
**August 7, 2011**

**5:07 PM EDT**

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## Debt Deal Reached But...

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There is so much to cover today, let's jump right in. Early last week, Congress agreed to a debt ceiling deal that would last through the 2012 election. The good part was that it had bipartisan support, showing that it is possible for both parties to work together. Since I continue to read about the far left and right both hating the deal, I guess the conclusion is that a decent compromise was reached.

One my clients who flies jets for Delta sent me this note about two weeks before the deadline and it was so spot on that I wanted to print it.

*"This is negotiating 101 for anyone who has been around organized labor for any length of time. By definition, they have to announce a deal at the 11th hour even if they have an agreement in hand well before. If they don't announce at the last minute the constituents from either side will harangue their representatives that they could have held out for just a little more. Once time is up, that's it. They can't hold out for any more,so it will appear to the constituents that each side on the negotiating table has done its best to get all that can be gotten. Frustrating? Absolutely, but that's the way these things work..."*

The question now is, was this deal enough? We are certainly going to find out as the
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bipartisan "Super Committee" created by the deal is going to have to cut several trillion more this fall or Draconian, across the board slashes are going to be made to every department!

For several years, I have written that America was out of painless solutions. Debt deleveraging was going to hurt, no matter which path we chose to go down. The right's tagline has been that we don't have revenue problem, we have a spending problem. The left counters with the record income disparity in this country with millionaires and billionaires not paying their fair share.

Frankly, it doesn't matter which side is more correct, we are not going to find solutions unless both sides compromise and give up their sacred cows. Whether taxes are raised and/or reformed, more spending cuts are enacted or a combination of both, the end result is likely to be muted economic growth, best case. Nothing I have seen in the list of solutions can be interpreted as pro growth.

What hasn't been properly communicated is that there will be ZERO spending cuts in 2011. Nada, zilch, goose egg. And in 2012 as I read it, the cuts only amount to $30B or so. This is more about passing a bill that the next Congress and administration will have to deal with.

## Precedents from Other AAA Cuts

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As you probably know, Standard & Poor's cut the c*r*e*d*i*t rating of the U.S. from AAA to AA+ on Friday night. This had been rumored for some time, but reality finally hit. There are three major rating agencies when you add Moody's and Fitch to the picture. While this is the first such move here, there are historical precedents from Japan (2001), Spain (2009), Ireland (2009), Italy (1998), Belgium (1998), Finland (1998) and Portugal (1998).

Without having specific foreign exchange data to analyze, it looks like the stock markets basically continued along with the rest of the world. In 1998, those markets chopped around, surged higher into July with the rest of the world and collapsed with everyone else from the Russian debt default and then Long-Term Capital's blow up.

In 2001, as you can see below, Japan's stock market was already in the throes of major bear market and after a short-term selloff, it saw a two month before rolling back over into decline, along with the rest of the western world.
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In 2009, Spain was downgraded during the final leg of the bear market, while Ireland's cut was made a few weeks after THE bottom. So it seems like in all cases, the markets generally followed the regime they were already in.


I want to share a few observations about what S&P did. First, let's remember that this is the same rating agency that had AAA on leveraged subprime derivatives. Remember how that panned out? According to CNBC, the Financial Inquiry Commission called the ratings agencies, "essential cogs in the wheel of financial destruction..."

As I have written about before, I believe the ratings agencies and banks have gone from overly loose and easy to the point of almost being criminal during 2005 - 2008 to the polar opposite end of the spectrum today. They are now overly conservative and difficult, not wanting to risk anything. Surely, there is somewhere in the middle that works!

Regarding the chatter that a ratings downgrade will lead to surge in interest rates, certainly the Japan case does not support that, where a weak economy saw interest rates continue to fall and fall and fall. Since there was warning here, I would imagine that investment funds with AAA only covenants have scrambled to amend their documents and charters in case this happened.

Watching the treasury bond market on Friday, it certainly looks like many players had advance notice of S&P's announcement. Since the decline began, when stocks moved down, bonds moved up. On Friday, long-term treasury bonds saw one of their worst days ever, while the stock market was essentially flat. This seems a lot like when the oil market got hit the day before the government announced releasing reserves from the SPR.

I think we will continue to see huge volatility in the bond market. In the past two weeks, yields (rates) on the 10 year note have collapsed from roughly 3% to 2.50% from the weakening economy. That means interest rates have gone much lower in a very short period of time. And I do not believe the ratings downgrade is going to mean much beyond a day or two in the bond market. When investors take off risk and seek safety, I believe they will still find a haven in U.S. treasury instruments. If economic activity and/or inflation picks up, that will significantly hurt treasury bonds prices as they have in the past.

I usually don't quote Warren Buffett, but he said something to the effect that if there was a AAAA rating, the U.S. would deserve it and that he remains of the belief that our government bonds are the safest investment in the world.

## Calling All Cars

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Well, I certainly picked a fine time to be wrong about the stock market! Long time readers know this wasn't the first time and I know it won't be the last. But that doesn't make it any better. After 23 years in the business, and hundreds and thousands of forecasts and opinions, you would think that laying an egg would just roll off like rain down a roof into a gutter. But it doesn't. I am a dweller. When I miss something, I do the "coulda, woulda, shoulda" and figure out what I missed and why.

After last Wednesday's sharp reversal from major losses, I thought the stock market began the bottoming process that would lead to the rally I had been expecting. That ended pretty quickly with Thursday's rout. I have said for a while that my biggest worry was that Europe was in even worse shape than most people realized. We saw just how bad late last week and over the weekend, the European Central Bank (ECB) began a Quantitative Easing (QE) of their own by announcing massive purchases of European sovereign debt. This is such an about face for the ECB, which is so (wrongly) focused on controlling inflation that it missed the opportunity to at least get with the impending crisis, let alone get ahead of it.

Watching Thursday's plunge, I couldn't help but recall similar times where we learned days or weeks later about a major fund blowing up and being liquidated. Or, as I vividly remember from January 2008, there were traders' errors from a major bank. We'll see shortly, but these panic waves of selling have similarities to other ones over the past few years.

And during these previous events, another common thread was the Fed stepping in to either cut interest rates or provide other sources of liquidity to keep the markets from seizing up. With rates at essentially 0% and the Fed beginning a two day meeting on Tuesday, it will be interesting to hear from Ben Bernanke and what, if any, new programs the Fed unveils.

As I finish this up on Sunday afternoon, markets in the Middle East saw heavy selling, closing down roughly 5%. At this point, I would imagine the Dow opens down between 225 and 300 points. From there, we will have to see if the low of the first hour is violated or not for more short-term clues.
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Strategy-wise, we made a few minor tweaks last week, but nothing major. Our two conservative programs, Short-Term Gold and High Yield Bond are 100% in cash. The next two on the risk scale, Spectrum and Global Asset Allocation are very different. Spectrum is 50% in cash and 50% invested in U.S. indices and sectors, while Global Asset Allocation saw some changes on Friday and remains diversified among U.S. indices, bonds and commodities. Diversified Growth and Relative Strength Sectors remain invested in U.S. indices and U.S. sectors respectively. On the aggressive side, Developed Markets owns several single country funds and Emerging Markets have two single country holdings. Lastly, Intermediate-Term Gold is now 75% invested, having added 25% on Friday.

Finally, as my good friend Sam Jones likes to say during times like this, "calling all cars, calling all cars". If you are sitting on cash waiting to add to one of your strategies or open a new strategy, now is a very good time into the weakness. In June, when Global Asset Allocation had decent loss during the month, I invested 25% of my planned amount for 2011 into that strategy and I plan on doing something similar here.

If you want to discuss your own situation, please call me directly at 203.389.3553 or just hit REPLY.

## Upcoming Appearances

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CNBC's Squawk Box - August 10 at 6:10am

You can view most of the past segments by clicking below.

# Media Appearances

(http://www.investfortomorrow.com/InMedia.asp)

## Investment Quotes/Adages To Live By

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"When in doubt, get out!"

"If it's obvious, it's obviously wrong."

-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."

-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can stay irrational longer than you can stay solvent."

-John Maynard Keynes

"Government is best which governs least" - Thomas Jefferson

Inflation is the one form of taxation that can be imposed without legislation.

-Milton Friedman

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for,that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it." - Dr. Adrian Rogers, 1931

"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market."

- Robert Rhea via Tim Woods

"Free enterprise is a rough and competitive game. Nobody too big to fail.  Nobody too small to succeed. It is a hell of a lot better than government control." - Ronald Reagan via Dan Kennedy

"A government big enough to give you everything you want is big enough to take everything you have." - Gerald Ford via Dan Kennedy

"The problem with socialism is that, sooner or later, you run out of other people's money." -

Margaret Thatcher via Casey Research

"Diversification alone is no longer sufficient to temper risk... You need something more to manage risk well."

- Mohamed El-Erian

## Friends And Family Plan

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Finally, as you know, our firm and this newsletter continues to grow mostly from your referrals. If you know anyone who is interested in securing their retirement, planning for it or just plain worried about it, please send them here. As always, thanks for thinking of us with your circle of family and friends.

**Sign Up Here**

You can also forward this email to family and friends by hitting the "forward email" hotlink at the bottom of this email.
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**To Your Financial Success,**

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