



For Clients and Friends of Financial Connections

U.S. domestic stocks outperformed international stocks in the first quarter of 2011. Bonds were essentially flat. Commodities and energy surged this quarter (see Inflation article), creating concerns that inflation has finally arrived.

Current

The consumer debt built up over the past 30 years continues to decline but is nevertheless still high. Lower spending leads to lower economic growth. In turn, corporate earnings usually decline. With lower corporate earnings, a lower stock market performance frequently follows.

The world's economies are interdependent, and the overseas picture is not encouraging. Europe continues to have debt problems; the Japan disaster and unrest in the Middle East create shocks to many economies. For instance, many manufacturers are having problems receiving parts for their products until Japan restarts its industrial activity.

Bond prices will decline when interest rates rise. And investors can earn higher interest rates outside the U.S.

Portfolio Design

Portfolio design is as much an art as a science. While statistics abound, they usually analyze previous performance—as we know, this is no guarantee of future results. The media outlets are saturated with pundits predicting the future. Only in hindsight can we know who was right.

As we've mentioned to you before, we look at risk before we look at returns. We would rather lose less when the market declines and participate when the market rises. As a result we underperform when the stock index rises quickly but usually outperform when the indexes drop steeply. Over time, having more stable returns without major downturns and upswings improves performance.

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Quarterly Newsletter, 1st Quarter 2011 4/20/2011

In our last newsletter, we referred to a system of client "vaults" allowing you electronic access to your reports. You will also be able to place your important documents in your personal vault. We're in the final stages of setting up the vaults. We anticipate being able to enroll clients for this service over the next 90 days.

One of our clients, Robin, has a close friend from Japan and, fortunately, her friend's family is safe. Being part of the Japanese community, Robin's friend supplied a list of organizations recommended by a member of the Japan Society.

If you would like to make a donation to help Japan rebuild, you might look at the organizations below.

<http://www.internationalmedicalcorps.org/Page.aspx?pid=1970>

<http://give2asia.org/japansociety> <http://www.shelterboxusa.org/>

<http://www.globalgiving.org/> <http://www.americares.org/> <http://www.jcccnc.org/>



NINE WAYS TO SAVE MORE FOR RETIREMENT

1. Envision what your retirement will look like, so we can develop a financial plan to match your resources to your vision.
2. Contribute the maximum to your retirement plan, especially when you have an employer match.
3. Review your current spending habits to determine if adjustments need to be made.
4. Review what your net income might be under current tax laws. You are looking for cash flow to support your expenses, so the taxes need to be taken into consideration. Remember that IRAs, 401 (k)s, etc. are taxable when withdrawn.
5. Saving now introduces the power of compounding your money for when you need it later.
6. Review large purchases that reduce savings or cause withdrawals. Are they necessary? Would it be better to wait and let your money grow?
7. It's never too late to start saving, but it is easier when you start earlier.
8. Work with a fee-only advisor who does not sell any products (i.e., annuities).
9. Monitor your spending via Quicken or Mint.com. Once in the habit, you can use this pattern for savings and retirement.

INFLATION—DOWN THE ROAD OR AROUND THE CORNER?

Most experts agree that inflation is in the offing. But uncertainty lingers:

- ◆ When will it start?
- ◆ How fast will it climb?
- ◆ How high will it go?

There is no consensus on the *when*, but arguments about sooner rather than later are heating up as energy and commodity prices increase rapidly.

Down the Road

The Federal Reserve continues to believe inflation is not ready to make an appearance. Janet Yellen, the Fed's vice chair, said current monetary policy "continues to be appropriate."

William Dudley, president of the Federal Reserve Bank of New York, said, "We think that it's important not to overreact to a rise in headline inflation because the increase in commodity prices is probably going to be temporary."

Analysts for the International Monetary Fund said the U.S. has so much "slack" in the economy, they anticipate inflation to be subdued. "Slack" refers to high unemployment and excess industrial capacity.

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INFLATION—DOWN THE ROAD OR AROUND THE CORNER?

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Around the Corner

When a country raises its interest rate to control inflation, its currency becomes more attractive and it benefits from capital inflow. At the time of this writing, 18 countries (China, Brazil, and India among them) have increased their interest rates. And in April, interest rates for currency denominated in euros increased. The other two major currencies, the yen and dollar declined.

As the dollar declines and the price of necessities such as food and energy rises, a larger portion of the consumer's paycheck goes toward these items. They include the price of gasoline (oil usually increases when the dollar declines), along with natural gas. When less money is available for optional spending, economic growth slows.

John Mauldin, a financial expert and journalist, argues that the Fed's point of view does not take into account what is behind the inflation indicators. For instance, while the Fed looks at the total employment number, a breakdown of this number shows a different picture.

The higher educated labor force has low unemployment—in fact 2.5% unemployment is considered full employment. The real problem is the lower educated work force. Jobs for these workers are unlikely to come back. Retraining them into more skilled professions might help the economy.

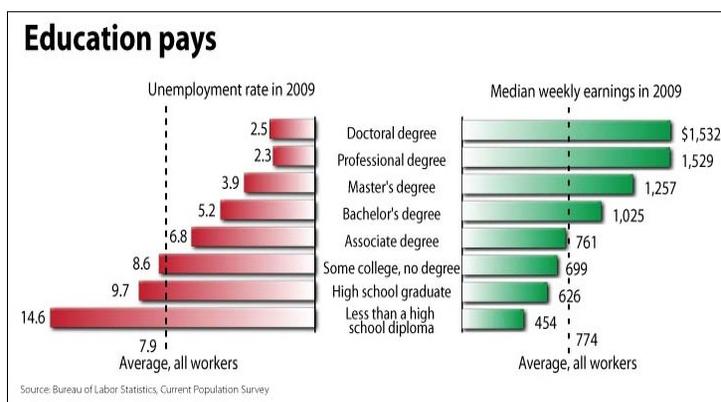
The Producer Price Index is rising at 20%. Bill Simon, CEO of Wal-Mart, said "U.S. consumers face serious inflation in the months ahead for clothing, food and other products." During a meeting with *USA Today's* editorial board, Simon said "We're seeing cost increases starting to come through at a pretty rapid rate."

Companies such as Kimberly Clark and Colgate provide staples we all buy. They've announced price increases of 5-7%.

Rent is a measure of inflation—in fact it makes up 23% of the Consumer Price Index and 40% of "core" CPI. Rental vacancies have dipped below 10%. There will be fewer units available since they aren't being built. It will most likely result in higher rental prices.

Conclusion

When experts in the public and private sectors who make their living on such issues cannot agree, how do we handle the issue of inflation? We have to look at it from both sides and find a middle ground. Your portfolios have investments that are supposed to hedge against inflation. They include commodities and global bonds that take advantage of the higher interest rates overseas.



TD AMERITRADE NATIONAL CONFERENCE

Jill attended the 2011 conference in San Diego. Tony Blair, former UK Prime Minister, was to be the keynote speaker but at the last minute was unable to attend. He sent a video message apologizing for having to back out but, as he said, "I left the high stress job as Prime Minister for 10 years and moved to one with less stress—envoy to the Middle East." He was on his way to Egypt representing a multi-nation organization.

Colin Powell spoke instead. It was an inspirational speech but some of the information was shocking. He said:

- ◆ 30% of children do not graduate from high school
- ◆ 70% of the people who apply to the armed forces are not qualified

Senator Alan Simpson and former Chief of Staff Erskine Bowles discussed the findings on deficit reduction. Simpson said "We decided to do this for 14 reasons. Erskine has eight grandchildren and I have six."

Other speakers included Jeremy Siegel and, of course, an economist.

The speakers' comments are valuable, yet the real benefit to this conference is meeting the mutual fund and software exhibitors and other advisors. This was the largest TD Ameritrade conference ever—2,500 advisors. Jill was able to discuss our stable of mutual funds with fund personnel and talk with managers at mutual funds we may add to our "farm team."


Jill D. Hollander


Brian Pon

Clients of Financial Connections

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Our goal is to build a core portfolio overlaid with our view of the world today. Remember that investing is a marathon, not a sprint—hence we include returns since 2000 on your reports.

Over the past several years, the following themes have been in our portfolio design.

- ◆ Managers with flexible mandates:
Two methods are typical. A mutual fund manager may use cash, bonds, or stocks to invest. Or, the manager's objective is not tied to a specific index (i.e S&P 500) which allows for more flexible investing.
- ◆ Defensive funds:
These funds do not move in lockstep with the market. They are sometimes referred to as hedge funds or absolute return funds. The objective is to hold up better when the market declines, as it did in 2008, and increase more slowly when the market goes up. Their goal is to provide consistent returns.
- ◆ Global:
As we've seen, the world's elements are more and more intertwined. One good example is Boeing. We think of it as a domestic stock, but its 787 Dreamliner uses parts from nine different countries. To us, it makes more sense to permit a mutual fund to look globally for investing opportunities.

We would like to meet with you at least once a year or anytime you want to talk about your finances. Please give us a call to arrange a time for a meeting in person or conference call.

Your reports for the first quarter are enclosed along with our new ADV (disclosure statement) and Privacy Statement.

