

Monthly Market Update



Markets Enjoy a Strong Month

Equity markets posted a significant turnaround in July, erasing all of June's losses.

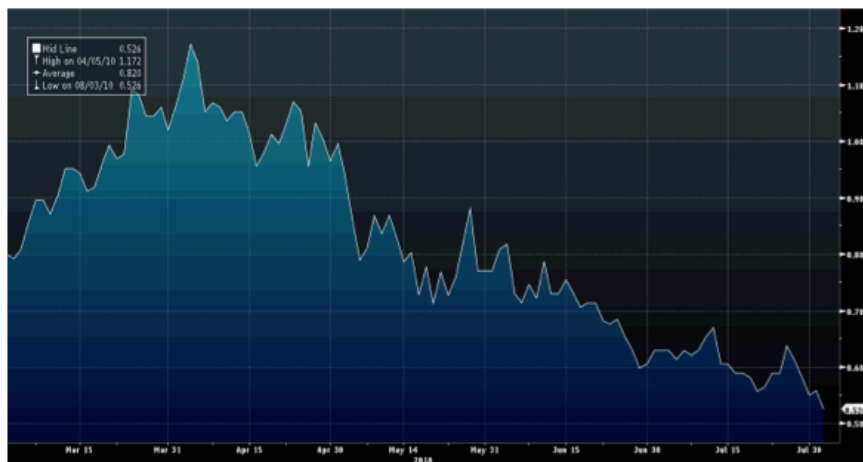
- The S&P 500 Index returned 7.01 percent; it is still slightly negative for the year, down 0.11 percent.
- The Dow Jones Industrial Average gained 7.23 percent and has moved into the black for the year, up 1.87 percent.
- International markets had a strong month as well, with the MSCI EAFE returning 9.48 percent.
- This year, markets have seemed to reflect one of two mindsets: embrace risk and drive equities higher or avoid risk and push equities lower. Recently, the focus has been on the former.



Interest Rates Remain Historically Low

Interest rates continued to hold at historic lows, indicating that markets saw little immediate concern for inflation; bond markets actually look to be more concerned with deflation in the near term.

- The 10-year bond yield, after dropping from a 4-percent level in April, held at historically lower levels, around 3 percent, for most of July.
- The 2-year yield has dropped since April, ending July at a historic low of 0.55 percent.
- The Barclays Capital Aggregate Bond Index returned 1.07 percent for the month.
- Credit-sensitive bonds, including high-yield, showed gains for the month, and tax-sensitive investors in municipal bonds also saw positive returns.



Source: Bloomberg



Recovery Slows; Where are the Jobs?

Recent economic data shows that the strength of the economy has diminished and recovery has slowed.

- Gross domestic product showed an annualized growth rate of 2.40 percent for the second quarter.
- As stimulus effects wind down, the economy must see signs of organic growth to strengthen further.

The absence of the consumer has been a concern during this recovery.

- At 70 percent of the overall economy, consumer spending must increase to support future growth.
 - Consumers are saving more, noted in June's 6.40-percent personal income savings rate.
 - Consumer confidence has declined for the past three months and was at 50.4 for July.

A catalyst for the weakening consumer has been the recent rollover in the housing market.

- The sharp 29.90-percent month-over-month decline in pending home sales in May, and a further 2.60-percent drop in June, followed the large drop in new homes sales after the homebuyer tax credit expired.

- Pending home sales have typically foreshadowed a drop in existing home sales.
 - This decline could be short-lived, as buyers reappear; however, it does create a cycle that likely will have an adverse impact on consumers' outlook and thus their planned future expenditures.

A particularly challenging reality has been the lack of job growth throughout most sectors.

- The unemployment rate has hovered at or above 9.50 percent for the year.
 - Changes have been more a result of workers entering or leaving the workforce as opposed to a significant increase in hiring.
 - It is unlikely that the rate will drop much, given that initial jobless claims continue to be reported at or around 450,000 per week.
 - Claims must fall below 400,000 in order to see the unemployment rate begin to drop.



Markets and the Economy

Global equity markets have rallied despite deteriorating fundamentals in the economic outlook, as three quarters of all companies reporting earnings have beaten analyst estimates.

- Investors have ignored risk for the time being.
 - The rally could persist if markets continue to ignore risk and technical indicators support higher equity prices.
- Moves higher could create buying pressures, as those who short the market may liquidate, helping to drive near-term price action.
- At some point, we believe markets must reflect that slowing economic activity will impact companies, particularly in the absence of a strong consumer.

In short, investors should pay close attention to risk.

- There are many variables that can impact outcomes, including future government policy, tax policy, and the resiliency of the private sector.
- Given that the recovery is still chugging along, it is early to sound the alarm bells.
- Nevertheless, keep a steady focus on risk to be positioned appropriately for an uncertain future.

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