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Midwest Investment Management

PERSPECTIVE™

Are Better Days Ahead For The Markets In 2012?

After a year of market volatility exacerbated by economic turmoil in Europe, Norm Klopp sorts through the data and summarizes his predictions for 2012 on page 4.

"…we never recommend mutual funds with high operating costs or hidden fees."

ATTENTION EMPLOYERS:

Are Various Fees For Your Company's 401(k) Plan Eroding Your Employees' Retirement Savings?

By William C. Grimberg, Managing Director

If they are, that could be bad news for everyone involved. First, high costs can erode the contributions your employees have saved for their retirement. Secondly, if your plan trustees are not vigilant in controlling costs to the plan and its participants, they can be held personally liable under federal law.

How can you know if your company's plan is costing "too much"? Let's examine the four main costs of 401(k) plans.

1. Performance

The most likely "cost" for your company's 401(k) plan is poor investment performance, making it the most expensive "fee" for everyone. If investment options are selected with a "set and forget it" attitude, and investment performance is sub-par, everyone's retirement savings are affected negatively. Even a modest positive difference in the rate-of-return on assets over many years could produce a much larger retirement nest egg.

We believe that Midwest Investment Management's *Preferred Funds 401(k) Investment Advisory Service* gives 401(k) plan participants a viable edge, because we actively research among thousands of mutual funds for those with attractive long-term characteristics.

2. Administration/record keeping

Administration costs are generally composed of a base annual fee of about $2000 plus a per-participant fee of about $50. However, some vendors also charge a "co-fiduciary" fee of up to 69 basis points (.69%) on top of the base and participant fees. This is a big red flag because no one knows what a "co-fiduciary" fee means or services it provides. (One basis point is 0.01%; thus 10 basis points would be expressed as .10%).

3. Asset Management

Many 401(k) plan providers, or vendors, offer a "platform" of fund choices and charge a fee of 50 or more basis points. Compounding that expense is a fee of another 15 to 20 basis points assessed by the person "recommending" the platform. In some instances, some funds even assess plan participants a costly (yet legal) 12b-1 fee of 25 to 50 basis points on fund balances. Over a person's working years, those fees will take an enormous "bite" out of their retirement savings.

Our 401(k) advisory service fee never exceeds 1%—and could actually decline, depending on total assets in the plan. That's our only fee! And, it's tax-deductible if paid by the employer.

4. Mutual fund expenses

Perhaps the least-understood 401(k) plan expenses are the built-in fees assessed by most mutual funds, some of which have a myriad of "share classes". For example, many of our competitors offer "R" (retirement) shares which have "embedded" (some would say hidden) fees which can be significant. For example, R5 shares may have an expense ratio of 75 basis points while an R3 class with the exact same holdings may charge 150 basis points. Some R3 funds assess 12b-1 (marketing) fees of 25 to 50 basis points which is typically shared with the platform originator or the plan's vendor.

When a 401(k) plan vendor is earning revenue-sharing and/or 12b-1 fees, it's likely the sales people will be motivated to "recommend" funds generating the highest fees (commissions) for themselves. Sadly, both plan sponsors and participants are generally unaware of this hidden incentive. The chart below shows how hidden costs can negatively affect a fund's long-term performance.

A Case Study Of Projected Plan Savings

Our recent analysis showed a Cleveland-area company how it could reduce the overall costs of its 401(k) plan by .84% annually. The plan recently had $2 million in assets. Assuming no additional contributions and the assets earn an annual average return of 7% for 20 years, the Midwest Investment Management alternative would earn plan participants $1.76 million more during that period. If the company chose to pay the tax deductible Asset Management fee, it could provide a critical difference for participants in the plan, specifically an additional $3.16 million to the value of the plan over that same 20-year-period.

	Current Plan	Our Alternative
Plan administrator	.40%	.26%
Asset mgt. fee	.69%	1.00%
Program administration	.71%	0.00%
Fund expenses (gross)	1.03%	.73%
TOTAL	2.83%	1.99%

(Continued on page 2)

A Compelling Case For The Power Of The "Humble Dividend"

By Roger I. McNamara, CFA, Investment Analyst

Roger McNamara

Determined to upgrade the quality of their balance sheets (which is to say, more equity combined with less debt) following the trauma of the 2007-2008 economic and market setbacks, America's corporate managers have, in general, pruned the rate of dividend payment growth. It's not unusual today to see payout ratios—commonly reckoned as the share of earnings returned to the stockholder in the form of cash dividend payments—30% (or more) *below* historical patterns.

Indications are that this managerial phase may be nearing its completion. We have noticed that cash-dividend payments of stocks in the Standard and Poor's Index grew by close to 17.5% in 2011, in the process lifting the average dividend yield from below 2% up to its year-end closing range of 2.1% to 2.4%.

Our contention is that the "humble dividend" is overlooked too often in both planning for—and eventual realization of—some total return from a common stock portfolio.

Among the dozens of considerations which undergird our analysis of, and faith in, companies in which our clients' capital is invested, is a conviction that not only will the existing dividend payment be maintained, but *that it will grow* over time.

"Let me emphasize: these are real money payments…"

Investor rewards

It can be shown that over extended periods—10 years or more—and through various market cycles, that dividends and their reinvestment have contributed as much as 40% to 50% of investor rewards. Since that coincides neatly with our own perception of a meaningful investment time horizon, our purpose here is to restore the dividend to its rightful place in portfolio construction and esteem.

As calendar 2011 drew to a close, the dividend (or cash, or current) yield on a market basket of stocks stood at just under 2%, using the Standard and Poor's Index of 500 stocks as a benchmark. Our clients with managed equity accounts will usually receive an aggregate dividend yield on their portfolio fractionally above that.

A 2.5% interest rate may not initially sound like much, but if properly deployed and reinvested, it will prosper and grow in accordance with the table below. Note that wealth effects accumulate slowly, but if allowed to percolate over a manageable time frame (such as 15 years) the outcomes are substantially more compelling. Let me emphasize: *these are real money payments, received by you in real time, opposed to unrealized gains noted on a sheet of paper.*

The Benefit of Reinvested Dividends

A 2.5% dividend rate may sound small, but if properly deployed and reinvested, it will prosper and grow over the long term (for example, 15 years) with an outcome that is substantially compelling.

Number of Years:	$100 Becomes:
5	$113
10	$128
15	$145

These are *real* money payments, received by you in *real* time, in contrast to unrealized gains noted on a sheet of paper.

Additional good news

Among our typical extended-period equity holdings, dividend growth has effectively matched strides with those of earnings and market prices. Recently, we reviewed shares of common stock that were acquired for client portfolios a decade or so ago at an average cost straddling $26 each and an annual dividend payout of $.69 per share. Gradually, but consistently over the years, corporate management increased the dividends, and at the end of 2011 the annual per-share dividend was $1.80. While the cash yield at time of acquisition was 2.7%, it is neither misleading nor an exaggeration to insist that the "Current Yield *At Original Cost" had mushroomed to an impressive 6.9%. At that rate, a sum of money will double in roughly a decade.*

"Gradually… the annual per-share dividend was lifted to $1.80"

It pleases us to share this analysis with you, and we ask that you join in our enthusiasm for the sturdy contributions made by dividends for long-term preservation and accumulation of capital.

Attention Employers… *(continued from page 1)*

At Midwest Investment Management, however, we never recommend mutual funds with high operating costs or hidden fees.

Conflicts and Transparency

Federal laws are clear: the only purpose of a 401(k) plan is to provide participants with a source of income after a lifetime of work. Therefore, plan sponsors, trustees, and other fiduciaries are required to understand exactly how much they're paying for services to the plan and what they are receiving in return.

As an employer, your most prudent option is to choose investment advisors who have no conflict-of-interest, operate transparently, and—most of all—pay attention to the fund choices offered to participants. Doing so is the best service of all.

For more information about Midwest Investment Management's Preferred Choice Funds 401(k) Investment Advisory Service, contact William C. Grimberg at (216) 830-1132 or wcg@mimllc.com.

We have it. A BETTER alternative to low-yield bank CDs and money market funds.

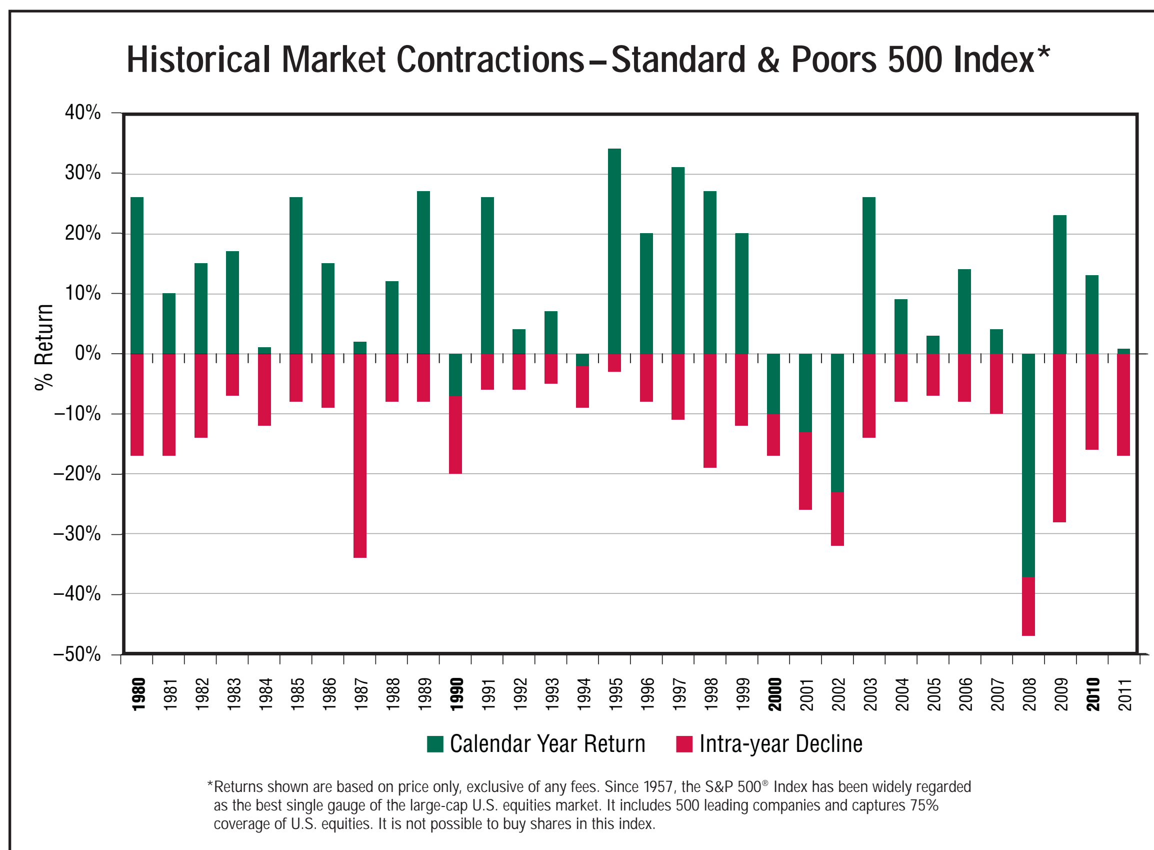
Midwest Investment Management's NEW "*Preferred Choice Funds Cash Alternative Service*" strives to generate annual returns 1% to 3% *ABOVE* current bank CD or money market funds… in a portfolio structured to meet YOUR requirements, and with no mutual fund sales charges.

Minimum account size: $50,000.

For more information, contact any of our Partners or Managing Directors listed on page 4.

What History Can Teach Investors About Market Contractions

Market volatility that seemed to exist throughout all of 2011 caused many investors to become fearful. Perhaps their concern was unwarranted, however, because intra-year market swings are very common, as the chart below indicates.



*Returns shown are based on price only, exclusive of any fees. Since 1957, the S&P 500® Index has been widely regarded as the best single gauge of the large-cap U.S. equities market. It includes 500 leading companies and captures 75% coverage of U.S. equities. It is not possible to buy shares in this index.

Over the years, when market gyrations caused a few of our clients to become uneasy, we took the time to remind them that overreacting to short-term market fluctuations often has a negative effect a person's long-term investment plans.

Secondly, we urge them to always have a strategy in mind, so that when market volatility actually does occur, they can be in a position to take advantage of the fluctuation, if they desire.

Full-calendar-year stock market returns (shown by the green bars), are most often positive. Yet, markets will often sag temporarily by 8% to 10%, or even 15% during the year, as shown by the red-outline bars. Note that over the 30-year period covered in this chart, the stock market generated an average annual return of 9.6%, while experiencing an average annual intra-year decline of 14.3%.

At Midwest Investment Management, we continuously monitor and re-balance the stocks in client portfolios relative to their price targets. We perform a similar service for clients with mutual fund allocations in their "managed account" portfolios.

Midwest Investment Management

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4th Quarter Economic Review

Our 2012 Outlook: Cautious optimism for moderate economic growth, continued market volatility

By Norman F. Klopp, CFA, Managing Partner

Norm Klopp

Back in August, during a period of extreme stock market volatility, we informed our clients via e-mail that we felt the stock market was undergoing a sharp correction, not a "crash", and added that we did not foresee a "double-dip recession". Then in the Fall issue of this newsletter, we reiterated our position that we did not foresee a double-dip recession.

The flow of economic data and the performance of the stock market in the fourth quarter of 2011 gave credibility to our earlier statements. The 17.5% market correction that took place between May 2 and Oct. 3, 2011 was dramatically reversed in the fourth quarter, with the S&P 500 Index posting a strong gain.

Some "bright spots"

Economic data compiled during the final weeks of the quarter portrayed a U.S. economy in a slow but steady growth mode, along with some moderation of the volatility so evident through the third quarter. Some "bright spots" included the following:

- The Conference Board's measure of consumer confidence rebounded 15.1 points in November to the highest level in four months, and the largest monthly increase since 2003. The Conference Board is a non-advocacy research association.
- Retail sales in November were up 2.2%, the largest monthly gain in two years, and by the end of that month, year-to-date sales were up 3.9%.
- In early-December, the national unemployment rate dropped to 8.6% from 9.0%, partly because many people stopped looking for jobs.
- Bank lending continued to expand a 5.6% annual rate over the last six months.
- Overall sales of cars and light trucks continued to increase and production schedules for the first quarter of 2012 suggested a 20% increase, compared to the same period of 2011.

Consumer dollars

Consumer spending has been surprisingly strong. Why? In October, the Bureau of Labor Statistics data reported that although the overall national unemployment rate was 9%, the unemployment rate among college graduates for most of 2011 was 4.4%. Although this demographic group represents about 30% of the collective labor force, it has higher discretionary income and therefore contributes to a larger share of consumer spending.

Market growth possible

We remain cautiously optimistic for 2012 and believe domestic economic growth is sustainable, but at a moderate rate of about 2.5% for the year. We expect the stock market to remain volatile in 2012, but believe it will deliver growth of about 10%. The market was selling recently at 12.4 times projected 2012 earnings, still well below its 10-year median multiple of 15.7 times. Even if a 10% market appreciation occurs, the market would still be below that long-term median multiple.

> ***"The flow of economic data … gave credibility to our earlier statements."***

European Influence on U.S. Markets

A major cause of U.S. stock market volatility during the fourth quarter was the European sovereign debt crisis, which had an impact on economic growth in that region of the world.

On December 9, 2011 European leaders announced a new "fiscal compact" to repair flaws in their currency union. Although the pact was not a total solution for Europe's economic problems, *The Wall Street Journal* reported that "progress clearly has been made."

Perhaps we have seen the worst in Europe. We anticipate fourth quarter 2011 and first quarter declines in economic activity there, combined with market volatility. We continue to actively monitor developments in Europe, especially as they could affect client portfolios holding stocks of U.S. companies that have operations in Europe and/or export goods there.

If Europe finds financial stability, the U.S. economy continues to expand, and the growth rates of "emerging economies" re-accelerate, we believe the large, well-managed global companies whose stocks are held in client portfolios should benefit. Growing cash flow and dividends will also underpin the strong fundamental performance.

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.

Perspective is published quarterly by Midwest Investment Management LLC, Cleveland, Ohio for its clients, friends and members of the business community. All information contained herein reflects the opinions of the authors and does not necessarily constitute investment advice. Past results are no guarantee of future performance.

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