

Your Family's CFO Report

A review of issues affecting your family's wealth

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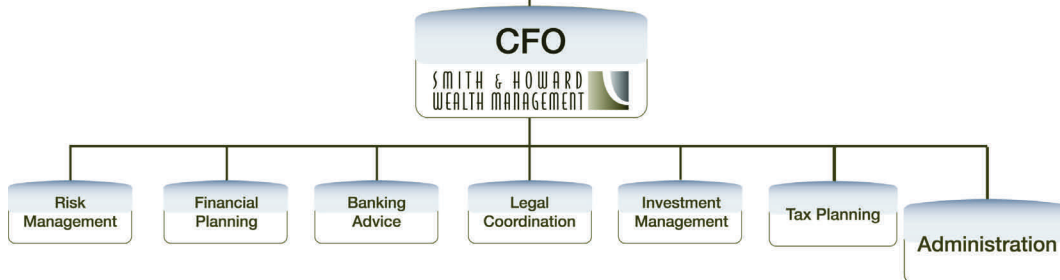
info@smithhowardwealth.com

Is it just us, or has the world had more than its regular share of crises and bad news lately? As if the continuing struggle out of the global recession and sovereign debt issues in Europe weren't enough, the world community witnesses a 500-year earthquake in Japan, with a resulting tsunami and nuclear disaster. Add to that increasing inflation in emerging markets, and a wave of civil unrest in the Middle East, which are leading to significant oil price increases. Last but not least, we spent weeks on pins and needles to see if the Federal government would stay open for business. And what's the reaction of the stock market? It goes up of course, turning in the best first quarter in over a decade!

In this edition of *Your Family's CFO Report*, we'll provide our perspective on how these events have affected and may continue to affect the markets and our clients' portfolios.

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Administration

We just completed our client survey, and the response was overwhelmingly positive. Thank you to everyone who took the time to complete it. Your feedback is invaluable as we continually strive to improve our service.

If you did not get a chance to participate and would like to, please send an email to info@smithhowardwealth.com with the word "survey" in the subject line, or give us a call at 404.874.6244 for a hard copy.

Economic Overview

Most economic indicators point to a rebound in global activity that should continue, despite recent headlines (this may explain the stock market's performance in Q1). Despite many positives for the broad economy, following are some concerns, generally in order of greatest to least concern.

Oil Prices

Our greatest concern is the continued increases in energy prices that could derail the global economic recovery. While we would love to believe this highly volatile

payments to its citizens. Fortunately, the amount of energy required to produce \$1 of GDP is half of what it was during the oil shock of the 1970s (*Jeremy Siegel, Wharton School of Business*). Also on the positive side, we are in better shape financially, having just completed a recession, than we were when prices spiked in 2008, and a recession was about to begin. Still, most analysts believe if prices stabilize around \$120 per barrel, it will knock 0.5% off this year's GDP...not a recovery-killer, but something else for us to worry about.

Vanguard estimates a sustained price of \$150 would be needed to generate a U.S. recession.

Inflation

Never before do we recall witnessing such resolute belief that we are experiencing both deflation and inflation at the same time. Most of the deflation camp lies with the

Fed; in their continuing effort to stimulate the economy, both short and long-term interest rates remain well below their natural levels. Most of the rest of us live in the real world – where energy, food and other prices continue to escalate. The Fed argues there is so

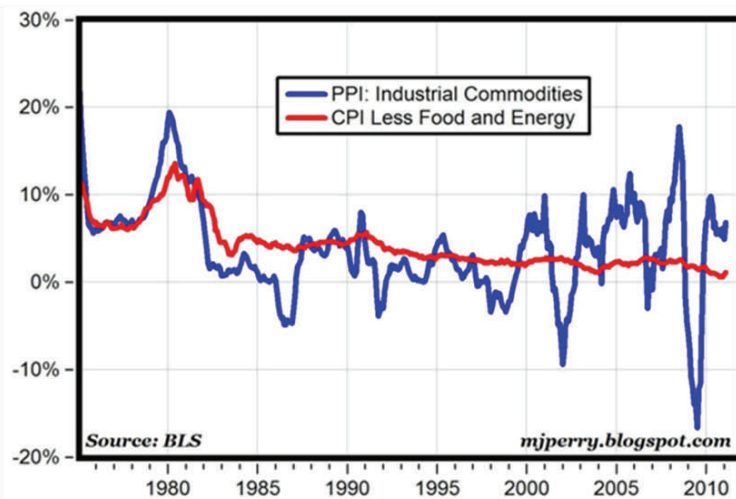
much slack in the system (e.g., unemployment, idle manufacturing, etc.) that they can continue these measures without fear of inflation (chart below, left). They may be right for a time, but we believe the compounding effects of the federal deficit will push interest rates higher over time, regardless of whether headline inflation increases significantly. Our bond portfolio is positioned accordingly.

Federal Budget Situation

In many respects, much of the root cause of the 2008 financial crisis remains: “too big to fail” banks are now even bigger, and much of the massive over-leverage of the private sector has been transferred to government balance sheets. Suddenly, Congress has gone from spending like drunken sailors (apologies to all those who have bravely served) to competitive spendthrifts. We are highly skeptical (election season approaches quickly), but encouraged by the tone of Washington lately – at least the discussion is taking place. Unfortunately, even the deepest cuts being discussed don't scratch the surface of the \$1.4 trillion deficit (it took the Congress weeks to agree on \$38 billion in budget cuts, which is only about 2.5% of just this year's deficit!)

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Inflation: Since the mid-1980s, volatile swings in commodity prices (blue line) have not translated into higher consumer inflation (red line)...so far.



area of the world is suddenly embracing Western-style democracy, the reality is more complicated. For now, Saudi Arabia, the country with the most spare capacity, appears capable of maintaining civil order, if only by cash

Economic Overview (cont'd)

Oddly, when quoting such figures, officials leave out the unfunded liabilities of Medicare and Social Security, which total many trillions more.

A pause for perspective...the number trillion is now thrown about in everyday conversation these days. Just how much is one trillion? For context, a million seconds is 11.5 days; a billion is 32 years...a trillion seconds is 32,000 years! We are talking about a lot of money here. This is more fuel for higher interest rates.

Japan

The human tragedy is horrific in terms of the deaths, newly homeless and the emotional toll. Economically speaking, however, the long-term effect of a natural disaster of this scale in

developed countries is usually neutral – lost production is more than replaced in the rebuilding that follows. Furthermore, even though Japan is the world’s third largest economy (having been surpassed by China in 2010), it is a relatively small player in global trade. Analysts estimate less than 10% of S&P 500 companies’ revenues come from Japan.

These facts may explain U.S. stocks’ muted response to the situation. It remains to be seen how long the ripple effect of delays in supply chains will last. But we are continually surprised at the swiftness of global markets to adjust and adapt.

Plus, there is plenty of spare capacity in many other countries to fill the gaps. There are sure to be longer-term consequences

for some stocks (and industries); many of these are simply unknowable at this time. This is yet another reason we prefer the broad diversification of asset class index and mutual funds.

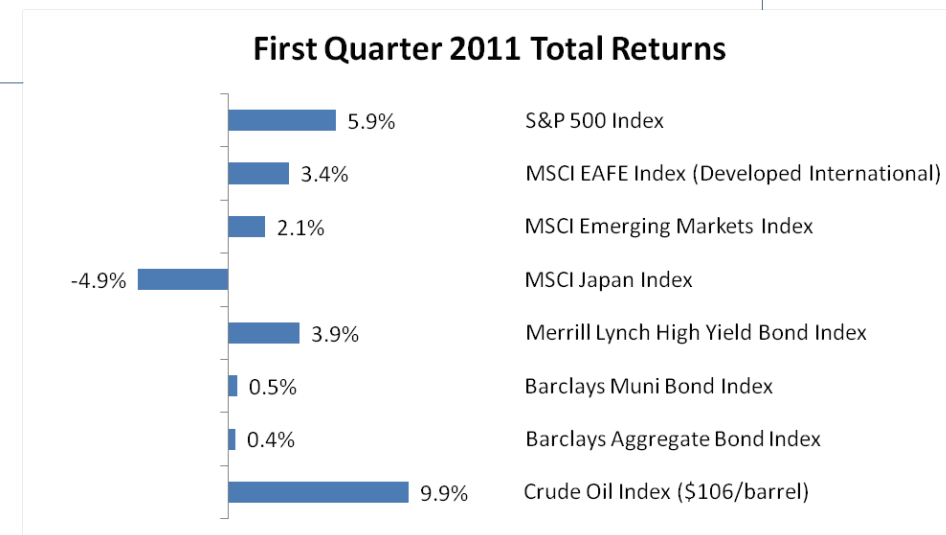
Summary

The bottom line for the economy: a sluggish recovery continues, but it can only handle so many curve balls. We are keeping a watchful eye on the lasting effects recent global events may have on the markets. As always, what is important for us as investors is to discern the difference between short-term noise and true long-term changes in fundamentals. That judgment, plus a reasonable view of valuations, gives us the best opportunity to avoid knee-jerk reactions to every piece of news that comes along.

Asset Class Summary

Stocks

The S&P 500 rose 5.9% in the first quarter, its second biggest first-quarter gain ever. Many investors were surprised by the market’s resilience in the face of so much uncertainty over oil, the Japan disaster and the continuing sovereign debt crises in Europe and the U.S. So what gives? The most common reason offered is that valuations remain reasonable (stock prices have nearly



doubled from the bottom, but earnings have increased even more). While this is true, we believe that given the still-fragile state of the economy,

businesses will have a tough time pushing through recent cost increases to consumers.

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Asset Class Summary (cont'd)

Therefore, profit margins seem destined to come off their extremely high levels – but still look attractive (see chart below). The more likely reason is “Animal Spirits” – the momentum generated by throngs of retail investors tired of sitting in cash and other low-interest bearing securities, and encouraged by Fed actions that continue to punish savers. Flows into equity mutual funds turned positive for the first time in over a year and a half (*Bloomberg*), as more investors finally feel some confidence about the economy and the markets. Even among professional investors, the spread between bullish and bearish is the widest in several

years. **These trends, and the fact that stocks have risen so much so fast, are tempering our enthusiasm and keep us on the low end of our recommended range of equities for most clients.**

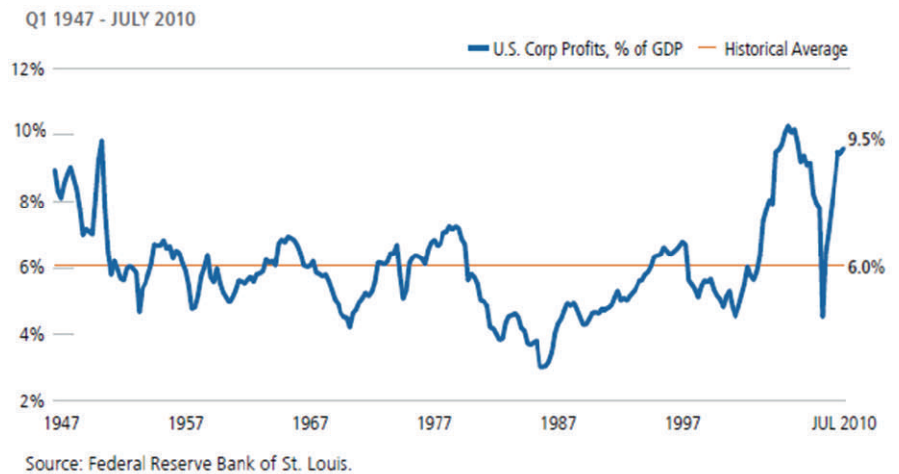
Bonds

The Barclays Aggregate Bond Index was flat for the quarter, as it was “risk on” again in the markets. Given our ongoing concerns about the Federal budget deficit, we continue to believe that the longer-term trend in rates will be up. This has already

begun, and we think the odds are good that it accelerates later this year, when the Fed is scheduled to end the second round of “Quantitative Easing”. Bill Gross (manager of the world’s largest bond portfolio) agrees, and recently sold all U.S. Treasuries in his

Even though spreads on these bonds are back to about historical levels, high levels of cash on corporate balance sheets (\$1.89 trillion, the highest level since 1952, according to the Fed) make defaults extremely low right now.

Corporate Profits Remain Very High



flagship fund, even putting on some short positions (which we have also done). **Therefore, we are maintaining our bias toward short-term bonds. We continue to favor our position in high-quality corporate bonds, as well as the floating-rate and “flexible” bond fund positions, which should hold up better in a rising rate environment. Our TIPs position is one way we are hedging against possibly higher inflation, and we continue to hold some high-yield bonds for most clients.**

Hedged Equity and Alternative Investments

We continue to hold considerable positions in these asset classes for most clients. The long-term goal with hedged equity is stock-like returns with less volatility. One example of a mutual fund in this category holds a broad basket of stocks and then buys put options to give some downside protection, while selling call options to produce income.

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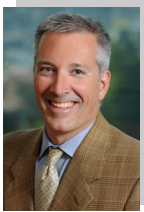
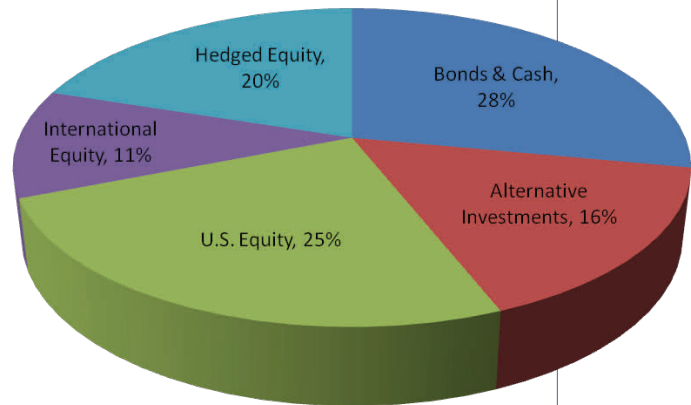
Asset Class Summary (cont'd)

The result is it tends to participate in much of the long-term gains of stocks, but skips some of the extreme highs and lows. For alternative investments, our goal is absolute returns that are as independent as possible from the traditional stock and bond markets. When achieved (of course there is no guarantee), this diversification can benefit portfolios when the stock market turns down.

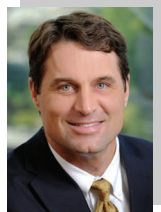
Your Family's CFO Team

The Smith & Howard Wealth Management team consists of specialists in the fields of tax, financial and estate planning, investment management and portfolio administration. We are committed to being accessible and responsive to our clients at all times, and to our goal of bringing a cohesive, organized solution to the issues that affect your family's wealth.

Current Allocation for Typical Client



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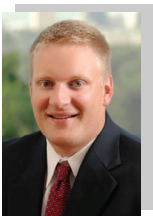
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Thank you for reading this issue of *Your Family's CFO Report*. We appreciate your continued confidence. We consider it a privilege to serve your wealth management needs, and would be glad to speak with anyone you think might benefit from our services.

All references in this publication referring to our average allocation or "typical portfolios" reflect those of the fully discretionary accounts of clients with moderate risk profiles. Actual client portfolios are tailored to individual client circumstances and asset allocations may vary. Any reference to returns reflect the performance of asset classes, are for illustration purposes only, and do not reflect the returns of any specific investment of Smith & Howard Wealth Management. No representation is made that any investment decisions discussed herein have been profitable in the past or will be in the future. Past performance is no guarantee of future results. A list of all securities recommended to clients in the past 12 months is available upon request.