LAUREATE
WEALTH MANAGEMENT

So What Do We Do Now?

Many market participants are wondering ---- "So what do we do now?" The vast majority of LWM clients are fairly well positioned in this market. Our conservative bond allocation and hedge fund of funds positions have been preserving capital relatively well, and our derivatives traders, and precious metals allocations have been making profits. However, I want to turn my focus in this article to the medium term outlook for the markets and economy. Doing so should:

1) Help us avoid the vortex of the market's current panicked mentality.
2) Provide a backdrop for us to look for opportunity to deploy capital opportunistically.

First a few thoughts regarding some medium term effects of the S&P's historic downgrade of longer dated US Treasury debt:

1) The immediate effect of lowering the credit rating of US Treasury debt ---- was to strengthen market demand for ----- US Treasury debt! Go figure. The yield on the 30 year Treasury bond dropped over 4% on the day. Whether the S&P got it wrong or there simply are no other alternatives --- the fact is that US Treasury debt is still acting like the safest debt instrument on the plant.
2) Consumer confidence could become a problem: Highly levered economies are very susceptible to large swings in "consumer confidence". In fact, deteriorating consumer confidence tends to feed on itself as fear tends to paralyze economic activity --- which tends to create more fear --- which further paralyzes economic activity… and so on. The risk here is that the consumer, already teetering on the edge, can tumble the US into such a cycle. And by extension the rest of the world.
3) Further downgrades? S&P has stated plainly that spending cuts must increase by an additional $2 trillion over and above the cuts already enacted to avoid additional downgrades. It is not clear how long Congress will have to secure these spending cuts ---- before additional downgrades are announced. Such massive spending reductions, if enacted, would have substantial negative effects on GDP over time.
4) Regarding the US debt binge: Hard landing or soft landing ---- at least we are landing! Clearly, it would be preferable to enact meaningful spending cuts over time through a bi-partisan Congressional effort thereby reducing our nation's deficit spending problems… As that has not materialized, it appears that the credit ratings agencies are forcing fiscal discipline into our lives ---- and likely at a pace less comfortable than we would have chosen for ourselves. It is ironic to me that the ratings agencies, being one of the main perpetrators of the 2008 financial crisis, should take such an integral role in forcing fiscal discipline. Historically, when sovereign debt is downgraded ---- the ensuing "belt-tightening" by the affected

country is substantial. The ultimate outcome should be a more tolerable national debt / deficit spending structure.

5) Turning Bullish: As you all know --- I have been generally bearish on the US economy and markets for the past 3 years. At this point I think it is important to note:
   a. Corporate balance sheets are strong
   b. Housing woes continue --- but are much closer to finishing than starting.
   c. In spite of the ensuing pain, it seems apparent that we are entering a time where one way or another ---- fiscal responsibility has a chance of being restored in the US.

   Certainly, unemployment continues to be a big issue. The market will also likely react negatively to full realization of any recession that actually materializes. Such a recession could provide a compelling entry point for risk assets ---- just when the rest of the world may swear off stocks yet again for the rest of their lives… I think it is wise to be searching for opportunities to take more market risk, should such an environment materialize.

Plan of Action:

1) Continue to hold substantial positions in high quality bonds and hedge fund of funds. The consequent risk management can now also be viewed as "dry powder" should substantially compelling ideas materialize.
2) Energy trade: Still long term bullish on energy. Would like to add to this position over time. Drawdown has been dramatic. Prefer to see markets stabilize before trying to "catch a falling knife"… MLPs now offer double digit dividend yields with oil currently trading in the low $80s/barrel…
3) Gold trade: Still bullish on gold.
4) Derivatives traders: More bullish on this than before. Volatility events like today and last week provide more opportunity for the derivatives traders that we utilize.
5) If market drops significantly (20% or more) --- move to increase distressed credit and/or deep value equity manager allocations.

As always, it is a privilege to work for and with you. Please reach out to me with any questions or comments you may have.

Best Regards,

Jeremy Boynton