

The Markets

The financial markets are currently filled with contradictions and that's contributing to head-scratching and risk-aversion on the part of investors.

Consider these head-scratchers:

- Mortgage rates are at a 50-year low, yet the housing market is still severely depressed.
- Ten-year Treasury yields hit a record low last week even though the government just experienced a downgrade in its credit rating and it is running trillion-dollar annual deficits.
- Gold prices hit a record high last week even though gold pays no interest and the core inflation rate is running below 2 percent.
- The value of the dollar fell to a record low against the Japanese yen last week even though Japan has been mired in a slump for 20 years and "Japanese government debt is more than double the Euro Area average and more than double the US," according to Jim O'Neill at Goldman Sachs.

Sources: Bloomberg, MarketWatch

The situations described above suggest there are "distortions" affecting the markets that may not be explained by traditional portfolio theory.

One distortion that has clearly impacted the markets is government policy and intervention. In just the past three years, we've seen the \$700 billion Troubled Asset Relief Program (TARP), the \$787 billion American Recovery and Reinvestment Act, the Federal Reserve's zero interest rate policy, and the Fed's QE1 and QE2 bond purchases. All these have generated numerous market side effects.

In addition, a major argument is unfolding between politicians who believe government intervention is necessary to prevent an even worse downturn and those who believe the free market should be left to fend for itself. Some politicians are even calling for the abolishment of the Federal Reserve.

A similar situation is playing out in Europe. For more than a year, European governments have scurried from one bailout strategy to the next in order to prevent a sovereign default.

All these distortions and philosophical debates are, not surprisingly, causing confusion in the financial markets. The result -- a stagnant economy and falling stock prices.

The denouement of these interventions and political squabbles is unknown. What we do know is we continue to do all we can to help ensure your goals and objectives are met.

Data as of 8/19/11	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-4.7%	-10.7%	4.8%	-3.9%	-2.8%	-0.4%
DJ Global ex US (Foreign Stocks)	-3.1	-13.1	0.1	-3.5	-2.3	4.3
10-year Treasury Note (Yield Only)	2.1	N/A	2.6	3.8	4.8	4.9
DJ-UBS Commodity Index	1.3	-2.1	20.3	-5.8	-1.5	4.5
DJ Equity All REIT TR Index	-3.1	-3.5	9.8	-0.1	-1.0	8.9

Notes: S&P 500, DJ Global ex US, 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.

DOES RISK GO UP OR DOWN as stock prices decline? The answer may surprise you.

Let's start with a definition. For our purpose, we'll define risk as the probability of losing money. With that shared definition, let's look at the S&P 500 index. On October 9, 2007, it closed at an all-time record high of 1,565. On March 9, 2009, it closed at 676, which was a 12-year low, according to CNNMoney.

Now, was it riskier to own stocks when the S&P 500 was at its all-time high in 2007 or its 12-year low in 2009?

Hindsight tells you owning stocks at the all-time high was much riskier. Why? Because stock prices proceeded to fall by 57 percent over the next 17 months, while prices rose about 100 percent over the next two years from the 2009 low.

Money manager John Hussman framed it this way in a May 23 commentary, "As valuations become rich, risk increases, and as valuations become depressed, risk declines. At the same time, rich valuations imply weak long-term prospective returns, while depressed valuations imply strong long-term prospective returns." In plain English, he's essentially saying as stock prices go up, risk goes up, and as stock prices go down, risk goes down.

Warren Buffett was even more succinct. In an August 11 *Fortune Magazine* interview, he said, “The lower things go, the more I buy.”

It may go against human nature, but the lower prices go, the less risky they become and the more likely you are to experience strong long-term prospective returns, according to Hussman and Buffett.

For investors who are saving for retirement or simply trying to preserve their wealth, seeing lower stock prices is no fun. However, assuming you don’t need to sell today, what matters is what prices will be in the future when you do sell. And, with prices dropping now, it may be setting the market up for better returns down the road.

Weekly Focus – Think About It

“Contradictions do not exist. Whenever you think you are facing a contradiction, check your premises. You will find that one of them is wrong.” --Ayn Rand

Best regards,



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*** 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.

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

* 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.

* Consult your financial professional before making any investment decision.