

Market Commentary

August 9, 2011

We are reaching out as you no doubt, like other investors, want to know what happened in the markets yesterday. Before you despair, it is important to keep several things in mind. Nothing fundamentally changed in the economy before the announcement of the S&P downgrade over the weekend. We believe the anticipation leading up to the debt ceiling vote primed the markets and created much of the angst that set the markets up for this fearful reaction. Aside from the vote, there were actually many other influences that led up to this massive selloff in Monday's markets. Among the many factors include the climbing debt to GDP ratio, disappointing manufacturing data last week, the downward revised GDP data from the first and second quarter, and the eurozone crisis to name a few. Surprisingly, all of this comes on the heels of encouraging news with over 80% of the S&P companies having released positive earnings with most better than analyst expectations. Positive corporate earnings are what has been historically and what should be now the leading influence of what drives the markets up. However, the ultimate of the decision by Standard & Poor's to downgrade U.S. Treasury debt added one more layer of fear and uncertainty to an already volatile market and set the markets into freefall.

The announcement itself actually changes nothing. The U.S. has had a AAA rating for over seven decades. The other two rating agencies Moody's and Fitch affirmed the US' AAA status earlier in the week leaving the US with a split rating from the largest agencies. This downgrade of the US was actually not based on the ability to repay debt, but rather in consideration of the political turmoil the US has gone through and the potential turmoil we have yet to go through in the coming months and years. The Federal Reserve has said it will continue to accept U.S. Treasuries as collateral and that, as far as the Fed was concerned, Treasury debt still counts as AAA for the purposes of bank capital requirements and there will be no need for a raising of cash in the banking system.

Folks, it is not impossible for us to make changes. We need our government in Washington to stop campaigning and get to work to make some real decisions to turn this ship around. Current policies have not done much to convince the average investor that things are getting better or that they will get better in the foreseeable future. There were no purposeful changes in the agreement and we are basically at another standstill with increased debt and no real solution. The US is still the world's reserve currency which means actual default is virtually impossible. The US economy navigated its way out of an economy that was worse in the late 1970s and early 1980s. The Federal Reserve will continue to ease policy this year through monetary tools and said in June they would keep rates exceptionally low for an extended period.

Meanwhile, the European Central Bank has taken unprecedented steps to stop the contagion that many feared would spread to Italy and Spain. The ECB announced they will begin the buying process of Spanish and Italian bonds. This should certainly be helpful in averting a new round of crisis, at least for the time being.

There's no doubt that we have been through a difficult period over the last two weeks and may have some more downside. It is important to remember that the biggest fear is fear itself. And fear can scare us into a recession. Some market analysts do believe that fear has already been factored into the current valuations.

The S&P downgrade alters nothing about the economy or corporate profitability in the short, medium or even long-term. The markets are over-reacting to fears about the economy, the debt deal and the European financial issues. Short term markets are difficult to navigate and we are seeing extreme valuations here. Fear has become a major factor and fear has already been factored in with the markets now being relatively cheap. If you are not on a short horizon of less than a year, are a long term investor and your risk tolerance has not changed from when your portfolio was established, then you should have some exposure to equities. If you need reserves for anything short term such as a down payment on a home or are in a withdrawal mode, you should have that set aside in cash and short term investments. This has not changed from any of our recommendations in the past. As your advisor, we are recommending that you keep a balanced perspective on where we are. We certainly can't tell where things will go in the short run, but if we stay balanced, stay disciplined and stay diversified, we will come out on the other side of this volatility as we have done in the past.

Now more than ever it is important to recognize some positives while at the same time understanding the negatives and maintaining a balanced position in unbalanced markets. We are educated investors and we must understand that we are in a period of a brief market correction. We know the markets can and do move in cycles. This is not the time to be market timers but rather to be educated investors of the inevitable ups and downs, to save and invest, to stay diversified and rebalance, and to maintain a logical stance rather than letting fear drive our actions. We continuously encourage all of our clients to come in for reviews, which is part of the rebalancing process of your portfolio.

Prior to sending this, the futures were up and the markets opened up in positive territory. This is just an example of how fickle the markets can be when dealing with short term news and fears compounding the issues. As always, if you have any questions or feel that you need to come in for a review, please contact us and we will try to answer them as quickly as possible.