KLS PROFESSIONAL ADVISORS GROUP, LLC
Complete Financial Management

Portfolio Addition

The past two years have been a period characterized by intense involvement of the U.S. government and the Federal Reserve in the aftermath of a financial crisis that (1) pressured real estate values, real estate related securities, and financial institutions, and (2) resulted in a recession and post-recession malaise that has pressured consumers and, in turn, gross domestic product. While legislators and the executive branch debate fiscal policy and deficit reduction, the Fed continues to "print money" attempting to further reduce intermediate and longer-term interest rates. As a result of these actions the U.S. currency has effectively been devalued and continues to devalue against the currencies of other major and emerging economies.

Although interest rates are at historic lows as a result of this activity, we recognize the continuing need to include fixed-income investments in client portfolios as a risk mitigator, notwithstanding that corporate earnings are currently supporting reasonable equity valuations. In order to mitigate the risks associated with fixed-income investing, we have participated in high-quality credits and have invested in shorter-term bonds to guard against the possibility of principal erosion due to a rise in interest rates (although such is not expected in the near term).

Talk of competitive currency devaluations in response to U.S. policy has been elevated though the fundamental problem of government sponsored trade imbalances has not received the same attention.

As the risks and opportunities in fixed income and currency markets have continued to rapidly evolve, we have decided to add a tactical international bond fund to most client portfolios. The fund derives its performance from a combination of interest-based returns in foreign currency denominated bonds (principally sovereign credits), tactical reallocation decisions based on movements along the yield curve (lengthening or shortening maturities) and currency related gains and losses. The fund has historically invested (and is expected to continue investing) in currencies through derivative securities used for the purpose of (1) hedging or offsetting currency exposure in foreign currency denominated bonds, (2) increasing exposure to desired currencies that are anticipated to appreciate relative to the U.S. dollar, and (3) creating negative exposure to currencies that are expected to decline relative to the U.S. dollar. It is anticipated that during periods of lower interest rates, the contribution of currency gains and losses to performance will have greater significance.

We view this allocation to a tactical manager experienced in foreign currency denominated investing as an opportunity to enhance portfolio returns regardless of whether the U.S. dollar is weakening or gaining in strength at any given point in time since the manager has the ability to modify strategy to address the changing environment.

A 5% portfolio allocation to this tactical fund will increase our overall allocation to tactical managers for most clients to the 25 – 30% range. We anticipate executing this investment on behalf of our clients in the near future. Should you have any questions or wish to discuss this fund or other investments in greater detail please call your KLS managing director or director.

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