

Winter
2012

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.

Is there a single phrase that will, or should, strike more terror into someone's soul than the statement, "Hi, we're from 60 Minutes. Do you have a moment"? Former Speaker of the House of Representatives, Nancy Pelosi, was the latest fly caught in the web when 60 Minutes showed up at one of her mundane, tightly controlled and scripted press conferences and began to question the legal and moral implications of the members of Congress trading stocks in their own personal accounts. It seems that Congress, for years, has been using inside information that they have been able to glean from investigations through their positions in Congress. It appears that what is considered to be one of the worst offenses in public ownership of corporate stock, the acting on information that is not available to, or before it has been made public to all investors, is perfectly legal in Congress! I guess this really should not surprise a constituency that has observed our solons enrich themselves with a gold plated retirement and health care system, no mediocre

Social Security, Obamacare or Medicare for our trusted public servants. So why should they be saddled with mediocre returns in the markets when it is so easy, and legal, just to investigate a company

Index	4th Qtr	YTD
DJIA	11.95%	5.53%
NASDAQ	7.86%	(1.80%)
S&P 500	11.15%	(0.003%)

or sector of the economy and invest based upon the testimony that often is done behind closed doors. Oh, the look on Representative Pelosi's face was priceless. If ever there was a purer mixture of fear and loathing in one person's eyes, I don't know when it would have been. But as usual with Congress and Washington, nothing will come of this. It will be sent to a "Blue Ribbon Committee" for study and die a thousand slow deaths. It will be business as usual for our poor public servants.

It would be impossible to characterize the investment world of 2011 as "business as usual". It was indeed an incredible year of volatile markets and once in a generation activities. The Arab world exploded in their version of the "Arab Spring" as authoritarian regimes were overthrown and replaced with an uncertain future and means of governance. European debt issues weighed upon investors every day and probably most darkly, gave a bird's eye view of what the United States debt bomb eventually will look like for us! A rag-tag group calling themselves Occupy Wall Street took to the streets protesting... I don't know what they were really protesting! I think each participant had their own personal agenda and most were unemployed so it beat sitting in a coffee shop or at home in their parents' basement. I don't mean to sound so condescending but I saw a picture of a young woman holding a sign that told what her major in college had been, how much student debt she had incurred and that she was unemployed. It was very obvious that she had a degree in something that made her less than employable. Some parent, guidance counselor or college advisor should have sat down with her years ago and told her that it was great to go to college and have fun but you must study something that will make you valuable and employable when you graduate. My grandfather sent four children through college in the 1920s and 1930s. Three

of these children were daughters. He told each one of them that they could study anything that they wished to in college just as long as upon graduation they were able to teach school! This is very pragmatic when you realize that the only professional jobs available to women then were nursing or teaching. I think back on protesters of the 1960s bleeding for Civil Rights and decrying the involvement in Viet Nam or in 1932 when unemployed World War I veterans of the Bonus Army marched on Washington to try to collect their cash payment of their service recognition certificates that had been promised to them by, you guessed it, Congress. The Occupy Wall Street protests just fail to elicit much response from me. I think that there are many issues for which they could have very legitimate anger which would elicit call to action by the masses. But right now, they are too disjointed and parochial in their demands. They were more of a media event than an actual call to action in 2011. Time will tell if they can find one or two rallying points to have a legitimate impact on the 2012 elections.

At the end of each year we summarize all of the important situations which unfolded during the year just past. 2011 had its share of events starting in February with the resignation of President Mubarak in Egypt and the eruption of the Arab Spring. Authoritarian regimes fell in Tunisia, Yemen, Egypt, Libya and fighting and whole-sale slaughter continue in Syria as we enter 2012. An event of truly biblical proportion next arrived on Japan's shores in March with the tsunami and accompanying nuclear disaster. Video of a muddy wall of water engulfing whole towns and their inhabitants made the old geography text books come alive in awe. In May, Osama bin Laden met his well-deserved and much sought after demise. Unemployment hit 9% in May and Greece started its eventual slide into default on its sovereign debt. The US ended its debate on extending the debt ceiling on August 1st and Standard & Poors promptly downgraded US sovereign debt from its highly treasured AAA rating to AA+. Gold hit a high for the year of \$1891 an ounce on August 22 as the eventual solution for US debt began to dawn on the world's investors. We will simply print more money. Holders of Greek debt were told that they were going to take a "voluntary" 50% haircut on their holdings of Greek bonds. In November, Greece and Italy's Prime Ministers were forced to resign over their inability to stave off the inevitable austerity measures that were imposed upon their electorate. Also in November, Jefferson County Alabama declared bankruptcy becoming the largest municipal bankruptcy in US history at \$4.2 billion. They joined notables like Harrisburg Pennsylvania, no less than the state capital of Pennsylvania, and Central Falls Rhode Island in declaring bankruptcy in 2011. Not to be out done, Jon Corzine, a former US Senator and Governor of New Jersey, drove his company, MF Global, into the 8th largest corporate bankruptcy in US history by borrowing large amounts of money to invest in Greek debt. Mr. Corzine, with all of his Washington connections, was sure that no one would let Greece default on their debt so he borrowed large sums of money to buy even more of the low

cost Greek bonds. Since he was the former managing director of Goldman Sachs, I guess Mr. Corzine learned nothing from the debacle of 2008 when Merrill Lynch and Lehman Brothers went under due to too much leverage. It got so dicey inside MF Global at the end that magically \$1.2 billion dollars of clients' supposedly segregated monies got pulled into MF Global's own accounts. What a surprise that no one seems to know how this happened or where the money went! If the Occupy Wall Street group wants to focus on something, focus on Jon Corzine and follow his trail of connections in Washington. And finally, the Dear Leader #2 died in North Korea and his son, the Dear Leader #3 was swiftly appointed to take his place. If anything really unnerves me, it is the thought of a 28 year old newly appointed leader, in a country that only survives by imposing a "state of siege" mentality upon its people, and this 28 year old has access to nuclear weapons. I don't know about you, but I was pretty immature at 28. I worry that Kim Jung-Un, or the Dear Leader #3, may try something incredibly stupid to show his people how tough he is.

For the year the Dow Jones Industrial Average was up 5.53%. The NASDAQ Composite Index was down (1.80%) and the S&P 500 was statistically break-even for the year. Europe and the daily news emanating from Europe completely drove the markets. We've said it before and nothing has changed our mind, Greece is broke. They eventually will default or at the very least, derive a substantial give back from their bond holders. The 50% "voluntary" cut so far probably will not be enough. Spain is in trouble with their debt, Portugal needs at least a 35% reduction in their debt and Ireland, while making valiant attempts at reducing their debt, may eventually need to reduce their overall debt, too.

The real pending disaster is in Italy. If Italy cannot find a way to reduce their debt and must push their bond holders into taking a cut as well, the whole Euro Zone and the Euro currency is at risk of collapsing. Italy is the 3rd largest borrower of sovereign debt in the world behind only the United States and Japan. While Germany and France continually are being bombarded by the world's investors to bail out their less credit worthy Euro Zone members, Italy is "too big to fail, too big to bail". France and Germany and the remaining small economies and tax payers of the Euro Zone just cannot absorb the debt of Italy. It is too large! France is already being threatened by the ratings agencies that the AAA rating on their own bonds may be in jeopardy of being lowered like the US bonds were in August if they take on too much of a financial obligation for their neighboring countries. 60 million people died during World War II, or 2.5% of the world's population at that time, all in the name of German and Japanese desire for world domination. All the Germans had to do was to wait 70 years and they may own all of Europe without a single shot being fired. The Germans are too efficient and thrifty. The remainder of Europe can't compete with Germany's industrial efficiency and their prudent management of their money.

The average interest rate on a 30 year fixed mortgage was 18.45% in October of 1981. The average interest rate on a 30 year fixed rate mortgage as of 10/13/2011 was 4.12% The rate in 1981 would produce a monthly principal and interest payment on a 30 year fixed rate mortgage of \$1,544 for \$100,000 while the 2011 cost would be just \$484 per month on the same \$100,000.

Germany just has to be patient and gobble up the debt of the countries and economies that they want like a Pac Man game of the 1970s. While this last statement is a tongue in cheek comment on the problems in Europe, it may not be such a whimsical statement twenty years from now if Germany owns Greece, Italy, Spain and Portugal!

Given the severity of the European debt issue, I should probably take some time to try to explain exactly what has occurred and why it is so difficult to rectify. When the Euro Trade Zone and the Euro common currency were put into place in the 1990s by the Maastricht Treaty, it spelled out in detail how each member was to run their governments from a financial aspect. Unfortunately, there were no procedures put into place to force governments to adhere to these strict policies. It is exactly like our current situation in the United States. Unlike the individual fifty states which are barred from running a deficit budget, our government has the ability to print money and spend way more than they bring in every year. So if Germany, France and the Netherlands choose to adhere to the rules, like our states, there is no apparatus in place to force Italy and Greece to toe the line. So simply put, Greece actually lied to the European Union and cooked their own national books and spent even more than other countries realized. Then when the Great Recession of 2008 hit everyone at the same time, we truly found out who was exposed financially.

The second issue is that unlike in the US where the vast majority of our US Treasury bonds are owned by individuals, European debt is owned primarily by the large banks in Europe. The banks were lending money to the individual governments instead of to the individuals. Why not, it was easy to do and the real problem was that since these were sovereign debt instruments the banks were told that they were "risk free" loans and that no collateral needed to be put up against these loans. Now, as Greece mandates a 50% drop in the face value of their bonds and Portugal contemplates a 35% reduction and who knows what Spain and Italy may require, you can see that the large banks in Europe could be teetering on the verge of collapse just like our big banks in the US in 2008. To further complicate the issue there is the political quagmire of 17 different sovereign governments having to agree upon one course of action. As we have indicated many times, this is like asking the taxpayers of South Dakota to pay more in taxes to bail out Mexico because we are all a part of NAFTA. This would be a difficult political sell to South Dakota. Slovakia, a member of the Euro Zone, has been asked to assist in the bail-out of Greece. Even though, with their current financial disasters, the Greeks have a higher standard of living than the Slovaks. This is a tough sell to anyone.

Europe is a mess. Simply put, Germany does not want to lend any more money to Greece, Italy, and Spain or to anybody else until these countries get their spending under control. Germany's plan is to withhold financial assistance until the markets force austerity on these profligate spenders with higher interest

rates. 10 year bonds are currently costing Italy 7% a year while the US enjoys an interest rate of around 2.00% a year for 10 years. And yet, while there are serious problems in Euroland, I'll take these problems at the negotiating table over the problems of 1918 when 15 million people died and 20 million more were wounded in the Great War. Just as the world began to recover from World War I the Spanish flu hit in 1920 and killed 50 million more! 10 years later, the Great Depression ravaged the entire world, driving industrial production and employment to its knees. If you wonder why the Germans have fared so well through this entire Great Recession you only need to know that due to the hyperinflation of the 1930s that brought Hitler to power, one US dollar traded even up for \$4 **trillion** marks. Obviously, our Teutonic friends have a long financial memory or an excellent history program in their public schools.

The reality of the European debacle is this: pragmatic and sane people in Europe know that they cannot let the Euro Zone and the Euro currency collapse. There would be financial chaos and political upheaval. While we in the States and the rest of the investing world would like Germany to step up with their own version of TARP for countries like our version of TARP for the banks and insurance companies in 2008, the numbers are so different that they are staggering. Our TARP plan was around \$800 billion for our financial institutions and look how much political fallout we had at the time and still do with Occupy Wall Street. Projections are in the **trillions** of dollars for a TARP to work in Europe. And oh yes, you are asking other tax payers to bail out countries and people for whom they may have a strong dislike!

We have come to the conclusion that Europe is a mess... and it will be a mess three years from now, and possibly ten years from now. At the same time, we cannot caution our readers enough on this very valuable lesson. What you are watching unfold in Europe is coming to the shining shores of America. Our debt bomb is real and no less onerous than the European counterpart that are affecting our markets every day. We have a spending problem in this country. Yes, we absolutely must raise taxes. However, even if we **doubled** the federal income tax on all tax payers in the United States who are currently paying federal income taxes, we would still have a deficit of \$207 billion per year. We wouldn't even cover the current deficit let alone start to pay down the debt. So while a tax on millionaires makes for great political theatre and is long overdue, it is not enough! Spending must be cut. It is only a matter of time before lenders realize how precarious their payment will become from the US government and demand higher interest rates in return to compensate for the risk. We discussed this at great length in the office. If it were your own hard-earned personal money, how much interest would you demand from Greece or Italy right now to loan them money? I imagine it would be considerably higher than 7% a year, given the likelihood that you might get nothing or only 35% of your original investment back.

Against this dark backdrop, what are our thoughts for 2012? Surprisingly, we are cautiously optimistic. When all investors agree that a specific outcome is likely, rarely, if ever, does it happen. In January of 2011 experts recommended that investors sell all of their bonds, that there was no way bonds could continue to rise in value. Guess what asset class was the best performing in 2011, bonds! Now obviously this was driven by a flight to safety as investors feared that on any given day Europe would implode. But don't forget the historic downgrade of US Treasuries that occurred in August. Yet, bonds still were the best performing asset class in 2011. If the general consensus is all gloom and doom for 2012 due to Europe, our contrarian view gives us a little more optimistic outlook. As we indicated earlier, Europe is a mess and will remain so for many years. To obsess over the possibilities of a European melt down prevents us from recognizing and benefiting from the opportunities that present themselves to us every day.

Corporate profits have never been higher and don't forget that this is why we own equities, to share in the profits of the companies whose shares we own. Unemployment is slowly dropping and yes, it will remain stubbornly high as companies resist adding the additional cost of benefits for adding employees. We still have over 90% of the work force employed. Interest rates remain at historic lows. Last but not least, it is an election year and a President and Congress running for re-election will do just about anything to juice an economy so that they can be re-elected.

2011 is in the books. In a year of incredible volatility and turmoil, the world and the equity markets survived to face another year. Always remember that in a day and age of instant communication, we often over-react to the negative news that the media is required to report. The old adage for news that "if it bleeds, it leads" has never been more true. The world has always been a dangerous place. It is now just so immediate and

visual that the negative can over-whelm perspective. Patience and perspective will always be rewarded.

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 to 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"***.

*"Investing is a marathon,
not a sprint".*



Spreng Capital Management Inc.

P.O. Box 47, 201 South Sandusky Avenue
Bucyrus, Ohio 44820-0047
P: 419.563.0084 F: 419.563.0234

www.sprengcapital.com

Jim Spreng: jspreng@sprengcapital.com
Leslie Kunzer: lkunzer@sprengcapital.com
Tom Brown: tbrown@sprengcapital.com

Monday-Friday 8:30am-4:30pm
Closed 12:00pm-1:00pm