



***"It's not whether you get knocked down; it's whether you get up."*** *Vince Lombardi*

The third quarter of 2011 may enter the history books as one of the worst for global equity markets. Share price fluctuation continued unabated in response to ongoing economic and political uncertainties. Fears of a double dip recession were everywhere despite the relatively even performance of the economy. If we have or had a recession, it was mild and may have already occurred. Market sentiment was extremely negative but has since shown considerable improvement.

The US Congress demonstrated to the world how democracy can sometimes work – we witnessed a distressing display of brinkmanship that truly provided a disheartening conclusion followed not unexpectedly by Standard & Poor's (S&P) downgrading US Treasury debt from AAA to AA+. The market response was ironic: buy US Treasury Bonds when all else is in doubt.

New employment in the US remains stagnant. Elevated levels of uncertainty discouraged businesses from adding new employees. As recently as October 7<sup>th</sup>, US employment figures showed only a modest pickup in private market employment and continued shrinkage of government employment at both the federal and state levels.

Meanwhile our friends in Europe struggle with sovereign debt issues and bank capital deficiencies. This is a systemically important issue that may take years of disciplined restraint to resolve. Unlike the US banking crisis, which was caused by domestic real estate lending and subsequent decline in asset values, Europe is dealing with sovereign nations that have revenue and expense imbalances which can be solved only through fundamental societal changes.

***"It's always too early to quit."*** *Norman Vincent Peale*

US companies, both public and private, continue to report solid earnings despite uncertainties. Public companies have deleveraged, and hold record sums of cash. The US consumer has likewise paid down both fixed and revolving debt obligations. Household debt as a percent of GDP peaked in 2009 at 99.4% and has subsequently declined to 88.7%. Household mortgage debt peaked in 2009 at 76.0% and has since declined to 66.1%.

September economic reports by the Institute of Supply Management for both manufacturing and services were surprisingly strong and continue to indicate an expanding economy. Industrial productivity numbers released for September indicate a moderately expanding economy. During the third quarter industrial production rose at a 5.1% annual rate – hardly recessionary. Third quarter GDP numbers released at the end of October indicated the US experienced a 2.5% annualized rate of growth (although this is a preliminary number that will be revised two times before year end). The Consumer Spending component of GDP measured a healthy 2.4%, however, this appears to have come at the expense of personal savings which softened somewhat.

The Federal Reserve Bank Board of Governors has reiterated its willingness to continue with the current highly accommodative policy. While attending an Economic Forum at the University of Wisconsin, I

visited with the President of the Federal Reserve Bank of Richmond, Jeff Lacker, who stated quite clearly that he felt the Fed would continue to accommodate. When I asked about the substantial amount of liquidity that had been created by the Fed and the potential implications for future inflation, he indicated the Fed was focused on its mandate to provide "maximum employment".

Interest rates are near historic low levels. Energy prices have declined as well. In the United States we consume about 140 billion gallons of gasoline annually. A drop of \$.10 at the pump immediately injects \$14 billion into consumer's pockets. A \$1.00 decline would be a substantial boost - \$140 billion. Further declines could be quite a stimulus.

***"There are no gains without pains." Benjamin Franklin***

Despite solid and profitable corporate earnings reports, low interest rates, etc., emotions rule the day. Characterizations of the markets during the third quarter could include "panic selling", or "forced liquidation", or possibly "ready - fire - aim". Regardless of the selected descriptive, the results for nearly all market participants were dismal.

Barron's sector report for the third quarter included the following: Financial Services -21.3%, Natural Resources -21.5%, Telecom -15.2%, Healthcare/Biotechnology -13.9%. Leading the field were Utilities which dropped by only -5.8%. Large domestic stock indices declined by 14% to 16%. World equity indices generally performed worse. China region -26.2%, European region -23.8%, Latin America -23.4% and Emerging Markets -22.3%. Enough said.

My nearly twenty five years of industry experience leads me to believe that after such a severe selloff we are bound to have a substantial rebound, which has already begun. I continue to find many high quality companies trading at reasonable valuations.

***"The buck stops here." Harry Truman***

Let's now look at the issue that has the potential to affect the global economy over the long term - US Government debt.

To begin, some background facts:

Summary of Federal Debt in billions (US Treasury annual data):

2006	\$8,530	8.5
2007	\$9,031	9.0
2008	\$10,048	10.1
2009	\$11,933	11.9
2010	\$13,586	13.6
2011	\$14,368	14.4 (as of June 2011 - latest period available)

The leading cause of increased Federal Debt? Annual budget deficits.

The US Government operates on a September 30<sup>th</sup> fiscal year, so the following numbers are just in:

Revenues (\$ billion) major sources only:

1. Individual Income tax	\$1,093
2. Corporate Income tax	\$180
3. Social Insurance	\$819
4. Other tax receipts	\$210
TOTAL Revenues	\$2,303

Expenditures (\$ billions) major categories only:

1. Defense - Military	\$679
2. Social Security Benefits	\$720
3. Medicare (net of offsetting receipts)	\$483
4. Medicaid	\$275
5. Unemployment Benefits	\$123
6. Net Interest on Public Debt	\$266
7. TARP	\$-39
8. Other expenditures	\$1,093
TOTAL Expenditures	\$3,600

2011 BUDGET DEFICIT \$-1,298

The following table provides historical context for the current year's deficit:

Year	2005	2006	2007	2008	2009	2010	2011
Receipts	2,154	2,407	2,568	2,524	2,104	2,162	2,303
Outlays	2,472	2,655	2,729	2,983	3,520	3,456	3,600
Deficit	-318	-248	-161	-459	-1,416	-1,294	-1,298
% of GDP	-2.6	-1.9	-1.2	-3.2	-10.0	-8.9	-8.6

(Data sources: Treasury Department and Congressional Budget Office)

The magnitude of the US debt burden is of critical importance. The US has been the world's primary economic driving force since WWII. In order to maintain its status the US will need to continue to produce strong economic growth and political leadership. Excessive levels of debt relative to its earnings power, or GDP, will compromise its strength.

***"It has been said that democracy is the worst form of government, except all the others that have been tried." Winston Churchill***

The US economy and consumer are pretty resilient as demonstrated by ongoing economic statistical releases.

Consumer confidence is depressed and market sentiment is negative. Yet the economy continues to show signs of modest growth. The National Bureau of Economic Research will tell us at some future date if and/or when the recession began and ended – driving through the rear mirror!

Looking ahead, political solutions will become clear, and market participant confidence will improve. With elevated confidence levels, we'll see growth in employment, revenue, tax collections and asset values, including real estate and bank balance sheets. Stronger banks with higher capital levels will be more inclined to lend, leading us into the next business cycle.

The fourth quarter got off to a good start during the month of October as equity markets returned roughly ten percent and a sense of order emerged across Europe.

At Milwaukee Private Wealth Management we remain calm, alert and opportunistic. Please feel free to call us at any time to discuss the market outlook or other issues that are of importance to you.

# # #

*The data used for this report was obtained from sources deemed reliable and then organized by the staff at Milwaukee Private Wealth Management, Inc. (MPWMI). All compiled data, figures, transaction summaries, and performance results were prepared using standard industry software and were not audited by a third party. Errors may have occurred in the data collection, in the calculations or in the compilation of this report. The data is furnished for informational purposes only and should not be relied upon as the basis for an investment decision. Although it is derived from information believed to be accurate, MPWMI cannot guarantee the accuracy of this information.*