THE PLANNING GROUP

A Wealth Management Firm

Weekly Commentary Report
August 8, 2011

Overview[6]

I wanted to start with my comments on the event that took place late on Friday – the downgrade of the US Federal Government credit rating. While this is the first downgrade in the history of United States of America, it is not surprising after watching the shenanigans that went on in Congress in negotiating the debt ceiling.

Yes, the downgrade was one notch to AA+ - but what effect does this have on other agencies and other countries. Do you downgrade GNMA? FDIC? How about Europe? How do countries like France and others keep their AAA rating? A logical outcome would be for interest rates on Treasuries to tick up a bit. My calculator ran out of zeroes as to the effect that even a 0.25% increase would have on just the interest the federal government pays on its obligations.

With regard to the downgrade, it is worth knowing that: the S&P cut the debt rating on the long-term debt while retaining the AAA rating on the U.S. short-term debt. Fitch and Moody's rating agencies kept their U.S. long-term and short-term ratings at the highest levels.

It should also be noted that apparently in S&P's initial report; they made an error resulting in undercounting the current budget plan's projected reduction in debt by $2 trillion. Once Treasury officials pointed out their error, that in fact there *was $2 trillion more of debt reduction than S&P thought*, S&P maintained their debt downgrade anyway, but changed their reasoning to one purporting that *"the downgrade reflects our view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges to a degree more than we envisioned when we assigned a negative outlook to the rating on April 18, 2011."* The Treasury issued a statement (and posted it on their website) blasting S&P and said their alteration *"raises fundamental questions about the credibility and integrity of S&P's ratings action."*

To maintain proper perspective, rating agencies are made up of people who make decisions based on qualitative and quantitative assessments. These are the same ratings' agencies (and people) that gave AAA ratings to now-defaulted mortgage-backed securities (MBS), and AA ratings to Lehman just before Lehman ceased to exist. In other words, one could argue they are given a lot more credibility than they deserve.

Bottom Line: While the downgrade is somewhat significant, we think the slowing global economy and Europe's problems are of greater concern. Our models indicate we are in the midst of the oft-described soft patch. Should the economy lurch any further into a slowdown, we will quickly reduce equity exposure. But it's not about the downgrade, it's about the economy. The fear and uncertainty are going to be far more distracting than the ultimate reality stemming from the impact of S&P's decision.

As I'm writing this over the weekend to be sent out on Monday, I can't help but wonder what Monday will look like given the effects this could have on our fragile economy. Could it be a non-event? Let's hope so. Will it have an ugly effect on the markets? More than likely. We'll start to see the ripple effect late Sunday night as the other world markets open up before ours.

Brief Summary of This Week's Extended Comments[6]

- A last minute deal staves off a U.S. default.
- Standard & Poor's downgrades U.S. credit rating from its long-held 'AAA.'
- Dow Jones Industrial Average now in correction territory with a 10 percent decline from its April 29th high, however, declines in the Dow of 10 percent have grown to be more normal, and have happened on average about once per year between 1900 and 2010.
- Contagion fears spread in Europe as Italy and Spain are drawn into the debt battle.
- Investors are nervous that the risk of another recession is rising; however, Warren Buffett said on August 6, "Financial markets create their own dynamics, but I don't think we're facing a double dip recession."
- It took the developed world decades to build a mountain of debt, and it will take more than a couple years of deleveraging to get out of it.
- We remain focused on providing you with the stability and return you need to meet your long-term planning needs.

The Markets[6]

The good news about last week is - it's over.

We started the week with a highly partisan, last minute deal to stave off the U.S. defaulting on its debt obligations and we ended the week with the U.S. losing its long cherished 'AAA' credit rating from Standard & Poor's. In between, the U.S. stock market, as measured by the Standard & Poor's 500 index, tumbled 7.2 percent -- its largest one week decline since November 2008.

In light of these major events, we'd like to take a step back and review what happened last week and then do a deeper dive into how we got into this situation and what the possible end game may be.

Last Week
To knock the market down seven percent in one week, you need a series of catalysts and we had a few that came to a head last week including the following:

- Worries about a U.S. default that culminated in a bitter compromise.
- Continued and expanding sovereign debt problems in Europe that now include Italy and Spain -- the third and fourth largest euro-zone economies, coupled with ineffective policy responses from European leaders.
- Concerns about the heavy exposure of European banks to the sovereign debt of overleveraged countries.
- A series of weak economic reports that have investors concerned about a new global recession.
- Concern that the U.S. government, particularly the Federal Reserve, is about out of bullets when it comes to using monetary policy to jumpstart the economy.
- Growing public anger with a dysfunctional Washington that may prevent both parties from reaching consensus on decisions that could help the economy.

Sources: *The Wall Street Journal, Barron's, BusinessWeek*

When you combine the above with human emotions that are still smarting from the 2008-2009 financial crisis, you create the potential for a bad week like we just had. Now, let's take a deeper look at how we arrived at this point in our economy.

How Did We Get Into This Situation?
For decades to come, historians will debate the exact causes of the financial crisis we experienced in 2008-2009 and the aftershocks we are feeling today. But, as Leonardo da Vinci said, "Simplicity is the ultimate sophistication." Taking da Vinci at his word, we think you can boil the financial crisis down to one word -- debt.

Individuals and governments have been piling debt upon debt for years and the burden has finally become unbearable.

One could argue the debt deluge began in 1966. That year, the first Baby Boomers turned 20 and Bank of America started to license its BankAmericard credit card (now known as VISA). It was a match made in heaven as Boomers loved to spend money and plastic made it easy.

In the mid-1980s, central banks got into the act as they began to pursue monetary policy which sought to, "avoid recessions at all costs," according to *The Economist*. Their weapons of choice were low interest rates and a flood of cheap money.

Now, when you combine human's desire to spend money with banks who are willing to lend and top it off with central banks eager to keep the economy greased, you have a recipe for a massive mountain of debt. And, that's exactly what happened.

Here are a few of the mind-boggling debt figures that hang like a ball and chain around the U.S.:

- $14,564,970,167,709 (Total public debt of the United States as of August 4, 2011)
- $ 2,446,100,000,000 (Total U.S. consumer debt outstanding as of June, 2011)
- $ 1,300,000,000,000 (2010 Federal Budget Deficit)

Sources: U.S. Treasury Department, Federal Reserve, BusinessWeek

Like politicians, Americans like to spend money. Between 1985 and 2007, American's disposable income grew 5.9 percent per year, but household indebtedness grew 8.7 percent per year, according to *The Wall Street Journal*. In other words, we were spending money much faster than we could earn it for more than 20 years. During that time, periods of cheap money and rising consumer debt levels helped fuel the 1982-2000 bull market, the 2002-2007 bull market, the tech stock boom of the late 1990s, and the housing boom of the early to mid-2000s.

Mirroring the U.S., a similar debt binge was happening with some foreign consumers and governments, too.

Why Come to a Head Now?
The world's accumulation of debt was unsustainable. The only question was, "When would it end?" Well, few people would have guessed that sub-prime mortgages in the U.S. would be the tipping point.

By the mid-2000s, cheap money, low credit standards, and the Wall Street money machine helped fuel an unprecedented housing boom in the U.S. This boom turned to bust in 2006/2007 when interest rates began to tick up and people started defaulting on their loans. Soon, a cascading domino effect ultimately pummeled the world banking system, greatly increased government debt levels, and led to steep stock market declines and a deep U.S. recession.

Dramatic levels of government stimulus helped fuel the stock market recovery in 2009 through mid-2011, but now that stimulus is wearing off and, today, we're left with the hangover.

What's Next?
As of last Friday, the Dow Jones Industrial Average had declined just over 10 percent since April 29, according to *The Wall Street Journal*. To put that in perspective, the *Journal* said, "Since 1962, the Standard & Poor's 500-stock index has seen 25 corrections of 10 percent during a bull market -- but in only nine of them did the losses grow to 20 percent or more, according to Birinyi Associates Inc. That means there is only slightly more than a 1-in-3 chance that the market is going to keep cratering."

Based on history, 10 percent corrections are normal and to be expected. Only time will tell if this one morphs into something more.

What happens to the economy, though, is another issue.

If what we experienced in 2007-2009 was a "normal" recession, we should have bounced back more strongly by now. But, it was not a normal business-cycle type recession. Instead, some people are calling it a "balance sheet" recession, in which over-indebted consumers (and governments) try to reduce their debt and spending, according to economist Richard Koo. This reduction in demand has helped keep a lid on economic growth.

One key to reigniting the economy is to find a way to lift growth while concurrently reducing public and private debt. That's no easy task as it's like trying to be tall and short at the same time.

Closing Comments

Realistically, it took the developed world decades to get into this debt situation and it will take more than a couple years of deleveraging to get out of it. There is no magic bullet that will quickly turn the economy into a growth machine.

As your advisor, we strive to develop a plan that, over time, has the possibility of providing you with the stability and return you need to meet your long-term planning needs. While we can't make any guarantees about performance or control what the market does, we have searched high and low for a plan and strategy that we believe is appropriate for you.

Data as of 8/5/11	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-7.2%	-4.6%	6.9%	-2.3%	-1.2%	0.0%
DJ Global ex US (Foreign Stocks)	-9.4%	-8.8%	2.0%	-3.8%	-0.9%	4.6%
10-year Treasury Note (Yield Only)	2.6%	N/A	2.9%	4.0%	4.9%	5.2%
Gold (per ounce)	1.9%	17.6%	39.15	23.4%	20.6%	20.0%
DJ-UBS Commodity Index	-4.1%	-3.8%	14.1%	-7.2%	-2.5%	4.3%
DJ Equity All REIT TR Index	-12.1%	-2.4%	6.2%	-1.0%	-0.7%	9.4%

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.

Additional Thoughts On The Economy [8&9]

The economic news from last week was mixed, and should not have resulted in the turmoil the markets experienced. One could argue the downgrade of the U.S. credit rating was perhaps nothing more than a slap in the face, I think the effects, if we are to have any, will play out this week. The best case scenario is the downgrade was anticipated, and already priced into the market.

It is starting to sink in the recovery will be less robust than estimated, and will take longer, perhaps much longer than originally anticipated. The lack of confidence on the part of the consumer, as well as businesses, will keep the recovery moving at a turtle's pace.

Additional Thoughts On The Market[7]

The weak real estate market has affected consumers both emotionally as well as economically. Over the past few years, home equity has fallen $8 trillion- more than 50%. Although we have seen minor improvements along the way, many are suggesting the recovery will take longer than initially estimated. If interest rates to edge up as a result of the U.S. credit rating modification, mortgage rates are likely to rise in tandem.

This week will be an interesting week as we have a Treasury auction of 3, 5 and 10 year maturities. It will be interesting to see how these auctions perform. Also, there are rumors that we are going to start to hear about QE3. The rumors are suggesting the Fed is going to buy long-term securities instead of the shorter end they had focused on in QE1 and QE2. Some very smart people are suggesting they do not believe the markets will react well if the Fed announces yet another quantitative easing step.

As we look to this week, it is likely to be very volatile as we start the week on the downside. But with the Treasury auctions along with the Fed meeting on Tuesday, things could be highly volatile as the week unfolds. I expect that we will probably hear from the President and certainly there will be plenty of rhetoric coming out of Washington D.C. pushing back on the S&P decision.

Our 'internal' tactical management portfolio (VPM All-Cap Growth) is now 90% cash with 1½ stocks (the half coming from selling out 50% of our position in LULU which has had substantial gains since we purchased the stock back in October) – and it has been 60% or more cash for many months now. DPS, one of our other outside tactical managers is now 100% cash. Our other tactical managers have cash positions as well, but to a lesser extent.

Financial Facts of the Week[7]

According to a recent report in *Bloomberg Businessweek*, only 42% of U.S. small employers offered medical insurance in 2009, compared with 47% in 2000. In 45 states, the share of small businesses offering coverage dropped, as premiums nationwide rose 82%.

Additional Thoughts[8]

"The reality of life is that your perceptions -- right or wrong -- influence everything else you do. When you get a proper perspective of your perceptions, you may be surprised how many other things fall into place." ~ *Roger Birkman*

"Without goals, and plans to reach them, you are like a ship that has set sail with no destination." ~ *Fitzhugh Dodson*

"If you want to make good use of your time, you've got to know what's most important and then give it all you've got." ~ *Lee Iacocca*

"Don't tell me how hard you work. Tell me how much you get done." ~ *James Ling*

"Most of the important things in the world have been accomplished by people who have kept on trying when there seemed to be no hope at all." ~ *Dale Carnegie, American Writer, Lecturer*

Closing Comments

America is a great country. We've been through difficult times before and we always find a way to overcome the obstacles. This time should be no different.

As always, we greatly appreciate the confidence and trust you place in us. We work hard every day to earn it.

Best regards,

Reid Johnson and the Investment Team

* The content of this newsletter has been prepared solely for informational purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell any security or to participate in any particular investment strategy. We derive information from a variety of sources we consider reliable, but we do not represent that the information is accurate or complete. The opinions and statements herein are subject to significant business, economic and competitive uncertainties and actual results could be materially different, thus there are no guarantees and are subject to change at any time. Financial planning and investment advisory services are offered through The Planning Group of Scottsdale, LLC, and Ives Asset Management, Inc., both firms are SEC Registered Investment Advisor and. Certain securities may be offered through Meridian United Capital, LLC, a registered broker/dealer and FINRA member firm. You should consult your financial professional before making any investment decision.

* 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 8/8/11* edition.
[7] The source for the information was derived from Bob LeClair's *Finance & Markets Newsletter 8/7/11*
[8] Information derived from *The Virtual Advisor 8/5/11.*
[9] Information derived from the *The Kipplinger Letter 8/5/11* edition.
* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

*To unsubscribe from the Weekly Commentary please reply to this e-mail with "Unsubscribe" in the subject line, or write us at:

Scottsdale Office - 8800 N. Gainey Center Drive - Suite 176 - Scottsdale - Arizona - 85258-2122
Sun City West Office - 13912 W. Stardust Blvd. - Suite 119 - Sun City West - Arizona - 85375
Telephone (480) 596-1580 - (888) 596-1580 - Fax (480) 596-2165 - e-mail - kris@theplanninggroup.com
www.theplanninggroup.com