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Financial Briefs

DECEMBER 2008

Should You Consider International Investing?

During the 1990s, the U.S. stock market significantly outperformed international stock markets. International investments drew little attention during that time. But now the situation has reversed, with international investments outperforming U.S. stock investments over the past few years. Is now the time to take another look at international investments? Before deciding, consider these points:

Do international investments really add diversification benefits to a portfolio? The primary objective of diversification is to reduce the volatility in your portfolio. For instance, when the U.S. stock market is declining, investments in other parts of the world may be increasing. Over the short term, especially during periods of crisis, stock markets throughout the world tend to move in the same direction. Many believe that the world economy has become more entwined, making world markets more correlated with each other, possibly reducing the benefit of global diversification. Yet, how closely a country's stock market is correlated to the U.S. stock market will depend on how heavily that country depends on exports to the U.S.

One way to determine the diversification benefits of adding an asset class to your portfolio is to review the correlation between the two assets. Correlation is a

statistical measure of the extent to which one asset class moves in relation to another asset class, ranging from +1 to -1. A correlation of +1 means the two assets are highly correlated and move very closely together in the same direction. Combining assets with a high positive correlation will not provide much risk reduction. A correlation of -1 indicates the assets move in opposite directions, a rare event in the investment world. A correlation close to 0 means there is no relationship in the price movements of the two assets. Combining assets that aren't

highly correlated can help reduce a portfolio's volatility.

A recent study comparing the correlation of returns between the U.S. stock market and major foreign stock markets for the period from 1988 to 2007 found the following correlations with the U.S. stock market:

Japan	.35
Pacific region	.42
Australia	.50
Hong Kong	.51
Switzerland	.54
Singapore	.55

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The Basics of Currency Fluctuations

An international investment's return is based on two factors — the investment's return in its local currency plus currency fluctuations. For example, suppose you purchase a British stock whose price increases 10% in one year in terms of British pounds. If, during that same year, the British pound increased in value by 5% compared to the U.S. dollar, your total return would be 15% — 10% from the investment's return and 5% from currency fluctuations. However, if the British pound decreased by 5%, your total return would be 5%.

When the U.S. dollar declines in value compared to other currencies, your investment increases in value since more dollars are required to

purchase the investment. An increase in the U.S. dollar compared to other currency means your investment decreases in value. Over the past couple of years, the falling U.S. dollar has caused increased returns for international investments. One study indicates that for the 2 1/2 years ended May 31, 2008, two-thirds of the gains in the EAFE index were a result of the dollar's decline against currencies in that index (Source: *On Wall Street*, August 2008).

Most countries use a system of managed floating exchange rates. Supply and demand factors set the exchange rate most of the time, as international banks, investors,

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Does Multinational Mean International?

With many U.S.-based multinational companies earning a significant portion of their revenue overseas, it's reasonable to wonder whether stocks of these companies are really a form of international investment.

With the U.S. market so mature in many industries, many of these companies have turned to overseas markets, where demand for their products is higher. This helps keep their sales growth percentages

higher, which often helps their stock price in the U.S. markets. Keep in mind that events in other parts of the world can affect the stock prices of these companies. But over the long term, a company's stock price is primarily determined by factors in its home country.

One of the primary benefits of international investing is to help reduce risk in your portfolio. When stocks in the U.S. are declining, it is hoped that stocks in other parts of

the world will be either increasing or not declining as steeply. However, stocks of multinational companies are more likely to follow the trend of the U.S. stock market than that of foreign stock markets.

While multinational company stocks may be a good investment alternative for your portfolio, they probably should not be your only exposure to international investments. ■■■

International Investing

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Germany	.60
France	.62
United Kingdom	.65
Netherlands	.67
Europe	.71
Canada	.73

(Sources: T. Rowe Price Associates, Inc., Standard & Poor's, 2008)

While some of the correlations are relatively high, others are fairly low. Since these correlations relate only to major foreign markets, there is potentially less correlation with developing countries' stock markets. In general, the correlations with foreign markets are still low enough to provide diversification benefits.

Do returns in foreign markets offer greater potential than U.S. stock market returns? No one can predict the future performance of any stock market. However, reviewing past performance can help develop realistic expectations. International investments outperformed the U.S. stock market for five-year rolling periods from 1974 to 1982 and from 1985 to 1990. From 1990 to 2003, international markets lagged the U.S. stock market. Since 2004, international markets have outperformed the U.S. stock market (Sources: *The Case for Global Investing*, 2005; *Diversifying Overseas*, 2007).

These returns, however, compare overall international returns to U.S. returns. From 1987 through

2006, the U.S. stock market never had the highest returns out of 10 major foreign markets. In 2002, the U.S. stock market ranked 9th out of 10 markets, 10th in 2003 and 2004, 8th in 2005, and 10th in 2006 (Source: *Diversifying Overseas*, 2007).

Even though international markets have had higher returns than the U.S. for the past few years, international investments lagged behind U.S. investments for such a long time that there may be opportunities to find investments in other parts of the world that are more attractively priced than those in the U.S.

Does international investing offer other advantages? The U.S. stock market now represents only 45% of total market capitalization in the world, down from 66% in 1970 (Source: *Diversifying Overseas*, 2007). Limiting yourself to U.S. investments means eliminating over half of the world's investments from consideration. In a number of industries, the world's leading companies are not U.S.-based. Of the top 10 industry leaders in terms of market capitalization, the following were located outside the U.S.:

- 9 in metals and mining companies
- 8 in electronic equipment and instruments companies
- 7 in automobile companies
- 7 in household durables companies
- 7 in telecommunications companies

(Source: *Diversifying Overseas*, 2007)

Also, since different countries

are at different developmental stages or at different stages in the economic cycle, you may find opportunities to invest in trends in other parts of the world that you missed in the U.S.

What percentage of your portfolio should be invested in international investments? It is usually recommended that you allocate at least 10% of your portfolio to international investments, since less than that will typically have little effect on your portfolio's total return. It is common to see recommendations of a 20% to 30% allocation to international investments. Inflows to international mutual funds have increased 89.6% from 2004 to 2007, with investments in international mutual funds comprising 20% of all equity mutual funds in 2008 compared to 18% in 2006 (Source: *Bank Investment Consultant*, July 2008).

However, what percentage you allocate will depend on personal factors, such as your risk tolerance, time horizon for investing, and comfort level with foreign investments.

International investing may not be suitable for everyone. In addition to the risks associated with domestic investing, foreign investing has unique risks, such as currency fluctuations, political and social changes, and greater share price volatility. Diversification does not ensure against loss.

Please call if you'd like to discuss international investments and your portfolio. ■■■

The Basics

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tourists, consumers, and multinational companies buy and sell foreign currencies and goods. Governments typically only intervene to prevent massive fluctuations in exchange rates.

Demand for a particular currency is determined by many factors, including a country's inflation rate, interest rates, political and economic outlook, monetary policies, and speculation. The U.S. dollar does not move uniformly against all currencies — it can be rising against one currency while it is declining against another one.

In general, a rising dollar makes it less expensive for Americans to travel abroad, to import foreign goods, and to purchase foreign investments. However, U.S. companies may suffer since cheaper imported goods hurt sales of domestic products. When the dollar is declining, it becomes more expensive for Americans to travel abroad and to import foreign goods, but U.S. goods become more competitive in international markets.

When looking at international investments, consider these tips about currency fluctuations:

- Foreign bonds are subject to more currency risk than foreign equities.
- Currency fluctuations tend to be more moderate in parts of the world where political and economic factors are stable and the local currency is strong. Avoid areas where inflation rates are extremely high.
- Diversifying your investments by country and region can help reduce the overall effects of currency risk.

If you'd like to discuss currency fluctuations and their impact on your foreign investments in more detail, please call. ■■■

Watch Out for These Portfolio Mistakes

Investing is a gradual process — purchasing some investments and selling others as the years go by. After a period of years, this can result in a mixture of investments that don't fit your overall investment strategy. Thus, periodically review your portfolio, watching out for these mistakes:

- **You don't use an asset allocation strategy.** Many investors select individual investments over the years, not considering their portfolio's overall makeup. Add up all your investments and calculate what portion is invested in each investment category. Assess your current allocation and determine whether it fits your personal situation.
- **You have too many investments that aren't adding diversification to your portfolio.** Diversification helps reduce the volatility in your portfolio, since various investments will respond differently to economic events and market factors. Yet, it's common for investors to keep adding investments to their portfolio that are similar in nature. This does not add much in the way of diversification, while making the portfolio more difficult to monitor. Keep in mind that diversification does not ensure a profit or protect against loss in a declining market.
- **Your portfolio's return is lower than benchmark returns.** While everyone likes to think their portfolio is beating the market averages, many investors simply aren't sure. Review the return of each component of your portfolio, comparing it to a relevant benchmark. While you may not want to sell an investment that has underperformed for a year or two, at least closely monitor

any investments that significantly underperform their benchmarks. Next, calculate your portfolio's overall rate of return and compare it to a relevant benchmark. Also be sure to compare your actual return to the return you targeted when setting up your investment program.

- **You trade too frequently without adequate research.** With so many choices and so much information, it's tempting to trade often based simply on other people's recommendations. Yet, besides the tax and trading costs associated with trades, frequent traders often underperform those who trade less frequently. Instead, purchase investments you are willing to hold for the long term.
- **You don't consider income taxes when investing.** Ordinary income taxes on short-term capital gains and interest can go as high as 35%, while long-term capital gains and dividend income are taxed at rates not exceeding 10% (0% for taxpayers in the 10% or 15% tax bracket). Using strategies that defer income taxes for as long as possible can make a substantial difference in your portfolio's ultimate size. Some strategies to consider include utilizing tax-deferred investment vehicles, minimizing portfolio turnover, selling investments with losses to offset gains, and placing assets generating ordinary income or that you want to trade frequently in your tax-deferred accounts.

Please call if you'd like help reviewing your investment portfolio. ■■■

Business Data

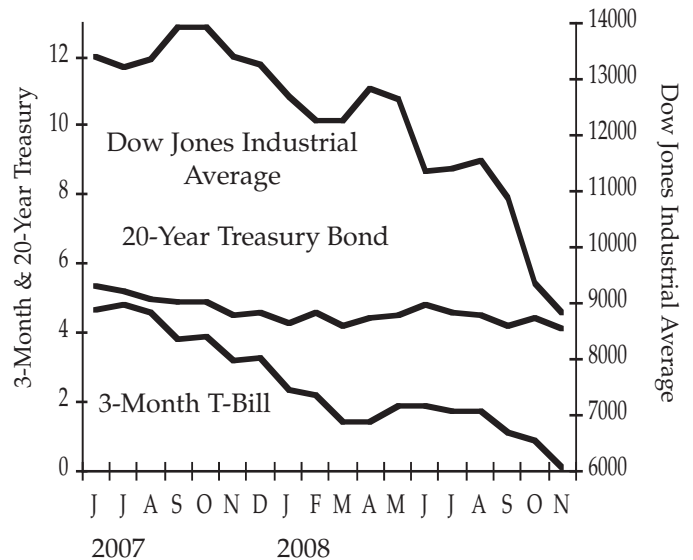


Indicator	Month-end				
	Sep-08	Oct-08	Nov-08	Dec-07	Nov-07
Prime rate	5.00	4.00	4.00	7.25	7.50
3-month T-bill yield	1.10	0.90	0.15	3.28	3.18
10-year T-note yield	3.54	3.74	3.38	4.12	4.04
20-year T-bond yield	4.20	4.46	4.14	4.58	4.49
Dow Jones Corp.	7.24	8.71	8.12	5.89	5.67
GDP (adj. annual rate)#	+0.90	+2.80	-0.50	+0.60	+4.90

Indicator	Month-end			% Change
	Sep-08	Oct-08	Nov-08	
Dow Jones Industrials	10850.66	9325.01	8829.04	-33.4%
Standard & Poor's 500	1164.74	968.75	896.24	-39.0%
Nasdaq Composite	2082.33	1720.95	1535.57	-42.1%
Gold	884.50	730.75	812.50	-2.5%
Unemployment rate@	6.10	6.10	6.50	30.0%
Consumer price index@	219.10	218.80	216.60	3.1%
Index of leading ind.@	100.30	100.40	99.60	-26.8%

— 1st, 2nd, 3rd quarter @ — Aug, Sep, Oct
Sources: Barron's, Wall Street Journal

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield June 2007 to November 2008



News and Announcements

Segregating Your Goals

Your willingness to assume risk with your investments is not necessarily a static concept. You may be less willing to take risk with investments designated for an essential financial goal, while you may be more willing to take risk for nonessential goals. However, those varying risk levels may be difficult to assess if all of your investments are commingled in one account.

For instance, assume you have three goals — to ensure you have enough funds to support yourself through retirement, to send your children to an Ivy-league college, and to purchase a vacation home. The most crucial goal is to ensure you don't run out of money during retirement. Thus, you want a high level of assurance that you'll reach that goal, devoting a substantial portion of your resources to the pursuit of it. Your investments for that goal are likely to be somewhat conservative, especially as you approach retirement age.

The next important goal is sending your children to an Ivy-league college. You have more limited resources to

devote to that goal, plus your children can still attend a less-expensive college or pay part of the cost themselves. For that goal, you may be willing to assume more risk with your investments to increase the likelihood of reaching that goal.

Your goal for a vacation home is clearly last, so you may have few resources to devote to it. For that goal, you may be willing to use very aggressive investments, since that may be the only way you can achieve that goal.

The point is that your willingness to assume risk is not static. It will vary depending on how important each goal is to you and how much you can designate to that goal. Commingling all of your investments for all goals in one account may make it difficult to analyze your investments in this manner. Thus, you might want to set up separate accounts for each goal, so you can more closely match the investments to your willingness to assume risk for that goal. Please call if you'd like to discuss this concept in more detail.

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