

SELF-INFLICTED WOUND

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Shoot first; think second. Thursday August 4 is another of those historical financial drawdown dates that will be firmly referenced for future years to come. The S&P 500 is down over 12% from its April 29 peak. In fact, since the passage by Congress of the debt ceiling increase, the financial markets responded terribly and embrace a recession outlook for the US. Investors are stating they disapprove of Congress' political process and end result; it's as though the US created a self-inflicted wound. Now, investors worry the fiscal drag effects on a still slow growing economy (domestic and global) will further slow the economy and hamper efforts to reduce high unemployment. There is the additional concern that neither Congress, the President, nor the Federal Reserve can offer stimulus to boost the economic situation. Businesses do not seem willing to hire and consumers do not want to purchase due to too much government involvement and uncertainty. Said differently, the government appears "out of bullets" to boost the economy. Yet, politicians know their paychecks and re-elections in 2012 are dependent upon quickly boosting the economy and reducing unemployment; but how? [We have solutions for this via flatter tax rates for individuals and businesses including repatriation of foreign earnings; but Congress is too political.] In essence, there is increasing intense pressure on policy makers.

Also Thursday (8/4), investors seem super worried that Europe sovereign and bank issues are spreading. This is probably an additional key driver to our domestic market drawdown. It appears to be an open-ended negative with no immediate solution. Intense pressure by market vigilantes will force policy makers to respond with stimulative policies to ease their struggling economic and financial situation.

Shoot first; think second. That suggests high emotional unrest by investors. Sell with fear so as to avoid yet another market drawdown in 3 years and the prospects for a third extremely bad stock market experience since 2000.

Has the "bill come due?" For sure, the ugly Congressional process to increase the federal debt ceiling opened a new door, ushering in a new era of US austerity. Did the bill come due? Hard to answer; time will tell. But, we are definitely into a new era of financial austerity (cut big government via spending reductions and changes to the tax codes for business and individuals).

What should investors be doing? What are we doing in client portfolios? Much depends on each investor's time horizon and stage of life. Many of our clients have many years before retirement to retain a long-term perspective; extreme emotional reaction is inappropriate to modify long term investment objectives and strategies. In fact, we witness time and time again, when clients continue to save and add money to invest during difficult times, their portfolio rebounds are spectacular. Other clients, approaching the doorstep of retirement, and in retirement, are psychologically exhausted and not willing to take further chances. These individuals would rather miss some future upside rebound than take chances that the market travels an extended time of drawdown of their financial assets.

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SELF-INFLICTED WOUND -CONTINUED-

We try to remind all clients that we invest portfolios in a diversified mix of historically strong performing no-load mutual funds. This creates within portfolios “buckets of time” assets (cash, bonds, and stocks). We advocate that these “buckets of time” assets do not force an investor during “rainy days” to sell first and think second.

HOWEVER, while we do not advocate market timing (the risk is great in timing when to reinvest), we recognize some investors are ready to throw in the proverbial towel (not endure another bad market experience); their time horizon is shorter and stage of life suggests more conservative pursuits. Thus, we are selectively reducing equity exposures and accumulating sale proceeds in low yielding money market funds (stable \$1 value). You know us well; we are not keen on this strategy; but are thinking more about your financial situation, stage of life, and investment stress attitude than adherence to this key investment philosophy of being a “time in the market” investor. We should however, at our next meeting, discuss if your risk tolerance changed and a different investment objective may be appropriate to pursue for reinvestment in the future.

What's next for the stock market? Bonds are pretty safe given how we invested during the last 2+ years (short and high quality). Stocks, (here are a few technical analyst comments):

“The Two-Year U.S. Treasury Note traded at a record low yield (high price) as investors looked for a foxhole. Focusing mainly on investor sentiment - it is now based on actions not words, meaning the emotional behavior of investors is what creates important bottoms (when they sell out of fear, market bottoms should be near). Today (8/4) was a day of clearly rising emotion; a day that fear really showed itself....and there is nothing more bullish than fear (conversely, nor more bearish than certainty). In the short term, the stock market will struggle; but the change in investor sentiment now occurring should be viewed as an indicator that is quite encouraging.”

In general, it is not easy to suggest the “bill is called.” It’s uncomfortable to be cautious and guarded when stocks already sell at low P/E ratios; with vast corporate cash hoards, and short interest rates at zero. Still, the political process on both sides of the Atlantic offer little to inspire confidence, leading one to think little will be done in the short-term. Some believe, even hope, that a “white knight” policy prescription could relieve the market of its current stress. It seems apparent to us, that pro-growth fiscal policies designed to bolster business confidence and capital formation are key next steps. These are key watching points for financial market upward opportunity. If market jitters have you stressing, please do not hesitate to call us. We welcome the opportunity to discuss your unique situation and provide insight and guidance.

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