Lassus Wherley ...a view from the top
Building Better Futures
Issue 34: August 12, 2011

A Crisis of Confidence………..

The Summer Ride

It has been a pretty crazy couple of weeks but this week takes the prize. We have seen the largest swings we have ever experienced in back-to-back days. I definitely prefer the boring market of the past to the current roller coaster ride. The volatility has been driven by many things, including a lack of confidence in both our leaders in Washington and those in Europe. It has also been driven by concern about a possible double-dip recession both in the US and Europe.

We want to thank our clients who have been totally amazing this week in dealing with the basic insanity in the markets. I cannot tell you how much your confidence in us means to each member of the Lassus Wherley team.

Good News

Yesterday, we had some good news on the jobs front, and investors responded with a healthy rally. Markets rebounded with some good indications that the economy may be slightly stronger than investors had been thinking.

Initial jobless claims were reported at 395,000. This was the first time since early April that this release was under 400,000. The four-week average is now at 405,000, the lowest since mid-April and the sixth down week in a row. This is a very positive indication of improvement in the job market. May it continue!

On the earnings front, Cisco Systems reported better-than-expected results. The stock was upgraded and earnings estimates raised based on acceleration in order growth. This is good news from such an important technology company. It may also be a good indication that capital spending may help pick up the economy in the second half of the year as we had expected.

Another positive news report came from Kohl's Corporation, the mid-scale department store retailer. Kohl's reported same store sales growth of 1.9%, which was in line with plan. We will continue to look at chain store sales numbers for an indication of just how the consumer is faring.

As we mentioned last week, it is normal for the economy to go through periods of weakness when recovering from a recession as deep as the Great Recession of 2008 - 2009. It now appears that stocks had gotten ahead of the underlying economic growth. Prices needed to come down to reflect the reality of slowing economic growth.

The markets have made this adjustment in record time and with lots of volatility along the way. The S&P 500 was at 1,345 as of July 22nd, up about 7% for the year to date. We are now looking at a market that through August 10th is down almost 11% year to date. This dramatic drop in such a short time is dramatic and has understandably increased the stress level for many investors.

We know that markets tend to move in cycles between greed and fear. So yes, there is definitely fear in the markets right now. The most important question is to what extent are the reasons for the fear, such as the global economic slowdown and the European debt crisis, factored into stock prices. We believe that markets have done a pretty good job of factoring in these issues.

We recognize that the fear in the market is also accompanied by extreme volatility and this increases the fear. However, we also know that the extreme volatility of this week has been driven by a combination of fear and machines. The speed of computerized trading has certainly added to the crazy and extreme swings in the financial markets.

The Europe Financial Challenge

On July 21st, European leaders hammered out a new €109-billion ($157 billion) bailout for Greece which was intended to keep the debt crisis from spreading further across Europe. Unfortunately, this attempt did not work as planned. The package forced Greece's private sector bond holders to accept a bond exchange that gave them a "haircut." This means they would get less from their bond investment than originally promised. The package also included an expansion of the €440-billion bailout fund and a change in its operations to allow the ECB's fund to buy euro-zone bonds. Unfortunately, investors focused on the effective "haircut" which was seen as a partial default of Greek debt and started to demand higher and higher rates on the sovereign debt of Spain and Italy.

Last week in Issue 33, we mentioned that the ECB (European Central Bank) had announced that they were resuming bond purchases. The initial purchases were limited to the bonds of Portugal and Ireland. This literally went over like a lead balloon. Investors reacted by dumping European and US stocks. The ECB was seen as not facing up to the seriousness of the threat of contagion reaching Spain and Italy.

After a telephone conference call on Sunday August 7th, the ECB signaled that it would engage in large-scale purchases of the sovereign debt of Spain and Italy. This was a major escalation of their efforts to contain the European debt crisis. This news was overshadowed on Monday, August 8th, by the S&P downgrade of US debt, news which has had, in fact, much less impact than the debt crisis in Europe.

This week, shares of European banks have been sold indiscriminately as the European banks hold much of the debt of Spain, Italy and France. The markets are considering that the ECB's program to buy bonds of Spain and Italy is at best a temporary measure.

We are more concerned about the European debt situation than we are about the ability of the US to work through our issues. We also don't believe that all these issues have been priced into the financial markets in Europe. The best case would be that, in spite of all the issues, European economies manage to continue to do what they have been doing for going on two years, i.e., they muddle through without falling back into recession. GDP growth expectations are already quite modest. Economic growth is forecast to be about 2% in 2011 and 1.4% in 2012.

The risks we see in Europe are that given slowing economic growth and limited options for either monetary or fiscal stimulus, there is the chance that markets have not yet discounted the possibility that growth will slow to either stall speed or turn negative.

For this reason, we prefer to stay on the sidelines and not add more dollars to our current position in large-cap international funds.

Now What?

We have continued to rebalance this week and gradually bring accounts back to target with the exception of the large-cap international funds. Although the volatility in the financial markets makes trading even more interesting than usual, we believe we are buying at what will prove to be attractive levels, given the sizable declines in the past few weeks.

We approved increasing our hedge strategies allocation this morning in our Investment Committee meeting and added a new hedge strategies fund to our Recommended List. You will be hearing more about this very soon. Our focus is to continue to work toward reducing the volatility of portfolios and in this way, more effectively reduce the risk.

As always, please let us know if you will be needing cash for any unusual or unanticipated need as soon as possible. This makes it easier for us to plan for how and when we will raise the cash to cover that need.

So………….. turn off the news and enjoy your weekend.

Diahann

Investment Committee:

Diahann W. Lassus, CFP®, CPA/PFS, Chair
Anne L. Kehl, Investment Officer
Betty S. Thomas, Investment Analyst
Chadderdon W. O'Brien, CFP®, Associate Financial Planner
J. Charles Pawlik, CFP®, Associate Financial Planner

Compliance Disclosure

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Lassus Wherley or any other investment professional. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her situation, he/she is encouraged to consult with the professional advisor of his/her choosing. A copy of our current ADV 2A is available for review upon request and may also be found on our website at www.lassuswherley.com.