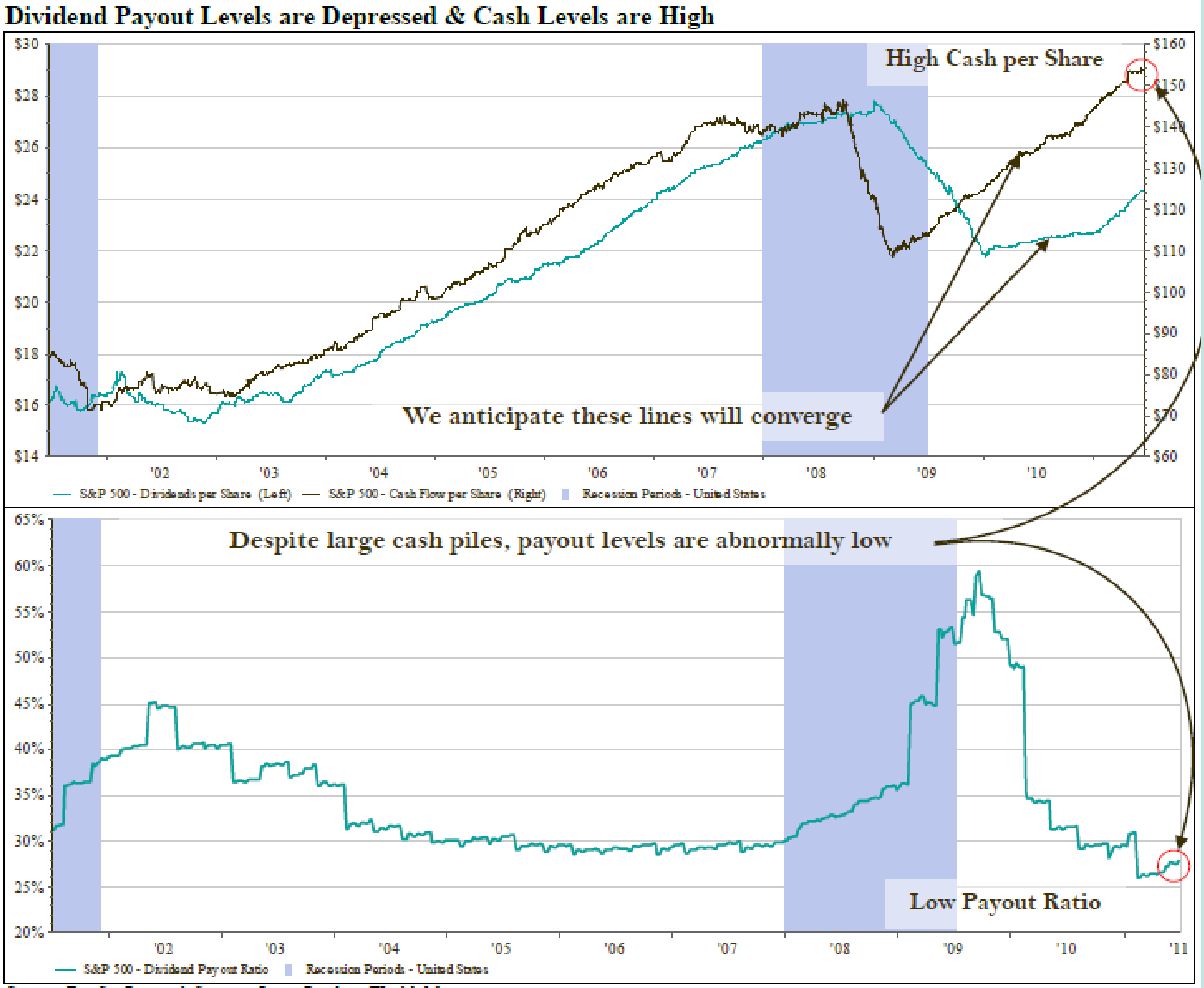
Source: FactSet Research Systems, Inc. – Rinehart Wealth Management

Overweight Potential for Dividend Growth

Despite the recent volatility, we have not dramatically altered our stance on asset allocation and the market. Given unsustainably low interest rates and our long-term view on inflation, which we see moving upward due to rising commodity costs and the effects of extreme monetary stimulus, we continue to recommend an underweight in fixed income. As a means of offsetting inflationary pressure, while simultaneously continuing to dampen volatility, we are moving to an overweight in hybrids.

At this point in the economic cycle, we continue to believe that clients should have holdings in high quality companies that have the potential to *raise* dividends. Corporate balance sheets are flooded with cash while dividend payout levels remain extremely low and we anticipate that investors will demand that corporations return cash to shareholders. Consequently, the market should reward companies that increase their payout ratio with higher price-to-earnings (PE) multiples. This increase in valuation should result in outperformance of such equities, and we are presently positioning portfolios accordingly – overweight large cap equities that are likely to raise dividends. On a sector basis, we see the most opportunity in technology, healthcare and consumer staples due to their high cash levels.

Below is a chart highlighting the current inverse relationship between corporate cash flow per share and the dividend payout ratio of the S&P 500. The top chart shows the rapid rise in cash flow per share (black line) while the bottom chart shows the declining dividend payout ratio (green line). This relationship exemplifies the extreme dichotomy between cash levels and dividends. Reversion to the mean suggests companies will need to reduce cash on the balance sheet, and because dividend payments are being neglected, they are an obvious place for cash to flow going forward.



Source: FactSet Research Systems, Inc. – Rinehart Wealth Management

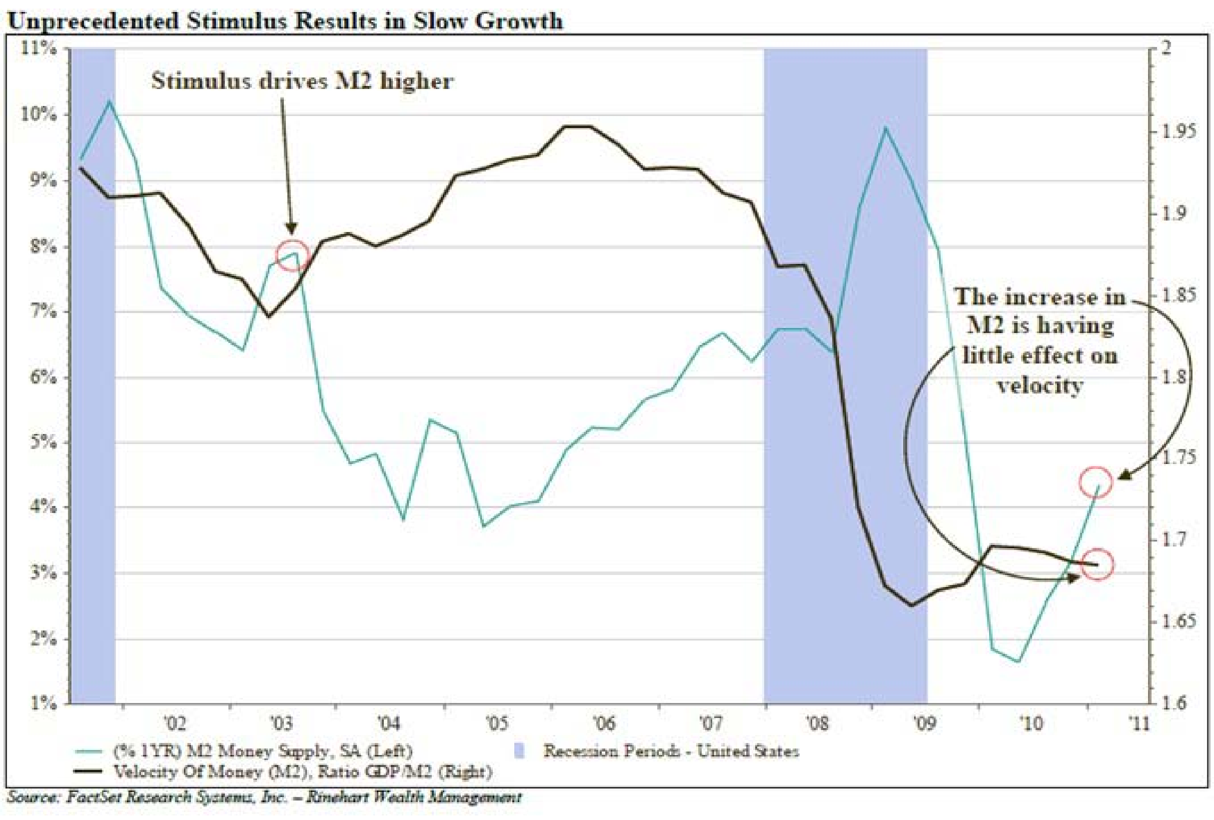
Unprecedented Stimulus Results in Slow Growth

We monitor the money supply (M2) as one factor in our analysis of the economy. Due to the current divergent opinions on the economy, we thought clients might benefit from an introduction to M2 and an understanding of its relevance in our investment recommendations.

M2 is a primary measure of the money supply in the United States and is representative of the total amount of money in the economy. It is a major focus of economists and the Federal Reserve when analyzing inflation and monetary policy. The Fed often uses monetary policy to inject money into the system to try to stimulate growth: the idea is that as the Fed injects more money into the system, the money supply (M2) will increase and hopefully drive growth in new business investments, employment and mortgages.

It is important to analyze M2 relative to its impact on GDP growth. The velocity of money enables us to determine the effectiveness of monetary stimulus (increasing M2) in driving desired GDP growth. The velocity of money is the ratio between nominal GDP and M2 and is used to gauge the benefit to the economy from a certain level of stimulus.

Below is a chart of M2 growth and the velocity of money. Currently, the growth in M2 has been dramatic (the green line). We attribute this growth to the aggressively accommodative nature of the Fed's monetary policy. The velocity of money is sluggish (the black line), despite dramatic levels of stimulus. We would like for an increase in M2 to positively affect the GDP growth rate more rapidly than what we are currently seeing. Initially, we saw a positive impact as evidenced by the upward move in the velocity of money after QE1, but despite additional stimulus in the form of QE2, the velocity of money has plateaued and may even decline. This far into an economic recovery we would expect velocity to be higher. There are multiple factors impacting M2 velocity, but we believe that the predominant impediments to increased velocity are the uncertainty surrounding financial regulation and the lack of an organic growth industry. With all of that said, we are still early in a very tepid economic recovery and may simply need to give the stimulus more time to work.



Though the economy is still not robust, that does not mean the equity market is doomed; it simply means we need to remain disciplined and vigilant. We will further address economic factors we monitor as well as our interpretation of the current economic condition on August 4th at 11:00 am. Please join us, and we can address any outstanding questions that you might have.

Regards,
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