PRATT, KUTZKE & ASSOCIATES, LLP

INVESTOR INSIGHTS & OUTLOOK

April 2011 | Vol. No. 2 | www.prattkutzke.com

SAMPLE

Letter from Dan

Wow! It's the end of the first quarter already! Or, it is about time we are at the end of winter.......! The historic world events so far in 2011 may make this a year to remember, with the disaster in Japan and the dramatic changes happening in Northern Africa and in the Middle East.

How will these events shape investment returns for the future? Let's start with the situation in Japan. The short term result will be that companies that rely on electronic parts from Japan may face shortages, slowing production here in the states. The longer view is that Japan's reliance on nuclear energy will change because of the continuing crisis at the Fukushima power plant. Will they turn to oil or natural gas to supplement their energy needs? What ripple effect (no pun intended) will be felt here in America? I wonder if Ford and GM are figuring how to turn this into a market advantage for their sales, especially in China? Next, how do the political changes in Egypt and other countries in Mideast affect us? The obvious answer is the increase in oil prices, but more specifically, diesel prices, especially in Europe. This will increase the cost of everyday goods.

The broader effect is that the Fed is now less likely to raise interest rates for the foreseeable future, as these market forces are serving as a slowdown to the economy, lowering the threat of inflation. The federal government stimulus (referred to as QE2) will end this summer, as the Fed sees inflation being stable over the long term. As interest rates remain low, it will encourage businesses to expand and help home buyers take on new mortgages. At the same time, seniors will continue to look for income in places other than their bank CDs.

Enjoy the Spring!!

Dan

Advisor Corner

Daniel Kutzke
Partner - Financial Advisor
dan@pkallp.com
507-281-6650
www.prattkutzke.com

Pratt, Kutzke & Associates Partner, Dan Kutzke, has more than 28 years of experience in the financial services industry. He works both as an Investment Advisor Representative for individuals as well as an employee benefits specialist for businesses.

He attained his Chartered Life Underwriter (CLU) and Chartered Financial Consultant (ChFC) designations in 1988.

Dan and his wife, Kim, live in Rochester and enjoy spending time with their children. In addition to community and industry involvement, Dan also enjoys playing golf, singing and traveling.

Monthly Market Commentary

As winter draws to a close, we're all looking forward to spring and a sustained recovery. Not all the news is good, however, especially with growing concerns over spreading violence in the Middle East and rising oil prices. In reaction to the global climate of economic uncertainty, the market experienced a few violent swings recently, but a positive jobs report helped stabilize it. On a more positive note, the S&P 500 has now officially doubled from its low in March 2009.

Employment: The economy added 192,000 jobs in February, the third-best monthly number of the recovery. The unemployment rate dropped to 8.9% from 9% in January. The private sector added 222,000 jobs, the second-best performance of the recovery. Averaging the January and February numbers together, the resulting private-sector employment growth of 145,000 jobs exceeded the past 12 months' average of 127,000. The bad news is that, while the private-sector portion of the economy is accelerating, the government portion appears to be doing the opposite. State and local governments lost 30,000 jobs in February, and the federal government is debating the need for more job cuts.

Consumer spending: More bad news is that hourly wages basically stagnated in February after a decent increase in January. So, even though more people have jobs, the average wage and consumers' buying power are staying low. Upper-income consumers account for the lion's share of the recovery, and it's also these consumers who drive the increase in consumer spending. The problem is that a lot of upper-income spending is discretionary and volatile, and it can fall as fast as it has risen. If the spending of the average consumer was growing as well, that could be considered a more sustainable long-term trend, but this is not the case.

Retail sales: The difference in where consumer spending is coming from can explain some of the February retail trends. Some high-end retailers like Nordstrom and Saks posted near-double-digit growth, while discount retailers like Target and Wal-Mart showed little to no growth this month. It seems that the more dependent a sector was on upper-class consumers, the better it performed.

Oil prices: Oil has risen to $104 per barrel from a low of $65 in May 2010 (it may be of interest to note that a $1 rise in the price of gasoline equates to about $25 billion of consumer spending per year). Although some fear that rising oil prices may kill the recovery, Morningstar economists estimate this will probably not happen until prices reach the $120 range. On the other hand, a slightly elevated oil price may curb commodities speculation and help the market readjust.

Housing market: Pending home sales showed yet another small decline, forecasting more gloomy home statistics over the next few months, as well. At this point it looks like 2011 won't be a wonderful year for housing, but if employment continues to improve and financing remains accessible, 2012 and 2013 could be better.

Economic growth and inflation: GDP growth for the fourth quarter of 2010 was revised down to 2.8% from the first estimate of 3.2%, because of inflation-adjusted inventories and a sharper-than-expected drop in government spending. Recent inflation estimates indicate that year-over-year inflation may approach 2.5% by June. When prices of goods rise faster than incomes, consumers are forced to cut back on consumption (or dip into savings). Slowing consumption in turn slows overall GDP growth and forces manufacturers to cut back on production and employment. Until recently both wage growth and inflation were muted, but rising inflation with no increase in wages could mean really bad news in the months ahead.

SAMPLE

Portfolio Performance

A portfolio is a group of asset classes, such as stocks or bonds, held by an investor. When it comes to constructing an investment portfolio, risk tolerance, time horizon, and investment objectives need to be carefully considered.

Would you lie awake at night worrying about your portfolio if it was heavily invested in stocks? How long is it before you will need to start withdrawing money from the portfolio? If retirement is still 30 years away, you might be able to invest in riskier asset classes because you have time to ride out potential down periods. Your financial advisor can help you address these potential situations and much more.

The table illustrates how various portfolios performed since 1926. Each portfolio's total return is presented along with its corresponding risk, and a few other statistics are highlighted as well. Notice that as the allocation to stocks increases, the returns increase. However, these higher portfolio returns are associated with much greater risk than in portfolios with a lower allocation to stocks. For instance, out of the five portfolios presented, the 100% stock portfolio provided the highest return but also came with the most risk. When the 100% stock portfolio is compared with the 50% stock and 50% bond portfolio, one will notice that the risk decreases dramatically; however, the return also declines—by 1.7%. Stocks have a higher level of risk than bonds and those who invested in this asset class were rewarded accordingly. One other thing to note is that the 25% stock and 75% bond portfolio came with the least amount of risk (8.9%) and a moderate return of 7.0%. Despite the fact that bonds are considered less risky than stocks by many investors, the portfolio with the least risk did not consist entirely of bonds. The reason for this is that stocks and bonds are not highly correlated; meaning, they tend to move independently of one another. So, if stocks took a hit, bonds might be up and vice versa. These opposite movements may help reduce the overall risk of the portfolio.

An investor with a long time horizon might be able to deal with short-term risk in order to receive the higher return opportunities that more aggressive portfolios may provide. On the other hand, an investor with short-term goals may opt for a more conservative portfolio for more stability and potentially less downside risk.

Constructing an investment portfolio is not an easy task. Moreover, once the allocations have been determined, they tend to shift over time because of the performance of the underlying asset classes. Consequently, the portfolio will need to be rebalanced in order to maintain a target asset mix and a given level of risk. Lastly, as you grow older and your goals and risk tolerance change, your portfolio allocation will need to change as well. Investing is an ongoing process—be sure to consult with your financial advisor throughout this challenging journey.

Summary Statistics of Various Portfolio Allocations 1926–2010

Portfolio	Return	Risk	# Positive periods	# Negative periods	Highest return	Lowest return
100% Stocks	9.9%	20.4%	61	24	54.0%	–43.3%
75% Stocks/ 25% Bonds	9.2%	15.5%	64	21	41.3%	–34.2%
50% Stocks/ 50% Bonds	8.2%	11.4%	66	19	34.7%	–24.7%
25% Stocks/ 75% Bonds	7.0%	8.9%	70	15	35.7%	–15.0%
100% Bonds	5.5%	9.5%	63	22	40.4%	–14.9%

Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. An investment cannot be made directly in an index. The data assumes reinvestment of income and does not account for taxes or transaction costs. Portfolios are always rebalanced. Past performance is no guarantee of future results.

Source: Stocks in this example are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds are represented by the 20-year U.S. government bond.

SAMPLE

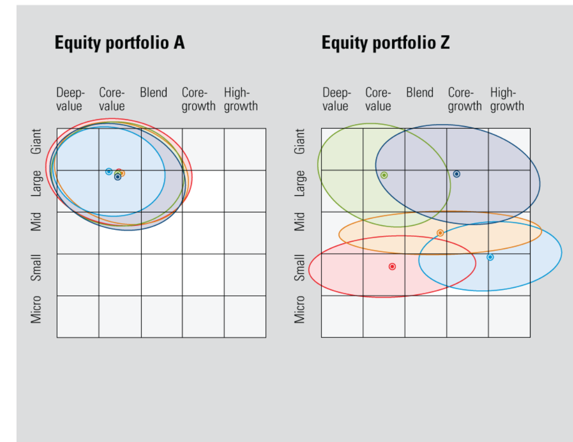
Exploration in Diversification

Important Disclosures

- Securities & Investment Advisory Services offered through Woodbury Financial Services, Inc., Member FINRA, SIPC & Registered Investment Adviser.
- Not FDIC Insured. Not Bank Guaranteed. Not a bank deposit. Not insured by any government agency. May lose value.
- Pratt Kutzke & Associates, LLP and Woodbury Financial Services, Inc., are not affiliated entities.
- P.O. Box 64284, St. Paul, MN 55164, 800-800-2638

Investors seeking a well-rounded portfolio often wonder how many funds they need to reduce risk through diversification. The answer isn't a specific number of funds, but rather the holdings of each fund in the portfolio. If multiple funds in a portfolio have similar holdings, an investor can fail to achieve diversification benefits. Portfolio A and Portfolio Z in the image contain five mutual funds. Each oval represents the ownership zone, which accounts for 75% of the fund's holdings. The funds in Portfolio A overlap, indicating that each fund shares similar style characteristics. Too much overlap defeats the purpose of using multiple funds to create a diversified portfolio. Portfolio Z spans across many styles, so positive performance by some investments can neutralize the negative effect of others. As illustrated, it is important to be aware of the possibility of security overlap when constructing a diversified portfolio.

More Concentrated Portfolio Versus Diversified Portfolio



Diversification does not eliminate the risk of experiencing investment losses.

Source: Funds chosen from Morningstar's open-end database.

SAMPLE

©2011 Morningstar, Inc. All Rights Reserved. The information contained herein (1) is intended solely for informational purposes; (2) is proprietary to Morningstar and/or the content providers; (3) is not warranted to be accurate, complete, or timely; and (4) does not constitute investment advice of any kind. Neither Morningstar nor the content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. "Morningstar" and the Morningstar logo are registered trademarks of Morningstar, Inc.

Daniel Kutzke
Partner - Financial Advisor

Pratt, Kutzke & Associates
2001 2nd Street SW
Suite 105
Rochester, Minnesota 55902

dan@pkallp.com
www.prattkutzke.com

Tel:507-281-6650
Fax:507-281-6884