



## “One Dip or Two?”

Stephen Rhea

Dear Clients & Friends:

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Alex Thompson

During the heat of a Southern summer, a visit to the ice cream shop is one of life’s great pleasures. The prospect of a double-dip ice cream cone makes one’s mouth water. However, fear of a double-dip economic recession made most investor’s palms sweat during the second quarter.

Lance Hollingsworth

John Laughlin

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The quarter was full of negative events, which seemed to compound into broader fears that the market declines of late 2008 and early 2009 would repeat. Our view is that the markets are in a slowdown, not a meltdown. Here is the effect on the major market indexes:

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	<u>2Q</u>	<u>YTD</u>
Dow Jones Industrial Average	-9.4%	-5.3%
S&P 500 Index	-11.5%	-6.7%
MSCI EAFE Foreign Equity	-14.0%	-13.3%
MSCI World Index	-12.1%	-9.4%
Barclay’s Aggregate Bond Index	3.5%	5.3%

The colossal rally that prevailed for almost a year through April lulled many into complacency. We had experienced subdued market volatility, increasing returns, and a parade of economic news that continued to confirm the global economic recovery. Consumer confidence was back, investor sentiment was high, and even President Obama’s approval rating had stopped going down.

Then things changed. First, the now infamous BP Deepwater Horizon drilling rig exploded. This was followed by news that Greece was likely to default on its sovereign debt, accompanied by television coverage of Athens streets filled with rioters protesting the austerity measures. The Greek crisis touched off fears of a European liquidity crisis that could engulf the U.S.

In the midst of the Greek crisis, a mysterious “flash crash” on May 6<sup>th</sup> sent the major market indices into a free fall. Indices moved 10% in less than 10 minutes, nearly touching off a panic before recovering most of the lost ground. The cause, a confluence of technical factors, reportedly has been corrected.

### **A Slowdown, Not a Meltdown**

When added up, these off-the-wall events ignited a sense of fear and pessimism we had not seen in a while. Pundits began to question the sustainability of the global economic recovery and raised the possibility of a double-dip recession.

You may recall, since last summer we have believed that the most likely shape of the economic recovery would be a “square root.” We have enjoyed the “V” part of the recovery, but have to admit that the levelling off of the tail has occurred

more abruptly than we anticipated. We blame a large part of this on the European debt crisis and the related plunge in both business and consumer sentiment. We remain committed to our view that the current economic numbers represent a pause in a continuing recovery, not a second recession.

Though people fear them at some point during almost every recovery, double-dip recessions are rare. According to the National Bureau of Economic Research (NBER), the most authoritative source of information regarding business cycles, there have been 33 recessions registered in the US since 1854. Over this entire time frame, there have been only three recorded instances of a double-dip recession. The first one was in 1913, the second in 1920, and the third in 1981.

The case for the double-dip rests on several legs, including:

- The peak impact of monetary and fiscal stimulus has passed.
- The housing recovery could falter now that tax credits have expired.
- Rampant uncertainty among business leaders continues to hamper hiring.
- Tax rates are likely headed higher in 2011, affecting sentiment today.
- US debt continues to build; which ultimately constrains private sector growth.

That being said, the case against a second recession is just as compelling:

- Unemployment claims have likely resumed their decline. Even at their current level they suggest 2.5% real GDP growth in the third quarter.
- Corporate profits are booming and corporate cash is at a record \$1.8 trillion.
- Bank lending to commercial and industrial companies has started to show improvement.
- Durable goods orders, though down in May, are in a strong rising trend and up nearly 20% from the recession low.
- Emerging market economies remain healthy.
- The Fed shows no sign of raising rates, and could reinstate quantitative easing were the recovery to slow further.

Again, we remain in the camp that believes we are in a slowdown, not a meltdown.

### **Growth vs. Debt**

As mentioned above, corporate profits are booming; so are US and world debt levels. This has created a tug of war between the strength of economic and company fundamentals on one side, and the effect of debt-related concerns on the other. The tension between these opposing forces has left the stock markets stuck in a trading range and the bond markets little changed. How world governments handle this debate in the shorter term will have lasting effects on this economic recovery and the environment going forward. Please see our website for a more thorough discussion of *The "Deficits vs. Austerity" Debate*.

## **Conclusion**

As long term investors, we discipline ourselves to gradually evolve our opinions as we review information rather than make sudden changes. That discipline has been tested in recent quarters as our assessment of the big picture has remained unchanged while the markets seem to signal otherwise.

However, we were not passive during the quarter. Recent developments in world markets have caused a shift in equity leadership, and we responded with changes to our Adaptive Indexing Strategy<sup>SM</sup>. We eliminated emerging markets investments and reduced overall international exposure. We used the proceeds from these sales to concentrate on domestic investments where we feel there is less risk.

Lastly, we continue to subscribe to the view that the stock markets may find clarity later in the year. Based on historical patterns after economic recessions, it would be very feasible for the markets to trend upward after bouncing in a trading range for another quarter or so.

## **Summit Industry Leadership Benefits Our Clients**

Summit had two occasions to meet with the senior management of Charles Schwab & Company in June. We were invited to the Schwab elite manager conference. Furthermore, Schwab executives met with our exchange group of CEOs of advisor firms in other cities. These opportunities allow us to be advocates for our clients on a number of issues.

Steve Rhea and Lance Hollingsworth were recently recognized by MBQ (Memphis Business Quarterly). Steve was named one of Memphis' 2010 Power Players in the category of Investment/Brokerage. Lance was listed as a MBQ Player in Financial Planning.

Summit Asset Management was again listed in the 10<sup>th</sup> annual Top Wealth Managers list published by Wealth Manager Magazine. We appreciate this distinction because it indicates the great relationships we enjoy with our clients. To us that is the most important measure of all.

Thank you for your faith in us and as always, please contact us if you have any questions.

*Summit Asset Management LLC*