



Boys, Arnold & Company
WEALTH MANAGEMENT

The View

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Investing and Wealth Management Insights

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Perspective Amid the Chaos

The pessimist sees difficulty in every opportunity; the optimist sees the opportunity in every difficulty. - Sir Winston Churchill

As we noted in our newsletter *The View* in June, the sentiment pendulum has swung hard from complacency (greed) toward fear. Investors have plenty to be concerned about. Indeed, if there was any doubt about whether we are in uncharted waters, whether it really is "different this time", these doubts were put to rest with the historic downgrade of U.S. debt by Standard and Poor's. A marked deceleration in U.S. economic growth, exploding debt crises across Europe, and the ugly U.S. debt ceiling debate caused equity investors to head for the exits, yesterday's rally notwithstanding.

That such issues would spark a sell off in equities is not that surprising, what is surprising is the speed and severity of the sell-off. Before yesterday's 5% rally, the S&P 500 was down an unbelievable 17% in just 12 days! It should be noted, however, that such unnerving moves are not uncommon for markets recovering from a severe financial crisis. In fact, from 1934-1937, as the U.S. was recovering from the Great Depression, the S&P 500 experienced six "corrections" of 20% or more on its way to *quadrupling* in value. In times like these, it is helpful to remember our nation has faced and conquered many difficult challenges before. In October 2008, during the depths of the financial crisis, Warren Buffett famously wrote an OP-ED in the NY Times entitled: *Buy American. I am*. In it, he reminded us that: "In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497."



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Trying to predict the outcome of all the macro factors weighing on the market is impossible. What is certain is that this is unsettling and it's human nature to be concerned. Often, the desire to do something, anything, can be overpowering. In times like these, it is important to revisit your game plan with your advisor. As Winston Churchill noted, some will see the glass half full and look for opportunities amid this chaos while others will see the glass half empty. There is no singular, universally correct answer or response, although decisions made out of emotion, especially fear, often prove to be bad ones.

Now more than ever, it is paramount to have an appropriately balanced, well-diversified portfolio. There are no asset classes immune from volatility or loss. For most of us, holding 100% cash with a zero (or negative) return is not an option. Here is a suggested game plan in this increasingly volatile environment:

1. Review your strategy, positioning, and short and long-term game plan with your advisor
2. Ask yourself: What does risk mean to me? What do I hope to achieve through investing?
3. Reexamine your expected returns for various asset classes in the context of your overall investment strategy. Ask your advisor for a realistic assessment of expected returns and volatility for various portfolio structures. Structural issues from too much debt and increased volatility mean the markets are increasingly susceptible to shock, which, in turn, likely means lower returns for assets over time than we have been used to
4. Amid lower expected returns, assess your options for lowering your expenses and cost of living accordingly. We can help you analyze your budget and run numbers/scenarios for you

The answers to these questions may necessitate an adjustment to your portfolio strategy, or, they may confirm that you are well positioned to weather the storm and that patience will ensure that you achieve your goals.

To be sure, recent data and events have had a significant impact on the economic and investment landscape. Below we offer a summary of our current thoughts:

- o Economic growth, already at stall speed, may suffer further from damage to confidence wrought by consternation over the U.S. debt ceiling, the downgrade of our debt, and worry over contagion from European debt issues. Consumers and companies have been pulling back, and this may accelerate. Will the resumption of the Japanese industrial complex in the second half of the year, coupled with much lower oil prices help fuel a reacceleration in the economy? This remains to be seen, but markets will likely overreact and overshoot to the downside as they digest the data.
- o The probability of recession has increased, yet from our vantage point it remains less likely than the scenario of continued sluggish growth for the U.S. and low single-digit growth for the global economy. Even if we skirt another outright recession, slower growth and concerns over longer-term structural issues will restrain asset values.



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- o Market volatility, somewhat of a self-fulfilling prophecy in that volatility can beget more volatility, is here to stay. The ongoing European debt issues, and the associated endless announcements, both good and bad, will create natural peaks and valleys in market volatility as investors assess the ripple effects of potential European defaults.
- o Expect the political drama we witnessed around the debt ceiling debate to return as the so-called "super committee" meets to negotiate further austerity. The committee is required to report back to congress by Nov. 23rd and Congress is required to vote on the plan by Dec. 23rd. It seems highly likely that the U.S. could face another downgrade if substantial cuts are not agreed to.

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What's Your View?

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