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Uncertainty Fuels Volatility

The ongoing negotiations to raise the federal debt ceiling have been difficult and protracted. As events have unfolded in Washington, financial markets have experienced higher levels of volatility. As of today, there remains considerable uncertainty about how and when the federal debt ceiling will be lifted. Most economists believe that an agreement will be reached to allow the United States to avoid defaulting on its obligations. The primary fear is that a default would push interest rates higher, increasing the borrowing costs of the government, corporations, and individuals, and further weakening an unsteady recovery. However, the federal debt limit negotiations are not the only factor involved in determining future interest rates. There are at least three major sources of uncertainty over the direction of interest rates over the next few months:

1. What will be the strength of the continuing economic recovery?
2. Will the Fed renew its efforts to provide additional stimulus to the economy?
3. How and when will the debt ceiling negotiations in Washington end?

It's very difficult to predict the outcome of these factors. That unpredictability is increasing the volatility in financial markets, as we have seen in the last week. A downgrade to debt and increase in interest rates is not a sure thing: There is a possibility that interest rates will remain low or even decrease depending on how the debt ceiling issue is resolved. In that event, bond prices could stay steady or increase. Regardless, we continue to believe that bonds have an appropriate place in a properly diversified portfolio for most investors.

Avoid Panic and Keep a Long-Term Focus

Financial Engines believes that investors should maintain a long-term perspective when faced with unpredictable events. It is natural to be concerned about your hard-earned savings when the news is full of scary headlines. Our Investment Advisor Representatives have spoken to thousands of investors in the past couple of weeks and we do understand what a nerve-wracking time it is.

Keep in mind that responding to short-term events with big changes in your investment strategy, no matter how newsworthy, is a form of market timing. We believe that trying to time the market is a dangerous game—very few investors have demonstrated the ability to do it well. With such changes, you run the risk of being out of the market at just the wrong time. Instead, our advice and management help you maintain an appropriately diversified allocation that is consistent with your time horizon and risk preferences. A disciplined approach yields better long-term results than reacting to every short-term event.

What can you do now? Verify your risk profile. For investors desiring a lower risk profile, we offer an approach that maintains a long-term focus but reflects a preference for more conservative investments. Investors should select an appropriate risk profile for their investment horizon and personal preferences. However, the risk of your portfolio should reflect a level that you are comfortable with in both rising and declining markets. Making big changes in times of stress is rarely a good idea.

We do not believe that moving to an all-cash position is prudent for most investors. History has shown it is extremely difficult to successfully time moves into and out of the market. In times of higher volatility, there is a higher possibility of both upward and downward moves in the market. Trying to predict which way things will go in the short run is a hazardous game. You can easily miss out on significant growth opportunities. We

believe that the best course is to maintain diversified exposure to multiple sources of potential returns, including bonds.

Financial Engines will continue to monitor markets as the negotiations in Washington unfold. We recognize that current events are causing anxiety among investors. In troubling times, a disciplined and diversified approach improves the chances of successful investing outcomes.