Between a Rock and a Hard Place

Scott Finlay

Q3 2011

Global markets went into sharp retreat in the third quarter, rattling the nerves of even the most seasoned investor. What I find most disconcerting is that the outcome was going to be determined by the Germans and the French agreeing on a solution, not something that happens often. Even the US was pulled into the frenzy as the European banks were now looking across the shore for the Fed to pump liquidity into the system. All of this has injected the question of a new recession into daily conversation.

As of the date of this letter, the market has responded positively to what appears to be some level of agreement between the seventeen countries that make up the EU. Can you imagine, with the partisan bickering that goes on in the US between two political parties who happen to occupy the same country, how difficult it must be to settle an issue between seventeen different economies?

Much remains to be done, but it appears that we have bought ourselves some time and are at least moving toward a partial resolution. With that said, we believe that there is no way Greece can do anything but default on their debt. There aren't enough austerity measures that could be enacted, nor is there the willingness on the part of the Greeks to pull back from this inevitability.

Now that I've covered that cheery topic, what lies ahead? As you can imagine, there have been numerous discussions over the past few weeks about risk, volatility, and investment options. We seem to be stuck between the proverbial rock and a hard place. "Safe" assets, such as CDs, Treasury bills, money market funds, and the like offer limited principal risk, but with that, little or no return. Stocks, on the other hand, are trading at significant discounts to historical averages, and many pay outsized dividend yields, but with that comes volatility. The irony is that global funds are rushing into US government securities at a time when we as a country face unsustainable debt levels, and away from corporations, which happen to be posting historic profits. Is it time we re- evaluate/redefine risk? Is it volatility, the possibility of losing principal, or is it earning less than the rate of inflation while invested in non-interest bearing, "safe" securities? We may, as investors, be forced to tolerate increased day-to-day volatility in order to position ourselves for a competitive dividend yield and/or future growth potential.

It is likely that our markets will remain volatile for the foreseeable future, but on a positive note, equity valuations appear inexpensive, and often the best entry point is when fear and uncertainty are at their highest. Trying to predict short-term market direction is a fool's game. Sticking with a well-thought-out investment plan is critical to long-term investment success.