

RBF Weekly Market Commentary

August 4, 2014

The Markets

Last week, investors took a long look at the crazy quilt of information and events around the world and decided they didn't like what they were seeing.

Geopolitical tensions puckered a lot of seams: Conflict in Ukraine was embroidered with additional sanctions against Russia, difficulty investigating the downed commercial airliner in Ukraine, and escalating anti-American rhetoric in Russia. Violence continued to roil through Middle East and North Africa. In Libya, hostilities escalated, causing many western countries to withdraw diplomats and leading Tunisia to close its border with the country.

Financial and economic issues overseas, including ongoing issues with one of Portugal's largest banks, and worries that European companies will be negatively affected by sanctions against Russia, marred investors' views, too. In addition, controversy swirled around Argentinian bonds. In the midst of a legal battle over bond repayment, the country missed a June interest payment. The 'credit event' triggers a payout of about \$1 billion for investors who hold insured Argentine debt.

Positive news in the U.S. offered some padding. The U.S. economy continued to recover and gross domestic product increased by 4 percent (annualized) during the second quarter which was a remarkable improvement after first quarter's contraction. *Reuters* reported, "Consumer spending growth, which accounts for more than two-thirds of U.S. economic activity, accelerated at a 2.5 percent pace... Despite the pick-up in consumer spending, Americans saved more in the second quarter... which bodes well for future spending."

The Federal Reserve issued a midweek statement confirming economic recovery was continuing apace. It caused some investors to throw what one expert called a 'taper' tantrum. *Barron's* said, "As the Fed's easy money policies reverse, people are forced to focus more on what they're paying for investments. If last week is any indication, investors didn't like what they saw in their portfolios."

By Friday, U.S. markets had experienced their worst week in two years. As investors adjust to the idea of rising interest rates, markets may experience additional volatility.

Data as of 8/1/14	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-2.7%	4.2%	12.8%	14.4%	13.9%	5.7%
10-year Treasury Note (Yield Only)	2.5	NA	2.7	2.7	3.6	4.5
Gold (per ounce)	-0.3	7.5	-1.8	-7.3	6.1	12.7
Bloomberg Commodity Index	-1.7	1.1	0.7	-7.9	-0.6	-1.4
DJ Equity All REIT Total Return Index	-1.5	16.0	12.3	11.9	20.5	9.4

S&P 500, Gold, Bloomberg 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 Total Return 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.

JUST AS SOME SCIENCE FICTION NOVELS DESCRIBE PARALLEL UNIVERSES, the Congressional Budget Office (CBO) report entitled *The 2014 Long-Term Budget Outlook* described

alternate realities for the United States, including futures that will be determined by the decisions of our policymakers today and in the future.

The CBO reported, “Between 2009 and 2012, the federal government recorded the largest budget deficits relative to the size of the economy since 1946, causing its debt to soar.” A deficit occurs when the government spends more than it takes in. One consequence of recent deficits is the federal debt (the amount of money the United States owes its creditors) is now equal to about 74 percent of the U.S. economy’s gross domestic product (GDP). That’s the highest percent ever except for a short period around World War II.

If nothing changes – meaning laws governing taxes and spending remain the same, and the economy recovers as anticipated – deficits are expected to remain relatively low from 2015 through 2018. However, after that, the CBO projects government spending on healthcare programs and interest payments will grow and the federal debt could be 106 percent of GDP by 2039.

In an alternate universe, “certain policies that are now in place but are scheduled to change under current law would be continued, and some provisions of law that might be difficult to sustain for a long period would be modified. With those changes to current law, deficits, excluding interest payments, would be about \$2 trillion higher over the next decade than in CBO’s baseline.” In that scenario, the debt of the United States balloons, swelling to about 180 percent of GDP by 2039.

A more attractive alternative requires deficit reduction measures. Depending on the amount of deficit reduction, the federal debt could diminish and be 42 to 75 percent of GDP by 2039. We can only hope the United States isn’t the country to answer an economic question recently discussed by *The Conference Board*: How high can debt-to-GDP ratios rise before crippling a nation?

Weekly Focus – Think About It

“The most difficult thing is the decision to act, the rest is merely tenacity.”

--Amelia Earhart, American aviation pioneer

Best regards,

Tony Kalinowski

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* Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

* Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.

* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. You cannot invest directly in this index.

- * The Standard & Poor's 500 (S&P 500) is an unmanaged index. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.
- * 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 afternoon gold price as reported by the London Bullion Market Association. The gold price is set twice daily by the London Gold Fixing Company at 10:30 and 15:00 and is expressed in U.S. dollars per fine troy ounce.
- * The Bloomberg 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 Total Return 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.
- * Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful.
- * Past performance does not guarantee future results. Investing involves risk, including loss of principal.
- * You cannot invest directly in an index.
- * Consult your financial professional before making any investment decision.
- * Stock investing involves risk including loss of principal.

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