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What Does The Downgrade Of U.S. Debt Really Mean?

Sentimental observations about the United States falling from a 94-year state of grace aside, Standard & Poor's recent downgrade of the Treasury's credit rating has real implications for investors and the nation.

In theory, a lower credit rating reflects a higher risk that an entity such as the Treasury will default on its debt or other financial obligations. To compensate lenders for the added risk, lower-rated borrowers generally need to offer higher interest rates. However, even though Standard & Poor's now considers U.S. debt no longer worthy of the top AAA rating, Treasury yields—the gauge of how much interest credit markets demand from the U.S. government—actually declined during the week following the downgrade. Although it may seem paradoxical, global investors still consider Treasury debt the safest place on earth to park their money in times of heightened risk, no matter what the rating agencies say. No foreign central bank is dumping our bonds; if anything, they're buying more.

In the longer run, if the Treasury fails to regain its AAA status, its reputation could eventually weaken, and U.S. interest rates may rise. On the eve of the downgrade, the two countries with AA+ ratings from S&P paid an average of 2.72% on their two-year bonds and 4.58% on their 10-year debt, compared with 1.12% and 2.65%, respectively, for the world's remaining AAA borrowers.

But averages can be deceiving. Switzerland, which S&P rates AAA, pays just 0.06% in annual interest on its two-year bonds, and the United Kingdom, also AAA rated, pays fully 10 times as much—still a very low rate.

And then you get to Japan, which S&P rates two steps lower at AA—a full step below where the United States is now—and pays only 0.15% on its two-year debt. That's right: this lowly AA-rated country pays less than a quarter of what AAA-rated Britain offers, while interest rates for most other AAA nations are nine times as high as what investors are happy to get from Tokyo.

Incidentally, the worst-case scenario S&P currently sees for the United States would prompt one more downgrade during the next two years, which would put the Treasury at exactly the same level where Tokyo is now.

Any upward trend in U.S. interest rates would also have to overcome the Federal Reserve and its new policy of setting the low end of the yield curve effectively at zero through mid-2013. As we have seen several times during the past last few years, the Fed has almost endless funds at its disposal to buy Treasury debt and keep the government's borrowing costs artificially low.

Of course, other U.S. borrowers lack the infinite resources of the Federal Reserve. In the S&P system, the new U.S. rating means most U.S. companies, state and local governments and other bond-issuing entities are now also

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Peace Of Mind When Markets Get Volatile

It seems that the volume of economic information and market predictions has been increasing exponentially in recent months. This may be due to the coming election cycle or it may be a reflection of the difficult economic times in Europe as well as the persistent unemployment in the United States.

Politicians in both Europe and the United States will determine the immediate future of global financial markets. But on a daily basis, the political news creates a high level of uncertainty.

The stock and bond markets have been reacting to this "headline risk." The Dow Jones Industrial Average has closed at least 1% higher or lower 38 times since August 1. Uncertainty tends to amplify extreme emotions that can drive markets.

While economic trends are important, for long-term investors the daily market fluctuations are background noise.

We encourage our clients to keep their eye on meeting their long-term goals and tune out the day-to-day market swings. We suggest:

- Focusing on tasks that are within your control
- Making well-thought out decisions about uncertain factors
- Reviewing your progress towards goals on a regular basis

We've found that this brings a measure of peace of mind during market gyrations. If you'd like to find out more about our goal-oriented investment approach, give us a call.

Colleen & Rob

5 Excellent Tax Blogs And Websites

Information flows fast and free on the Internet. You can find advice on anything from stringing a tennis racket to pottery classes to square dancing. So why should taxes be any different?

Our advice: Approach the tax information you find on the web with a healthy dose of caution. Some of the numerous blogs and websites devoted to taxes are significantly better than others, and you shouldn't assume that everything you read online is entirely accurate. It's certainly advantageous to be well informed, but you should consult with a tax professional before implementing any sophisticated tax strategies.

With that caveat in mind, here is a brief review, in alphabetical order, of five reputable online resources of tax planning information.

1. Fairmark at http://fairmark.com. Fairmark touts itself as a "Tax Guide for Investors," but it's actually much more. This site includes blogs that can benefit a wide range of taxpayers. For instance, a recent posting, "Tax Provisions of the Recovery Act," summarizes tax breaks in the 2009 economic stimulus law affecting both individuals and small business owners.

2. TaxHawk at http://www.taxhawk.com. In addition to providing free federal income tax filing services, TaxHawk offers add-ons such as professionally bound tax returns. It also features insightful articles such as "Seven Common Tax Mistakes" to help guide you through the tax return season.

3. TaxMama at http://taxmama.com. Does "Mama" know best? TaxMama (Eva Rosenberg) dispenses free advice with a mother's loving touch and a sense of humor. She talks to you, not at you. Questions from readers are answered and blogs such as "Mind the pitfalls in claiming homebuyer tax break," provide useful information.

4. TAXSites.com. at http://www.taxsites.com. TAXSites is a comprehensive online service accommodating both individual taxpayers and tax professionals. It is divided into three categories: Taxes, Accounting, and Payroll H/R. You can find information and links covering finances and investments, auditing procedures, and benefits administration.

5. UncleFed's Tax Board at http://www.unclefed.com. UncleFed (not Uncle Sam) serves as a complete online source for tax relief. It provides quick links to IRS tax forms and instructions, offers practical solutions, and disseminates information about the latest developments in tax law and guidance.

Finally, don't overlook the IRS itself as a resource. This is probably the most accurate site of all. Visit http://www.irs.gov for tax news, vital information, and updates.

Again, though educating yourself can help in the tax planning process, free Internet advice can't replace professional advice. Don't hesitate to contact us for assistance or referrals. ●

A Walk Every Day Can Keep Aging At Bay

It's much easier to talk the talk about staying young than it is to walk the walk. Starting in our 20s and 30s, we commence a long, seemingly inevitable physical deterioration. Our maximum heart rate declines, and with it the amount of oxygen-bearing blood the heart can pump. Muscle is gradually replaced with fat and weight edges upward. And decade by decade, as oxygen intake drops, it becomes a little harder just to get around. Eventually, in our 70s, 80s, or 90s, most of us lose our "functional independence," the ability to live on our own. We move to assisted-living or nursing homes because, literally, our living needs to be assisted.

But what if there were a simple way to turn back the clock? In a recent article in the British Journal of Sports Medicine, Roy Shephard, a physician at the University of Toronto, reports that for people 64 and older, a vigorous, hour-long walk five days a week cuts a dozen years from their biological age. In a review of other published work on the subject, Shephard found that such an exercise program could also extend a person's functional independence, which tends to be lost when maximal oxygen intake falls below 18 milliliters per kilogram per minute in men and 15 ml/kg/min in women.

Without this kind of exercise program, about 10 years of physical aging normally corresponds with a loss of about five ml/kg/min. But Shephard found that beginning a program of vigorous aerobic exercise could restore about 25% of maximal oxygen intake within three months, raising that essential level by an average of six ml/kg/min and decreasing biological age by 12 years.

Shephard also found that regular exercise provides other benefits, helping prevent conditions that may

Search Optimization Tips For Biz Owners

The Internet has become the tool of choice for people seeking information, and that includes the lowdown on local businesses. In a recent study by the University of Southern California journalism school, 78% of respondents considered the Internet to be an important source of information, compared with 68% citing television and 56% naming newspapers. And a 2009 survey by The Nielsen Co. revealed that 63% of consumers were using the Internet to get information about local companies. Those numbers have since increased.

As a business owner, you need to optimize your website so that it will show up near the top of search engine rankings. Otherwise, your competitors will be listed higher on the page, and many consumers may never learn what you can do for them.

The need for high search rankings has led to a new marketing field called search engine optimization, or SEO. It involves taking a number of steps to ensure that search engines such as Google recognize your business as an important local service provider, worthy of a top spot when consumers conduct a search.

You can hire companies to optimize your website, or you can do it yourself. If you choose to handle it in-house, here are 10 tips to help you navigate this brave new world.

1. Content is still king. Google and its competitors are filled with brainy folks who create search algorithms designed to display high-quality companies and weed out the rest. Today's search engines won't be fooled by sites that type in the same word thousands of times or similar tricks. They are designed to recognize well-written, meaningful content.

2. Do your keyword research. You may offer a great product or service, but you can't optimize your website content unless you know what words consumers type when searching for your kind of services. There are many tools for finding out, including Google Keyword Tracker, Google Insights, Wordtracker, and SEO Book.

3. Choose the right keywords. Building on your keyword research, put yourself in the place of your potential customers—if you were looking for the particular product or service you provide, what would you type in a search box? Be specific. If you sell shoes, for instance, you may want to sprinkle your website with terms such as "hiking shoes" or "formal attire," depending on your niche. Also, make sure your keywords mesh with your larger marketing strategy that includes social media, public relations, and advertising.

4. Provide good customer service. Great service is important in its own right, of course, but it can also affect your reputation on the web. Social media sites such as Yelp encourage consumers to review businesses, so if a potential customer conducts a search and your company turns up, you want it to be a positive reference.

5. Control your message on other sites. Dozens of websites, from Yahoo Local to Manta to Bizquest, list local businesses whether you ask to be listed or not. Because search engines often provide results from these sites, it pays to log on to each one and verify the information on your company. Also consider listings in paid directories such as Business Directory, Best of Web, Go Guides, and others.

6. Keep it fresh. You need to add new content (articles, photos, videos) and pages to your website regularly, and ensure the content is unique, because search engines discount copy that appears on multiple sites. Then post links to your content on Twitter, Facebook, LinkedIn, and YouTube.

7. Link up with others. Search engines are impressed by links to other websites, as long as they are high-quality sites, and especially if they are sites within your geographic area. But they won't be fooled by so-called shadow sites, set up to serve solely as links. Ask other high-ranking websites to link to your site.

8. Place your keywords where they will count. Along with lightly sprinkling your website copy with appropriate keywords, add your best keywords in the following places: domain names, sub-domain names, meta tags, ALT tags, and page headers.

9. Look out for bad links. Having broken links that send visitors to a "page not found" message or the like is a big mistake, because search engines take that to mean your site is out of date or untended and thus irrelevant to your target audience. Check regularly for bad links and eliminate them.

10. Keep your domain name. Avoid changing your domain name, because search engines interpret older names as implying stability and give them more credit than newer domain names. ●

hasten aging including obesity, high blood pressure, diabetes, heart disease, osteoporosis, and even some kinds of cancer. And the improved muscle tone that comes with brisk walking, swimming, or other aerobic activities may help older people avoid falls.

Another study, from Texas, further highlights what exercise can do. In 1966, five healthy 20-year-olds were kept in bed around the clock for three weeks—and suffered many of the ills normally associated with aging. They gained weight, their heart rates and blood pressure rose, and their hearts lost pumping capacity. Then, an eight-week exercise program more than reversed the effects of inactivity.

In a follow-up with the men 30 years later, actual aging had imitated the effects of the forced bed rest. But here, too, an endurance exercise regimen undid most of the damage, restoring all of their lost aerobic capacity.

The moral? Exercise always helps, and it's never too late to start pushing back the hands of time. ●

Modern Portfolio Theory Is Alive And Well

For more than 50 years, Modern Portfolio Theory, or MPT, had been an article of faith for investors. The basic idea was that you could keep investment risk and reward in balance by choosing a diverse mix of assets. But then came the bear market of 2008 and 2009, during which nearly every kind of stock, bond, and most alternative investments plunged simultaneously. That led some analysts to pronounce Modern Portfolio Theory dead. What good is diversification, they asked, if everything sinks together?

But Modern Portfolio Theory never asserted that asset classes couldn't fall at the same time. Moreover, a look back over the past decade shows that investors who stayed diversified, continuing to rebalance during the downturn, enjoyed healthy returns. In fact, the market meltdown has proven a powerful validation of MPT.

MPT asserts that the best way to maximize returns while minimizing risk over the long term is to allocate your money among diversified classes of investments and periodically rebalance to keep the proportions in line with original targets.

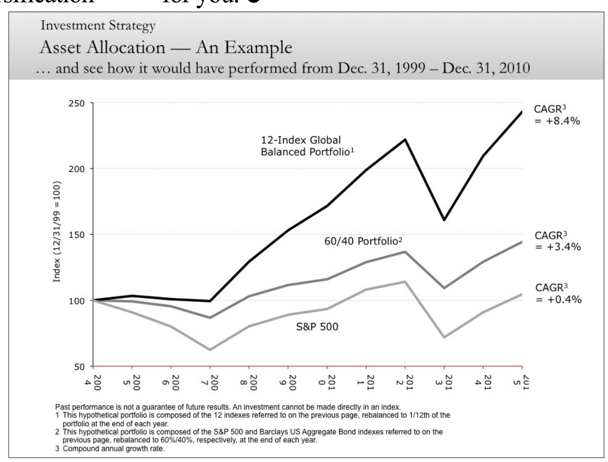
MPT attempts to build a portfolio of asset types that won't necessarily move together in response to changes in the economy. The hope is that when one portion of your portfolio—say, large-cap stocks—falls in value, another part—commodities, for instance—will rise. Rebalancing lets you "buy low and sell high," because to keep allocations at proper levels you end up selling assets that have gained in value and buying others that have lost ground.

For long-term investors, one of the most distressing aspects of the 2008 economic crisis was the unprecedented way that nearly all asset classes—bonds, stocks, commodities—lost value at the same time. The notion that diversification ensures gains in some sectors despite losses in others seemingly lay in tatters. But diversification can't, in fact, ensure that outcome, and MPT never suggested it could. It can merely increase the likelihood of that result.

And even when, inevitably, there are times when every part of a portfolio loses value for a while, MPT has great potential value. According to economist Fritz Meyer, a global portfolio using 12 asset classes managed according to MPT principles would have earned a compound annual growth rate of 8.4% during the volatile decade ending in 2010, compared with a 0.4% gain for a portfolio holding only stocks (represented by the Standard & Poor's 500 index).

The secret is in the rebalancing, Meyer says, because disciplined rebalancing forces you to ignore macroeconomic considerations and keep emotions out of the process.

As we embark on another decade of economic and market uncertainty, we will continue to design portfolios that are properly diversified and regularly rebalanced, allowing MPT to work for you. ●



Past performance is not a guarantee of future results. An investment cannot be made directly in an index.
1 This hypothetical portfolio is composed of the 12 indexes referred to on the previous page, rebalanced to 1/12th of the portfolio at the end of each year.
2 This hypothetical portfolio is composed of the S&P 500 and Barclays US Aggregate Bond indexes referred to on the previous page, rebalanced to 60%/40%, respectively, at the end of each year.
3 Compound annual growth rate.

Downgrade Of U.S. Debt

(Continued from page 1)

subject to a maximum rating of AA+, and that has led to downgrades of many formerly AAA-rated borrowers. However, S&P has made numerous exceptions to its normal operating rules, leaving the AAA ratings on some states, cities, and corporations intact.

In explaining why it didn't downgrade all municipal issuers, S&P noted that "the institutional framework for U.S. public finance is among the most stable and predictable in the world." Meanwhile, the behemoths of American industry—including Johnson & Johnson, ExxonMobil, and Microsoft—are also considered unassailably reliable, and their AAA ratings are safe as well. And though the entities whose debt was downgraded may suffer over the short term, the pain need not be permanent.

Standard & Poor's won't speculate on when or how the United States might get its AAA rating back, but other nations—Germany, Sweden, and Canada, among others—have rebounded from downgrades. It's often a slow process, taking as long as a decade, but if Congress can find the will to work out a sustainable budget that satisfies the ratings analysts, it can happen.

And that prospect in itself may be the silver lining in this situation. While Standard & Poor's has been criticized by the President, Warren Buffett, and others for publicly challenging the will of one of the greatest economies on earth to pay its debts, the challenge may be an opportunity in disguise. Any nation that owes 74% of its annual gross domestic product could stand to look seriously at its budget. If nothing happens to change the way the government spends, Standard & Poor's calculates that we would owe 101% of GDP by 2021, which would put us roughly where Italy is now. This was a wake-up call. Now we can prove to the world how we became the greatest economy on earth in the first place. ●