

## Are further market gains possible?



The fundamental basis for further market gains will become more evident, possibly in the fall as the U.S. economy moves into positive territory and corporations report improved earnings, says Partner Norm Klopp.

His full story is on page 4.

**“...remember that 401(k) investing requires a long-term focus.”**

## “Our Education Services For 401(k) Plan Members Excel, When Compared To... Other Providers”

By J. Mark Wipper, Managing Partner

How well do you understand the investment choices in your company's 401(k) plan? Has anyone explained the opportunities, or limitations, of investing in the equity, bond, or money market fund choices available?

Recent findings suggest that many people lack adequate information to make informed decisions affecting their retirement savings. For example:

- An April 22nd story in the *Chicago Tribune* declared that “many Americans are not educated adequately about investment decisions and fumble mutual fund choices.”
- On May 12th, String Financial, a Connecticut-based consulting group, released the results of a national survey in which 41% of the respondents said their 401(k) plan educational materials lack information specific to their needs or goals.
- On June 18th, the U.S. Department of Labor and the Securities and Exchange Commission held a joint one-day hearing on issues relating to investments in “target date mutual funds by 401(k) plan participants.” The Senate's Special Committee on Aging recently expressed concern that some people may invest in target date funds “without being aware of their financial risk.”

Fortunately, clients of Midwest Investment Management's 401(k) Plan Investment Advisory Service are spared the problems cited above. That's because we provide comprehensive information about the investment options we offer to plan participants. In addition, we do not believe that “retirement target date” mutual funds offer a desirable investment strategy.

I believe our education services for 401(k) plan members excel, when compared to most insurance companies, banks, or other providers. Let me explain why:

- The educational component of our 401(k) Investment Advisory Service actually begins at our initial meeting with the plan's trustees, when we inquire about the goals of the plan and demographics of the employee base.
- We participate in group enrollment meetings with employees and provide everyone with a carefully screened and selected list of investment options.
- We fully explain the objective of each option and help employees develop a 401(k) savings



*“Midwest Investment Management's 401(k) Investment Advisory Service includes special attention to participant education,” says Managing Partner J. Mark Wipper.*

plan that can be suitable to their investment goals, age, and tolerance for risk.

### Objective counsel

Federal regulations require plan sponsors to seek independent advice for plan participants and avoid conflict-of-interest issues regarding compensation. Because Midwest Investment Management is an independent and established Registered Investment Advisory firm, our advice and counsel is completely:

- Independent
- Objective
- Free from any conflict-of-interest

We do not manage any mutual funds, and we do not receive any fees, commissions, or incentives from any mutual fund we recommend.

### Serious consideration

Although recent turmoil in the financial markets has caused many 401(k) plan participants to become uneasy, it's important to remember that 401(k) investing requires a long-term focus.

We believe that when you compare Midwest Investment Management's 401(k) Investment Advisory Service—and its focus on participant education—your opportunity for investment success can be enhanced.



*If you or your company have a 401(k) plan, and you believe your investment goals could be better met by receiving more information and education about your investment choices, I invite you to contact me at (216) 830-1125 or [jmw@mimllc.com](mailto:jmw@mimllc.com)*

# The U.S. Economy: Emerging From The Tunnel

By Norman F. Klopp, CFA, Partner

In both the Winter and Spring issues of our *Perspective* newsletter, we wrote of “lights at the end of the tunnel” in discussing the positive or “less-negative” indicators of the economy that we began to see.

We now believe that we are “emerging from the tunnel” (the recession) that enveloped the economy for the last nine to twelve months. Continuing this metaphorical comparison, we find it productive to formulate a view of what the economy might look like on the “other side of the tunnel”— a long-term view beyond the next 12 to 18 months.



*We believe the trough of the current recession is behind us, and brighter days are ahead.*

## But first...

Let's look at three critical areas that must be considered, knowing that answers will lack clarity and certainty at this point.

### 1. Consumer spending

**Economic growth** is importantly driven by consumer spending and thus the question “will it ever be the same again?” At this point, we expect *it will not be the same, it will be different*. Consumers have already shown an inclination to get their financial houses in better order, and we have seen the savings rate increase. This trend will probably continue well into 2010.

**The “wealth factor”** that drove sustained levels of consumer spending from 1992 to 2007 has been reversed. This will be particularly evident in an important segment of the population: “baby-boomers” who have had a significant impact on the economy in each decade of their lives. Now as they begin to reach retirement age, they are—in the aggregate—faced with much lower levels of personal wealth as a result of significant erosion in real estate and stock market values. We believe this particular segment of the population will be much more conservative and disciplined over the long term.

We expect that consumer spending will start growing again in 2010, but the rate of growth will be limited for some time, reducing the annual rate of GDP growth by 0.5% to 1.0% over the next five years. Long-term, the deleveraging of consumers is a positive factor for the economy.

### 2. Government spending, new regulations

Current and potential actions present some of the most serious long-term questions for the economy. These questions are also the most difficult to answer. For example:

**The Federal Reserve Bank** has implemented an historic massive expansion of liquidity in the banking system to “deal with the financial crisis.” This liquidity must be extracted in an orderly fashion if long-term inflation is to be kept under control.

**Note:** This inflation/deflation question is so critical that you will find on page 3 a separate article on this topic written by Al Meszaros.

**The Administration and Congress.** In our view they need to:

- demonstrate a commitment to reversing and eliminating the creation of government ownership of private companies and industries;
- recognize the temporary nature of economic “stimulus” efforts and not allow them to become new “programs” and bureaucracies;
- articulate and practice a level of financial discipline that builds confidence of consumers, business, and our global financial partners;
- recognize that the growing list of new “mandates” such as increases in passenger car fuel efficiency, carbon policy, “new mandated industries,” health care policies, and other increased industry regulations all have direct and indirect economic costs.

To expect this realistic thinking in Washington, on either side of the political aisle, might be wishful thinking on our part. We are, however, encouraged by polls released in mid-June suggesting that voters have become very concerned about government spending; the federal deficit; and government's intrusion into private industry. *One thing we know: politicians pay attention to voter polls.*

### 3. Economic fallout ahead?

In summary, as we focus on the longer-term economic outlook, the most difficult challenge will be measuring the economic impact of massive structural change taking place at the Federal level.

At Midwest Investment Management, we remain focused on determining where investment opportunities and risks appear to be developing company-by-company and translating our findings into investment value for our clients.



*If you're not a client of Midwest Investment Management, let Norm use his impressive experience to assemble an investment portfolio that's positioned for long-term growth. Contact him today at (216) 830-1135 or [nfk@mimllc.com](mailto:nfk@mimllc.com)*

**“...we have seen the savings rate increase.”**

**“...deleveraging of consumers is a positive factor for the economy.”**

# What's Down The Road, Inflation or Deflation?

By Elmer L. (AI) Meszaros, CFA, Partner

The economy and the stock market are showing signs of recovery. However, inflation and much higher interest rates are now widely feared, due to unprecedented spending by the federal government, budget deficits amounting to a whopping 13% of Gross Domestic Product, and a radical expansion of the monetary base by the Federal Reserve Bank.

At Midwest Investment Management, we believe these actions collectively pose a serious risk to the U.S. economy. Thus, we track various important economic indicators that can serve to warn us of worsening trends, including:

- The price of gold
- U.S. Dollar
- Commodities
- Bond yields
- Consumer price indices

So far, these indicators—although up from recent lows—are not behaving abnormally, implying subdued inflationary pressures.

At some point, The Federal Reserve will need to drain *excess* reserves away from the economy (banking system). It has the tools available. For starters, it can:

- Increase reserve requirements or rates paid on bank reserves;
- Increase the Fed funds rate;
- Contract the base;
- Cease asset purchase activity;
- Sell Federal Reserve Securities (a potential new power).

The debate centers on if, and when, the Fed will act, given political pressures of the day. On the budget side, stunning levels of government spending and deficits are beginning to generate push-back from China, Europe, some members of Congress, and even Fed Chairman Ben Bernanke.

## Is Deflation Possible?

A minority view put forth by some credible economists is that deflation (i.e. 1%-2% “good deflation”) will be the order of the day over the next several years or even a decade, resulting from:

- Worldwide overcapacity for goods and services, combined with rising productivity;
- Consumer savings rates increasing 1% annually because of a need for consumers to repay debt or save for retirement;
- Shifting demographics means an older population consumes less;
- Tax increases resulting in reduced consumption.

How would securities markets be affected? Sharp increases in either inflation or deflation would not be good for equity markets.



## Deflationary Risk

The best scenario is for either very mild deflation with prices falling 1%-2%, aiding consumer purchasing power, or mild price increases of up to 2% annually. The purpose of the recent historic intervention by the government was to derail extreme deflationary risk. Mild deflation on the other hand, can be accompanied by a rising market, as it was post-Civil War and in the 1920s.

Although inflation is correctly feared as damaging to real returns in the long run, the most recent bout of inflation between 1975 and 1980 was accompanied by a rising and then a see-sawing market. During the most intense 2½ -year period (1978-1980) of rising interest rates, which peaked at a 20% prime rate, and inflation which peaked at 15%, the Dow Jones Industrial Average actually rose 33%, before declining into the 1982 recession as former Fed Chairman Paul Volker quenched the inflationary flames, initiating an 18-year-long rising market as inflation eased.

## What Are We Doing Now?

First, we continue to build and maintain an all-weather portfolio of stocks for our clients, representing financially strong companies that can prosper over the next five years. Secondly, we'll monitor the inflation/deflation indicators closely and shift either sector weightings within the equity portfolio or to a more conservative overall stock weighting, if warranted. Meanwhile, we will not lose sight of the distant horizon—an S&P Index back at 1600 within 5 years. This assumes only normal (8% earnings) gains to reach \$110 of earnings and a historical average Price/Earnings multiple of 15.



*If you are not a Midwest Investment Management client, this is an ideal time to switch the management of your investment portfolio to Al Meszaros, whose experience has produced impressive results for more than three decades. He can be reached at (216) 830-1133 or [elm@mimllc.com](mailto:elm@mimllc.com)*



**“Inflation and much higher interest rates are now widely feared...”**

**“The purpose... was to derail extreme deflationary risk.”**

## How To Reach Us.

You may contact our partners or staff by phone or e-mail. Here is a complete listing for your convenience.

### PARTNERS:

#### MEG HALLORAN

216.830.1139 or  
meh@mimllc.com

#### NORM KLOPP

216.830.1135 or  
nfk@mimllc.com

#### AL MESZAROS

216.830.1133 or  
elm@mimllc.com

#### CHUCK NYE

216.830.1127 or  
cen@mimllc.com

#### MARK WIPPER

216.830.1125 or  
jmw@mimllc.com

#### BOB YAROMA

216.830.1129 or  
rjy@mimllc.com

### STAFF:

#### JACK NAKEL

216.830.1142 or  
jwn@mimllc.com

#### MARY SALZER

216.830.1110 or  
mrs@mimllc.com

The Tower at Erievue  
1301 East 9th Street  
Suite 1110  
Cleveland, Ohio 44114

Phone: 216.830.1110  
877.945.9900

Fax: 216.830.1159

e-mail: invest@mimllc.com

web: www.mimllc.com



## 2nd Quarter Economic Review

# Our Economic Outlook: More Optimism, But More Diligence Required To Select Stocks

By Norman F. Klopp, CFA, Partner



In the Spring 2009 issue of this newsletter, I wrote that the stock market was dealing with a long list of “unknowns”, but that “some of those unknowns are starting to clarify.” We identified that clarifying process as “one of the reasons for the positive market tone we saw in mid-March.”

As the recently concluded second quarter played-out:

- the stock market gained growing confidence that the credit markets were moving toward a more normal state;
- the housing market was continuing its “clearing process”;
- the economy was showing signs that it had moved past the trough of the current recession.

These developments provided an environment for a classic strong market recovery coming out of the bottom of a recession. In our previous issue of this newsletter, we concluded that “the fourth quarter of 2008 and the first quarter of 2009 will mark the trough of the recession.” That now appears to be a growing consensus.

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**“These developments provided an environment for a classic strong market recovery...”**

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### Recovery leaders

As this issue of *Perspective* went to press, we had seen a 12.2% rise in the Standard & Poor’s 500 Index during the second quarter. From the market low set on March 9, 2009 the S&P 500 was up 32.3%. As often happens in the early stages of market recoveries from recession-driven lows, this recovery was led by the financial, industrial and consumer cyclical sectors of the market.

However, a market move of this magnitude is not without pause or modest correction. In the closing weeks of the second quarter, a moderate pause appeared to be developing.

We anticipate that the second quarter earnings season (the first three weeks of July) will result in increased market volatility. On a more positive outlook, though, we anticipate less pessimism from corporate executives as they comment on their earnings outlook for the balance of this year than has been the case in recent quarters.

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**“Participation in the early stages of this economic recovery will vary widely...”**

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Remember what we have stated in the past: *Before things (the economy and earnings) can get good, they first have to get less bad. We are in that “getting less bad” period right now.*

### Further gains

As the economy moves from less negative to positive, probably in this year’s third quarter, and corporate earnings move from down to up, at some point in the second half, the fundamental basis for further market gains will be more evident.

Participation in the early stages of this economic recovery will vary widely company by company. The focus of our equity research and investment discipline will continue to attempt to identify where the risks and rewards might be.



***Norm Klopp has produced enviable results for clients in all market conditions. If you are not a Midwest Investment Management client, this is an ideal time to let Norm assemble an investment portfolio that’s positioned for long-term growth. Contact him today at (216) 830-1135 or nfk@mimllc.com***

The S&P 500 is a broad, market-weighted average of U.S. blue-chip companies. The index is unmanaged and investors cannot actually make investments in this index.

We hope you enjoy reading our quarterly newsletter, which contains news about our firm, its investment philosophy, the economy and market trends. We suggest you retain these newsletters for future reference.

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