

**Headlines**

*Debt ceiling debacle*

*S&P Downgrades U.S. Debt*

*The Stock Market Swoon*

**Reality**

1. The debt ceiling deal and the downgrade have little long-term impact on the economy or stocks. The market pullback isn’t unusual after a 100 percent rally in stocks and bonds actually rallied after the downgrade.

2. The Dow Jones Industrial Average, 136 times since 1915, has had a downturn of 15 percent or more in 15 days. This is the case with the July–August pullback. Our research shows the Dow then rallied 8.3 percent in the next three months. It did not rally every time, but did approximately 6 out of 10 times. Our research shows the more significant the selloff, or waterfall, the bigger the following rally. When the market fell 25 percent or more in 15 days, the market rallied an average of 55 percent and the next 3 months rose in value about 75 percent of time. Based on the past, it is reasonable to anticipate a rally this time.

3. We do face some headwinds: Historically, after a financial crisis, the economy, housing and the stock market take years to settle down and then recover. We currently have high unemployment, excessive regulations and many negative leading economic indicators. Rising producer prices will likely put a squeeze on corporate profits. Future inflation is in the cards, once consumer demand picks up. Our white paper, **How to Offset Inflation**, points out that stocks do best when inflation surges. Surprisingly, intermediate term U.S. treasury bonds tend to keep up with inflation while new homes, gold and silver lag. We would note, however, that gold often moves before inflation does.
4. Good news: Low interest rates – Money markets are near 0 percent and the yield on the 10 year treasury is about 2.3 percent. This tends to push folks who want higher returns into other assets. The S&P 500 currently has a dividend yield of 2.2 percent. Our research shows 1,500 companies with a dividend yield above 2.3 percent. Sentiment has grown more negative but insiders have been increasing their purchases of their own companies. Our Risk Exposure Ratio estimates the probability of a significant decline at 25 percent. It had been as high at 80 percent the day before the market peaked on the second of May. In addition, Congress is out of session until September and earnings rose about 17 percent in the second quarter. Our indicators point to lower risks in stocks.

5. What we are doing: We are using the pullback to buy some attractive stocks. We had been at low equity levels in many balanced accounts. We have taken our usual “salami approach” to slicing into the equity market. We will continue to add more as our indicators lead us. We have seen Non-cyclical and Utility stocks hold up fairly well and we continue to like them. We also like some REITs. We continue to hold bonds but realize that time is starting to run out on longer term bonds. We do not intend to buy and hold longer term bonds, but sell them when our indicators point to higher levels of risk. Fortunately, our heavy weighting in bonds has helped us during the recent market storm.