

Monthly Market Update



Equities ease lower, bonds up again

In August, markets gave back more than half of their July gains, and most equity markets saw negative returns for the month.

- The S&P 500 Index lost 4.51 percent, and the Dow Jones Industrial Average lost 3.91 percent.
- The indices are negative for the year by 4.62 percent and 2.11 percent, respectively.
- It was the worst August since 2001 and the only losing August in the past five years.

Interest rates continued to plummet across all maturities in the U.S., as investors showed a healthy appetite for U.S. Treasury debt.

- Yields on the 10-year fell from 2.91 percent at the end of July to 2.48 percent at the end of August—the largest monthly decline in yield since the credit crisis began in November 2008.

- Yields on the 2-year dropped further, ending the month at 0.47 percent, within a couple basis points of the August 24 all-time low in 2-year yields of 0.45 percent.

The fall in rates helped bolster bond returns.

- The Barclays Capital Aggregate Bond Index rose 1.29 percent, leaving it 7.83 percent higher for the year.
- The Barclays Capital 10-Year Municipal Bond Index, returning 2.77 percent and now up 8.76 percent for the year.
- Lower interest rates and improvements in bond prices relative to Treasuries have helped longer-maturity municipal bonds.



The Federal Reserve has helped drive bond markets

Investors poured money into bonds and bond funds, confounding analysts and economists who had looked for yields to rise throughout 2010 on inflation fears.

- The Fed has been a strong catalyst for the move, pushing forward with a program of *quantitative easing*, accomplished through buying securities on the open market.
- The purchases have prompted speculators and investors to buy securities across the yield curve, helping to spur the rally in longer-maturity bonds.

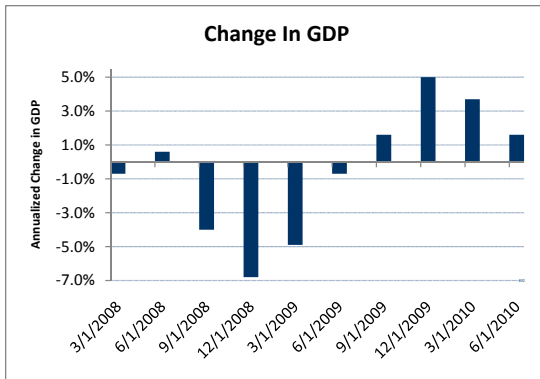


The recovery continues to slow

The recovery has slowed, which has been evident in much of the economic data released as of late.

- The gross domestic product (GDP) estimate for the second quarter showed the economy growing at an annualized rate of 1.60 percent—below the long-term trend.
- GDP declined for the past two quarters, since its 5-percent high—a result of massive stimulus—reached in the fourth quarter of 2009 (Please see chart).

**Quarterly Changes in GDP:
March 2010—June 2010**



Source: Bureau of Economic Analysis

Given the slower economic growth, it will be a challenge for companies to grow revenue in the near-term. The slowing recovery has been, in part, a catalyst for the Fed’s quantitative easing program.

- The unemployment rate has been sticking at the 9.50-percent mark, and current forecasts suggest that hiring won’t improve any time soon.
 - The housing market has deteriorated, turning downward over the past two months.
 - Existing home sales were 3.83 million in July, and new home sales were at 276,000 units sold.
 - Both were well below forecasted numbers and considerably below levels that would support a stronger recovery.
- Housing and employment have no doubt put a damper on consumers.
 - Consumers have shifted to lower-priced stores, deferred big-ticket items, and demonstrated a new propensity toward saving.
 - As of June 2010, the personal savings rate is 6.40 percent, way up from a level that was close to zero during the “go-go” years before the recession.
 - Though good for getting finances in order, this trend is not helpful for supporting a higher level of economic activity.



Where does this leave us?

Markets continue to exhibit volatility. For the most part, they are at similar levels to a year ago, which has been discouraging to investors looking for returns on invested capital. With the slowing economy, there is the risk that markets may react badly to deteriorating economic data.

So, again, this is a time to be mindful of risk in portfolios to cushion against volatility moving forward. It is also a time where a focus on income may help to bolster returns, given that capital appreciation strategies, based on an upward-trending market, may prove elusive.

Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. All indices are unmanaged and investors cannot invest directly into an index. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The Barclays Capital Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Barclays Capital government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk. The Barclays Capital 10-Year Municipal Bond Index is an unmanaged index with maturities between nine and twelve years.

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