The Triad Perspective

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2012: A Second Quarter Review

A quick summary of economies & markets for you.

The opening quarter of 2012 was the finest quarter for U.S. stocks since the late 1990s; the second quarter was a markedly different story. After an all-but-flat April and an abysmal May, the Dow finally managed to advance in June. Q2 2012 wasn't as bad as it could have been, but institutional and individual investors contended with plenty of bumps in the road.

The quarter in brief. The blue chips pulled back 2.51% in a quarter filled with major news items – the European Union's struggle to bail out banks and governments while trying to stave off a Greek exit from the euro, the Supreme Court approval of the bulk of the Affordable Care Act, the Facebook IPO, a drop in oil and retail gas prices and another apparent "soft patch" in the U.S. recovery.[1]

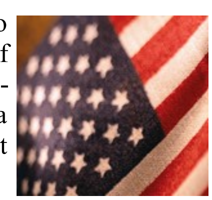
Domestic economic health. The strong job growth of the first quarter faded. The unemployment rate ticked up from 8.1% to 8.2% in May, but the bigger story was payrolls expanding by just 69,000 new jobs, even fewer than the (revised) 77,000 net new hires in April.[2,3]

Consumers were spending less and apparently worrying more by the quarter's end. The price of gas had more than a little to do with that: average retail gas prices hit a peak of $3.94 in April, ending the quarter 12.3% lower at $3.45. Personal spending was flat in May for the first time in 6 months after a (revised) 0.1% gain in April. Consumer sentiment (as measured by the University of Michigan) hit a six-month low at the end of the quarter (73.2) while the Conference Board's index declined in April, May and June, ending the quarter at 62.0. Producer prices dropped a full percent in May after a 0.2% retreat in April; by May, the annualized gain in the PPI was just 0.7%.[3,4,5,6]

The Institute for Supply Management's much-watched PMI tracked a slowdown in American manufacturing. April's short-term peak of 54.8 gave way to May and June readings of 53.5 and 49.7, the first contraction signal in 35 months. The Institute's non-manufacturing index came in at 53.5 in April and 53.7 in May. Hard goods orders improved 1.3% in May after two months of declines, and factory orders were up 0.7% in May after slipping the same amount in April. New cars were being bought left and right, with GM's sales up 16% from a year ago, Nissan's up 28%, Ford's up 7% and Chrysler's car sales up 42%.[7,8,9,10]

Facebook's IPO excited the market in May, but the NASDAQ fumbled the debut and shares did not soar. The Fed's major move during the quarter was a minor one – an extension of its Operation Twist bond-buying program through the end of the year. The most controversial aspect of President Obama's healthcare reforms passed a Supreme Court test: in a 5-4 vote, the Court decided that the oncoming requirement for individual health insurance was constitutional, characterizing it not as a legal mandate but as a tax. The Supreme Court nixed the Affordable Care Act's expansion of Medicaid, saying that the federal government cannot threaten states with losing 100% of Medicaid funds if they do not expand the program.[11,12]

Global economic health. At the start of Q1 2012, 12 European nations had slipped into recessions, including Great Britain, Spain, Italy, Ireland and the Netherlands. The quarter ended with Greece still in the euro and with strong evidence of a global manufacturing slowdown. After May's Greek parliamentary elections failed to result in a workable coalition government, special elections were held in June. The Syriza party that had threatened to reject the latest EU bailout did not get the most votes. Two more moderate parties were left to create a coalition, with a Greek exit still a question mark over Europe.[13]



Other Eurozone economic problems worsened in the quarter. S&P cut Spain's credit rating from A to BBB+ and downgraded 11 Spanish banks, which cued a rescue. The EU jobless rate hit a Euro-era high of 11.1% in June and the Markit PMI index sat at 45.1 in both May and June (at that was better than the mid-30s, which is where it was in Q1 2009).The EU came up with a couple of bold ideas in June: it crafted a plan to recapitalize troubled banks with liquidity injections from the Eurozone rescue fund (without adding to existing sovereign debt), and it proposed a single Eurozone banking regulator.[14,15,16,17,18]

With dips in consumer demand around the world, key manufacturing economies saw declining PMIs. By the end of the quarter, the economies of China, Japan, Germany, Great Britain, Italy, France, South Korea and Taiwan all shared something in common: manufacturing sector contraction. India's PMI stayed above 50 in June, but China's HSBC PMI was at 48.2.[19,20]

World markets. The twin MSCI indexes reeled during the quarter. MSCI's Emerging Markets Index fell 10.0%; the MSCI World Index lost 5.82%. Those global indices aside, national benchmarks hardly fared better: Sensex, -0.76%; CAC 40, -6.63%; DAX, -10.63%; FTSE 100, -3.42%; Hang Seng, -5.45%; Nikkei 225, -12.85%; All Ordinaries, -6.44%; TSX Composite, -7.97%; Shanghai Composite, -1.65%. (All this is measured in U.S. dollar terms by MSCI and Morningstar.)[21,22]

Commodities markets. The quarter was not kind to precious metals – or oil. In New York, gold ended the June at $1603.50 an ounce after its poorest quarter since 3Q 2008. Gold slipped 3.9%, palladium 10.6%, platinum 11.7% and silver 15.0% in Q2 2012. The U.S. Dollar Index advanced 3.3% in the quarter. Oil cratered, losing 17.5% with prices dropping $19.91 per barrel over May and June to end Q2 2012 at $84.96. Natural gas rose 33%; wheat futures rose 12%. Coffee futures fell 6.8%.[23,24,25,26,27]

Real estate. Things were looking up, or at least not so down. In May, the National Association of Realtors said existing home sales were 9.6% better than a year ago, with prices up 7.9% in the past 12 months and just a 6.6-month supply of unsold homes; the listed sales inventory was 20.4% smaller than in May 2011. NAR's pending home sales index was at 95.5 in April and 101.1 in May. The Case-Shiller Home Price Index saw price gains in the majority of its metro markets for a second straight month in April. New home sales were up 7.6% in May according to the Census Bureau.[28,29,30]

Back on March 29, Freddie Mac had average mortgage interest rates as follows: 30-year FRMs, 3.99%; 15-year FRMs, 3.23%; 5/1-year ARMs, 2.90%; 1-year ARMs, 2.78%. On June 29, the averages were lower across the board: 30-year FRMs, 3.66%; 15-year FRMs, 2.94%; 5/1-year ARMs, 2.79%; 1-year ARMs, 2.74%.[31]

Looking back … looking forward. After the best June for the S&P 500 since 1999 (+3.96%), Q2 2012 didn't look so dismal. The CBOE VIX ended the quarter at just 17.04 after a 9.94% Q2 rise.[1]

% CHANGE	Y-T-D	2Q CHG	1-YR CHG	10-YR AVG
DJIA	+5.42	-2.51	+5.05	+3.93
NASDAQ	+12.66	-5.06	+7.10	+10.06
S&P 500	+8.31	-3.29	+4.19	+3.76
REAL YIELD	6/29 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	-0.46%	0.74%	2.65%	3.48%

Sources: cnbc.com, bigcharts.com, treasury.gov, treasurydirect.gov - 6/29/12[1,32,33,34]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.

This third quarter may be a trying one for investors worldwide. Will we see Greece make a managed exit from the euro? Will the widespread recession in Europe deflate demand, translating to a summer and fall of weakness in global manufacturing and perhaps earnings? There could be a downside to any upside: if positive news rolls in (i.e., the EU manages to exert real control over its debt crisis and U.S. economic indicators provide pleasant surprises), the Fed might be convinced to abandon any notions of quantitative easing. With the 6-month extension of Operation Twist, the Fed has signaled a preference to stand back from the market – a preference that may be reaffirmed as a result of its upcoming policy meetings. It may be that the third quarter presents some jarring potholes for the markets, with investors faced with the challenge of hanging on until the promise of the fall arrives. With all the negativity pushing global equity markets around, it could also end up as a great buying opportunity. Diversification and rebalancing will remain of extreme importance over this next quarter.

In October, we'll send you our third quarter review detailing what could be a momentous three months for the global economy. Should you have any pressing financial questions or concerns in the meantime, feel free to contact us at 425.455.6623.

Sincerely yours,

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