

Weekly Commentary

August 8, 2011

Brief Summary of This Week's Extended Comments

- A last minute deal staves off a U.S. default.
- Standard & Poor's downgrades U.S. credit rating from its long-held 'AAA.'
- Dow Jones Industrial Average now in correction territory with a 10 percent decline from its April 29 high, however, declines in the Dow of 10 percent are normal and have happened, on average, about once per year between 1900 and 2010, according to American Funds.
- Contagion fears spread in Europe as Italy and Spain are drawn into the debt battle.
- Investors are nervous that the risk of another recession is rising; however, Warren Buffett said on August 6, "Financial markets create their own dynamics, but I don't think we're facing a double dip recession."
- Took the developed world decades to build a mountain of debt, will take more than a couple years of deleveraging to get out of it.
- We remain focused on providing you with the stability and return you need to meet your long-term planning needs.

The Markets

The good news about last week is... it's over.

We started the week with a highly partisan, last minute deal to stave off the U.S. defaulting on its debt obligations and we ended the week with the U.S. losing its long cherished 'AAA' credit rating from Standard & Poor's. In between, the U.S. stock market, as measured by the Standard & Poor's 500 index, tumbled 7.2 percent -- its largest one week decline since November 2008.

In light of these major events, we'd like to take a step back and review what happened last week and then do a deeper dive into how we got into this situation and what the possible end game may be.

Last Week

To knock the market down seven percent in one week, you need a series of catalysts and we had a few that came to a head last week including the following:

- Worries about a U.S. default that culminated in a bitter compromise.
- Continued and expanding sovereign debt problems in Europe that now include Italy and Spain -- the third and fourth largest euro-zone economies, coupled with ineffective policy responses from European leaders.
- Concerns about the heavy exposure of European banks to the sovereign debt of overleveraged countries.
- A series of weak economic reports that have investors concerned about a new global recession.

- Concern that the U.S. government, particularly the Federal Reserve, is about out of bullets when it comes to using monetary policy to jumpstart the economy.
- Growing public anger with a dysfunctional Washington that may prevent both parties from reaching consensus on decisions that could help the economy.

Sources: *The Wall Street Journal*, *Barron's*, *BusinessWeek*

When you combine the above with human emotions that are still smarting from the 2008-2009 financial crisis, you create the potential for a bad week like we just had. Now, let's take a deeper look at how we arrived at this point in our economy.

How Did We Get Into This Situation?

For decades to come, historians will debate the exact causes of the financial crisis that we experienced in 2008-2009 and the aftershocks we are feeling today. But, as Leonardo da Vinci said, "Simplicity is the ultimate sophistication." Taking da Vinci at his word, we think you can boil the financial crisis down to one word -- debt.

Individuals and governments have been piling debt upon debt for years and the burden has finally become unbearable.

One could argue that the debt deluge began in 1966. That year, the first Baby Boomers turned 20 and Bank of America started to license its BankAmericard credit card (now known as VISA). It was a match made in heaven as Boomers loved to spend money and plastic made it easy.

In the mid-1980s, central banks got into the act as they began to pursue monetary policy which sought to, "avoid recessions at all costs," according to *The Economist*. Their weapons of choice were low interest rates and a flood of cheap money.

Now, when you combine human's desire to spend money with banks who are willing to lend and top it off with central banks eager to keep the economy greased, you have a recipe for a massive mountain of debt. And, that's exactly what happened.

Here are a few of the mind-boggling debt figures that hang like a ball and chain around the U.S.:

- \$14,564,970,167,709 (Total public debt of the United States as of August 4, 2011)
- \$ 2,446,100,000,000 (Total U.S. consumer debt outstanding as of June, 2011)
- \$ 1,300,000,000,000 (2010 Federal Budget Deficit)

Sources: U.S. Treasury Department, Federal Reserve, *BusinessWeek*

Like politicians, Americans like to spend money. Between 1985 and 2007, American's disposable income grew 5.9 percent per year, but household indebtedness grew 8.7 percent per year, according to *The Wall Street Journal*. In other words, we were spending money much faster than we could earn it for more than 20 years. During that time, periods of cheap money and rising consumer debt levels helped fuel the 1982-2000 bull market, the 2002-2007 bull market, the tech stock boom of the late 1990s, and the housing boom of the early to mid-2000s.

Mirroring the U.S., a similar debt binge was happening with some foreign consumers and governments, too.

Why Come to a Head Now?

The world's accumulation of debt was unsustainable. The only question was, "When would it end?" Well, few people would have guessed that sub-prime mortgages in the U.S. would be the tipping point.

By the mid-2000s, cheap money, low credit standards, and the Wall Street money machine helped fuel an unprecedented housing boom in the U.S. This boom turned to bust in 2006/2007 when interest rates began to tick up and people started defaulting on their loans. Soon, a cascading domino effect ultimately pummeled the world banking system, greatly increased government debt levels, and led to steep stock market declines and a deep U.S. recession.

Dramatic levels of government stimulus helped fuel the stock market recovery in 2009 through mid-2011, but now that stimulus is wearing off and, today, we're left with the hangover.

What's Next?

As of last Friday, the Dow Jones Industrial Average had declined just over 10 percent since April 29, according to *The Wall Street Journal*. To put that in perspective, the *Journal* said, "Since 1962, the Standard & Poor's 500-stock index has seen 25 corrections of 10 percent during a bull market -- but in only nine of them did the losses grow to 20 percent or more, according to Birinyi Associates Inc. That means there is only slightly more than a 1-in-3 chance that the market is going to keep cratering."

Based on history, 10 percent corrections are normal and to be expected. Only time will tell if this one morphs into something more.

What happens to the economy, though, is another issue.

If what we experienced in 2007-2009 was a "normal" recession, we should have bounced back strongly by now. But, it was not a normal business-cycle type recession. Instead, some people are calling it a "balance sheet" recession, in which over-indebted consumers (and governments) try to reduce their debt and spending, according to economist Richard Koo. This reduction in demand has helped keep a lid on economic growth.

One key to reigniting the economy is to find a way to lift growth while concurrently reducing public and private debt. That's no easy task as it's like trying to be tall and short at the same time.

Closing Comments

Realistically, it took the developed world decades to get into this debt situation and it will take more than a couple years of deleveraging to get out of it. There is no magic bullet that will quickly turn the economy into a growth machine.

As your advisor, we strive to develop a plan that, over time, has the possibility of providing you with the stability and return you need to meet your long-term planning needs. While we can't

make any guarantees about performance or control what the market does, we have searched high and low for a plan and strategy that we believe is appropriate for you.

America is a great country. We've been through difficult times before and we always find a way to overcome the obstacles. This time should be no different.

If you have any questions about your individual situation, please contact our office. As always, we greatly appreciate the confidence and trust you place in us. We work hard every day to earn it.

Data as of 8/5/11	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-7.2%	-4.6%	6.9%	-2.3%	-1.2%	0.0%
DJ Global ex US (Foreign Stocks)	-9.4	-8.8	2.0	-3.8	-0.9	4.6
10-year Treasury Note (Yield Only)	2.6	N/A	2.9	4.0	4.9	5.2
Gold (per ounce)	1.9	17.6	39.1	23.4	20.6	20.0
DJ-UBS Commodity Index	-4.1	-3.8	14.1	-7.2	-2.5	4.3
DJ Equity All REIT TR Index	-12.1	-2.4	6.2	-1.0	-0.7	9.4

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

Weekly Focus – Think About It

“Most of the important things in the world have been accomplished by people who have kept on trying when there seemed to be no hope at all.” --*Dale Carnegie, American Writer, Lecturer*

Best regards,

Todd and Gillette

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

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* This newsletter was prepared by Peak Advisor Alliance.

* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* The DJ Global ex US is an unmanaged group of non-U.S. securities designed to reflect the performance of the global equity securities that have readily available prices.

* The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.

- * Gold represents the London afternoon gold price fix as reported by the London Bullion Market Association.
- * The DJ Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
- * The DJ Equity All REIT TR Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
- * Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
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