

Fall
2011

Spreng Capital Management Inc.



Spreng Capital Management is an investment advisory firm registered with the SEC. Founded in 1999 by James Spreng, Spreng Capital has grown to encompass the very best in service and support for our clients.

Our client base is quite diverse. With clients in 18 states, we offer structured, customized investment management for individuals, profit sharing plans, Foundations, endowments and businesses. We are fee only investment managers, receiving no commissions nor do we sell any financial products. We are paid only by the investment management fees of our clients. We advise our clients on financial planning and manage their assets, making recommendations based entirely upon our clients' needs and goals. Everyone on the Spreng Capital team has a vested interest in the success of our clients' portfolios. Our team has a unique blend of experience, youth and business credentials.

Our use of high quality stocks and mutual funds along with investment grade bonds, allows us the opportunity to deliver consistent long term returns. We focus on minimizing risk and volatility, striving ultimately to deliver the very best after-tax returns possible, within the constraints you have established.

There is nothing that signals success more than referrals from existing clients. Our success is a result of our clients' continued confidence in us and their willingness to recommend us to their family and friends.

Paradox of Thrift is an economic term that simply states that a government or household that has too much debt in relation to their assets or incomes should cut back consumption to pay down their excessive debts. It is a responsible and commendable action on the part of any entity or individual to undertake this task. Unfortunately, when too many governments or households choose this strategy at the same time, a very nasty event occurs. You create a recession! The payment of the debts instead of buying trinkets from China reduces consumption, which leads to lower economic activity, which leads to employee lay-offs, which leads to more recessionary pressures which ultimately will lead us to a recession. This is a classic description of a self-fulfilling prophecy!

The third quarter of 2011 was a particularly nasty one in the world equity markets. The

Index	3rd Qtr	YTD
DIJA	(12.09%)	(5.74%)
NASDAQ	(12.93%)	(8.95%)
S&P 500	(14.36%)	(10.05%)

S&P 500 was up 5% for the first six months of the year. Investors were "whacked" in the quarter just completed and gave away all the first six months of gains and then some. For the quarter just completed the Dow Jones Industrial Average was down (12.09%). The NASDAQ Index was down (12.93%) and the S&P 500 Index was down (14.36%). There were three primary reasons for the sell offs over the last three months. There is continued concern about European debt and the effect that an eventual default in Greece will have on European banks. There is considerable fear that the Chinese economic revolution is slowing down and that China's economy will slide into a recession. And finally, there is fear that the US economy is heading back into a recession, or perhaps we never really climbed out of the last one. We have said for many months now that this massive debt overhang on families and governments has been 30 years in the making. To assume that we can clean up 30 years of excessive debt and deleverage all of this debt in just 3 years is sheer folly. Households, corporations and governments are just beginning the long, tedious process of paying off debt. Corporations have already laid off millions of workers to become leaner and more efficient. Households are now doing the same in their own method and manner.

"Technology has no respect for tradition"

Peter C. Lee

Federal, state and local governments are now slowly and begrudgingly acknowledging the path that lies ahead for them and are starting to deal with lay-offs and down-sizing at all governmental levels. This will not be a pretty or pleasant process.

This process has been termed the “New Normal”. This description describes overall slow to possibly negative economic growth, high unemployment, reduction of public and private debt and artificially low interest rates. Anyone who lived and worked through the 1970s and 1980s became intimately aware with the term “stagflation”. This term adequately described the economy at the time, stagnant with high inflation. We survived the 70s and 80s and set up the next great economic boom of the late 80s and 1990s. Business cycles are normal. Their causes and time frames may vary, but since the formation of this country in the late 1700s, business cycles have occurred. Our present cycle is one of deleveraging of debt which is a very good thing. Again, that which took 30 years to develop cannot be remedied in 3 years.

A momentous event occurred on August 5, 2011. Standard & Poors downgraded United States sovereign debt from AAA to AA+. S&P felt, and let’s be realistic, with considerable justification, that the US voters and their elected representatives did not have the political will to make the necessary hard choices. It is no secret to anyone on this entire planet that we have massive budget deficits that absolutely require raising taxes, broadening the number of people who are paying taxes and cutting entitlements. Pew Research took a survey of Americans in June of this year. 60% of those surveyed said that it was more important to keep Social Security and Medicare benefits than it was to cut the deficit. A Bloomberg poll also taken in June indicated that 61% of Americans were not willing to pay more in taxes to cut the deficit. There is not only a Paradox of Thrift; there is a Paradox of the American Public! Some basic numbers:

- 51 million people are on Medicaid
- 47 million are on Medicare

- 52 million are on Social Security
- 8 million are on unemployment insurance
- 45 million are on food stamps
- 24 million get earned income credit (money back from their tax returns)
- 75 million baby boomers are just starting to retire
- National Health Care will add 30 million to government health care roles
- We have gone 17 years without a federal income tax hike, a record
- Income levels are flat for the last 6 years
- The number of unemployed has doubled in the last 4 years from 7 million on 6/30/2001 to 14.1 million on 6/30/2011
- According to the IRS, 52 million individuals who filed tax returns in 2008 paid absolutely no federal income tax
- Unemployment is at 9.1%
- Home prices have fallen an average of 32%
- The average life expectancy for a new born male in 1900 was 46.3 years. For a male born today it is 75.3 years. When FDR instituted Social Security retirement age at 65 the actual life expectancy was 61 years. Should today’s retirement age for Social Security now be 80 years of age?

It is fairly obvious from this litany of facts why S&P downgraded US debt in August. This does not even take into consideration the sad state of affairs that is the American political system today. The downgrade of US debt is not the end of the world. Five countries have lost their AAA rating in the past, only to have gotten their fiscal house in order and were awarded back the coveted AAA rating. We remain optimistic and predict that as Winston Churchill said, “America will always do the right thing, but only after exhausting every other option”. The irony of the AAA downgrade is that investors have flocked to US Treasury bonds even though they should be perceived as a more risky asset now that they have been downgraded. Perception and reality are often completely opposite of what they should be. In an ever uncertain world, investors still think

“The world hates change, but it is the only thing that has brought progress”

Charles Kettering

that owning US government debt is the safest asset to own.

We said back in May that we felt that Greece would eventually default on its' debt. Nothing has changed our outlook on this prediction. The Swiss drug giant, Roche, has stopped providing drugs to Greek hospitals since they have not been paid for drugs sent two years ago. Germany, France, the International Monetary Fund and the European Central Bank can all talk about not allowing Greece to default, but it will happen. It may be in 2012 or even later but to our way of thinking, it is a forgone conclusion. 20% of all Greek workers work for government. 14% of the US population works for government. Both of these numbers include teachers as part of the government work force. In a poll, 80% of Greek voters would refuse to make any more sacrifices for continued European Union or IMF financial support. The problem with a Greek default is the systemic risk that suddenly comes into play. Do bond holders then turn their attention to Portugal and Ireland? What about Spain and Italy? Italy's debt has been described as "Too big to fail, too big to bail"! Do European banks fail? Do the Euro currency and even the European Union disintegrate? This sounds eerily familiar to the failure of Lehman Brothers in 2008 and the accompanying financial meltdown. You can see why the world equity markets are on edge. Our thought has always been to take the money that everyone has been pouring into Greece and put it into the European banks and more stable governments that are also in trouble. If, and when, Greece defaults, other governments in the European Union will try to build a "financial fence" around other vulnerable governments and banks. If they are not successful, lenders will turn on the next weak, over leveraged country. There may even be "runs" on the banks in Europe as everyone fears for their savings or even the Euro currency and its ultimate value. Time will tell how this 21st Century Greek Tragedy plays out.

Unemployment continues to plague the American economy and the political aspirations of candidates of all persuasions. The current unemployment rate

is 9.1%. A disastrous August jobs report showed that no new jobs were created in the month of August. To put this into perspective, there have been only two months since the beginning of 1945 with zero job growth, February of 1945 and August 2011. That is 66 years of data! Unemployment is not political party specific. Over the last ten years, spanning both Republican and Democratic occupants of the White House, only 1.8 million jobs have been created while the available work force has grown by 15 million. It would appear that neither party knows how to put people to work in the "New Normal". David Rosenberg of Glushkin Scheff in Canada probably sums up the needs of the unemployed best when he says, "I would have a shovel in the hands of the unemployed from 8 in the morning until noon and from 1 to 5 they would be studying algebra, physics and geometry". Again, all part of the "New Normal".

Bottom line, what does all of this financial drama mean for you as an investor? None of this discussion on European debt, Chinese, or American recessions surprises us. Many of you with a shorter time line or with more conservative investment agendas will have observed that we have already raised some amount of cash in your account in anticipation of the current problems. All that we did was remove some of the risk from your portfolio. For instance, we might have sold an investment that was highly dependent upon the American consumer for the company's prosperity. These investments are termed as cyclical stocks and they do well when economies are booming and they do poorly when economies are slow to stagnant. We have also continued to move into dividend paying investments that will continue to pay a good, healthy and safe dividend no matter how the overall markets are currently behaving. We will take a nice 5% annual dividend on our investment any time in any economic environment. The fact that these healthy dividends tend to increase by 5-8% a year is just icing on the cake.

No matter what the economic environment may be, there are always good opportunities in which to invest. As we indicated, a healthy company paying

"The only title in our democracy superior to that of president is the title of citizen"

Louis D. Brandeis

a healthy dividend always sounds appealing in any economic environment. While this uncertainty in the markets can be more than a little unnerving, even disconcerting, we are monitoring and moving as we think necessary. The European drama may take some time to play out and the markets will respond accordingly. Our experience with the 1970s and 1980s prepared us for the reality of a “New Normal”. But just like “stagflation” that came and went, the “New Normal” or the “Paradox of Thrift” will come and go as well. Be patient and recognize what is occurring in the markets for what it is, a correction of 30 years of excesses. We will move through this storm in due time and come out on the other side with new innovations, products and prosperity.

For those of you unable to attend our Client Appreciation Evening on September 8th, we had a wonderful time. A record turn-out of over 180 clients and their guests were treated to a beautiful evening of music, fine food and friendship. We do hope that you can join us next year.

We are excited and optimistic about the future both for you and for our firm. We continue to receive large influxes of new funds thanks to you and your many referrals. No one said securing a viable financial future is easy; nor should it be. There are many challenges and headwinds that we will face every day. The markets contain risk and they offer

reward. Our task is to balance the two and deliver good returns with an acceptable amount of risk.

If you have questions about your holdings or about the general condition of the economy, please contact us at once. If we do not have a current email address for you would you please email us and allow us to add you to our regular list of clients with whom we correspond. Our email addresses are jspreng@sprengcapital.com, tbrown@sprengcapital.com and lkunzer@sprengcapital.com Please be assured that we are monitoring market situations at all times.

If there have been any changes in your financial circumstances of which we should be made aware, please notify us at once. If you would like a copy of our most recent Form ADV or our Privacy Policy, please call the office. If you have not visited our website, please do so at www.sprengcapital.com.

We appreciate the opportunity to work with you, your families and your businesses. We are very grateful for the many referrals that you have provided to us. We can think of no greater compliment than to have you recommend us to your family and friends. We will continue to do our very best to provide you with healthy, consistent returns with a minimum of risk. Always remember, ***“Investing is a marathon, not a sprint”***.

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