



This Is Not What the World Wants To See at a Time Like This September 22, 2011 by MKG Financial Group

At a time like this references the current environment in which Europe faces stiff headwinds as it struggles to keep Greece—and other sovereign nations—financially solvent long enough to avoid a financial meltdown that would wreak significant damage to the euro zone.

Not what the world wants to see gives reference to a world that is moving into an economic slowdown before our eyes—it keeps showing up in the numbers—yet popular belief is that this is not happening and that the weakened global economy will limp along the bottom without going over the edge.

Recent financial and political news has focused on economic danger signs and the increasing downside risks. Christine Lagarde, managing director of the International Monetary Fund (IMF), has repeatedly commented on the IMF's belief that the policy choices are declining and the risks of a global economic slowdown are increasing, while at the same time the Federal Reserve's Open Market Committee (FOMC) minutes have referenced concern about increasing downside risks to economic growth in the United States. Yet, perhaps these "concerns" are falling on deaf ears. We wonder if today's leaders understand that in a world where interdependent global economies must work together, movement might be likened to a big ship in the ocean; it takes great power to turn the ship around, and therefore movement in the wrong direction will take time to correct. The cost of fixing today's problems is much greater than six months ago, and it will be even greater six months from now.

United States' leaders are struggling to formulate policy action that creates coordinated, cooperative economic growth and jobs, while at the same time addresses the deficit and budget problems. The greatest need today may be sustaining any economic growth and that may be fruitless, should euro zone dysfunction and emerging market economic cooling persist. The United States, as well as other developed nations, is dependent on manufacturing and exports to other countries such that economic slowdowns will ripple back to our shores—and vice versa.

An Important Piece of the Global Economic Picture

The September 21st announcement of the preliminary HSBC Flash China Manufacturing *Purchasing Managers' Index* (PMI), or flash PMI, fell to a two-month low in September, indicating a broadening slowdown in the Chinese economy with industrial output swinging from a modest expansion to contraction. The headline preliminary PMI in September was 49.4, down from 49.9 in August where a reading of less than 50 indicates a contraction in activity, while a reading of more than 50 signals growth. The PMI's *Output Index* fell to 49.2 for the month, down from 50.2 in August and below the all-important expansionary 50 level. Growth in China appears to be slowing, although it remains high by international standards. Eight percent growth is perceived by many, including Chinese government officials, to be a critical hurdle rate in order to create enough jobs for the large population of people flowing into the cities from rural areas.

Reports coming out of Europe suggest that activity across the euro zone in manufacturing and service sectors is contracting. The European Markit Economics Initial *Purchasing Manager Index* for September declined for the first time since July 2009 below the 50 level to 49.2 from 50.7 in August. The PMI reading for the service sector plunged to 49.1 from a reading of 51.5, while manufacturing PMI dropped to 48.4 from 49.0. This brings about a major concern for economic growth during a time when the 17-nation region is struggling with a sovereign debt crisis in the face of an uncertain global economic outlook.

Market Reaction

Asian markets witnessed dramatic declines in stock prices following the Chinese PMI report, which came on the heels of the U.S. Fed announcement of its “Operation Twist” maneuver, which encompassed selling short-term bonds while buying long-term bonds. In addition, the Central Bank’s comment that there is “significant downside risks to the economic outlook” emphasizes the Fed’s concern about the future. The European bourses declined in response to the economic indicators, which in turn has impacted the U.S. markets, which have now returned to the bottom of their recent trading ranges as the Dow breaches the 10,800 level. Any sustained move below this level would put the market into a new low territory. While there has been denial that the economy is weakening despite the fact that most economic data points to this trend being in place, we believe upcoming third quarter company reports will show the effects of this weakening macroeconomic picture.

As we described in our latest *Market Commentary*, we are moving toward what may be the *Perfect Storm*.

~Mark Gaskill, Chief Investment Officer

~Julie Bryan, Director of Research, CFA

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