Quarterly Market Update

Volatility Returns to Markets

The second quarter brought renewed volatility, as markets continued to trade on fears of a global slowdown and worries over the worsening European debt situation. Markets ended the quarter to the downside, with major U.S. indices trading sharply lower on the last two days of the quarter. European markets were hardest hit, and there were ripple effects across global markets.

- The **MSCI EAFE** lost 13.97 percent for the quarter, and it has lost 13.23 percent for the year.
- The broad U.S. market, as measured by the **S&P 500 Index**, lost 11.43 percent for the quarter and is now down 6.65 percent year-to-date.
- The **Dow Jones Industrial Average** lost 9.36 percent for the quarter and is off 5 percent for the year.

Bonds are a Bright Spot... Again

Bonds made strong gains during the quarter, helped in large part by a significant reduction in interest rates.

- The yield on the 10-year bond moved from 3.83 percent at the beginning of the quarter to 2.95 percent at the end of the quarter.
- The **Barclays Capital Aggregate Bond Index** gained 3.49 percent for the quarter and is higher by 5.33 percent for the year.
- As opposed to the beginning of the year, when credit-sensitive corporate and high-yield bonds saw strong gains, **interest rate-sensitive U.S. Treasuries helped push the index higher** last quarter.

Greece and the Other "PIIGS"

Greece took center stage on the global news front as the severity of its debt crisis came to light.

- The nation had reached the end of its borrowing capabilities and was **threatening to default on its outstanding debt**.
- While Greece took most of the heat, other "PIIGS" nations—namely, **Portugal, Italy, Ireland, and Spain—also began to raise the alert** over difficulties in refinancing their own debt.
- The European Union provided a **comprehensive aid package of roughly $1 trillion** to avoid widespread default.

There could be a larger crisis looming, however.

- Roughly $3 trillion of debt is held by European banks, and ongoing concerns over this huge liability have helped pushed many of these bank stocks sharply lower.
- **Global markets have continued to be cautious** over the potential for further fallout from the debt crisis, which could add to volatility in the coming months.

The Recovery Continues, but How Strong Will It Be?

Signs that the economy is continuing to move forward can be seen in the manufacturing sector.

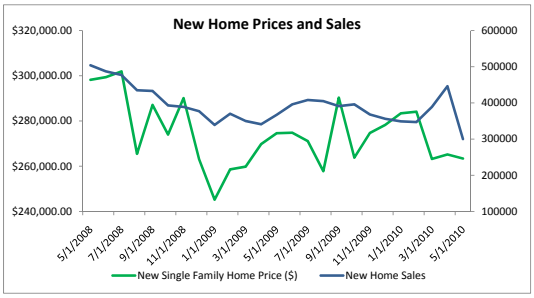
- Companies have been **rebuilding inventory** and factory reorders have been strong.
- Industrial production ticked up 1.20 percent in May, after a 0.70-percent increase in April.

Yet this recovery is showing signs that it is not as strong as past recoveries.

- The Federal Reserve has continued to cite **high unemployment, modest income growth, and tight credit as a caution to growth prospects**, saying, "Financial conditions have become less supportive of economic growth on balance."
- We believe this continues to support the argument that interest rates will remain low; we **may even see short-term rates at or near zero percent** through 2011.

Signs show that the housing market is turning down again, following the expiration of the $8,000 tax credit.

- Only **300,000 new homes were sold in May**—the lowest level since the Census Bureau began recordkeeping in 1963.
- Existing home sales also fell to 5.66 million units in May, from 5.79 million units in April.



Source: Bloomberg

Many economists also point to a less followed metric from the Economic Cycle Research Institute for some insight into the future health and direction of the economy.

- The readings for the **Weekly Leading Index** were down 6.90 percent for the week ending June 18, following a 5.80-percent decline the week before.
- In addition, first-quarter GDP estimates were **lowered to a 2.70-percent annualized growth rate**, from the initial reported estimate of 3 percent.

Investing in This "New Normal"

Equity markets have definitely become more volatile recently, and investors need to be vigilant about risk, positioning portfolios to take advantage of the potential for a slower growth environment.

- Investors may want to s**eek market returns as well as income** to help cushion some of the volatility and preserve capital.
- **Income-producing stocks with strong fundamentals** may make sense for investors, as could **diversification within fixed income** to help provide an ongoing income stream.
- Also, with the current turmoil in Europe, a **focus on domestic holdings** could prove to be more beneficial in the near term.

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