

Sound Investments Inc.

Kenneth A. Gilpin CFP

Second Quarter 2012

DJIA 12880

S&P 500 1362

NASDAQ 2948

Summary

While we are not excessively defensive, we are conservative enough that we risk underperforming if the stars align: the euro zone pushes the right buttons, U.S. and global growth accelerates, and China avoids a hard landing

Although we hold almost 100% domestic equity today from 2003 to 2006 almost all of holdings were international and it returned triple the return of the S&P 500 over that time period. Today, Europe is going through what happened in North American in 2008. The chart on the back of this page shows Europe and Emerging Markets down more than 20% compared to the U.S. A number of analysts are saying this generational opportunity to buy Europe. To be sure they are plenty of problems, but there are companies there with no debt that have unique products and are making money. These stocks are trading at low and we look to highly rated mutual funds with experience management to seek out these opportunities. We are starting to tip toe back into foreign markets

The Investment Letter is mailed quarterly to our clients and friends. The intent of this publication is to share some of our more interesting views and research with our clients.

Quarterly Report

Despite sluggish global growth and debt crisis hurdles, stock markets around the world surged in June. However, after factoring in market declines for both April and May (driven by more pessimistic news out of Europe), U.S. stocks finished down almost 3% for the quarter while developed foreign market stocks were off 7% and emerging-market stocks lost more than 8%.

In spite of all the negative news the broad U.S. stock market is about 5% above where it was a year ago. Corporate earnings growth continues to outpace stock gains, making stocks cheaper. Lower interest rates and cheaper oil and commodities prices are simulative. Also we are further along the road to working through the financial crisis.

Two weeks ago, I attended the Morningstar conference in Chicago. It was a busy three days and enjoyed meeting the fund managers and have listed below some of the main themes discussed:

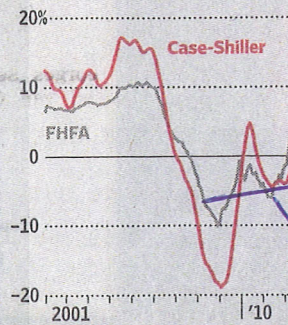
- ♦ Based on price / earnings ratios and dividend yields, stocks haven't been this cheap since the 1950's
- ♦ Given how low interest are now and that bonds have outperformed stocks for the last 10 years is it reasonable to think bonds will outperform in the next 10 years. Currently the interest rate on high grade bonds is lower than the dividend yield on stocks. Companies that can grow dividends will beat bonds and inflation over the next 10 years.
- ♦ Housing has reached a bottom. This was confirmed in a Wall Street Journal survey that found 41 out of 44 forecasters believed the housing market had reached a bottom only 3 didn't. (see chart on back of this page)
- ♦ Government Debt divided by Gross National Product of the United States is projected to be over 100% while there are many less developed countries where debt ratios are less than 50% and have higher growth rates. Also interest rates on the ten year treasury are 1.8% compared to 5 or 6% on government debt of foreign countries.

International and domestic stock markets had similar returns for the last decade: The S&P 500 gained an annualized 5.0% for the last 10 years ending June 30 2012. while the EAFE (Europe,

The End of the Bust

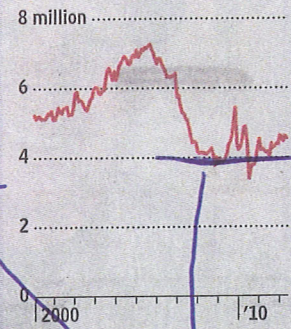
Home prices are inching up...

Case-Shiller 20-city and Federal Housing Finance Agency Purchase-Only indices
Change from the previous year



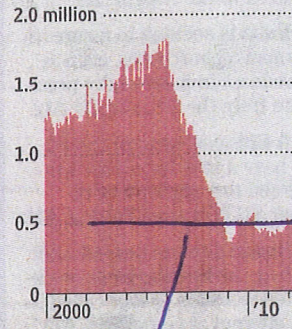
...and more homes are being sold.

Sales of existing single-family homes
Seasonally adjusted annual rate



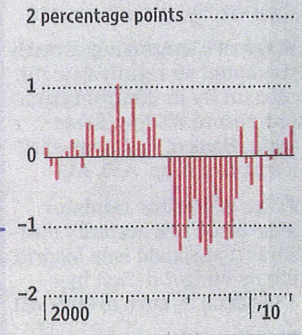
Housing starts are turning up...

Single-family home starts
Seasonally adjusted annual rate



...and home building is adding to economic growth.

Contribution of home building to GDP growth

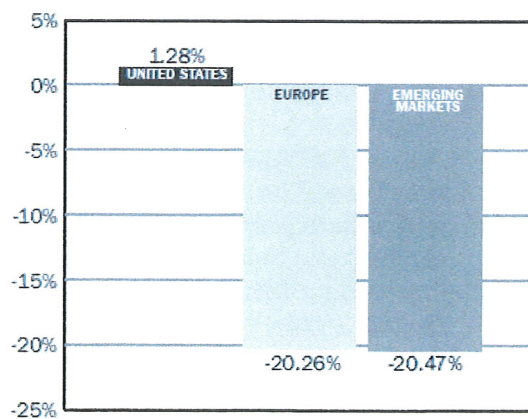


Sources: S&P/Case-Shiller; FHFA; U.S. Department of Commerce via Federal Reserve Bank of St. Louis

The Wall Street Journal

These charts show a "bottoming out" of house prices

Global Stock Market Performance (April 2011-May 2012)



Europe and emerging markets stock markets have hugely underperformed the U.S. stock market over the past year resulting in much improved relative value.

Australia, & Asia) index gained 5.0%. But within this 10-year period, there was a 5 year period (2002-2007) when international out performed and a 5 year period (2007 – 2012) when domestic markets led. Although we hold almost 100% domestic equity today from 2003 to 2006 almost all of holdings were international and it returned triple the return of the S&P 500 over that time period. Today, Europe is going through what happened in North American in 2008. The chart on the back of page 1 shows Europe and Emerging Markets down more than 20% compared to the United States. A number of analysts are saying this is a generational opportunity to buy Europe. To be sure, there are plenty of problems, but there are companies there with no debt that have unique products and are making money. These stocks are trading at low and we look to highly rated mutual funds with experience management to seek out these opportunities.

The June 30th closing of the S&P 500 at 1362 represents a price / earnings ratio of 13.2 times our operating earnings estimate of 103. We expect investors to value these earnings at price/earnings multiple of up 14.5 to 15 times earnings going forward. This suggests the S&P 500 index has the potential to reach the upper 1400 to lower 1500 within the next year.

Portfolio Positioning

While we are not excessively defensive, we are conservative enough that we risk underperforming if the stars align: the euro zone pushes the right buttons, U.S. and global growth accelerates, and China avoids a hard landing.

We have structured all balanced accounts so that risk is somewhat below average: This will provide some protection in down markets and importantly, will leave us with some dry powder that we can re-deploy if stocks get cheaper.

Our aim is to maintain some exposure to risky assets but skew toward equity markets that offer a better risk/reward relationship: What this means is we own more growth funds than value as they are performing better. In addition, we own high dividend paying stocks. Also we are starting to tip toe into foreign markets over the next few months. The declines in Emerging-markets stocks and European stocks created decent value so that returns even in a subpar growth world are pretty good. In short we are now being paid to take some risk. We continue to monitor the situation, daily and look for confirmation of our position.

I know we all live busy lives, but I reprinted an article entitled a Global Mid-Year Investment Review by Randy Myers which is worth reading.

Conclusion

We think the tug of war will be won by the bulls, but there could be plenty of angst before that outcome is achieved. Stocks have come down in price and over the longer term are attractive at these levels; however you have to be able to shoulder an elevated level of volatility. There are no easy solutions and we have to recognize that volatility is part of investing and we have to look at the long term. It is confusing for clients to see the markets roar for a month or more, only to be followed by a surge in scary headlines and sharp sell-offs. We try to provide a disciplined, unemotional approach which is absolutely necessary in order to resist the emotional pull of these ups and downs.

Americans' Assets Shift to Stocks From Homes

BY BEN CASSELMAN

The collapse of the housing market has left Americans more exposed than ever to the whims of the stock market.

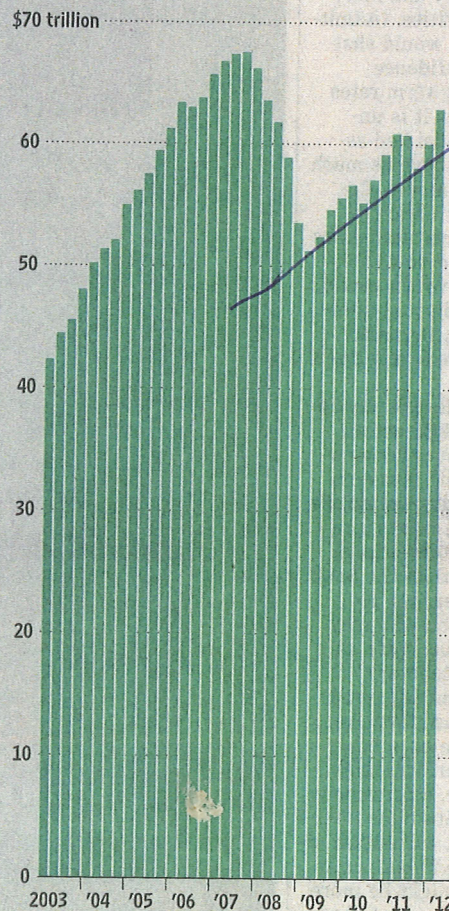
Household net worth rose by \$2.8 trillion, or 4.7%, in the first three months of the year, the Federal Reserve said Thursday, the fastest growth since before the recession. But the increase was driven primarily by a big jump in the value of financial assets, mostly corporate equities, which added \$2 trillion to household wealth. The recent swoon in the stock market likely wiped out most of those gains.

Before the recession, Americans were less vulnerable to the ups and downs of the markets because more of their wealth came from the value of their homes. In 2003, nearly 40% of Americans' net worth was in real estate and about a quarter in equities. After the housing bust, however, real estate now accounts for less than 30% of household net worth, a slightly smaller share than equities.

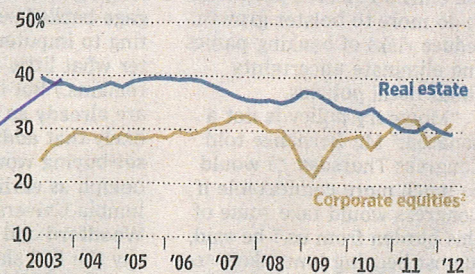
The housing market has shown signs of stability, however, which could help household balance sheets. The value of households' real-estate holdings rose by \$425 billion in the first quarter, and the amount of equity owners have in their homes rose to its highest level since 2008. Americans have pared their mortgage debt by \$885 billion in the past four years.

U.S. Household and Corporate Assets

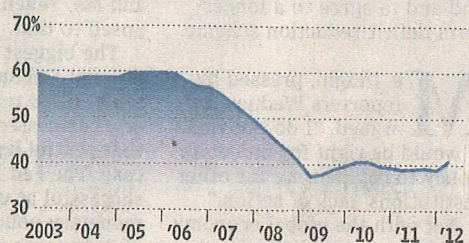
Americans' net worth¹



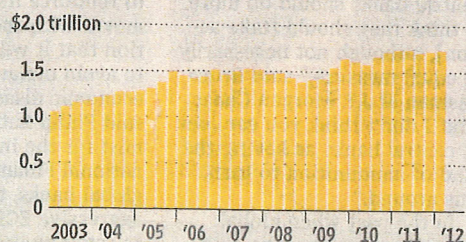
Household assets, share of net worth¹



Homeowners' equity in real estate as a share of its total value



Cash holdings of nonfinancial corporations³



Source: U.S. Federal Reserve; 1. Includes nonprofits; 2. Directly and indirectly held; 3. Includes other liquid assets

The Wall Street Journal

This shows a Recovery in people's net worth.