

Dear Valued Client,

Over the last 10 days, the U.S. stock market (S&P 500) has declined by more than 10%. While the nightly news may "sell panic", it is our job to look beyond short-term gyrations and focus on fundamentals and risk management. 10% declines in 10 days are rare occurrences. According to research from Thomas Lee of JP Morgan, there have only been three such instances in bull markets (which we are currently in) since World War II. In all three instances, markets bottomed shortly after the rout and were up an average of 18% over the following three months and 27% over the following six months.

To be clear, there are a myriad of concerns for investors to focus on right now, many of which we have written about in recent quarterly communications. These include the high levels of U.S. debt, the Euro zone crisis, and general concerns about a U.S. double dip recession. On Friday evening, Standard & Poor's added fuel to the fire by downgrading the U.S. debt rating to AA+ from AAA. Given the ability of the U.S. treasury to print currency, some investors have called in to question S&P's reasoning. Following the downgrade, Warren Buffet remarked, *"In Omaha, the U.S. is still triple A. In fact, if there were a quadruple-A rating, I'd give the U.S. that."* On the other side of the coin, some might view the downgrade as strong signal to our political leaders to rein in our long-term deficit/spending issues.

While there has been additional selling pressure following the debt downgrade, there is some historical precedent for a recovery in stock prices following a sovereign debt downgrade. When Canada lost its AAA rating in 1993, the country's stocks gained more than 15% in the following year, while the Tokyo stock market climbed more than 25% in the 12 months after Moody's downgraded Japan in November of 1998.

On the positive side, large U.S. corporations are flush with cash, and corporate earnings (a key driver of stock market returns) continue to come in strong. Additionally, while GDP growth has been slow, the Conference Board's leading economic indicator continues to trend higher. Historically, this indicator has been a good predictor of recessions *after trending lower* for 9-12 months, the opposite of what we see now. Additionally, the steep shape of the U.S. treasury yield curve (i.e. low short rates and higher long rates) signals a low likelihood of a U.S. recession. When the yield curve is inverted (the opposite of today) it has predicted 10 out of 10 recessions since 1956. While we cannot be 100% certain that there will not be a double dip recession, from our current vantage point, we feel there is a higher probability that the economy and markets will recover in coming months.

Our core focus during these periods is to remain objective, conscientious stewards of our clients' capital. Our diversified asset allocation portfolios have generally fared better than the stock market through this period as they have had exposure to several asset classes (some which have actually moved higher) besides stocks. Nevertheless, we understand that stock market weakness can be unnerving regardless of your investment time horizon or underlying strategy. Please do not hesitate to call us if want to discuss portfolio strategy in greater detail, or if your investment objectives or tolerance for risk has changed since we last spoke.

As always, it is a great privilege to be entrusted with the stewardship of your retirement and investment assets.

Sincerely,

Your Portfolio Management Team
American Money Management, LLC