



The Portfolio Reporter

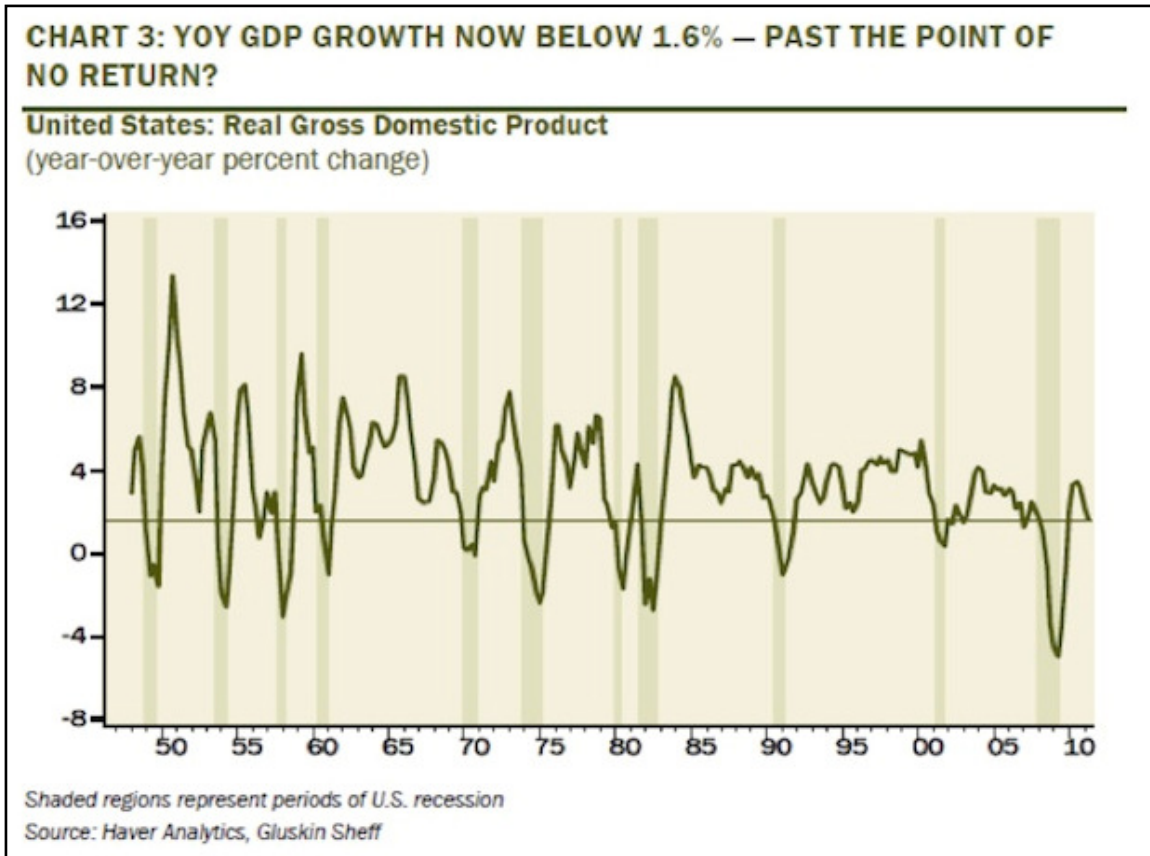
Stock Market Catches Up to the Economy

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The bickering around the debt ceiling is overshadowing the true news event: The economy is slowing.

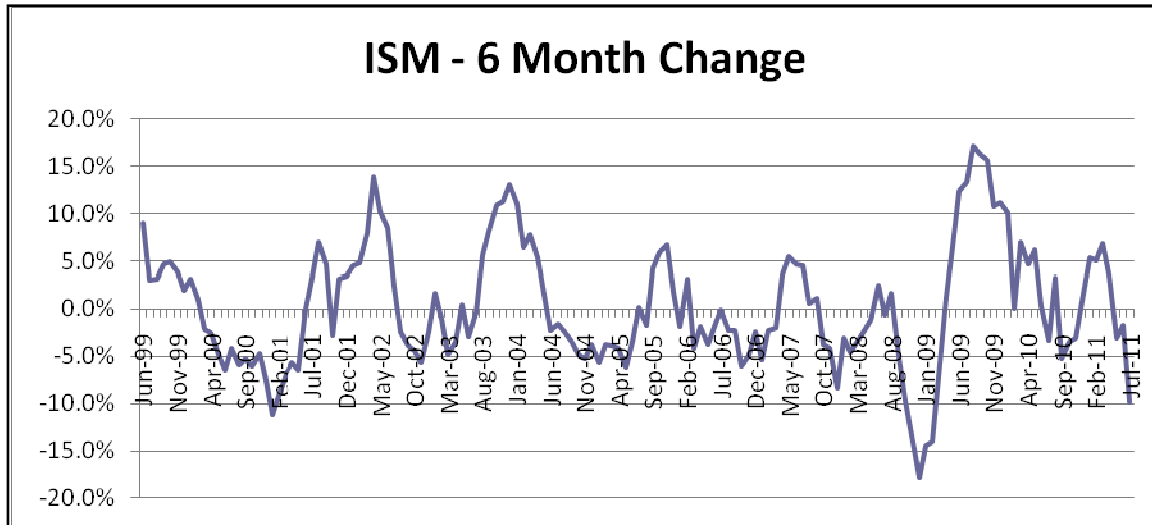
On Friday July 29th, as the flurry of press coverage converged on Washington, the Bureau of Economic Analysis reported Gross Domestic Product (GDP) increased at an annual rate of 1.3%. This is an improvement from the first quarter, which only increased at a rate of 0.4%. However, the growth from quarter 1 was just revised lower from 1.8% to 0.4%, a sharp revision, and a recognition that the economy is not as rosy as the stock market has presented it to be. More of a concern is that the annualized growth rate of 1.3% is below what David Rosenberg says is “Past the point of No Return.” Historically, as David Rosenberg shows in the graph below, once GDP growth falls below 1.6%, the economy continues into a recession.



I certainly can't foretell the future. To say the economy is going to resume growth in the second half, or that it might stabilize or decline from here, is just guess work. We do know a few things: First that the slow down is broad, covering many segments of the economy and across continents. Second, economic indicators have been in a decline for a persistent time, beginning to slow down at the end of 2010, before the earthquake in Japan. Last, the decline has been significant.

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The ISM manufacturing index (Institute of Supply Management Purchasing Managers Survey) peaked in February at 61.4 and is now at 50.9. This is a diffusion Index. Any reading above 50 means that manufacturing is growing, while a reading below 50 means that manufacturing is in a decline. More importantly, the ISM rate of growth over a 6-month period is now declining at 10%. The ISM rate of growth has been decelerating (growing, but at a slower pace) since February 2011. Since May 2011, the ISM has been in a decline (the rate of growth goes below 0%). See the graph below for an illustration of this.



As we expressed in our monthly call in July and most recently in the five minute update, the current portfolio positions are reducing stock market risk. In the ETF portfolios, 20% of the stock allocation includes inverse funds, (investments that increase (decrease) in value if the stock market decreases (increases)). For variable annuities that do not have inverse fund investments, we have increased the allocation to bonds.

If the economy were to do any of the following: a. slow down further, and/or outright decline, b. exhibit a prolonged economic decline or c. the depth of the economic decline persists, then we would invoke plan B. Plan B is to increase the exposure of inverse funds to create a market neutral position. Market neutral means to negate the impact of the stock market by offsetting the long positions with our inverse positions. For variable annuities, we would increase cash bonds and alternatives to about 75% of the portfolio.

Last, Plan B' (B prime) is the scenario where we see an improvement in the economy. If this were to transpire, we would increase our exposure to stocks by reducing the inverse funds in those portfolios where they are being used. For Variable Annuity accounts, we would reduce the bond positions. We will continue to monitor the economy closely according to our methodology.

Please feel free to pass "The Portfolio Reporter" to interested friends and family members. For more information about your investments, please contact your financial professional.

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MONTHLY CONFERENCE CALL

Our next monthly conference call will occur Thursday, August 18th at 11 a.m. Mountain Time (1 p.m. EST).

Phone Number: 866-740-1260

Access Code: 4682824

To view slides on the internet during the call, go to www.readytalk.com and enter 4682824 under “Join a Meeting”.