BEACON'S POINT: ALL FRANTIC ON THE WESTERN FRONT

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All Frantic on the Western Front

After the market close on Friday, August 5, Standard & Poor's ("S&P") reduced the U.S. credit rating one notch to AA+ and maintained its negative outlook. While this event has generated significant volatility and is pushing financial markets lower across the globe, it should not come as a huge surprise: the S&P had previously said that a downgrade was likely if the budget deficit reduction plan fell short of their expectations in terms of size (the rating agency believed that $4 trillion in cuts would be needed to keep the rating) and level of bi-partisan support. Also on Friday, the S&P affirmed the U.S.'s short-term rating at A1+, which should provide stability and support for short-term rates and money market funds. Each of the other two rating agencies, Moody's and Fitch, reaffirmed the U.S's top AAA rating.

The implications of the S&P downgrade for credit and equity markets will become clearer in the coming days and weeks. We believe that last week's sell-off in risk assets was, at least in part, driven by expectations for a possible downgrade. Today's market action shows more signs of frantic trading, increased volatility, and a flight-to-safety that results in relative outperformance by high-quality stocks and - ironically - Treasury bonds. Global blue-chip companies benefit from their diversified revenue sources, cash reserves, and ability to grow market share. U.S. government obligations remain the most liquid safe-havens in the world.

While a serious matter, the downgrade of the U.S. debt by the S&P is not a good reason to materially alter one's long-term portfolio strategy. Beacon Pointe's client portfolios are deliberately and broadly diversified across global equity and fixed income assets. The fixed income managers we work with - on both the taxable and tax-exempt side - do not rely on the rating agencies for their due diligence, but maintain their own credit analysis and ratings. The equity investment managers we work with invest in excellent businesses with superb balance sheets and the flexibility to reallocate their resources globally to take advantage of growth opportunities and protect against economic, regulatory, or political risk.

In fact, the higher market volatility generates improved valuations and more plentiful buying opportunities for these quality-biased and valuation-focused investment managers. For instance, Mr. Kevin Tanner of Saratoga Research & Investment Management stated that: *"The downgrade impacts our investment approach and long-term perspective* ***not at all****. In an AA+ world, a business is still worth the net present value of the future cash flows to be generated over its remaining lifetime. And because that remains true, we believe that our portfolio is deftly positioned for today's uncertainties -- populated as it is with rock-solid businesses, and the ample cash balances necessary to either add to existing positions or take new ones opportunistically when market conditions warrant it. That holds true regardless of whether investors panic or yawn over the coming few weeks."*

This is the type of challenging market environment that Beacon Pointe prepares for when we design our asset allocation and manager selection recommendations. We will continue to exercise caution given the ongoing uncertainty, but we strongly believe that our clients are well positioned for what lies ahead. Our differentiated, intensive, and focused research process helps us identify investment managers that protect principal in down markets, yet are able to grow capital through the power of compounding over the long run. Furthermore, each client's strategic plan is customized according to their specific investment objective and risk tolerance. We are confident that this strategy will serve our clients well going forward, as it has done so in the past.

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.