

GATESMAN FINANCIAL Presents Monthly Economic Update for June, 2010

Quote of the month. “The formula for success is simple: practice and concentration, then more practice and more concentration.” – Babe Didrikson Zaharias

The month in brief. Stocks corrected, investors sighed, and Wall Street couldn't wait for May to end. In performance terms, it was the Dow's poorest May since 1940 and the S&P 500's weakest May since 1962.¹ European debts hung like a dark cloud over the markets – and took attention away from earnings and some positive indicators at home.

Domestic economic health. Consumer incomes outpaced consumer spending in April: while personal spending was flat, personal wages were up 0.4% and disposable incomes up 0.5%, and the savings rate increased half a point to 3.6%.² We also had a bit of deflation: the Consumer Price Index and the Producer Price Index each declined 0.1%. (Core CPI was flat for April.)³ The unemployment rate kicked up to 9.9% for April, even as the economy added 290,000 more jobs.⁴

The twin consumer sentiment barometers showed monthly gains: the University of Michigan/Reuters survey improved to 73.6, and the Conference Board's index hit 63.3, a level unseen since September 2008.⁵ More concretely, we had April improvements in industrial output (+0.8%), retail sales (+0.4%) and durable goods (+2.9%).^{6,7}

The Senate passed its take on the financial industry reform bill 59-39 on May 20, with the next stop reconciliation with the House version passed in late 2009. That will occur during June, with Democrats aiming for President Obama's signature by the July 4th weekend.⁸

Global economic health. The whole world watched Europe, fearing that even as the EU/IMF plan to ease the debt burden on Greece, Italy, Spain, and Ireland got underway, it wouldn't be enough. The 27 European Union governments have amassed debt equal to 80% of the EU economy.⁹ The flashing red debt light naturally led economists to ponder the chances of a double-dip recession. German chancellor Angele Merkel's mid-May opinion that the bailout effort had “done no more than buy time” didn't exactly boost confidence within global markets.

How about Asia? Well, new tensions between North Korea and South Korea built in late May, adding to global financial concerns. Away from that, Japan's

household spending retreated by 0.7% in April (better than the -2.5% economists expected) and its unemployment rate reached 5.1%.¹⁰ Manufacturing indexes in China, Taiwan, South Korea and Australia all pointed to further expansion in May (though the pace of expansion was slower than in April).¹¹

World financial markets. There were actually some monthly gains in May – the Philippines All Shares Index advanced 1.0%, and Chile's IPSA rose 0.6%. That positive news aside, sizable May losses occurred on multiple continents. The DAX fell 2.8%, Canada's TSX Composite 3.4%, the Sensex 3.5%, the South Korean Kospi 6.0%, the Hang Seng 6.4%, the Bovespa 6.6%, the FTSE 100 7.1%, the Singapore STI 7.5% ... and all of those indices did better than the Dow. Others suffered double-digit drops: Australian All Ordinaries, -10.3%; Spain's IBEX, -11.1%; Russia's RTSI, -12.0%.¹² The MSCI World Index lost 9.91% in U.S. dollar terms; the MSCI Emerging Markets index fell 9.18% in those terms last month.¹³

Commodities markets. So how did gold do given all this turmoil? Very well. Those futures gained 8.88% in May. The other notable NYMEX/COMEX gains: coal, +7.72%; milk, +7.59%; pork bellies, +6.30%; orange juice, +5.62%; silver, +5.15%. The major monthly declines included oil (-11.89%), gasoline (-12.46%), copper (-12.62%) and at the bottom, sugar (-14.47%). The U.S. Dollar Index gained 6.00% in May.¹⁴

Housing & interest rates. The numbers were influenced by expiring tax breaks, an expiring school year and warmer weather, but they were still encouraging: existing home sales rose 7.6% for April month according to the National Association of Realtors, and the Commerce Department had new home sales up 14.8% that month (and 47.8% above year-ago levels).¹⁵ Pending home sales, affected by the same phenomena, were 5.3% higher in March and reached a five-month peak.¹⁶ Housing starts increased by 5.8% for April, but the Commerce Department had building permits down 11.5% - again, an effect of expiring federal credits.¹⁷

With no murmurs of the Federal Reserve hiking interest rates in the near future, average rates on assorted home loans remained low. In fact, they went lower. According to Freddie Mac's Weekly Primary Mortgage Market Survey on April 29, the average rate for a 30-year FRM was 5.06%; on May 27, it was 4.78%. The average rate for a 15-year FRM went from 4.39% to 4.21% during that interval. As for 5/1-year

hybrid ARMs and 1-year ARMs, the average rates for those home loan types in the May 27 survey were 3.97% and 3.95%. Compare that to 4.00% and 4.25% in the April 29 survey. With Treasury yields going lower last month, some called this the American silver lining to the European debt crisis.¹⁸

Major indices. The numbers tell a rather painful story, hopefully not to be repeated in June. The CBOE VIX rose 45.40% in May, the biggest monthly percentage increase since October 2008.¹

% Change	1-Month	Y-T-D	1-Year
DJIA	-7.92	-2.79	+20.62
NASDAQ	-8.29	-0.53	+28.84
S&P 500	-8.20	-2.30	+20.13
10-Yr TIPS Real Yield	+2.33	-10.81	-20.96

*(Sources: cnbc.com, bigcharts.com, ustreas.gov, 6/1/10)^{1,19,20}
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.*

June outlook. Will the austerity measures and bailout package in the European Union inspire confidence? Will investors stop selling out of fear and buy with renewed confidence? Will the correction reach a point of capitulation soon? (Has it already?) Can certain European countries alter their financial behavior as well as their balance sheets? These are the big questions. Could a rebound start with news of a drop in the jobless rate, and further encouragement from other domestic indicators? There is plenty of bullish sentiment left in the tank – and there could plenty of volatility to contend with this month and this summer if the situation in Europe isn't stabilized. Let's hope that the market has witnessed a bottom and can return to rally mode.

Let's look forward for a few weeks now at this month's calendar of economic releases. We have the May ISM service sector index and April factory orders (6/3), May's unemployment report (6/4), April wholesale inventories and the Fed's latest beige book (6/9), May retail sales, April business inventories and the University of Michigan's initial May consumer sentiment survey (6/11), May industrial production, housing starts and building permits and PPI (6/16), May CPI and the Conference Board's leading indicators for May (6/17), May existing home sales (6/22), May new home sales (6/23), May durable goods orders (6/24), May consumer spending (6/28), and lastly, April's Case-Shiller home price index and June consumer confidence as measured by the Conference Board (6/29).

Riddle of the month. You stand 8' away from a door. With each move, you advance half the distance

to the door. How many moves will it take to reach the door? (You may want to use pen and paper as you consider this.)

Last month's riddle: A zoo keeper has a certain number of cages and a certain number of tigers. If she puts one tiger in each cage, she has one tiger too many. If she puts two tigers in each cage she has one cage too many. How many tigers and cages does she have?

Last month's riddle answer: She has three cages and four tigers.

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If you would like us to add them to our list, please reply with their address
and we will contact them and ask for their permission to be added.***

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