

Tough Day in the Market:

Today, June 1, 2011, has been a tough day in the market as US and International markets trade down nearly 2%. Employment data from ADP suggests the pace of hiring slowed significantly in May and data from the Institute for Supply Management (ISM) provided additional support to the fact that US economic growth is slowing. Despite the fact that ADP data is historically unreliable and that ISM numbers are still in expansionary territory, it appears that the US recovery is slowing.

The reasons why growth is slowing are multiple. The horrific events in Japan were not only a severe human tragedy, but also threw a wrench into global manufacturing supply chains. The Japanese economy is back in recession, and technical and automotive goods produced in Japan are in short supply. On the back of this disaster, consumers in the United States continue to watch the value of their homes fall as the real estate market not only remains weak, but continues to fall in many regions. There are many other reasons why the recovery appears to be slow, including reduced levels of government stimulus rushing through the financial system and rising oil prices that have lightened consumers' wallets.

In addition to the headwinds slowing economic recovery, markets are contending with the financial meltdown of Greece. Beyond being less than honest about its finances in order to gain entry into the Euro, Greece has failed to live up to the austerity measures promised. The odds of a Greece debt default or restructuring appear overwhelming. Credit Default Swap markets, used by investors to hedge against bond defaults, are priced to assume a 70% probability of default – an almost unheard-of level of pessimism. We hope that Greece and the European Central Bank move sooner rather than later to resolve this issue.

With such dramatic and generally negative events ongoing in today's market, what should investors do, and is there any reason to remain invested in stocks?

Investors should mind two important rules:

1. Always be prepared. List all of the possible events that might transpire and ask yourself whether your portfolio is prepared for such a situation. As an example:

- Do you believe that the excessive efforts of the Federal Reserve to stimulate the economy will eventually prove hyper-inflationary? Then identify what assets in your portfolio are responsive to rising inflation.
- Do you believe that the slowing economic recovery and weak housing market pose the risk of causing a double-dip recession? If the US enters back into recession, what assets in your portfolio will do well? Are these assets the same ones that will do well in a hyperinflation environment? Maybe, maybe not. These are critical questions to ask yourself and your financial advisor. Think ahead for possible outcomes, prepare today.

2. Don't overestimate your ability to predict the future. Economics is known as the dismal science, because predicted outcomes are usually gloomy, or worse, but coincidentally economic forecasts also tend to be dismal in their accuracy. Yet, economists spend all day long studying the economy and still aren't very good at predicting future movements. Individual investors rarely do better; they try to predict changing economic trends by merging the events they witness personally at work and in their neighborhoods with data drawn from reading or watching television. While economists and individuals are able to formulate well-defined expectations for what changes will occur to the economy, both often fail to prepare for the possibility of being wrong.

Even being right can cause headaches. Investors who correctly anticipated an economic slowdown that likely began in 2010 may not have accounted for the level of Federal stimulus that poured in to pick up the slack.

Our local radio station holds an annual game show called "You Can't Win." Every day for several weeks, callers try to answer six unimaginably difficult questions. Nobody knows all the answers or manages to win the grand prize, but over time -- a process that can take three months or longer -- the listening public comes up with all six answers. Each daily caller fails to win the grand prize, but walks away with a free dinner or token memento. So, as the host likes to say, "If you win, you win; if you lose you still win."

When constructing your portfolio try to remember that phrase: "If you win, you win, if you lose you still win." Make sure your portfolio has lots of good answers, but that it is not solely dependent on winning the grand prize every day.