

- Quarter In Review - Pages 1-2
- Proxy Voting and the Vault - Pages 2-3
- Diversification is Not Dead - Pages 3-4
- Rockford Office Opening - Page 4
- China, Deficits, and Reasons to Believe - Pages 5-6

VOYAGER

CAPITAL MANAGEMENT, LLC



Your journey begins here...

SECOND QUARTER-2010

ECONOMY AND MARKET RETURNS

QUARTER *in* REVIEW



Economy: The recovery from the 2007-2009 Great Recession continued to be subdued and unimpressive during the second quarter. On top of that, the implosion of Greece's debt markets created a worldwide fear of a global debt failure that sent equity markets reeling. Although Germany, France, and other European countries committed funds to shore up Greece's finances, investor confidence remained weak.

The underlying U.S. economic data supported the theme of moderately improved economy. Housing and Unemployment data weighed on the recovery. The housing industry remained glutted with foreclosures and empty commercial spaces, but signs of stability surfaced. Prices rose slightly and new houses were under construction. Also, inventories (excess supply) dropped. During past recessions, Unemployment has been slow to fall. This recession is no different, with 9.5% Unemployment and meager job creations. Other data support a growing economy, including improved Durable Goods Orders (big-ticket items such as washing machines), retail sales (consumers out

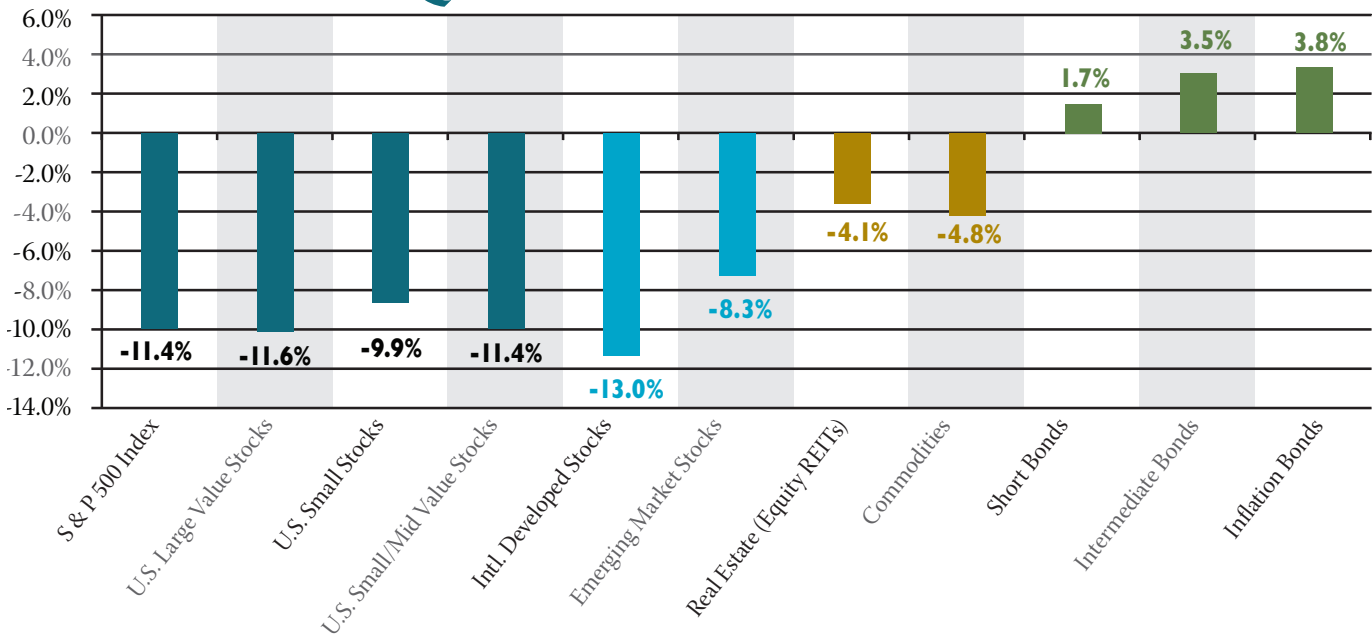
shopping again), and an uptick in manufacturing. The Federal Reserve remained committed to low lending rates until additional signs of the recovery materialize.

Market Returns: U.S. Stocks: You may be tempted when looking at Figure 1 to declare that the second quarter was really bad for U.S. Stocks. You would be right that it was bad, but not really bad. Over the past 337 quarters, the S&P 500 Index has had worse quarterly returns. In fact, the Index fell more than 11.4% in 25 quarters. Given the volatile nature of the index, a normal return may be anywhere from -15.3% to 34.7%, which is the return range of one standard deviation above or below the annual return. While the S&P 500 Index fell 11.4%, this drop is within the normal range of returns. Small stocks held up slightly better.

International Stocks: While International Developed and Emerging Markets dropped during the quarter, the cause was linked not to the underlying countries' economics, but to fear that Greece's debt market failures would cause the other countries' current economic recovery to stall. Significant countries with improved growth (as measured by Gross Domestic Product, or GDP) include Japan, France, Germany, Switzerland, Canada, China, Brazil, and Taiwan. Most of the major economic powerhouses continued to grow again. In fact, the Chinese Central Bank ordered banks to increase cash reserves — an effort to take money out of the economy, lower lending, and slow growth.

U.S. Fixed Income: With the European markets in jitters over the Greece issues, the fear spilled over to U.S. Fixed Income assets and created a demand for the safety of U.S. Government Bonds. Short- and Intermediate-term Bonds rose slightly.

SECOND QUARTER 2010 QUARTER MARKET RETURNS



With prices of consumer goods such as apparel and home furnishings dropping, the Consumer Price Index fell to a 44-year low during the second quarter. Under normal circumstances U.S. Treasury Inflation Protected Bonds would have had a negative return, since their prices generally rise with an increase in inflation; however, the demand for U.S. Treasury bonds overrode the lower inflation.

Real Estate (REITs): According to *REIT*[™] magazine, there are no specific factors driving the Equity REIT market down 4.1%. The price of REIT equities fell in tandem with the overall stock market.

The real estate market, while benefiting from low borrowing rates, is stuck in neutral as few buyers are rushing to scoop up inexpensive property.

Commodities: Gold, long considered a haven in rough waters, rose sharply. However, the impact on the index was muted since gold is just a small portion of the whole index. The energy complex and the industrial metals were flat, driven primarily by lack of demand from the developing nations. Ideal crop growth conditions put significant downward pressure on crop prices. For the quarter, the commodity index fell 4.8%. ⚙️

ENHANCING YOUR EXPERIENCE: *Proxy Voting and Vault*

Proxy Voting: At the beginning of the year, Voyager began Enhancing Your Experience, a new communication series, to share internal improvements. We recently mailed a third installment of Enhancing Your Experience announcing a new option in voting proxies.

We wrote; “Voyager can now offer to lower the level of unwanted paper in your mailbox. While we cannot stop the mailings for window cleaning and yard services, we can with your permission have the investment company mailings such as prospectuses

and proxy voting ballots cease coming to your address. A new service enhancement – Outsourced Proxy Voting – can make your life simpler.”

“To sign up for the new service, Voyager clients must sign the attached TD Ameritrade form: Authorization to Mail Proxies to Financial Advisor (Agent). If you have more than one family member’s name on an account, such as Tom and Sandy Jones, then both parties must sign. The form lists all of your account numbers. If you wish to retain the power to vote on one or more accounts, then cross the account number(s) off the form. Once signed, return the form to Voyager.”

divERSiFiCATION

is not dead

During our recent client meetings, we've heard a common theme of "I'm OK financially, but I'm frustrated with the slow recovery and negative markets." While Voyager can't possibly change the slow pace of the economic recovery, we can address the return concern.

The source of the frustration is that the U.S. stock market has had a return well below our expectations. Since 1926, the S&P 500 Index has had an annual return of over 9%, or 241,346% on a cumulative basis. To put this into perspective, if an investor had purchased one dollar of the S&P 500 Index* in January 1926, the investor would now have \$241,346. In contrast, the recent return has been paltry. Figure 2 illustrates the return over various periods. Using 2010 as the end point and counting backward, the three-, five-, and ten-year S&P 500 Index returns have been negative. To earn a fifteen-year return, an investor has to have bought and held the investment the whole time. If invested in 1995 and held to 2010, \$1.00 would have grown to \$2.48.

In reality, many investors not only own stock but also hold bonds because high-quality bonds stabilize a portfolio. A basic portfolio composed of 70% S&P 500 Index and 30% BarCap Aggregate Bond Index, a highly diversified bond index, will have less loss in a bear market as well as less gain in a long-term bull market. However, in the fifteen-year period as shown in Figure 3, the S&P 500 Index experienced a lower return than that of the stock-bond basic portfolio — 147.9% vs. 164.8% — because of a combination of effects of two bear stock markets: the Tech Bubble in 2000-2002 and the current Housing/Leverage Bubble. In comparing Figures 2 and 3, you can see that increasing diversification through adding bonds has improved past returns.

The Voyager portfolios add even more diversification. Whereas the basic portfolio had two asset classes (first, U.S. Large Stocks as represented by the S&P 500 Index and, second, Intermediate-term Bonds as represented by the BarCap Aggregate Bond Index), the Voyager 70/30 portfolio has 12 asset classes. The portfolio contains thousands of stocks and bonds issued by corporations and governments around the globe. The reason that diversification improves return and reduces risk is that the factors that drive investment prices vary from country to country and from industry to industry. Figure

If the dog ate your copy or the mailman lost it, please call Voyager's office for a replacement letter and form.

The Vault: In December 2009/January 2010, Voyager learned from the client survey that many of you wish for a private, secure location on our website to store information. As a direct result, we worked with Morningstar, Inc., the firm providing our portfolio management software, to create a Client Vault.

The Vault has four sections (tabs): *My Accounts*, *Reports*, *Documents* and *Notes*. *My Accounts* tab displays the current balances of your accounts managed by Voyager and is updated daily. While we don't advise your looking at your balance every day, you

could do so. *Reports* tab is a warehouse for current and past performance reports. We can upload other reports such as Capital Gain/ Loss Reports. *Documents* tab will store documents such as wills, trusts, powers of attorney. We encourage you to use this tab because it would help us manage your estate. On the final tab, *Notes*, we can upload any type of document, such as notes from a previous meeting. To begin storing information in the Vault, e-mail Mesine at mb@voyagercapitalmgt.com for login instructions. When you are ready to fill your vault with your valuable documents, please mail them to Mesine Bukalski since the program restricts you from adding the documents yourself.

4 shows the returns of a Diversified Index Portfolio. The results ignore costs in order to make them comparable to the example above.

While diversification does not work all the time, especially in the short-run, it is effective in the long run. The recent bear market was global in nature, dragging all equity markets down. Thus, the short-term (one- and three-year) performance of the diversified portfolio was less than that of the basic portfolio, but the longer-term results showed improved returns. Over the ten years shown above, the Diversified Portfolio beat the Basic Portfolio by 45.6%! A patient investor can reap the rewards of diversification over time.

While the absolute level of return over the short-run is nothing to write home about, your diversified portfolio has been working hard to add value. Over the longer haul, the diversified portfolio has been able to stabilize the impact of market movements and, depending on your investment horizon, eke out a small return. The power of diversification is not dead. 🌀

* Investors are unable to own an index, but may purchase an index fund. Investor return would be lower due to the fund expense. ** Basic Portfolio is composed of 70% S&P 500 Index and 30% BarCap Aggregate Bond Index rebalanced quarterly. ***Portfolio construction details are available by contacting Voyager at 262.348.9981.

Figure 2: Cumulative S&P 500 Index Returns

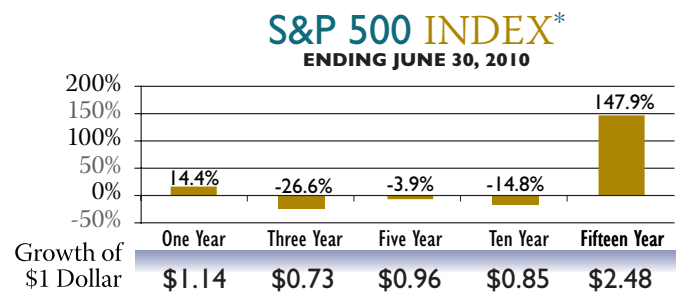


Figure 3: Cumulative Basic 70/30 Portfolio Returns

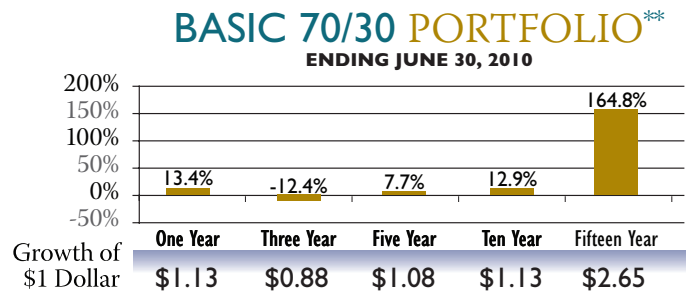
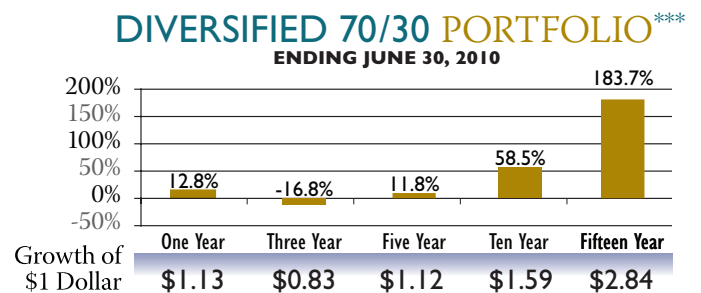


Figure 4: Cumulative Diversified Index 70/30 Portfolio Returns



VOYAGER NEWS: New Rockford Office!



Bob Anderson's and Jody Jungerberg's family and professional roots are in Rockford, IL. They tell stories of growing up and working in the town that became Illinois' second largest city. While Bob moved into Wisconsin in 2004 to be closer to Voyager's (previously called McSherry Anderson, LLC) office, Jody stayed in town and dedicated her career to providing financial advisory services to local residents. With Jody's addition to Voyager earlier this year and with many of you living in or near Rockford, Voyager can now more effectively service the Rock River Valley. If you're in the area of State Street and Alpine Road, we invite you to come see Jody, who will be working from the office full-time. Bob and Amy Barrett will be there from time to time too.



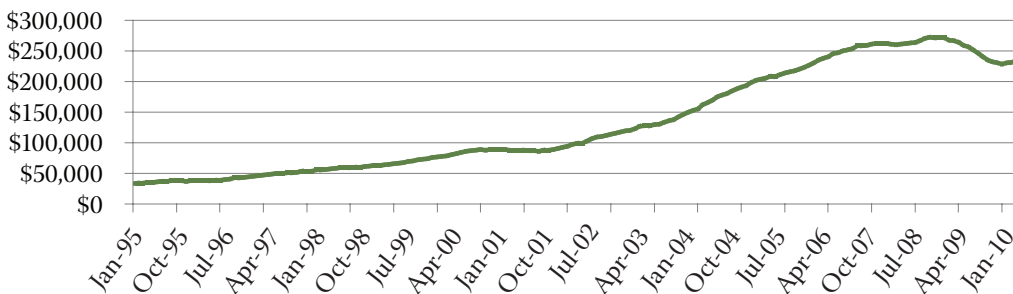
CHINA, DEFICITS, and Reasons to BELIEVE

According to the first available U.S. Census Bureau data (1985), the annual U.S. deficit with China was \$6,000,000. The U.S. imported slightly more goods than we exported. Nine years later, the annual trade deficit had grown to \$29,505,000 (shown below in Figure 5); and while that number is not large by today's standard, the increase from 1985's level was massive. A fast forward to April 2010 reveals that the annual deficit expanded to \$230,721,000.

Figure 5: The Growing U.S. Trade Deficit with China

ROLLING ANNUAL U.S. DEFICIT WITH CHINA

1/1/1995 - 4/1/2010



China is the U.S.'s largest trading partner behind Canada and Mexico. While the U.S. has a trade deficit with all three, only China has had strict control of the value of its currency since 1995, as illustrated in Figure 6. With the combination of growing deficits and a currency without the ability to trade freely, the potential risk of large-scale destabilization could develop. While these facts are not new, what is new is that the Chinese government and its people are making a concerted effort to right the economic imbalances. Just recently, the Chinese government announced that it will allow the Chinese yuan to float more than it has in the past. *This is a significant economic and political maneuver.* The likely benefit,

while not guaranteed, is to slow the growth of and possibly reverse the extent of the trade deficit.

How could the U.S. trade deficit decrease to a manageable level? First, the U.S. government, companies, and citizens could cut their budgets and increase tax revenue to reduce the government debt. Second, the government could create inflation by increasing money in the monetary system and effectively lower the dollar's value relative to foreign currencies. This reduces the deficit because the debt is paid back with cheaper dollars. Third, the U.S. could default on its debt. Finally, a country could grow its way out of a deficit. While the U.S. is working the first strategy of slowing our consumption of Chinese-made goods and raising taxes, China is focusing on the second. China is allowing their

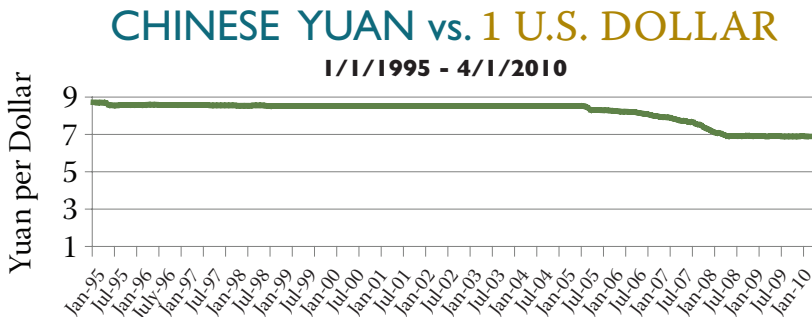
currency to rise vis-à-vis the dollar, in effect lowering the value of our currency while strengthening the value of the yuan. The effect is to increase the price of Chinese goods to U.S. consumers.

To illustrate the point, assume that in 1995 a McDonald's hamburger cost approximately \$1 if purchased in the U.S., while the average

U.S. engineer earned approximately \$71,900. A visiting Chinese engineer would have had to spend the equivalent of 8.46 yuan for the hamburger, while Chinese engineers earned 65,210 yuan (\$7,708) per year. Ignoring taxes and other practicalities, the U.S. engineer could have eaten 71,900 hamburgers while the Chinese engineer could consume just 7,708 burgers. Fast forwarding to today and assuming no inflation and salary changes (to show the impact of the currency shift), the U.S. engineer would still buy 71,900 hamburgers. The Chinese engineer would pay at the current exchange rate of 6.83 yuan per \$1 and therefore be able to buy 9,548 of McDonald's tasty fare. His yuan is stronger today, as is clear in

the fact that it takes fewer yuan now to buy a buck's worth of hamburgers than it did in 1995. Looking at it from this side of the ocean, if you were to change your dollars into yuan, you would receive fewer yuan today than you would have in 1995. Our dollar is weaker. China's allowing the currency to float more reasonably should bring the valuations more into line.

Figure 6: Chinese Yuan versus the U.S. Dollar



We have seen this kind of currency adjustment happen before. During this past decade, the deficit with Canada expanded significantly (mostly due to imported energy products). Early on, the exchange rate was such that an investor needed 1.6 Canadian dollars to get 1 U.S. dollar. In layman's terms, U.S. consumer could eat a whole Big Mac, but a Canadian could buy only .63 of a Big Mac. During this decade, the Canadian dollar strengthened to a point where now a Big Mac costs the same in the U.S. as in Canada. Recently, the U.S. deficit with Canada has contracted to a healthy level.

In addition to the Chinese currency's now floating, the other noteworthy event in China is the emergence of labor protests: the recent worker strikes at the Honda factory (Shanghai) and at the Toyota factory (Guangzhou) plus serious worker unrest at Foxconn Technology Group. The workers demanded and received significant — 20-25% —

pay raises. The Chinese youth are more educated and worldly than have been the past generations and are resisting long hours, low pay, and less-than-ideal work conditions. It is likely that workers' pay increases will force Chinese product prices higher. While U.S. consumers have become accustomed to inexpensive Chinese-made goods, in future we should expect to pay more. Going back to basic economics, with the cost of Chinese products increasing, our demand for their products could drop. The long-term benefit to us could be lower deficits.

The common thread between the freer floating yuan and the new Chinese worker pay raises is that both could contribute to a lower U.S. deficit with the China. This could be a tremendous benefit to the U.S. economy as we keep our dollars at home, creating a stronger U.S. balance sheet.

We have reasons to believe that over the long haul, China's righting of its currency valuation will lead to more manageable trade balances, similar to what happened with Canada's and likely to result in a sustained period of better stock market returns. As Professor Laopolis of Fairfield University in Connecticut found in his recent study, deficits do matter for stock market returns. Laopolis stated that investors expect large deficits to adversely impact stocks because of an increase in interest rates and lower national savings rates. Using data on federal budget deficits, monetary policy, and stock market returns from 1960 to 2004, he employed mathematical models to test the validity of investor expectations. Empirical evidence found no link between deficits and monetary policy but did show a link between deficits and stock returns. Small deficits are linked with higher stock market returns. ☀



875 Townline Road, Suite 100 Lake Geneva, WI 53147 • 16655 W. Bluemound Road, Suite 160 Brookfield, WI 53005 • 4615 E. State Street, Suite 130, Rockford IL 61108

Telephone: 800.998.1013 Fax: 262.348.9982 www.voyagercapitalmgt.com