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2013: A Second Quarter Review

A quick summary of economies & markets for you.

Dear Client,

Stocks advanced for the third quarter out of the last four in Q2 2013: the S&P 500 rose 2.36% in three months and climbed to a new record close of 1,669.16 on May 21. While the Federal Reserve threatened to let the air out of the rally as the quarter wound down, key indicators largely showed improvement even as the effects of the sequester cuts presumably trickled down to Main Street. The dollar strengthened and gold was hit hard, though oil pushed toward $100 a barrel. The housing recovery continued undeterred.[1]

Domestic economic health. When Federal Reserve chairman Ben Bernanke mentioned on June 19 that the central bank might reduce its easing effort later this year and end QE3 altogether in mid-2014, global markets tumbled and the S&P 500 ended up having its first losing month in several (-1.50%). While this was the major event affecting investors in Q2, there were many other consequential economic developments.[1,3]

Non-farm payrolls expanded by (a revised) 199,000 in April and 195,000 in May, the Labor Department noted. The jobless rate was at 7.6% by May, with the long-term unemployed numbering 4.3 million (1 million fewer than a year before). Consumer spending staged a rebound – it declined 0.3% in April, but then rose 0.3% in May. Consumer incomes rose 0.5% in May (the biggest gain in three months) after a 0.1% rise in April. As for consumer inflation, it was certainly mild: the Consumer Price Index rose 0.1% in May to bring America's annualized inflation rate to 1.4%. Perhaps as a reflection of the increase in personal spending and low inflation, retail sales were up 0.1% in April and 0.6% in May. While the Commerce Department revised Q1 GDP down to 1.8% in June (from an initial 2.4% estimate), the hope was that the Q2 figure might show solid improvement.[4,5,6,7,8]

Consumer sentiment improved. April's Conference Board consumer confidence index was at 69.0; by May it was at 74.3 and in June it reached 81.4. The University of Michigan's survey also logged an ascent, rising from 76.4 in April to 84.5 in May, then settling at 84.1 in June.[9,10]

The Institute for Supply Management's manufacturing PMI had its ups and downs in the quarter. It wound up at 50.9 in June after coming in at 50.7 in April and 49.0 in May. ISM's non-manufacturing index rose to 53.7 in May from a 53.1 mark a month earlier – and then it declined in June to 52.2. The Producer Price Index showed similar ups and downs, dropping 0.7% for April and rebounding 0.5% in May. Overall durable goods orders rolled in at a consistent pace: up 3.6% in May.[11,12,13,14]

When the Supreme Court repealed Section 3 of the Defense of Marriage Act (DOMA) in June, it brought federal recognition of same-sex marriages. Financially, that allowed married gay and lesbian couples to file joint tax returns with the IRS and tap into partner health insurance benefits; it also made surviving spouses in such marriages eligible for Social Security survivorship benefits. College students watched interest rates on Stafford loans double to 6.8% due to congressional inaction as June ended, though Capitol Hill lawmakers talked of a fix this summer. Finally, Standard & Poor's upgraded America's credit outlook to "stable" from "negative" in June.[15,16,17]

Global economic health. China's economy showed distinct signs of cooling off in the quarter. Markit's monthly PMI showed the nation's manufacturing sector contracting in May (49.2) and June (48.2), and fears emerged that China might fall short of its 7.5% GDP target for the year. The PRC's leaders were increasingly focused on rooting the country's economy in personal consumption rather than exporting and investing. In an effort to clamp down on shadow banking, the People's Bank of China attempted to curb funding in the interbank lending market, resulting in skyrocketing short-term interest rates. Chinese stocks fell 5.3% in the wake of that move. By the end of the quarter, manufacturing PMIs were at 50.3 in India, 51.0 in Indonesia, 49.5 in Taiwan and 49.4 in South Korea.[18,19,20]

The good news from Europe: by June, eurozone inflation had declined 0.8% in a year. The bad news: it had risen 0.4% since April to 1.6%. Unemployment for the euro area reached 12.2% in May, up 0.1% from April and up 0.9% in 12 months; at the quarter's end, jobless rates among EU members ranged from 4.7% (Austria) to 26.9% (Spain). In June, the European Central Bank cut its 2013 GDP projection for the eurozone to -0.6%. It did forecast 1.1% growth in 2014.[21,22,23]

World markets. It was a down quarter for many benchmarks. Some Asia Pacific indices logged gains – the Nikkei 225 (+10.32%), the Sensex (+2.97%), the KSE 100 in Pakistan (+17.04%), the TAIEX in Taiwan (+1.81%). Others didn't - the Shanghai Composite went -11.51%, the Jakarta Composite -2.47% and Australia's ASX -3.30%. In the west, the TSX Composite went -4.87%, the Bovespa -15.78% and Mexico's IPC All-Share -7.84%. While the DAX (+2.10%) and CAC 40 (0.20%) managed small Q2 advances, quarterly losses were more common in Europe – including descents for the RTSI (-12.64%), IBEX (-1.99%) and FTSE 100 (-3.06%). Among regional and multi-country indices, the Global Dow lost only 0.03%, the DJ STOXX 50 3.46%, the Asia Dow 3.30%, the MSCI World Index just 0.07% and the MSCI Emerging Markets Index 9.14%.[24,25]

Commodities markets. With hints of waning demand in China, U.S. stocks hitting new all-time highs and the dollar growing stronger, there was plenty of selling. The quarter was a disaster for gold, which dropped 23.3% to settle at $1,223.70 on the COMEX on June 28. (In the first half of 2013, gold futures declined $452.10.) Silver's quarter was even worse: it dropped 31.3%. Platinum futures sank 14.9% in Q2, palladium futures 14.0%. For some other commodities, it was a different story: the first half of 2013 ended with oil up 2.4% YTD, natural gas up 3.9% YTD and cotton up 10.0%. The U.S. Dollar Index went +0.19% in the quarter.[26,27,28]

Real estate. A steady stream of positive news arrived from this sector. The April Case-Shiller Home Price Index came out in June, and it showed home prices across 20 cities rising 12.1% in 12 months. The Case-Shiller hadn't seen a yearly gain that large since March 2006. By May, the National Association of Realtors reported a 12.9% annual gain in existing home sales with a 15.4% increase in the median price of a residential resale; NAR also noted a 12.1% annual improvement in pending home sales. Housing starts and building permits were respectively up 28.6% and 20.8% above year-ago levels by May, and the Census Bureau also noted a 29.0% annualized gain in new home sales.[14,29,30,31,32]

This might have been the last quarter for rock-bottom mortgage rates. In Freddie Mac's June 27 Primary Mortgage Market Survey, the average interest rate for the 30-year FRM had risen to 4.46%. (Compare that to 3.57% on March 28.) Other mortgage types also grew more expensive: 15-year FRM, 2.76% to 3.50%; 5/1-year ARM, 2.68% to 3.08%; 1-year ARM, 2.62% to 2.66%.[33]

Looking back … looking forward. Q2 2013 was not as spectacular for U.S. equities as its predecessor. Still, all three major U.S. indices advanced. At the close on June 28, the Dow settled at 14,909.60, the S&P at 1,606.28 and the NASDAQ at 3,403.25. In addition, the Russell 2000 gained 2.73% for the quarter, closing at 977.48 on June 28. Fear increased, at least as measured by the CBOE VIX. The VIX soared 32.26% in the quarter.[1]

% CHANGE	Q2 CHG	Q1 CHG	1-YR CHG	10-YR AVG
DJIA	+2.27	+11.25	+18.31	+6.59
NASDAQ	+4.15	+8.21	+19.43	+10.94
S&P 500	+2.36	+10.03	+20.86	+6.45
REAL YIELD	6/28 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.53%	-0.48%	1.48%	1.90%

Sources: cnbc.com, bigcharts.com, treasury.gov - 6/28/13[1,34,35]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

Gloom invaded Wall Street late in the quarter when Ben Bernanke spoke of tapering QE3. Intellectually, investors knew the Fed couldn't ease forever – but the market sure had a hard time swallowing the pill. The market dip was far from a correction, though, and subsequent economic indicators lightened the mood on the Street. The coming quarter presents the market with strong challenges: few analysts see great things ahead for this next earnings season, there is fear that the jump in mortgage rates may slow the housing comeback, and investors are keeping wary eyes on economic and political developments in China, Europe and the Middle East. If the housing, hiring and personal spending numbers measure up to expectations in the coming months, stocks may move a little higher this quarter while Wall Street waits for fall.

At the start of October, we'll recap how the markets performed in Q3 and note the factors that influenced their performance. Should you have any financial questions or concerns in the meantime, please contact us at 425.455.6623.

Sincerely yours,

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