DELTA
FINANCIAL ADVISORS
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Economic Comments

Both U.S. and global economic outlooks have taken a turn for the worse in recent weeks. Having withstood the continued drum roll of negative news from the Greek debt crisis, Middle East unrest, U.S. budgetary woes and natural disasters, confidence has ebbed into a potentially self-reinforcing cycle of pessimism.

In the face of these diminished expectations, ñthe Twistò is back - sadly not the Chubby Checkerôs dance from the 1960s but rather the Federal Reserveôs version, ñOperation Twist.ò Following its September meeting, the Federal Reserveôs Open Market Committee (FOMC) reached deep into its increasingly limited bag of tricks. Under Operation Twist, the FOMC is aiming to drive down long-term interest rates by buying $400 billion of long term Treasuries which will be funded by the sale of a like amount of short maturity Treasuries. The swap programôs aim is to reduce long term rates and was last carried out in 1961 where it met with meaningful success. However with the U.S. Treasury market having grown sharply both in size and complexity over the last 50 years, it is far less clear whether the current Twist will meet with similar success to its 1960ôs forbearer.

Looking at recent U.S. economic activity, GDP growth has averaged 1.6% in the yearôs first half with unemployment continuing to hover above 9%. In short, the tea leaves are not looking promising. Historically, a sub 2% GDP growth rate has been a harbinger of recession. Many economists are now projecting up to a 50% likelihood for the U.S. to fall back into recession.

Further hindering the current situation have been the continued Greek/Euro drama and the U.S. deficit crisis. In Europe, Greeceôs slow motion drama has accelerated and is moving towards a climax. Concerns have become increasingly strident over the lack of soundness of Europeôs major banks due to their substantial Greek debt holdings. EU leaders have been extraordinarily reluctant to take the necessary steps to contain the growing emergency. Key government leaders and central bankers have continued to address the symptoms of the expanding crisis rather than trying to cure the underlying illness.

On the domestic front, partisan bickering appears to be the rule of the day with no political party being able to see the forest for the trees. Largely due to the governmentôs inability to reach a budget/deficit consensus, the U.S. had the ignominy of losing its long vaunted AAA credit rating. While the U.S. has the resources to address the problem, the childish bickering

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has severely harmed investor confidence. Having been unable to reach a deficit agreement themselves, Congress futilely kicked the problem down the road to a Congressional super committee with the forlorn hope of forcing the committee to make the hard decisions that Congress was unable to make itself.

Trying to address persistently high unemployment, the President has proposed a $400 billion jobs bill to be paid by a surtax on higher income individuals. While his goal of greater employment is admirable, the means of doing so appears ill thought. Assessing the key drivers of the economy, the best near term opportunities appear to be with investments and trade. Holding record levels of cash, corporate America has the resources to invest but remains hesitant due to abundant supply and concerns over future demand. The other ray of hope has come from U.S. exports which have shown recent strength amidst the dollar’s weakening and continued U.S. productivity growth. Regrettably, a weakening global economy would not bode well for U.S. exports in the near-term.

The other major economic drivers remain tepid, at best. Representing 2/3 of economic activity, spending by consumers showed a slight, 0.1%, growth rate for the 2nd quarter as consumer confidence remained wary. Finally, governmental outlays usually increase in slack economic periods - more recently though, total federal, state and local spending has declined by 3.5% over last year’s inflated economic stimulus levels. With federal spending under heavy pressure to be reduced, little good economic news is likely to come from Washington in the near-term.

Yet all is not a loss. The U.S. does have the resources to address its budgetary woes. What it has lacked until recently is the desire to address these problems. While the EU’s response to the Greek debt crisis has been timid so far, there are signs that the critical core governments of Germany and France are starting to come to grips with the need for decisive action. All we can be sure of at this stage is that we will continue to live in interesting times!

Analyst Corner

With oil prices having fallen more than 15% in recent months, the oilfield service sector has taken a beating. However, to use a colloquialism, we believe that the baby has been thrown out with the bath water. As such, we forecast that the energy sector’s strong long-term fundamentals will prevail over the sector’s recent pricing weakness. In particular, industry leader Schlumberger (*NYSE: SLB*) appears to have overly suffered from the decline in oil prices which has created an attractive investment opportunity. With 80+% of its revenues generated overseas, SLB goes wherever its clients need it to be. Having a rock solid balance sheet and producing attractive returns on shareholder capital, this industry bellwether is positioned to sharply profit as industry and economic expectations turn less wary. For the appropriate investor, a little bit of SLB could go a long way!

Market Comments

This summer, the equity markets suffered their largest decline since the Fall of 2008 as stocks retreated by 14%. With investors becoming increasingly wary, the marketôs fear gauge, the VIX, moved up to its highest level in over a year with more than a 150% increase for the quarter. Driving the recent downturn and market volatility increase has been a chronic lack of confidence by investors in each other and in their governments. While in 2008 the challenge was too much consumer debt that borrowers were having trouble repaying, the current market issue is too much government debt which its governmental borrowers are having trouble repaying.

In counterpoint to the equity marketôs decline, the bond markets rallied sharply and drove the 10-year Treasuryôs yield down by almost 1/3 to 1.92% as fearful investors sought the greater stability of fixed income. Moreover, despite the lowered credit rating of the U.S., investors have continued to flee to the perceived safety of U.S. Treasury obligations.

Driving the equity market downward with 22+% quarterly declines were the financial and materials sectors. Finance holdings were pummeled over escalating U.S. and Euro debt concerns while the materials sector suffered as commodity prices plunged on worries over the strength of the global economy. Only the utility sector was in the black for the quarter as investors sought stability amid the marketôs turmoil.

Looking to corporate earnings, the picture has become less rosy with analyst optimism abating as the dog days of summer arrived. While the likelihood and expectations remain for meaningful growth over 2010 levels, forecasts for the 2nd half of 2011 and full year 2012 have been ratcheted down. To reinforce this message, and for the first time since March 2009, more companies have been reducing earnings estimates than increasing them. With Wall Street having declined by more than 17% since its April highs, stock prices reflect big doubts about the economy.

While the near-term market prospects appears more drab, we are bullish longer-term. The few times that the stock market has treaded water for a decade, the subsequent decades have experienced strong returns. Since the Internet bubble and bust, companies have spent the last decade sharply growing earnings as stock multiples returned to more historic levels. Having done so, stocks, relative to a number of pricing models, are quite inexpensive. For instance, the S&P 500 dividendôs yield is now 2.25% - meaningfully higher than that of the 10-year U.S. Treasury.

While we are not certain what will be the driver for the next renewed market advance, we are certain that we will continue to see elevated levels of volatility. In tumultuous times such as these, we believe that maintaining a liquid and risk appropriate portfolio is of paramount importance.

Performance as of 9/30/11

	Close	Month	YTD	1 Year
DJIA	10,913.38	-5.91%	-3.89%	3.84%
S & P 500	1131.42	-7.03%	-8.67%	1.15%
NASDAQ Comp.	2415.40	-6.36%	-8.95%	-1.98%

	Quarter end yield	Prior Year end yield	Yield 1 year ago
10 yr. U.S. Treasury	1.92%	3.31%	2.95%

Planning Thoughts

Over the last couple of years, we have encouraged clients on several occasions to consider re-financing their existing mortgages. With 30-year mortgage rates now hovering at 4.0% (yes, this is not a typo) and 15-year mortgages resting at 3.375%, now is the time to refinance. If your current mortgage is at least one percentage point higher than these rates and you plan on staying in your current home for at least several more years, a mortgage re-financing could result in substantial savings.

We can assure you (and with near certainty) that this will be our last time to make this suggestion for quite a while. Why you ask? Simply put, there is very limited room for mortgage rates to decline much further from their current levels. Even Japan, with its notoriously low rates, has 15-year mortgages of around 3%. If you would like help assessing your unique situation, please pick up the phone and call us - we would be happy to help!

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