

THE PLANNING GROUP

A Wealth Management Firm

Weekly Commentary Report October 3, 2011

Big Picture¹⁰

The S&P 500 just completed its worst quarter performance since 1928, and we are glad that we remained cautious throughout that time. The U.S. economic activity has slowed, and to quote the Fed, “there are significant downside risks to the economic outlook, including strains and global financial markets.”

The recent stimulus policy, known as “Operation Twist” (or E3) has done little to inspire the markets, and amounted to little more than pushing a string. The bottom line is, you can't force or entice people to buy when either they don't have any money, or they lack the confidence about the future - or both.

The Fed's activities up to this point have simply continued to mask the underlying weakness in demand, as unemployment and economic growth are still far from desired levels. The global financial system is getting worse, not better. Europe is still very much a wild card, with Greece on the brink of default (which has the potential to simultaneously take down additional countries).

Two widely respected sources, the Economic Cycle Research Institute and DoubleLine Capital have recently publicly declared that we're already in a new recession.

Yes, there are some positive things occurring - but given the downward slope of our economic and earnings indicators from around the world, one could argue there is more potential on the downside than upside. The economy can't expand until employment comes down. Current unemployment today (at the 9% level) is projected by the Fed to eventually fall to 8% by the end of 2012 - but most would argue this is too slow to be considered optimistic.

Stock markets ended a turbulent quarter with the Dow dropping 2.16% on Friday, ending the quarter down 12%. Financial stocks were among the hardest hit during the quarter, with bank stocks falling 25% or more. Morgan Stanley's stock fell 10% on Friday alone. Economic data out of China, for many the key driver for the world economy, is becoming increasingly futile, raising new doubts about future demand for commodities and other goods. The yield on most high-quality bonds is now below the current rate of inflation.

We will continue to be cautious and follow our money managers who are performing quite respectably, as preservation of principal is the mantra in markets such as we been experiencing for the last 12 years.

The Markets⁶

The word “volatile” has been so overused in the media, but it’s hard to find a better way to describe recent movements in the financial markets. On any given day, the markets can rise or fall based on the latest thinking about euro-zone sovereign debt problems, a possible U.S. or Chinese recession, weak banks, inflation, deflation, or poor job numbers.

In the just completed third quarter, uncertainty (there’s another overused word!) was in full bloom as the three major U.S. stock market indices posted double-digit declines, according to Barron’s.

Goldman Sachs said we may be moving from the 2007-2009 “Great Recession” to an upcoming “Great Stagnation.” As quoted by Bloomberg, Goldman Sachs said a “Great Stagnation” would be characterized by “‘high and sticky’ unemployment.” But, not everyone agrees with that assessment. Warren Buffett told CNBC last week, “It’s very, very unlikely we’ll go back into a recession.”

So, who are you going to believe? The market’s jumpiness may reflect the fact that smart people have completely different views of the economy.

Data as of 9/30/11	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-0.4%	-10.0%	-1.3%	-1.0%	-3.2%	0.9%
DJ Global ex US (Foreign Stocks)	2.0%	-18.7%	-12.8%	-1.1%	-3.8%	5.0%
10-year Treasury Note (Yield Only)	1.9%	N/A	2.5%	3.8%	4.6%	4.5%
Gold (per ounce)	-4.1%	14.9%	23.9%	22.4%	22.0%	18.7%
DJ-UBS Commodity Index	-2.0%	-13.7%	-0.1%	-5.8%	-2.5%	4.0%
DJ Equity All REIT TR Index	-1.5%	-6.6%	0.4%	-2.1%	-2.4%	9.1%

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron’s, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

WHAT TO WATCH IN THE FOURTH QUARTER

Here are a few things that made the headlines in the third quarter and may affect the markets over the final three months of the year:

- The S&P 500 index dropped 14.3% in the third quarter and is now down 10.0% for the year.

What to Watch: Third quarter corporate earnings will start rolling in soon and investors will scour them for any sign of weakness. For the past few quarters, strong earnings helped the market recover from the Great Recession. While some earnings weakness may already be priced in the market, we have to wait for the actual earnings to see how the market reacts.

- Commodities and precious metals experienced significant price movements during the quarter. Gold prices finished the quarter up 8%, while silver dropped 14%. Oil prices declined 17% for the quarter, while copper dropped a stunning 26%. On the agricultural side, corn prices finished the quarter down 25% from their June 10 all-time high, according to *The Wall Street Journal*.

What to Watch: Recent declines in oil and copper prices are particularly noteworthy because they may presage a slowing worldwide economy. If the declines continue, it may not bode well for stock prices.

- The housing market is still weak and that puts a significant drag on economic growth. According to the most recent S&P/Case-Shiller Home Price Indices, housing prices around the country are back to where they were in the summer of 2003.

What to Watch: Mortgage rates are at a record low yet the housing market is still in the doldrums, according to Bloomberg. Any sign that housing is turning the corner could bode well for the economy and the markets.

- Interest rates on U.S. government securities dropped significantly in the third quarter as the flight to safety continued. The yield on the 10-year Treasury note recently hit a paltry 1.67% -- the lowest yield since the 1940s. While low rates are good for businesses and our indebted government, it's bad for savers who rely on interest income to support their living expenses.

What to Watch: If interest rates keep dropping in the fourth quarter, it may suggest investors are still in a fearful state. Ironically, it could be a good thing to see interest rates rise -- as long as it's due to economic growth and not due to money printing by the Federal Reserve.

- Sovereign debt woes in Europe and budget wrangling in the U.S. weighed on the financial markets in the third quarter.

What to Watch: Continued bad news here could be very problematic. However, if there's any concrete resolution to the Euro-zone debt problems or a credible bi-partisan budget solution in Washington -- look out. The financial markets could rally strongly on that kind of news.

With the above issues looming, you can see why the markets are a bit nervous. Yet, even if the market swoons in the fourth quarter, it could make valuations so compelling that it sets the stage for the next bull market.

Additional Thoughts On The Economy ^{7&9}

Last week's data showed the economy continued to bump along the bottom. There's no clear evidence of a more robust recovery, or any monetary or fiscal policy that might give the economy a quick and necessary boost.

New home sales dropped 2.3% in August, a six-month low despite near record low mortgage rates. Personal income was lower by 0.1% in August, the first decline since October 2009.

The volatility of the markets seems to have discouraged longer-term investors, many of whom are still on the sidelines in 0% yielding money market funds.

Financial Facts⁷

The number of investment advisers registered with the SEC has fallen for the first time in 10 years.

Chuckle For The Day

Only in America do drugstores make the sick walk all the way to the back of the store to get their prescriptions while healthy people can buy cigarettes at the front.

Additional Thoughts⁸

"Expect more than others think possible." ~ *Howard Schultz*

"The world we have created is a product of our thinking; it cannot be changed without changing our thinking." ~ *Albert Einstein*

"Time is the coin of your life. It is the only coin you have, and only you can determine how it will be spent. Be careful lest you let other people spend it for you." ~ *Carl Sandburg*

"You become what you think about." ~ *Earl Nightingale*

Best regards,

Reid Johnson and the Investment Team

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* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance. Past performance does not guarantee future results.

* You cannot invest directly in an index. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. The DJ Global ex US is an unmanaged group of non-U.S. securities designed to reflect the performance of the global equity securities that have readily available prices. The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market. Gold represents the London afternoon gold price fix as reported by the London Bullion Market Association. The DJ Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14,

1998. The DJ Equity All REIT TR Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.

⁶ The source for the information was derived from Peak's *Weekly Commentary* 10/3/11 edition.

⁷ The source for the information was derived from Bob LeClair's *Finance & Markets Newsletter* 10/2/11

⁸ Information derived from *The Virtual Advisor* 10/1/11.

⁹ Information derived from *The Kiplinger Letter* 9/30/11 edition.

¹⁰ Information derived from John Mauldin as noted in this weekend's *FrontLine Thoughts*.

* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

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