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# THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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## Chicken Little is Alive and Well.

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### Greetings from the Personal Wealth Coach.

As the subject line suggests, Chicken Little is indeed alive and well and pretty clearly running around screaming, "The sky is falling! The sky is falling! A piece of it just hit me on the head!" The other barnyard animals, pigs, turkeys, ducks, and the other chickens are running about screaming, "SELL! SELL! The market is falling!"

For us humans out here in the real world, the fear those barnyard animals are expressing is causing some deep concern. Obviously, if the barnyard animals are running about squawking, snorting, and grunting in obvious terror, shouldn't we join them? I mean, if all those traders are panicking, shouldn't we be afraid too?

Let's take a look at what happened leading up to Chicken Little getting bashed on the head.

In the U.S. House of Representatives a group of Congresspersons threatened to block the ability of the United States Government from borrowing the money necessary to pay its ongoing obligations. Interestingly enough, those same Congresspersons had passed a "Continuing Resolution" (budget) earlier this year which not only authorized but mandated about \$3.7 trillion be spent by the Treasury. Since in that Continuing Resolution it was clearly stated that revenues were expected to be around \$2.2 trillion, the difference would have to be generated through the sale of U.S. Treasury securities. Then, those Congresspersons warned they were going to refuse to authorize that borrowing unless there were some rather large budget cuts in unspecified areas. The House did indeed pass a budget (the Ryan Plan), unfortunately the idea of basically eliminating Medicare in ten years did not go over well and did not pass the Senate.

After a great deal of heated discussion, the President and Speaker Boehner appear to have agreed on a plan that would meet Standard & Poor's warning that they must either reduce the projected deficit by \$4 trillion or face a downgrade. When Speaker Boehner took that proposal back to the House, because it included elimination of some favored tax breaks and some tax increases in the upper income brackets, it was rejected.

In the waning minutes before the U.S. Treasury was to default on its legally mandated obligations, the Senate cobbled together a compromise that changed little, but passed the responsibility to a committee of twelve members of Congress. That Senate compromise was finally passed by the House as well and signed into law by

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the President on Wednesday. The committee is to be composed of three members of each party from the Senate and the House. If the 12 cannot get at least a 7-5 majority on what to do to cut the deficit by about \$2.4 trillion, then draconian cuts hit automatically. Here is the rub. If those draconian cuts hit, then there will be contractual obligations that the United States will not fulfill. Contractors with valid contracts funded by laws passed by this Congress will not get paid. Presuming the committee comes up with a plan that can garner a majority, then the plan will be presented to the House and the Senate for an up or down vote with no amendments allowed.

In either of those steps there is the potential for failure. If the committee determines that there are just not enough places to cut and as a result eliminates some tax deductions and credits or in any way increases taxation, a lot of Republicans have already said they will vote it down. If the committee cuts Medicare, Medicaid, or Social Security in any way, then there are Democrats who have stated they will vote it down.

On Wednesday night following the passage of the bill raising the debt ceiling, representatives from S&P arrived at the Treasury Department to brief the Secretary and warn that they were going to downgrade the sovereign obligations of the United States. The Treasury folks found a \$2 trillion error in the S&P calculations, which would negate what S&P was going to announce as the shortfall. S&P changed their press release to read that the downgrade was because of the political gridlock and the potential for the United States to not pay some of its obligations as well as the long term deficit problem.

The bottom line here appears to be not just that we (the federal government) are spending about five dollars for every three we are collecting in taxes, but that a large enough block of Congressional representatives appear to be willing to default that it just might happen. No one questions the ability of the United States to pay its bills, but the fact that Congress might choose simply to not pay those bills as a means to reduce our federal debt is something that any credit agency has to take seriously.

### **So What Comes Next?**

The fact is that while our political leaders appear to be behaving in a less than ideal manner, the rest of the economy is busy doing the right thing. We are paying down our debts and balancing the books on the individual level while corporations are making the capital investments needed to keep us competitive. This is not fun, but it is the kind of activity that produces great returns a few years down the road.

About 70% of the S&P 500 member companies have reported their second quarter earnings. So far about 78% have come in with profits greater than expected. On Thursday, as the Dow dropped 500 points, General Motors reported that earnings were up 92% on good global demand for new cars. It also announced that it was going to be increasing the price of the 2012 models by 1%. The forward price to earnings ratio (P/E) of the S&P 500 is currently the lowest it has been since 1982. In fact this August sell-off almost perfectly mirrors the one in August 1982. Unemployment in August 1982 was about the same as it is today. The time before that when all the numbers line up is 1952. These things seem to come in about 30 year intervals. And, yes there was one in 1922 as well, and for that matter in the early 1890s too.

The stock market went on to rise by the end of 1982 to break all previous records. I don't know if that will happen this time around, but I can say that this sell off is an irrational panic in which owners of stocks, which have not been downgraded, are selling in order to purchase Treasury securities, which were downgraded. If you can find any logic in that please let me know what it is. But that is it. Panic is an extreme version of the emotion "fear." Fear is not rational but it is contagious.

My advice is the same as it was when the S&P 500 was at 676 and the Dow Jones Industrial Average was at 6627, just over two years ago: "DON'T PANIC." As Rudyard Kipling wrote over a hundred years ago, "If you can keep your head when all about you are losing theirs.... then the world and all that is in it will be yours..." Only a short while ago I was getting challenges for keeping bonds, gold, and other such things in portfolios to a higher degree than some wanted. I sort of suspect they will have a better understanding now why we do that.

As always if you have questions or thoughts, don't hesitate to call or email (or if you are so inclined to write on paper).

Jeff