Summer
2013

Spreng Capital Management Inc.

Spreng Capital Management is an investment advisory firm registered with the State of Ohio. 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 19 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.

"In deciding how best to handle the Great Recession of 2008, Federal Reserve Chairman, Ben Bernanke, looked at the 1930s with its staggering deflation and the resulting Great Depression, and he looked at the 1970s with their era of inflation and stagnant growth (stagflation) and he chose the 1970s!"

We think this statement, while grammatically clumsy, best sums up the thoughts, deeds and actions of United States financial leaders since 2008. Current Federal Reserve Chairman, Ben Bernanke, did his undergraduate work at Harvard and has a doctorate degree in economics from MIT. He taught at Stanford, NYU and Princeton before beginning his work in the public policy realm under President George W. Bush. He has done extensive study and is widely accepted as a world renowned expert on the Great Depression of the 1930s. With this educational pedigree, scholarship and employment resume, it is very difficult, if not downright impossible, to argue or disagree with Dr. Bernanke's decisions concerning our economy. That being said, investors took issue with the Federal Reserve's recent news release that the Fed would ***"eventually"*** begin to taper back their buying of US Treasury bonds due to a strengthening US economy. Did investors fear the removal of "the punch bowl just as the party was beginning to become fun?" Or did they disagree with the esteemed economists on the Federal Reserve Board's impressions that the economy is now on a healthy footing? High gasoline and food prices in the heartland and the uncertainty of impending health care taxes and radical changes have this annoying habit of dimming the best of economic prognosis. Investors might just have decided that the first six months' returns in the markets for 2013 have been pretty good and it was time to take some profits off of the table. Once Dr. Bernanke issued his press statement that it was inevitable that interest rates eventually would rise, investors reacted like the old line from the movie Casablanca. Investors were "shocked, shocked I say" to think that the lowest interest rates in 400 years would not remain at their current levels forever.

Index	2nd Qtr	YTD
DJIA	2.27%	13.78%
NASDAQ	4.15%	12.71%
S&P 500	2.39%	12.70%

The Federal Reserve, for the last 17 years beginning with Fed Chairman Alan Greenspan and continuing with current Chairman, Ben Bernanke, have lowered interest rates every time the economy slowed down or sneezed. But since 2008 the Fed has embarked upon a new, never before tested, experiment labeled Quantitative Easing. Simply put, Quantitative Easing or QE as it is referred to in the financial press, is printing money. This is how it works. The US government spends approximately ***$1 trillion*** a year more than it brings in from tax revenue. To pay for this trillion dollar deficit the government goes to the Treasury Department and the Treasury issues US Treasury bonds in various denominations and lengths of maturity, anywhere from six months to thirty years. The Treasury then offers these bonds for sale to foreign governments, pension plans or private investors like us. These debt instruments of the US government are backed by the full faith and power of the United States of America. But suddenly with Quantitative Easing, instead of selling these bonds to investors who are giving the Treasury their hard earned dollars in return for these bonds, the Federal Reserve is buying $85 billion of these bonds per month. Where does the Federal Reserve get $1 trillion a year to buy these bonds? They just print the money!!!!! Again, it is backed by the full faith of the United States of America on both sides of the trade, both for the Treasury bonds to finance our deficit but also in printing an additional trillion dollars a year to buy our own debt. These additional dollars are not backed by anything but our word; no gold backing, no land or building collateral………. nothing except our promise that we'll make good on the value of the dollar and on our debt. This is why the price of gold soared to record highs last year. There was a very real and valid fear that by just arbitrarily printing money the government was going to destroy the value of the dollar and generate hyperinflation like the German currency in 1920s Germany! In 1921 seven German marks equaled one US dollar in purchasing power. Just two years later in 1923, it took 4.2 **BILLION** German marks to buy the same amount of goods and services as 1 US dollar! This is why Germans were literally burning money in their stoves and furnaces to heat their homes and businesses. Their money was worthless and could not even buy any fuel to burn to keep warm or cook. Hyperinflation in Germany led directly to Adolph Hitler's rise to power and the eventual devastation of World War II. While Bernanke and the Fed might choose inflation over deflation, investors instinctively know that, taken to extremes, neither of these economic maladies is a good thing.

It is easy to see why investors are dubious as the Fed eventually discontinues the purchasing of $85 billion a month in US Treasury bonds. At the same time that the Fed stops buying new debt instruments, they will begin the process of trying to sell the trillions of dollars of debt that they have already accumulated over the last four years! Liz Ann Sonders of Charles Schwab probably summed up this experiment the best. She said, and we are paraphrasing here, the Quantitative Easing experiment is like watching a gymnast at the Olympics. The gymnast has just performed a spectacular vault and she is spinning and somersaulting through the air performing things that have never been done before by a gymnast at any level of competition. The crowd is spellbound but the question remains, "Can she stick the landing"? This is exactly the dilemma that the Federal Reserve faces with the eventual ending or tapering of Quantitative Easing. Can the Fed "stick the landing" and remove themselves from an artificial marketplace that they have set up to help support a struggling US economy? It is a noble experiment and one that very few countries have the ability or financial standing in the world's eyes to attempt. Without question, it has been successful to this point. But the investors of the world wait in breathless anticipation to see if the Fed can indeed, "stick the landing".

The sell-off in late June could have been precipitated by any one of these issues or just the usual knee jerk reaction to any number of geo-political issues fomenting at the moment. The NSA leaker, Edward Snowden, obviously caused Washington to sweat a little more uncomfortably in the hot, humid weather of June. The very notion that China and Russia had the access and time to download everything on Mr. Snowden's laptop would make anyone who worked in the national security realm sweat for more reasons that just the hot Washington summers. That paragon of good cheer and warmth, the Internal Revenue Service, has embroiled the Administration in yet another second term scandal in which all presidents, regardless of political persuasion, inevitably find themselves. We have no idea who ordered the harassment of political opponents. We really don't think that all of the "Blue Ribbon Committees" appointed by Congress from now until 2016 will ever find out either. President Nixon released the hounds of the IRS onto his political opponents over 40 years ago. No one would have ever known unless someone within the Administration had not felt that this was wrong and leaked it to the press. The investigation of this IRS scandal will go nowhere either unless someone in the know steps forward like "Deep Throat" from the Watergate era. The only clue that we find interesting is the log book from the White House that indicated that Doug Shulman, the IRS Commissioner, had visited the White House 118 times in just two years. When asked under oath by a Congressional Committee on Oversight and Government Reform why he had visited the White House more times than any other IRS Commissioner in history Mr. Shulman could only remember that he had taken his children there once for the annual Easter Egg Hunt…………….

In a further sign that the apocalypse is upon us, one need look no farther than our esteemed solons currently residing in Washington. Within the Obamacare bill set to be passed in the wee late hours of 2009, Congress had tried, but failed, to sneak in language in the 2000 plus pages of the bill that exempted all members of Congress **and** their Congressional aides from being forced to use Obamacare. Congress and their aides would have continued to have their own insurance plan and not be forced into the exchanges that would be offered and forced upon the very constituents that they were elected to serve. The explanation was that there was fear that the level of care and the expense of Obamacare for their aides would be less generous than what is currently being provided. There was a fear of a "brain drain" from Washington, that all of the Congressional aides would balk at any cut in health services and increase in expense and just leave Washington for a real job. When questioned as to why it was necessary to offer a different plan to Congress and their aides from that which would be offered to their constituents, Senate Majority Leader Harry Reid said that they were just ensuring that the generous subsidies in the current plan can continue to flow to their aides once they are required to obtain coverage under Obamacare's insurance exchanges…………

Lest we focus too much on dirty politics and spying it is important to put geo-political events in their proper perspective and their ultimate effect on financial markets. Three months ago, the news cycle was obsessed with North Korea's less than emotionally stable dictator for life, Kim Jong-un. North Korea was rumored to be ready to launch a ballistic missile with a nuclear warhead at South Korea, Japan or the western United States. The stock markets were abuzz with the daily breathless reporting

"The median down payment made by first time home buyers in 2012 was just 4% of the purchase price."
National Association of Realtors

of missile locations and to where they were being moved. Then something happened. Two warped religious fanatics chose to set off two bombs in Boston with the express purpose of killing and maiming as many innocent “infidels” as they could; the Boston Marathon Bombings. Suddenly, and for the next month, every lead news story was about the investigation of, apprehension of and recovery of the bombings. North Korea became a distant memory in the flash of a bomb laced with shrapnel. It’s quite interesting since Kim Jong-un’s 15 minutes of fame has run its’ course in the US press, now he wants to open negotiations with the US and South Korea!

Markets are driven by the wants, needs and psychological desires of millions, if not billions, of investors around the world. We tend to think that rising interest rates indicating a strengthening and vibrant economy is a good thing and not a reason to panic and sell everything that you own that carries any degree of risk, no matter how small that risk might be. Obviously, there will be investors on the other side of this coin that think that rising rates will doom any economic recovery both in the immediate future and in their thinking, probably forever! We think that these Cassandras are wrong. Interest rates have risen in the past and the economy and equity markets have adjusted and thrived in a rising rate environment. This time will be no different.

We remember borrowing money in the early 1980s and paying 12% a year in interest payments. We were able to get the low rate of 12% because we were a good credit risk and thus qualified for a lower rate! We paid the interest, paid off the debt and still own the asset we bought at the time and it is still a good investment today. Higher interest rates are not the end of the world. They can moderate valuations of investments and add to the overall risk of an investment ending poorly but higher interest rates by themselves do not doom an economy or investments to failure.

A great deal of the volatility in the equity and bond markets that we experienced in late June was driven by traders of investments not investors. There is a huge difference between the two. Traders try to make money simply by buying and selling investments, usually in a short time period. With all due respect, they often do nothing more than shuffle paper around and charge a commission to do so. We are investors. We own shares of companies that share their profits with their owners, that have fair management that run the company like they are owners and are not out to milk every dime they can for their own benefit. We try to own shares of companies that make quality products at fair prices and treat their employees fairly. Warren Buffet, in one of his many folksy quotes, summarizes our philosophy well. Again paraphrasing him, we try to own companies that if we were stranded on a desert island for five years and could not find out a stock quote on our holdings for five years, we would still be comfortable owning this company. Stock and bond traders certainly do not take the same view of their holdings that we do. As investors we need to be prepared that stock and bond traders will increase the volatility of our holdings as interest rates start to rise.

We found a very interesting research project in our reading that relates to the previous paragraph. The following results are from the S&P 500 Index from 1950 to 2012 and pertain to how you might feel depending entirely upon how often you check your investments:

• If you checked daily, the Index would be positive 52.8% of the time.

• If you checked monthly, it would be positive 63.1% of the time.

• If you checked quarterly, it would be positive 68.7% of the time.

• If you checked once a year, it would be positive 77.8% of the time.

The moral of the story.............don’t obsess over your investments. Invest in quality companies and give them the time to weather the ups and downs of the business and political cycles. Just because we have the ability to have instantaneous information and act on that information does not always make it a good thing!

The first six months of 2013 have been very good for investors. The second quarter ended with the Dow Jones Industrial Average up 2.27%. The NASDAQ Index was up 4.15% and the Standard & Poors 500 Index was up 2.39%. For the year, the Dow is up 13.78%, the NASDAQ is up 12.71% and the S&P 500 is up 12.70%. Year to date these are impressive results and if the markets closed for the year at these levels we would be very satisfied. However, all investments are not created equal nor do they move equally in value up or down. In the second quarter, many of our stalwart investments, companies with innovative products, good management, growing sales and profits under-performed the overall indexes. Traders sold and thus drove down the value of many of our dividend paying holdings. The traders decided that they wanted more “growth-oriented” holdings in a rising interest rate environment. While for this particular three month period our holdings may have under-performed we still continue to favor these investments long term and view any particular sell-off as a buying opportunity.

“One month does not a trend make.” While historically the investments that we have chosen for you have held up under selling pressure very well, the month of June was not kind to our overall investments. Many investors around the world had followed our early investment lead and had moved into stable, dividend-paying, yes, even dull and boring stocks and mutual funds that we have held for years. However, as interest rates began to rise in June, investors sold off their dividend paying, “defensive” stocks more aggressively than they did their investments that might be construed as more aggressive ”growth stocks”. Investors decided that cash streams from bonds were safer than comparable cash streams from high dividend paying stocks. We obviously disagree with that premise but feel it is necessary to clarify why returns from our holdings suddenly did not compare favorably with the overall market. One month of returns is but a blip on the investment horizon. We are monitoring the situation daily and will make changes if we feel that they are necessary to preserve our hard fought gains of the last ten years.

Where do we go from here? As we indicated last quarter in our newsletter, interest rates will eventually rise. When and by how much they will rise, no one knows. That statement by itself is worthless. It is like saying that it will rain, eventually. Will it rain in 18 days or 18 months? Will it rain 3 inches or 3/10 of an inch? There is a huge difference in both instances. The single most important thing to remember about interest rates, the US government is the largest debtor in the world. Low interest rates favor borrowers. Who sets the low interest rates? The largest borrower in the world sets the rates. If interest rates were to "normalize" and rise 1% a year for the next five years, the interest expense for the federal debt would increase from $360 billion in 2012 to $1.51 trillion in 2018! This is just interest payments; forget any reduction of outstanding debt or issuance of new debt. So in keeping with that thought, we expect rates to rise but also to fall from time to time as we slowly grind our way back to more normal interest rates. It is quite conceivable, that many of us will not see significantly higher interest rates for the remainder of our lifetimes. That is not a good thing nor is it a bad thing. It will just change the dynamic of investing over time and in deriving the values of various investments be they stocks, bonds, farm land, houses, commercial buildings or commodities.

Our job of providing the best return for you with the least amount of risk continues to provide challenges each and every day. We continue to monitor events on a daily basis and how these events affect your investments. We continue to be optimistic, with a healthy degree of skepticism, that investors who continue to focus on their long term goals and needs will be rewarded. The world is an exciting and sometimes frightening place in the 21st century. We appreciate your confidence in allowing us to work with you, your families and your businesses to achieve your financial goals. It's been a good six months. We will continue to strive to meet your expectations every day in the era of the "New Normal" of economics, politics and investments.

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 that we receive every month. 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."

Please plan on joining us on Wednesday September 4th at 6:00 at the Crawford County Youth Building at the fairgrounds in Bucyrus for our Annual Client Appreciation Evening. We had over 200 clients and their friends join us last year for a relaxing evening of fine music, food and friendship. We do hope that you will be able to join us.

"Investing is a marathon, not a sprint."

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