Financial Management Group
Building and Preserving Client Wealth Since 1989

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# Financial Management Group
# Economic & Investment Outlook
# Second Half 2011

## *Fear and Uncertainty Block Clear, Productive, Counter Intuitive Thinking, and TRUTH*

**Here's why FMG advises that fundamental economic truth and investment growth will prevail over current investor fear, noisy political rhetoric and media fear mongering…**

Moody's and Fitch reaffirmed their AAA ratings on US government long-term debt last week, while Standard & Poor's lowered theirs a notch to AA+. The US now has split ratings from the three largest rating agencies. The truth is that this has no serious fundamental consequences.

The bond market has for some time has been well aware that a downgrade was possible. In fact, when the US was put on credit watch by S&P in mid-July, purchases of US debt actually increased substantially, signifying that the markets were not concerned about the creditworthiness of the US government. The end result was that interest rates on Treasury debt fell to near all-time lows. Moreover, despite the S&P downgrade in US credit, ten-year interest rates are lower in the US than in Canada, Australia, United Kingdom, France, New Zealand, and Norway – all AAA-rated countries.

In our opinion, the S&P credit rating agency is attempting to rectify its past sins and instill some credibility to its rating process by this time leading the markets, not following. You may recall that S&P shamefully did not lower its AAA credit rating on debt securities of the low-income, low credit score, no-documentation, no-down-payment loans to homebuyers until after the credit markets crashed and became illiquid. This S&P downgrade of US long-term debt was not based upon an ability to pay obligations, but more so upon the irresponsible political maneuvering that has been transpiring and the possibility for more unacceptable political behavior ahead.

Meanwhile, as we expected the equity markets have been volatile and we anticipate that this volatility will continue as a result of investor fear and speculative market short-sellers trying to take advantage of the current rash of bad news offerings. The truth is that the S&P downgrade alters nothing about our positive outlook for the US economic recovery and corporate profitability. Our opinion is that the equity markets are currently under-valued and over-reacting to fears being generated about the overall global economy, the US economy and debt, and the European sovereign financial issues. Of course we have concerns, but we are continuously monitoring for opportunities to make beneficial tactical asset allocation adjustments in client portfolios to take advantage of uncertainty.

History shows that the US finds ways when necessary to alter course for correcting economic concerns. The truth is that the US economy was in much worse shape during the late 1970s and early 1980s. Elections of the early 1980s changed the country's course then, and a boom of unprecedented magnitude ensued. If this downgrade by S&P moves the US to get more serious about cutting spending, then the rating drop will have been a very positive development. If it influences the political environment by pushing the US to a more responsible set of legislative, fiscal and monetary policies, it will be even more positive.

**An FMG reminder: Bad news can be good news!**

Most people fear bad economic and investment news which makes them often behave poorly as investors. Fear causes investors to run away when they probably should be moving forward and immobilized when they should be taking informed positive actions. Our investment process is emotionally detached from the present moment noisy rumblings, whether bad or good. Reacting to today's news is typically too late to formulate investment decisions. Therefore, we instead make proactive present moment investment management decisions based upon our internally formulated economic forecasts.

In the economic and investment realms, bad news can be good news. This is because when bad news prevails, good things are most likely to happen due to corrective actions not otherwise taken. Consider the recent "Armageddon" bad news noise about the US debt ceiling and possible default. FMG maintained all along a stance that there would be a resolution to the debt-limit political debate, and that more responsible political, fiscal, and monetary actions will be forcibly taken for achieving positive results that would not otherwise occur.

As we previously forecasted and anticipated, the US along with most of the other global economies have been experiencing continuing recoveries at varying momentums despite all of the unsettling political and economic happenings. Accordingly, our client investments have achieved substantial gains because we took advance action to tactically rebalance the portfolios from a defensive positioning held throughout 2008 to participate in the equity growth occurring during the current bull market run, which began in March 2009 and has continued until the present interruption.

Throughout most of 2009, all of 2010 and for the first half of in 2011, we have decidedly not made any significant tactical asset allocation shifts from the strategic asset allocation targets established on an individualized basis for each client's widely diversified portfolio structure. Our investment process during this growth period has been to proactively rebalance the portfolio allocations by peeling away the gains from the asset classes which have risen above strategic target levels for reinvestment in those asset classes which have fallen under target levels.

This has resulted in sizable gains in client portfolio values even after the recent disconcerting market declines. Moreover, we expect the 2011 outcome will be another positive year for portfolios and intend to continue this same periodic rebalancing process for at least the remainder of this year while monitoring for making proactive, opportunistic tactical asset allocation shifts.

In the meantime, please feel free to inquire for more information about our Investment Policy and to share any concerns you might be experiencing.

Best regards,

The Financial Management Group Investment Policy Committee