SFMG WEALTH ADVISORS
AN INDEPENDENT WEALTH MANAGEMENT FIRM

ECONOMIC AND MARKET UPDATE

AUGUST 2011

CURRENT ECONOMIC CYCLE

Early Expansion → Middle Expansion → **Late Expansion** → Early Contraction → Middle Contraction → Late Contraction → Early Expansion

ECONOMIC NEWS

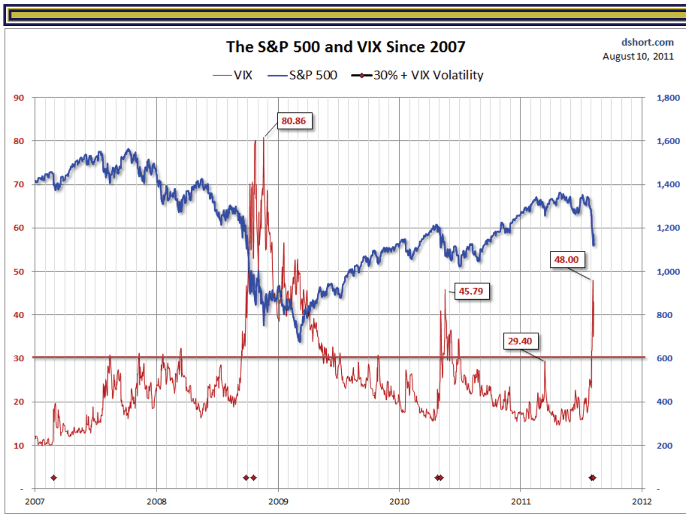
- The economy continues to show signs of weakening as both the service and manufacturing sectors reported declines.
- July retail sales grew modestly, but August consumer sentiment plunged to 30 year lows.
- Economic output (GDP) for the 1st quarter was revised from 1.8% to .4%, and initial 2nd quarter growth was only 1.4%.

CURRENT ASSET CLASS ALLOCATIONS

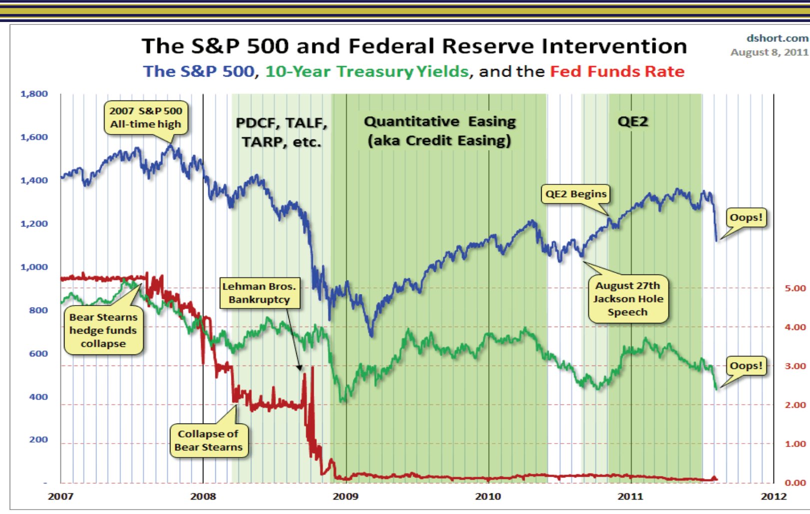
Cash & Equivalents	*Underweight*
Fixed Income	*Overweight*
Equities	*Underweight*

MARKET TRENDS

- The volatility in the U.S. equity markets reached epic proportions last week with four consecutive trading days with moves of over 4.5%, both down and up.
- With stocks already trending lower from the April highs for the year, the news of the downgrading of the U.S. credit rating to AA+ sent the market into a bi-polar trading frenzy.
- Now the focus has shifted to the European sovereign debt crisis.



The VIX index (red line above) is a measurement of the expected volatility of the market over the next 30 days. It is also referred to as the fear index. When compared to the S&P 500, you can see that as the VIX rises, selling pressure increases.



The chart above shows the impact of the Federal Reserve's intervention in the economy by easing credit and increasing liquidity (Quantitative Easing). The European Central Bank has announced its intention to do essentially the same thing as the Fed, apparently hoping for different results.

CURRENT THOUGHTS

With the recent swings in the U.S. equity markets, it is apparent that fear and elements of panic are present. With the memory of what happened in 2008 fresh in the minds of investors, comparisons of then and now are becoming more frequent. Even though a meltdown of our banking and financial system does not appear likely to happen again, there are growing concerns that the European banking system is fragile and exposed to the risk of default by countries like Greece and Italy. Germany and France will have to take the lead in structuring a way to protect the bonds held by the banks for the markets to calm. In the U.S., a Rasmussen poll showed that 70% of adult consumers believe we are in a recession. Perception can easily become reality and until confidence returns, a defensive approach remains warranted in these volatile times.

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