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Lindisfarne Market Report

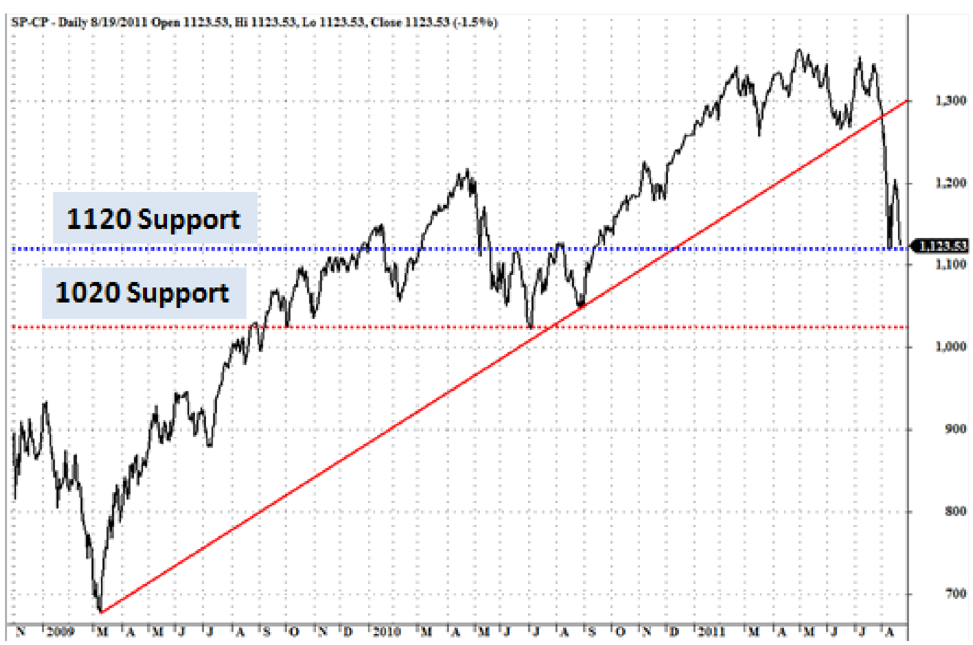
August 19, 2011

Market Action

On Friday, the S&P 500 closed at 1,123, down from 1,199 on August 5th, our last report. If you recall, the market was in a freefall from 1,345 on July 22nd. We suggested that the S&P 500 could find support at 1,120 followed by 1,020 levels.

What actually happened? As you can see below, the market closed at 1,119 and then bounced 85 points before, dropping again to the 1,123 level on Friday. I was somewhat disappointed that the bounce stopped short of the 1,250 level which represents the confluence of the 50 day moving average and a 50% retracement of the drop from the July 22nd levels.

S&P 500 - 2 ½ Years



Lindisfarne Investments, LLC
322 High Street, Wadsworth, OH 44281
(330) 335-3000
www.lindisfarneinvestments.com

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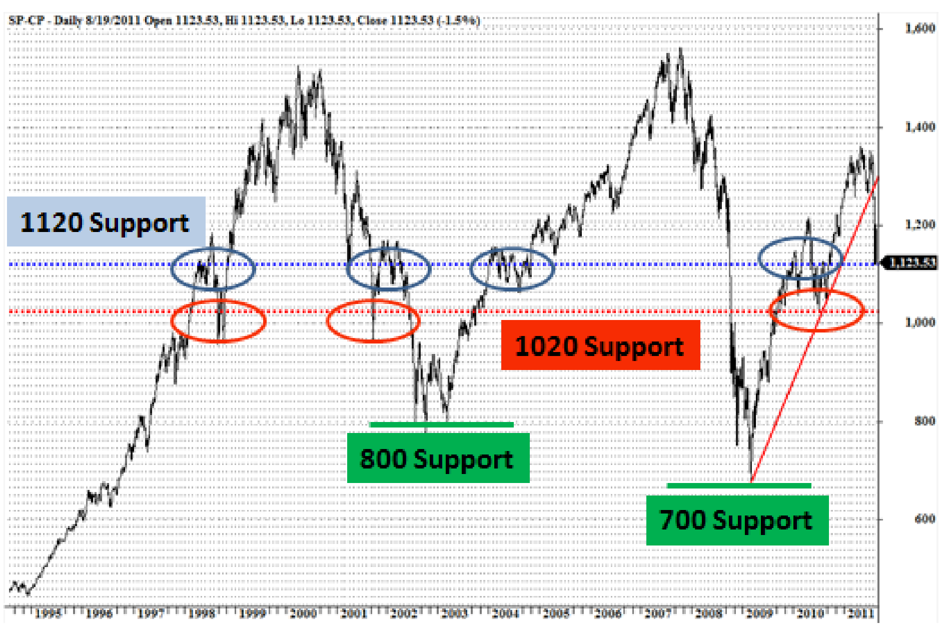
How did we pick the 1,120 and 1,020 support levels? Looking at a longer term chart below, we can see how the market had shown previous congestion, high points or low points at those levels. The 1,120 level (blue line) hosted four previous halts and the 1,020 level (red line) had three pauses at its value.

I am looking for the 1,120 level to be tested next week. If it breaks, the 1,020 level is next in line to be tested. If that breaks, there is minor support in the 880 to 940 area, but the next major supports are at 800 and 700 respectively (green lines). The latter is the 2009 low when the auto companies were about to be closed.

It took 6 months to drop from this level to 700 in 2009. If we descend at about the same rate, mid January could be quite interesting. What could take us there? How about a Congressional Super Committee that can't reach agreement and a bickering Congress that enables the automatic spending cuts and tax increases to take effect? That is just one possibility. I'm sure you can think of others.

S&P 500 - 17 Years



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Credit Downgrade (cont.)

We spent a bit of time last report talking about the Standard and Poor's downgrade of the U.S. debt, looking at some of the thinking that went into their decision. That prompted me to look further, wondering who has maintained their countries at the highest credit rating given.

The table below lists the countries with the highest debt rating given by the three major rating agencies as of 8/5/2011. Also included is the Dagong agency which is a relatively new Chinese based rating firm. As you can see, Fitch and Moody's rate the United States at AAA. Each agency uses different letter combinations for their rankings. I will use "AAA" to represent everyone's highest rating. Isn't it interesting that Guernsey and the Isle of Man have higher ratings than the U.S.? Do you even know where they are?

Current Highest Rated Countries

	Std & Poors	Fitch	Moody's	Dagong
Australia	X		X	
Austria	X	X	X	
Canada	X	X	X	
China				X
Denmark	X	X	X	X
Finland	X	X	X	X
France	X	X	X	
Germany	X	X	X	
Guernsey	X			
Hong Kong	X		X	X
Isle of Man	X		X	
Liechtenstein	X			
Luxembourg	X	X	X	X
Netherlands	X	X	X	
New Zealand			X	
Norway	X	X	X	X
Singapore	X	X	X	X
Sweden	X	X	X	
Switzerland	X	X	X	X
United Kingdom	X	X	X	
United States		X	X	

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Notice the major European countries in the table. The powerhouses are France and Germany which are making the major deals to keep the Euro currency afloat. These support the well known and much discussed debt problems of the PIIGS (Portugal, Italy, Ireland, Greece and Spain). Standard and Poor's Credit Rating and Outlook for the major European countries is shown in the next table.

Country	Rating	Outlook
Austria	AAA	Positive
France	AAA	Stable
Germany	AAA	Stable
Belgium	AA+	Negative
Spain	AA+	Negative
Italy	A+	Negative
Netherlands	AAA	Stable
Portugal	BBB-	Negative
Ireland	BBB+	Stable
Greece	CC	Negative

There has been talk of a downgrade of France's credit rating similar to the U.S.'s. Doing so would shake whatever remaining confidence there is that Europe could emerge from their debt issues. If we are looking for a trigger for the global recession that is beginning to be discussed, this could be it.

This is the dangerous thing about the world markets. The mood is negative and the triggers are everywhere. Any one of them could be the catalyst to begin the house of cards tumbling down.

Each of these agencies gives their highest rating to about 15% of the countries they cover. They also rate their Outlook for the countries. Looking across the board in the table below, you can see that the U.S., while still rated the highest by Fitch and Moody's, has been given a negative Outlook across the board. This to me is disturbing, as much as the implications around the downgrade by Standard and Poor's. Yet no one is talking about this aspect of the ratings, only that Fitch and Moody's maintain the AAA rating.

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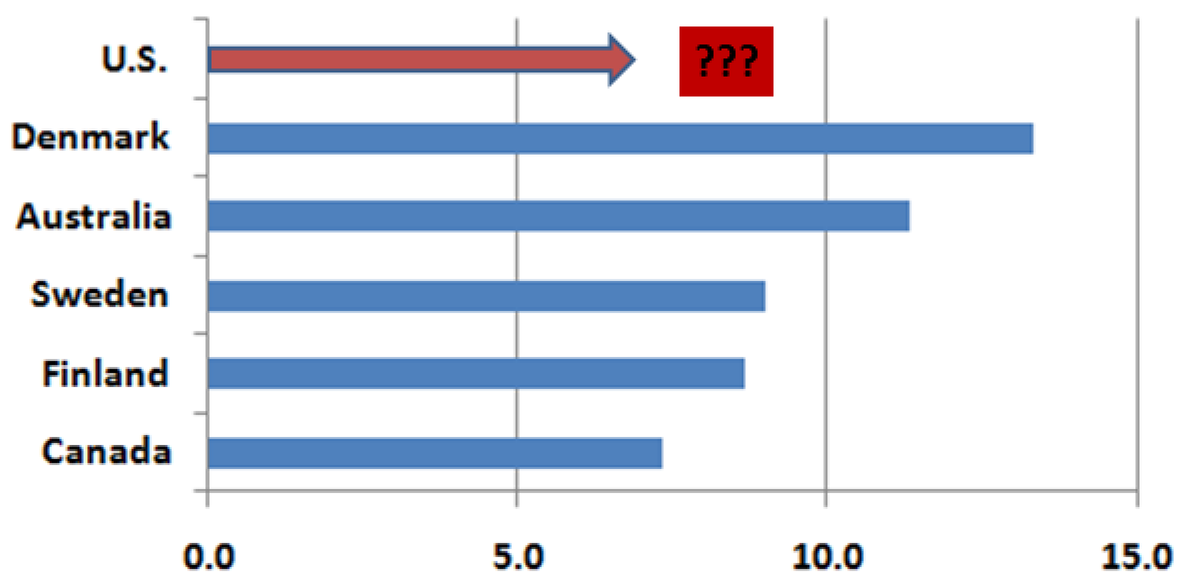
Current U.S. Outlook Rated by Agency

	Std & Poors	Fitch	Moody's	Dagong
Rating	Negative	Negative	Negative	Negative

How long does it take to recover from a credit rating cut? The chart below shows that for the major industrialized countries that have been downgraded recently, it has taken from 7 to 13 years to regain AAA rating status. If we use those numbers, the U.S. will be upgraded anywhere from 2018 to 2024.

Years To Regain AAA Rating



If you want more details about credit ratings, rating levels and implications, visit the blog **Infographic: The Idiot's Guide to the S&P Credit Downgrade** at the following URL:

http://www.visibletechnologies.com/blog/2011/08/17/credit-downgrade-infographic/

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Please feel free to pass this update on to anyone that you think might be interested in it. If they wish to be on the mailing list or if you would like more information about the services of Lindisfarne Investments, we can be contacted by phone at (330) 335-3000 or by email at dave@lindisfarneinvestments.com .

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