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A recovery in stock prices during October bolstered portfolios just enough for investors to come out about even for 2011. That is hardly a grand achievement, although things could have been worse in a year that saw capital markets buffeted by a lot of bad news. The economy muddled through with minor improvements to employment and housing activity. While troubling headlines captured the spotlight, corporate profits quietly grew by double-digits during the year and remain on an encouraging uptrend. At current prices, we believe stocks offer attractive upside potential, and they are likely to be an important income generator for clients in the coming years, particularly when compared to yields available in the fixed income marketplace.

Securing income has traditionally been the role of bonds in a portfolio, but yields have been on a downward trend for more than 30 years. In 2011, interest rates defied most economic forecasts and continued to decline. Demand for perceived safe haven positions has driven yields to extraordinarily low levels for the best credit quality issuers. In our opinion, yields on U.S. Treasury securities appear unreasonably low, but it is anyone's guess as to how long they might remain that way. The Federal Reserve has signaled their intentions to keep rates low for the foreseeable future. That suggests low yields for U.S. government agency obligations, CDs that have FDIC protection and high credit quality corporate issues that typically offer a modest spread above the Treasury rates.

We typically recommend stocks for their growth potential. However, extreme pressure in the fixed income markets has pushed the yield on the bellwether 10-Year Treasury note below the dividend yield on the S&P 500 Index. In addition, companies frequently raise their dividend payments over time, whereas the coupon payments on bonds are generally fixed for the term of the security. In the coming years, it is likely investors will look to their stock holdings to provide a significant and rising portion of total portfolio income.

The enclosed illustration examines a \$1 million investment in stocks over the recent 20 years. The investor begins in 1992 with a purchase of \$1,000,000 in stocks that comprise the S&P 500 Index. Each year, the investor spends the dividends but continues to hold the stock shares. It was not a particularly easy time for this hypothetical investor, especially during the 2000-'02 Tech Wreck and 2008 Credit Crisis, but they were able to sit tight and make no purchases or sales during the 20-year period.

In spite of some difficult market conditions, the tenacious investor did fairly well with their stock investments during the 20-year period:

- Dividend payments grew at a compound annual rate of 3.9 percent, while the value of the shares grew at a compound annual rate of 5.7 percent.
- The effective yield on the stock holdings rose during the time those shares were held. The \$63,368 of dividends received in the final year represents 6.3 percent yield on the original \$1,000,000 cost of shares held in the portfolio.
- Even with the ups and downs along the way, the original \$1,000,000 tripled in value to \$3,015,177 after 20 years.

Economic conditions made some progress in 2011, although many of the issues that troubled the capital markets in recent months are yet to be resolved. Political uncertainties continue to dominate the investment landscape as we enter another contentious U.S. Presidential election season. Tax policies, entitlement reforms and managing heavy national debt loads are critical topics that are open for debate across most of the developed world. Whatever problems are faced by the U.S. seem to be magnified across the Atlantic, where Europe is struggling to preserve the Euro currency system that began ten years ago and is now shared by 17 member nations.

Corporate profits are the strong part of the equation right now, and rising profits allow companies to increase dividend payments to shareholders. Income received from stock holdings may bring some comfort and cushion during periods of price volatility in the capital markets. Dividends tend to be more stable than stock prices, and dividend payments generally provide rising income over time.

We welcome your call if you have any topics you would like to discuss. Our best wishes to you and your family for a healthy, happy and productive New Year.

Illustration - A Million Dollars Invested in Stocks for 20 Years

The investor begins in 1992 with a purchase of \$1,000,000 in stocks that comprise the S&P 500 Index. Each year, the investor spends the dividends but continues to hold the stock shares. No purchases or sales are made during the 20-year period.

	Year	Dividends Received Each Year	Value of Shares at Year End
1	1992	\$29,682	\$1,044,643
2	1993	\$30,161	\$1,118,344
3	1994	\$31,600	\$1,101,129
4	1995	\$33,062	\$1,476,732
5	1996	\$35,724	\$1,775,972
6	1997	\$37,138	\$2,326,668
7	1998	\$38,841	\$2,947,158
8	1999	\$39,512	\$3,522,621
9	2000	\$38,289	\$3,165,456
10	2001	\$37,738	\$2,752,595
11	2002	\$38,529	\$2,109,425
12	2003	\$41,694	\$2,665,899
13	2004	\$46,610	\$2,905,656
14	2005	\$53,298	\$2,992,855
15	2006	\$59,651	\$3,400,465
16	2007	\$65,286	\$3,520,487
17	2008	\$68,043	\$2,165,600
18	2009	\$53,729	\$2,673,524
19	2010	\$54,521	\$3,015,272
20	2011	\$63,368	\$3,015,177
	Total	\$896,476	

Source: Baseline.

Dividend payments grew at an annual rate of 3.9 percent over the 20-year period, while the value of the shares grew at an annual rate of 5.7 percent.

The effective “yield” on the stock holdings rose during the time those shares were held. The \$63,368 of dividends received in the final year represents 6.3 percent yield on the original \$1,000,000 cost of shares held in the portfolio.

Even with the ups and downs along the way, the original \$1,000,000 tripled in value to \$3,015,177 after 20 years.

Past performance is not indicative of future results. The information contained in this report is based on internal research derived from various sources and does not purport to be statements of all material facts relating to the items mentioned. The information, while not guaranteed as to accuracy or completeness, has been obtained from sources we believe to be reliable. Opinions expressed herein are subject to change without notice.