

May 26, 2010

It's Always Different This Time

Here we go again. With just two short years since the last global crisis, we are potentially confronted with yet another one. Though this time the problem was not generated in the US, with our ever interconnected world does it really matter where the problems originate?

Similarly to Bear Stearns two years ago, Greece was initially perceived as a small problem. It has since evolved and spread like a financial cancer into other parts of the financial system. All the while we are assured by the European authorities, plagiarizing the previous stance of their American counterparts, that the problems are containable. What is interesting about these two events is just how similar the unfolding of the crisis has been. From the abrupt surprise, to the escalating government responses, to the stock market's initial acceptance of Europe's issues, we are seeing quite a few parallels.

So if the script unfolds like the previous crisis, the next response will be a unified global plan that will shore up and create credit facilities for troubled debt burdened countries. This time the problems are not as easy to resolve as propping up the banking system within one country. Instead of individuals and banks, we have entire countries taking on more debt than they can support. If we had endless discussion within our country about supporting our own citizens and institutions, can you imagine the kind of debate that will ensue as cash strapped and fiscally stressed countries decide on whether to support other more fiscally irresponsible countries?

So Why Does The Market Suddenly Care?

This issue has been festering since last March, and in our last quarterly letter and special bulletin written in early May, we played out why the debt strapped PIIGS (Portugal, Ireland Italy, Greece, and Spain) are a principal cause of the market's volatility. We should not assume that the market immediately identifies all of the issues and implications involved when there is a major shift in confidence. We like to think of [the market as a reflector of every investor's collective perception of the future, not a mechanism to show today's conditions](#). So why is it that the market is going down when all of the economic data has been so positive? For the same reason that the market was blossoming a year ago with bleak news all around; [investors are looking forward and seeing a shift in direction](#).

Many economists say this decline is unjustified given the current economic environment. They might be right, but economists are usually very good at telling us what has happened but not particularly prescient when telling us what will happen.

Regardless of who turns out to be right, for now, investors are adjusting their perspective and horizon about the future. Currently, there is a litany of issues being digested by the market:

- Massive indebtedness by many countries that will lead to reduced spending and higher taxes by governments. This will invariably lead to lower benefits, higher taxes and lower growth around the globe.
- The potential collapse of the Euro as a viable unifying currency for the Euro zone. This would significantly increase the cost of trade around the world (like a tax) and shift the flow of money to different reserve currencies (witness the incredible run in the dollar and the Yen).
- China putting on the brakes to reign in rampant growth and a potential real estate bubble. If they succeed, the massive consumption engine that has driven world growth will slow.
- An impending tax increase in the US, accompanied by many individual states cutting back on benefits at a level unseen for several decades (see the first bullet above).

What Is An Investor To Do?

First and foremost, do not panic. No good decision is made in the fog of emotions. Remember, historically the market delivers 10% setbacks on average every twelve months, 20% declines every few years, and once in a while we experience more unruly bear markets. We mentioned in our last newsletter that we are probably in a time of very uncomfortable declines and amazing advances. When that is true (as it was in the late 1960's and 70's), having the right discipline and strategy is of utmost importance. [Not getting sucked into emotional responses is an important key to survival.](#)

A second survival strategy is to make sure you have a plan that includes potential setbacks as part of your analysis. At United Capital, our teams always make conservative assumptions about market volatility whenever we assemble a portfolio. We also have a wide array of investment alternatives from passive to extremely active that will help your adviser to craft a strategy that assures you comfort and peace of mind. A more pro-active investment strategy can be comforting in times of stress, yet frustrating when the markets go up because they seldom capture all of the market gains. We have some of the finest dynamic allocation minds in the country designing strategies for our clients. If you are more comfortable with a passive strategy with good stock selection, your overall risk can be meaningfully diminished by simply allocating a portion of your portfolio to a less market sensitive investment. If you wonder whether an adjustment is appropriate in your case, please make sure to speak with your wealth adviser.

Lastly, remember that if your plan is in place, and nothing has fundamentally shifted in your life, go on living every day with gusto because the stock market is a strange and unpredictable creature. For now, stocks are incredibly oversold and we would expect that the market is poised for an impressive rally. It is quite possible that it is temporary, and that we will see several more whipsaws back and forth as investors take time to reflect on how all of the changes in our forecasts need to be priced in.

While not cheap, stocks are nowhere near the valuations we had prior to the past two big declines, in 2000 and 2007. [That means there should be less downward adjustment needed](#), even if growth expectations are revised lower.

One thing is certain, market volatility has surged back and reminded us why we need discipline to make it through. Your team is here every day, overseeing your portfolios, rebalancing those accounts as appropriate for all those we have discretion, and getting more defensive for the past several weeks, wherever we have been given the mandate to do so.

Thank you for your continued trust and confidence and we will send new bulletins as market conditions warrant.

Regards,

Joe Duran, CFA and the United Capital Investment Committee

Disclosure

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