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As investors, periods of price volatility are unsettling. Volatility, as measured by the VIX index, has remained at elevated levels since the beginning of August. With a current reading of approximately 32, the equity markets are still pricing in economic uncertainty; although materially below the levels seen in early August. Typically a reading under 30 (red line in chart below) coincides with a consensus view of more stable economic conditions.



Other useful indicators, such as the ECRI index discussed last month, have verified the market sentiment of lower growth and the potential for a recession. But, based on our analysis we do not see an eminent recession; *however it is quite possible we experience a text-book recession sometime in the next 6-12 months.* I am cautious to use the much taunted “double-dip” term as it is historically typical to experience a recession every 3 to 5 years; the last recession ended in 2009. Given the magnitude of the 2008-09’ financial driven recession, and the massive ongoing deleveraging process, I would assert that more frequent recessions are to be expected and a higher level of volatility, induced in large part by the ever-present media, leveraged indexed products and high-frequency trading, will be with us for some time.

We feel the current price of the S&P 500 is pricing in future GDP growth around 1.5% annually. This would echo the 2<sup>nd</sup> quarter 2011 GDP figures released by the U.S. Bureau of Economic Analysis/U.S. Department of Commerce. Stubbornly high unemployment, which we agree is a serious threat, and a clear lack of governmental clarity are additional points postulated by certain economic circles to advocate even weaker GDP going forward. While we can understand others point of view, at the end of the day, our own analysis suggests the current consensus for future GDP may be too low.

Highlighting just a few examples, recent record orders for airplanes, improving industrial equipment sales, tractor purchases, steel and raw materials demand, and rebounding sales of autos will all have a positive impact on GDP going forward. While consumer spending still accounts for the bulk of GDP calculations, the fore mentioned statistics suggest the fundamental demand story of the global economy is intact as ultimately all of those 'sales' are driven by current and expected consumer demand.

Contrary to what our emotions may advocate, periods of dislocation allow for tactical rebalancing and the ability to purchase high quality securities at very reasonable prices. Furthermore, given the return assumptions of more conservative assets (namely very low bond yields and a lack of inflation protection) our preference resides with equity investments; within the context of your personal risk tolerance and asset allocation. If history has taught us anything as investors, one lesson we should all remember is the best time to buy something is when no one else wants it. At this point in time, stocks remain unloved, and the patient investor should be rewarded once again for using history as their guide.

We have been accused of being perennial optimists and that we are missing what's going on in the 'real' world. This is precisely why we have spent so much time developing our analytic tool chest. While even the best investors may trip over their own ego, the tool set we use on a daily basis provides us with a non-emotional, data driven analysis of the current market. It is from this tool chest and our own research we conclude the market has it wrong, and stand by our conviction for higher equity prices.

Maynard Keynes famously once said "when the facts change, I change my mind. What do you do, sir?" To that we say, if the facts do change, our opinion will also.

Sincerely,

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President, Center Street Wealth Strategies

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