



Just a Soft Patch?

Though the economy continues to recover from the 2008-2009 recession, it has slowed entering midyear 2011. In January the recession had been declared over, but with all the headlines about the U.S. debt levels, high unemployment figures, and troubles in the European Union, it is understandable that people are still concerned. Whispers of a double dip recession were once again heard in June, but at The Masters Group we think this is highly unlikely. A more likely explanation for the slow in recovery is that we are encountering an extended “soft patch” in the economy and we will see a pick up in the 3rd and 4th quarters this year. Our current interest rate environment, tax policy, and productivity growth are most often indicative of an expanding economy and a rising stock market.

Since 1960, there have been eight business cycle expansions and all of them have had soft patches. There was an economic soft patch that started in March of 2004 and lasted until May 2005. The S&P 500 rose during that time. In my opinion, the current soft patch is a result of a number of issues.

The second round of quantitative easing (QE2) ended in June at the time the Fed stopped pumping liquidity into the markets. The market responded by having its worst month of the year. The S&P 500 was down -1.82% in June (*source: www.bigcharts.com*), instigating those rumors of a double dip recession. The definition of a recession is two quarters of negative gross domestic product, and we haven't slipped into negative GDP yet; in fact first quarter GDP was 1.9%. Through June 30th the S&P 500 is up 6.02%, according to First Trust Advisors.

Unemployment does continue to be a thorn in the economy's side. The unemployment rate rose to 9.2% as reported in the July 8th numbers. From January, the unemployment rate rose .2%. On the bright side, the U.S. has added about 2 million private sector jobs since early 2010 (*source: New York Times*). According to First Trust Advisors, the U.S. has had 16 consecutive months of private sector job growth. This year, private sector jobs are up 945,000, or, 157,500 per month (versus 98,000 per month in 2010). The speed of job creation will continue to play a major role in the sustained growth of the economy, market performance, and the rate of inflation.

There has been a lot of commentary lately about the debt ceiling, and how the U.S. will default if it is not raised by August 2nd. The word default is thrown around a lot, but not necessarily used correctly. For the U.S. treasury to default it would not be able to make payments of interest or principal on outstanding debt. According to Ken Brouwer of MarketWatch, the U.S. Treasury has about \$200 billion of revenue every month. The interest payments on its debt are between \$15 and \$20 billion, therefore, according to definition, default is impossible. While somewhat comforting, the heart of the matter is the U.S. needs to get control of its spending habits. It's safe to say the debt topic will be at the forefront of upcoming election campaigns.



With the European Union's debt problems, one of the worst natural disasters in history in Japan, and Libya's unrest; it's no surprise international events are on people's minds and in the headlines hampering economic gains. However, it is important to keep things in perspective. Greece seems to be the main concern in the EU, but really it is only 1.9% of the EU's GDP. Other countries like Germany, for example, have opportunities for growth. Oil prices have been a concern ever since the unrest in Libya, but according to Dian Chu of Business Insiders; Libya exports account for 2% of the world's 88 million barrels per day of oil, which could easily be made up by increasing production from other countries.

So while there is not a shortage of negative things for the media to concentrate on, we think the outlook is positive and the economy is still making headway. It takes time to recover from a recession and there will be many bumps along the way. The economy is resilient, and the fundamentals are slowly improving. *Additionally, this is the third year of a presidential election cycle. Since 1949 there have been 15 presidential election cycles, whereby the third year of each cycle has produced a positive result in every instance with an average total return of 22.4% (source: S&P 500 Index, Ibbotson).*

The keys to financial success are to maintain patience with this economy and the investment process. Focus on things that you can control – a well diversified portfolio, prudent tax planning, and a plan that fits your situation. No one said the journey would be easy, but we are still moving forward with cautious optimism.

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The above commentary contains opinions and analysis that are provided by the author for informational purposes only and should not be used as the primary basis for an investment decision.

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