

QUARTERLY ECONOMIC UPDATE FOR 2Q 2010

The quarter in brief

The second quarter of 2010 brought a significant correction in the bull market and questions about the pace and strength of the global economic recovery. Few analysts were seeing a bear market ahead, but stocks did retreat – 2Q 2010 was the first down quarter for stocks since 1Q 2009, with the S&P 500 losing 11.86%.¹ At the end of the quarter, we had new concerns emerged about the real estate market, a bill poised to become law that would bring great reforms to the financial world, and worries about foreign economies that stole the headlines from corporate earnings and domestic indicators.

Domestic economic health

Consumer spending (the ultimate driver behind any U.S. economic recovery) increased by 0.2% in May after a flat April. This was after month-to-month increases of 0.2%, 0.5% and 0.6% in 1Q 2010.² As for consumer prices, they fell 0.2% in May following a 0.1% slip in April. Producer prices, too, headed south – down 0.1% in April and 0.3% in May.³

Unemployment may have peaked in April. It was 9.9% then, 9.7% in May and 9.5% for June. However, just 83,000 net jobs were added to the economy in June, and Bureau of Labor Statistics data indicated that the main reason the jobless rate declined was because 625,000 job seekers stopped looking for work.^{4,5}

We saw sustained growth in manufacturing, another big cog in the economy. However, the PMI number got smaller as the quarter proceeded. The Institute for Supply Management's manufacturing index read 60.4 in April, 59.7 in May and 56.2 in June. How about the service sector? Well, across the quarter, ISM's non-manufacturing index posted a 55.4 in both April and May, so we were seeing growth.^{6,7}

Industrial output was up 0.7% in April and 1.2% for May, the Federal Reserve noted.⁸ Yet while durable goods orders were up 1.0% for April, we had an unforeseen 1.4% May decline announced at the Commerce Department.⁹

The Fed did not hike the benchmark interest rate, and there were clear hints that it would not be doing so in the near future. Congress settled on a huge financial reform bill destined for President Obama's signature in July, which would create a Bureau of Consumer Financial Protection and an Office of Credit Ratings to regulate agencies like Standard & Poor's and Moody's. In the biggest victory for Wall Street, the bill permitted banks to continue foreign exchange dealing and interest-rate swaps.^{10,11}

Global economic health

After years of not exactly minding the store, several European countries were looking at massive sovereign debt problems. When the crisis went full-blown in the media in May, Greece, Ireland, Italy, Portugal and Spain held debts ranging from \$236 billion to \$1.4 trillion – and not only that, these countries owed tens of billions worth of debts to each other.¹² An austerity plan and a bailout was rolled out, which the healthier economies of the EU (notably Germany) had trouble stomaching. As the quarter ended, the sense was that a massive credit and banking crisis had been averted ... at least for the short run.

In Asia, something interesting was happening with PMI indices: by the end of the quarter, the pace of manufacturing in some notable emerging markets was slowing, another development that hurt U.S. equities. China's PMI was 52.1 in June, down from 53.9 in May and the second straight month of decline. PMI indices in India, Taiwan, South Korea and Australia all showed growth, but at a slower pace than in preceding months.¹³

World financial markets

We had it rough here in America, but other stock markets had an even tougher time of it in 2Q 2010. France's CAC 40 was down 13.36% for the quarter, and Brazil's Bovespa fell 13.41%. The Nikkei 225 dropped 15.40% and the Shanghai Composite took the biggest hit of any overseas benchmark, losing 22.86%. Even England's FTSE 100 fell 13.43%. However, there were some gains. In South Korea, the KOSPI gained 0.32% on the quarter. India's Sensex gained 0.99%. Chile's IPGA climbed 8.03%. As for the MSCI World and MSCI Emerging Markets Indices, they respectively lost 13.26% and 9.14% in the quarter.^{14,15}

Commodities markets

Marquee commodities saw some big swings last quarter. It was a good quarter for the U.S. Dollar Index,

which advanced 5.18%. Oil futures had their poorest quarter since 4Q 2008 – a 9.71% decline. Natural gas, on the other hand, managed a 19.31% quarterly gain. Gold gained 11.87% in 2Q 2010, while copper continued its rough 2010, falling 17.20% in that period.^{16,17}

Housing & interest rates

With federal tax credits set to expire, the second quarter was a test for the real estate market. What grade did it earn? How about a D? The month-to-month pace of new home sales, according to the Commerce Department, went from +26.9% (March) to +14.8 (April) to a record low drop of -32.7% (May). Correspondingly, pending home sales fell 30.0% for May. Existing home sales were up 8.0% for April, but down 2.2% for May. Fortunately, in early July President Obama put the tax credits back in place through September 30.^{18,19,20,21}

If the home sales numbers of months past appeared more than a little aided by the government stimulus, another kind of low was getting some very positive attention. Mortgage rates were setting all-time lows. On June 30, Freddie Mac's Primary Mortgage Market Survey had rates on 30-year FRMs averaging 4.58%, 5/1-year ARMs averaging 3.79% and rates on 1-year ARMs averaging 3.80%. Could rates on the refiner's favorite, the 15-year FRM, fall below 4%? As June concluded, that almost happened: nationwide, they averaged 4.04%.²²

Looking forward

As we get into the third quarter, the wide belief is that the recovery is still progressing – just not as quickly or as robustly as we would like. It certainly is not thrilling Wall Street. Fears about overseas debt did rock the market in May and June, but we had a series of underwhelming domestic indicators that didn't help. We seem to have hit a soft spot, particularly in terms of consumer confidence. And what builds up consumer confidence come from? Employment. Home sales. The sense that the pace of growth in the U.S. economy is accelerating rather than decelerating. So July may be the most important month of 2010 on Wall Street. We will almost certainly see major volatility. Yet as Standard & Poor's chief strategist Sam Stovall told AOL's Daily Finance, "The market is like a rubber band. Stretch it too far, and it's likely to snap back." Stovall noted that since the early 1920s, Wall Street has seen 41 quarters with declines of worse than 5%, including 2Q 2010. The good news: 29 of the 41 quarters that followed those pullbacks brought gains. Let's hope history repeats.²³

Looking back

So how did the market do last quarter? Well, here are the numbers. For the record, it was the poorest second quarter for the S&P, DJIA and NASDAQ since 2002.¹

<i>% Change</i>	2Q 2010	1Q 2010	Y-T-D
DJIA	-9.97	+4.11	-6.27
NASDAQ	-12.04	+5.68	-7.05
S&P 500	-11.86	+4.87	-7.57
10YrTIPS Yield	-28.13	+8.11	-22.30

(Source: CNBC.com, ustreas.gov, 7/1/10)^{1,24,25}

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

QUOTE OF THE QUARTER
<i>"Sing like no one's listening, love like you've never been hurt, dance like nobody's watching, and live like it's heaven on earth." – Mark Twain</i>

Please feel free to forward this article to your family, friends or colleagues. If you would like us to add them to our distribution list, please reply with their address. We will contact them first and request their permission to add them to our list.

«RepresentativeDisclosure»

This material was prepared by Peter Montoya Inc., and does not necessarily represent the views of the presenting Representative or the Representative's Broker/Dealer. This information should not be construed as investment advice. The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks. The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. It is not possible to invest directly in an index. NYSE Group, Inc. (NYSE:NYX) operates two securities exchanges: the New York Stock Exchange (the "NYSE") and NYSE Arca (formerly known as the Archipelago Exchange, or ArcaEx®, and the Pacific Exchange). NYSE Group is a leading

provider of securities listing, trading and market data products and services. The New York Mercantile Exchange, Inc. (NYMEX) is the world's largest physical commodity futures exchange and the preeminent trading forum for energy and precious metals, with trading conducted through two divisions – the NYMEX Division, home to the energy, platinum, and palladium markets, and the COMEX Division, on which all other metals trade. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The Bovespa Index is an index of about 50 stocks that are traded on the São Paulo Stock, Mercantile & Futures Exchange. Nikkei 225 (Ticker: ^N225) is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. The Shanghai Stock Exchange Composite Index is a capitalization-weighted index that tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange. The FTSE 100 Index is a share index of the 100 most highly capitalized companies listed on the London Stock Exchange. The Korea Composite Stock Price Index or KOSPI is the index of all common stocks traded on the Stock Market Division. The BSE Sensex or Bombay Stock Exchange Sensitive Index is a value-weighted index composed of 30 stocks that started January 1, 1986. The General Stock Price Index (Indice General de Precios de Acciones, or IGPA) is the main index of the Santiago Stock Exchange in Chile. The MSCI World Index is a free-float weighted equity index that includes developed world markets, and does not include emerging markets. The MSCI Emerging Markets Index is a float-adjusted market capitalization index consisting of indices in more than 25 emerging economies. All information is believed to be from reliable sources; however we make no representation as to its completeness or accuracy. All economic and performance data is historical and not indicative of future results. Market indices discussed are unmanaged. Investors cannot invest in unmanaged indices. The publisher is not engaged in rendering legal, accounting or other professional services. If other expert assistance is needed, the reader is advised to engage the services of a competent professional. Please consult your Financial Advisor for further information. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards.

Citations.

- 1 – cnbc.com/id/38027917 [6/30/10]
- 2 – bea.gov/newsreleases/national/pi/pinewsrelease.htm [6/28/10]
- 3 – bls.gov/bls/newsrels.htm#major [7/3/10]
- 4 – ncsl.org/?tabid=13307 [7/2/10]
- 5 – newsfeed.time.com/2010/07/02/unemployment-rate-rises-to-9-7-in-june-is-the-recovery-slowing/ [7/2/10]
- 6 – ism.ws/ISMReport/content.cfm?ItemNumber=10752 [7/3/10]
- 7 – ism.ws/ISMReport/NonMfgROB.cfm?navItemNumber=12943 [6/3/10]
- 8 – marketwatch.com/story/us-industrial-output-jumps-12-in-may-2010-06-16 [6/16/10]
- 9 – ottawacitizen.com/business/factory+orders+decline/3231375/story.html [7/3/10]
- 10 – abcnews.go.com/Business/financial-reform-bill-means-big-consumers/story?id=11012343 [6/25/10]
- 11 – cnbc.com/id/37927853 [6/25/10]
- 12 – nytimes.com/interactive/2010/05/02/weekinreview/02marsh.html [5/1/10]
- 13 – online.wsj.com/article/SB10001424052748703426004575339730963818218.html [7/2/10]
- 14 – cnbc.com/id/38027917 [6/30/10]
- 15 – mscibarra.com/products/indices/international_equity_indices/gimi/stdindex/performance.html [7/1/10]
- 16 – cnbc.com/id/38027917 [6/30/10]
- 17 – blogs.wsj.com/marketbeat/2010/06/30/data-points-energy-metals-310/ [6/30/10]
- 18 – southflorida.bizjournals.com/southflorida/stories/2010/06/21/daily25.html [6/21/10]
- 19 – marketwatch.com/story/home-buyers-win-more-time-to-claim-tax-credit-2010-07-02 [7/2/10]
- 20 – realtor.org/press_room/news_releases/2010/07/phs_drop [7/1/10]
- 21 – liveshots.blogs.foxnews.com/2010/06/22/home-sales-fall-unexpectedly/ [6/22/10]
- 22 – cnbc.com/id/38037896 [7/1/10]
- 23 – dailyfinance.com/market-news/ [7/4/10]
- 24 – cnbc.com/id/36116955 [3/31/10]
- 25 – ustreas.gov/offices/domestic-finance/debt-management/interest-rate/real_yield_historical.shtml [7/1/10]