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Serving Your Personal Investment Needs Since 2003

Sunday, August 07, 2011

This letter may be more information than is needed or desired, but there has been so much press commentary about the S&P Index downgrade of U.S. Treasury debt that a quick review is probably appropriate.

As most of you know, S&P downgraded U.S. debt from AAA to AA+.

How will the markets take this? Not well, but not as badly as some suggest. The Asian markets are open as I am writing this, as are the U.S. Futures markets. It appears that the Monday's opening markets will be down. At this time, the Dow futures markets are down about 200 points and the S&P futures are down about 19 points.

CNBC ran a special earlier this evening, providing input from a number of sources, all of which indicated that this event has been in the market for quite some time – at least the expectation of a downgrade was well anticipated. The general consensus is that there is likely to be no significant impact, short term, from this S&P downgrade – to the markets or to the business community.

That being said, then why is the market down 200 points in the Dow? The answer lies in Europe.

Today, the European Central Bank (ECB) announced that it would be buying Italian and Spanish government bonds in the secondary market. This is what is being called QEE-1 (Quantitative Easing Europe – 1). The current fund designed to support Greece and Portugal does not have sufficient money to support additional sovereign debt failures. Thus, alternative measures are necessary in order to manage a sovereign debt crisis that seems bent on getting out of hand.

Interestingly, this European Union issue is following a similar path to what happen in the U.S. in 2008 and 2009, when Lehman Brothers failed, and the Central Bank stepped in to provide liquidity, successfully preventing a banking system collapse. The primary difference to this time around is that the Europeans have the benefit of that experience. In addition, global central bankers are tuned in to what is likely in the future and are prepared to help deal with the fallout from actions taken by the EU and by the ECB.

If the markets are down on Monday, the reason lies in Europe.

<u>RECOMMENDATION:</u> We continue to believe that it is too early to sell out of the market - to go to cash and out of all equities. The market is very oversold and technically, should provide a pretty strong bounce to the upside. More important, the U.S. economy is showing a continuing growth momentum, which has not turned negative. It is worth waiting, to see if this growth momentum will continue. Our models are projecting that it will continue, at least for 3-6 months.

<u>NOTE:</u> It is important that each person make his/her own decision about being invested in stocks and mutual funds. Though we recommend that you be patient, if you are not comfortable with your stock market positions, you should instruct us to sell out of your equities. This is one of those times that sleep is important, and if you are not sleeping at night because of your stock market positions, you should sell and go to cash. Call us and it will be done.

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Sincerely,

Dick Brackett
High Desert Investment Advisors