
Spero-Smith's Views Regarding the Japanese Crisis

March 15, 2011

We are deeply saddened by the human tragedy resulting from last Friday's severe earthquake and tsunami in Japan and the continuing risks of radiation seepage from nuclear reactors north of Tokyo. The actual and feared damages are contributing to selling pressure in equities and other risk-oriented investments which we are monitoring closely. The purpose of this memo is to reflect on certain things that are known and to restate our view of the importance of keeping a disciplined approach to investing.

What we know:

- In terms of the human impact, the number of lives lost or unaccounted for now exceeds 10,000, with over 3,000 persons confirmed dead and nearly 7,000 missing. Approximately 400,000 people are currently housed in make-shift shelters and evacuation centers.
- In terms of economic functioning and impact:
 - Several nuclear reactors are endangered as power disruptions have limited the plants' cooling capabilities. At least three explosions have occurred and radiation levels are elevated.
 - Vital supplies have been disrupted, resulting in fuel rationing and hindrance of evacuation attempts.
 - Many production facilities in Japan have been shut down including major auto and technology component plants. Early estimates are that Japan's economic output may be reduced by about 3% this year. Since Japan accounts for about 6% of the global economy that would translate directly to about .2% of global output being affected.
- In terms of global equity markets, Japan's market has been hurt the most, not surprisingly, having dropped about 16% over the past two days. Developed international markets, which include Japan, are down about 4% since Friday. The U.S. market, as measured by the S&P 500, is down about 2.0%
- About 70% of our clients' equity portfolios are invested in the U.S.; 18% in developed international markets (of which Japan makes up 6%); and 12% in emerging markets. Thus, equities in client accounts are down approximately 2.3% since the earthquake (through mid-day Tuesday, March 15). Our clients' fixed-income portfolios are essentially unchanged in value and are serving their purpose of diversification.

We are concerned about the human and economic toll resulting from the earthquake, tsunami and potential exposure to radioactivity. It is the unknown that is always the most disconcerting since it cannot be measured. Undoubtedly, the amount of damage would increase significantly if all safety measures at any of the reactors fail and high levels of radioactivity are dispersed widely. It appears as if the Japanese government, aided by global nuclear experts, is taking all available measures to limit the damage. We will not be surprised to see continuing volatility in the markets until there is greater clarity of the extent of the damage.

Japan's recovery from the recent recession has been meager, and the massive government spending now going toward the earthquake recovery will increase its debt burden. Despite this, the country is rich in terms of per capita income, and a World Bank report has documented that wealthier, developed countries recover faster and more fully from natural disasters than poorer, less developed countries.

There are several things worth remembering during this stressful period:

- Economies and capital markets have demonstrated their resilience repeatedly throughout history; they have recovered from numerous natural disasters, wars and other crises.
- The long-term trend of global growth fueled by the strength of emerging markets remains intact.
- The U.S. economy is making steady strides in recovering from the recession, as demonstrated by the drop in the unemployment rate and continuing expansion in manufacturing. The Federal Reserve produced a statement today indicating that the U.S. is on firming footing.
- Dislocations in certain sectors of the economy present opportunities in others. For example, while auto production in Japan may be temporarily reduced, we can expect that construction industries will experience greater demand as infrastructures and buildings are replaced or repaired.
- Dislocations in investments also present opportunities. Increased volatility can present buying opportunities as certain investments are dragged down excessively. As always, we are on the lookout for prudent opportunities where pricing appears to be out of sync with intrinsic value.

Lastly, and most importantly, we reiterate our commitment to maintaining a long-term perspective. As your financial advisor we have worked closely with you to develop a portfolio that takes into account your near-term goals and your longer-term goals. Near-term goals have been funded primarily with fixed-income investments that have low volatility and can be easily liquidated. Longer-term goals have been invested in growth-oriented investments, primarily equities, which are expected to produce greater long-term returns. While equities generally experience greater volatility over the short-term, they are important in portfolios to dampen the effects of inflation and to reach longer-term goals.

Human nature often produces an impulse to try to escape from uncertainties, but, unfortunately, that tendency does not typically result in attractive long-term results. As you've heard us discuss previously, the problem with trying to make overall market calls is that it requires being right twice: 1) knowing the right time to get out; and 2) knowing the right time to get back in. As we saw in the recent crash of 2008-2009, many ill-advised investors sold out of equities after experiencing substantial declines and only recently began returning to the market after it had nearly doubled from its lowest point. Senior Vice-President Matt Olver has a new article that you'll receive soon that provides a fuller discussion of the importance of having a longer-term view.

We encourage you to call us if you would like to discuss your portfolio, your concerns, and any changes you may have in your financial situation and your goals. We also encourage you to schedule a meeting if you'd prefer to speak with us in person, and especially if you haven't been into the office recently. We greatly appreciate the trust you place in us as your financial advisor.