

2009: A Second Quarter Update

A quick summary of economies and markets for you.

The quarter that just concluded gave stock market investors reason to celebrate. Let's look at what happened on Wall Street and in the broad economy this spring.

The quarter in brief. We just saw the best quarter for stocks since 1998 - the S&P 500 gained 15.2% from April to July.¹ The global rebound in equities was simply phenomenal this spring. All of it happened while two major automakers went through bankruptcy, major banks weathered the drama of stress tests, and oil prices took off. The Obama administration proposed more reform, and indicators offered hope and hints of economic recovery.



Domestic economic health. Some key indicators moved into the plus column this spring. Consumer spending was up 0.3% in May after a flat April; personal income was up 1.4% in May after rising 0.7% for April.² Retail sales? Up 0.5% in May, following a 0.2% contraction in April.³ Durable goods orders rose 1.8% in both April and May.⁴ Perhaps we were taking advantage of lower prices. The Consumer Price Index dropped 1.3% between May 2008 and May 2009, the biggest year-to-year decrease since 1950. CPI was flat in April and only rose 0.1% in May.⁵

Turning from individuals to institutions, it was another trying quarter for banks and auto-makers. Once-invincible Chrysler and General Motors each filed for Chapter 11 bankruptcy; with the help of the federal government, Chrysler found a buyer in Fiat. The government simply took a 60% stake in GM as it fostered its reorganization.⁶ High anxiety preceded the Federal Reserve-administered stress tests of 19 major U.S. banks, and 10 of 19 banks were directed to find more capital - most notably Bank of America, which was told to find another \$34 billion. Other big thrifts (among them Goldman Sachs, American Express, MetLife, Capital One, and JPMorgan Chase) were judged adequately capitalized.⁷

In Washington, reform was in the air. In May, Congress passed new rules forcing credit card issuers to notify cardholders of rate hikes 45 days in advance, restrict credit limits for teens and collegians, and curb retroactive rate increases.⁸ June saw the Obama administration and Congressional leaders working hard to revamp financial industry regulations and the American healthcare system. The President proposed making the Federal Reserve the great watchdog over major banks, insurers and other financial industry firms. Proposed legislation would give the Fed, Federal Deposit Insurance Corporation and Treasury more power and set up a Consumer Financial Protection Agency to police mortgages and derivatives and credit cards.⁹ Now, should the government get into the healthcare business? In the vision of the President, such a move could make health care and health insurance more affordable and accessible to 45 million more Americans. Two versions of a bill to do so meandered through Congress in spring. The House version included a government-sponsored healthcare option, and the Senate version jettisoned that idea.¹⁰

Major indexes. Look at the turnaround. At the end of June, the S&P 500 was a mind-blowing 35.89% above its March 9 low. History will record 2Q 2009 as the best quarter for the S&P since 4Q 1998, the hottest quarter for the NASDAQ since 2Q 2003, and the best quarter for the Dow since 4Q 2003.¹

% Change	2Q 2009	1Q 2009	Y-T-D
DJIA	+11.01	-13.30	-3.75
NASDAQ	+20.05	-3.07	+16.36
S&P 500	+15.22	-11.67	+1.78

(Source: CNBC.com, 6/30/09)¹

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

Global economic health. Were things getting better, or not? The jury was out - though plenty of opinions were in. The World Bank said things were getting worse - it revised its 2009 forecast in June, projecting 2.9% global economic contraction for the year instead of the previously speculated 1.7% decline.¹¹ "We need to clean up the banks," European Union commissioner Neelie Kroes stated in June, adding that the global economy was "far away from a proper recovery."¹²

Then again, finance ministers in Japan and South Korea felt the world economy showed signs of bottoming, and in late June, the Organization for Economic Cooperation and Development positively revised the economic forecast for its 30 member nations for the first time since 2007.¹³



World financial markets. The rally was truly worldwide. Some 2Q 2009 performance statistics: Hang Seng, +35.38%; Shanghai Composite, +24.70%; Nikkei 225, +22.80%; FTSE 100, +8.23%; DJ Stoxx 600, +16.64%; CAC 40, +11.87%; the DAX, +17.72%. The Australia All Ordinaries gained 5.42%; South Korea's Kospi gained but 1.51%.^{14,15}

Three emerging-market indices gained more than 40% last quarter. India's Sensex advanced 49.29% to put it up 50.24% across the first half of the year. Russia's seemingly boom-or-bust RTSI gained 43.12% - and ended the first half of 2009 up 56.20%. Argentina's Merval index rose 41.03% last quarter.¹⁵

The MSCI World Index gained 19.7% in 2Q 2009; between the March 9 close and the June 30 close, it gained 40.0%. Its sibling, the MSCI Emerging Markets Index, climbed 33.6% last quarter and ended the quarter 56.9% above its March 9 close.¹⁶

Commodities markets. It was quite a quarter. Oil futures finished 2Q 2009 at \$69.89 per barrel for a 40.74% 2Q gain. Oil hasn't had a quarter that hot since 3Q 1990. Oil ended 2Q 2009 up 56.70% for the year. Diesel, RBOB gasoline and heating oil also had strong quarters with double-digit gains.^{17,18}

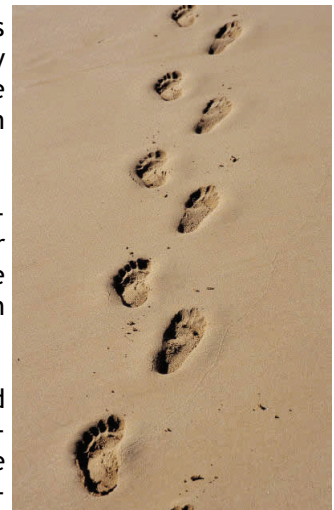
Among precious metals, copper couldn't be ignored, gaining 22.78% for the quarter to put it up 61.86% for the first half of the year. Gold ended 2Q 2009 at \$927.10 an ounce, eking out a 0.49% quarterly gain - gold futures fell 5.28% in June, but ended the first half up 4.92% for the year. Silver futures rose 4.5% in the quarter to go up 20.0% for the year at the end of June.^{17,19} Turning to the dollar, it lost 2.66% versus the yen and 5.30% against the euro in the quarter.²⁰

In crop futures, soybean and sugar prices respectively gained 29% and 33% across the quarter; corn futures slid 9.3%, their fourth straight quarterly loss.^{21,22}

Housing & interest rates. Were existing home prices cheap enough to spur a sales recovery? Was anyone interested in buying a new home? Would rising Treasury yields send mortgage rates upward? The respective answers were maybe, maybe not, and perhaps slightly. Answers were still hazy in a sector in which the bottom may or may not have emerged.

Pending home sales rose in May for the fourth straight month, according to the National Association of Realtors. When was the last time that happened? July-October 2004.²³ Existing home sales rose in April and May, although the May median sale price was 16.8% below the median price a year ago.²⁴ New home sales went north 2.7% in April but fell 0.6% in May.²⁵

Comparing the Freddie Mac Weekly Primary Mortgage Market Surveys from April 2 and July 2, we see that average rates on 30-year FRMs rose from 4.78% to 5.32%. However, average rates on 5-year ARMs decreased from 4.92% to 4.88% within that time frame. Rates for 1-year ARMs went from 4.75% to 4.94%. As for 15-year ARMs, average rates went from 4.52% to 4.77% during this stretch.^{26,27}





Third quarter outlook. The bullish might want to consider the latest Reuters quarterly poll of 150 equity strategists worldwide. In their collective opinion, the S&P 500 will gain another 8% by the end of 2009, and the benchmark indices of Japan, Germany, England and Hong Kong will register double-digit gains in 2010.²⁸ As great as all that sounds, the U.S. and global economy just don't seem to be rebounding as fast as the markets would like. With unemployment numbers still weighing on stocks at the top of July and the real estate sector still weak, some economists think things won't really pick up until the end of the third quarter or the start of the fourth quarter. Will the stock market herald the recovery with a fine summer and fall? Let's hope so, as we close the book on a terrific quarter.

We will send a review of the third quarter to you in the opening weeks of October. In the meantime, if a financial question or issue is in your mind, we welcome your call or e-mail. We hope you have been able to enjoy the wonderful summer we are having and again, thank you for your business.

Sincerely,

Larry Knudsen & Dan Stober



Citations.

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