

GATESMAN FINANCIAL Presents Monthly Economic Update for May, 2010

Quote of the month. “A mind all logic is like a knife all blade.” - Rabindranath Tagore

The month in brief. As the weather warmed up, the market was still pretty hot: the S&P 500 pulled off a 1.48% gain for April.¹ On the whole, stocks overcame some major challenges: credit ratings were slashed for three European nations, and Goldman Sachs faced an investigation on charges of securities fraud. With scandal on Main Street’s mind, a financial reform bill started a journey through the Senate.

Domestic economic health. There were two great economic developments in April. First, consumer spending rose by 0.6% for the month (after a 3.6% increase in the first quarter). There was also a 0.3% gain in wages, the first gain of 2010. Additionally, the Institute for Supply Management’s factory index hit 60.4 for April, the best reading since June 2004 and a nice complement to the ISM March service sector index, which moved north 2.4 points to 55.4.^{2,3} Durable goods orders also improved in March, with a 1.3% gain.⁴

On paper, the recession seemed by all means over ... but it seemed the recovery was only starting to trickle down to Main Street. As President Obama remarked last month, “You’re hired’ is the only economic news [Americans] are waiting to hear.” The jobless rate remained at 9.7% in March, and analysts see little movement for the April report.⁵ Consumer sentiment polls differed: the Reuters/University of Michigan survey slipped to 72.2 – still better than the 71.0 economists forecast – while the Conference Board’s April survey indicated the best consumer sentiment since September 2008.⁶

A massive financial reform bill was cleared for debate in the Senate. If made law, it will create a new consumer watchdog agency regulating banks and brokerages, impose the “Volcker Rule” to bar banks from proprietary trading, and put tighter scrutiny on hedge funds and derivatives – all with the ultimate mission of preventing another bank bailout.⁷ Is this a good and necessary move, or more bureaucracy and more pain for banks when they are trying to recover from the downturn? You’ll hear both sides of the story across spring, summer and maybe fall.

Global economic health. In the last week of the month, Standard & Poor’s downgraded the debt ratings of Spain, Greece, and Portugal – cause for alarm, and a shock to the Euro.⁸ The International

Monetary Fund and the European Union announced a \$144 billion bailout package for Greece as April ended.⁹ However, investors worried about contagion. Was this just a band-aid on the way to default? How hard would this hit global banks?

In the Asia Pacific region, the news was decidedly better. China’s gross domestic product was growing at its fastest pace since 2007 – annualized GDP was projected at 11.9% off the February data.¹⁰ Australia learned that its inflation rate nearly doubled during 1Q 2010, and Japan’s overall retail sales saw a third straight monthly gain. Japan’s central bank changed its 2011 economic forecast to show minimal inflation instead of mild deflation.¹¹

World financial markets. Most of the foreign indices had a poor month, thanks to sovereign debt issues. Ireland’s ISE index actually rose 6.9% last month; the Philippines All Shares rose 3.3% and Argentina’s Merval rose 1.0%. Russia’s RTSI was flat for the month.

As for the downside, Germany’s DAX was down 0.3%. Australia’s All Ordinaries lost 1.4%, the FTSE 100 lost 2.2%, Spain’s IBEX fell 3.0% and France’s CAC 40 slipped 3.4%. Portugal’s PSI 20 dropped 9.4%.¹² The MSCI World Index gained 0.07% in local currency terms for April; the MSCI Emerging Markets index lost 0.15% in local currency terms last month.¹³

Commodities markets. Call it a flight to quality, a flight to safety, whatever you wish – it was a fine month for gold and other precious metals. Gold advanced 6.0% for April, settling at \$1,180.10 on the NYMEX at month’s end. Silver gained 6.4% and platinum 6.0%; palladium went north by 15.8%. Copper was not so fortunate – futures fell 5.9% in April. The metal that had such a fantastic 2009 was up only 0.3% YTD through April.^{14,15}

Oil gained \$2.39 a barrel in April, putting prices at \$86.15 at the end of the month and capping an 18.19% jump in crude futures since the start of February. The U.S. Dollar Index gained 0.97% last month.^{14,16}

Housing & interest rates. The numbers got a little wacky, skewed again by the rush to take advantage of expiring tax credits. March new home sales rose by 26.9%. It was the biggest monthly jump in new home purchases since 1963. Census Bureau data had new home prices averaging \$258,600 nationally, right about where they were a year before.¹⁷ Existing home

sales went north by 6.8%, and pending home sales rose by 5.8% - both encouraging signs, even with the seasonal fluctuations of the residential real estate market.¹⁸ the February's S&P/Case-Shiller Home Price Index had prices surveyed across 20 cities (on average) 0.6% above February 2009 levels. Yes, the average price was 0.9% below January, but this marked the first year-over-year gain in the index since December 2006. (In April 2009, prices were 24.0% below year-ago levels in the index.)¹⁹ Construction spending also increased by 0.2% for March.²

So did mortgage rates shoot through the ceiling last month? No. The Federal Reserve made its way out of the mortgage market, and it was not the end of the world.

Looking over Freddie Mac's Weekly Primary Mortgage Market Survey, here is the movement from the April 1 snapshot to the April 29 snapshot: average rates on 30-year FRMs went from 5.08% to 5.06%, averages on 5/1-year hybrid ARMs went from 4.10% to 4.00%, averages on 1-year ARMs rose from 4.05% to 4.25%, and averages on 15-year FRMs were 4.39% on both dates.²⁰

Major indices. As mentioned earlier, it was another up month for stocks. The NASDAQ led the way among the big three, gaining an impressive 2.64% for April. The Russell 2000, by the way, advanced 5.59% last month, bringing its performance to +14.58% through the first third of 2010.¹

% Change	1-Month	Y-T-D	1-Year
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Last month's riddle answer: The paragraph does not contain a single "e" ... the most common letter in the English language.

DJIA	+1.40	+5.57	+34.78
NASDAQ	+2.64	+8.46	+43.32
S&P 500	+1.48	+6.42	+35.96

*(Sources: cnbc.com, bigcharts.com, 4/30/10)^{1,21}
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.*

May outlook. As May opens, all eyes are on Europe, and on whether the EU can adequately solve the debt crisis plaguing three nations. Will Spain need a bailout? How about Portugal? And for that matter, is China's real estate market overheated? While there is plenty of speculation, and while speculation makes for juicy economic headlines, there is also the reality that the manufacturing and service sectors and consumer spending are also quite healthy here and in other parts of the globe. So the adage "sell in May and go away" may be ignored. In fact, May is the month that has seen the best returns for the S&P 500 since 1990.²²

Riddle of the month. 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: This is an unusual paragraph. How quickly can you find out what is unusual about it? It looks so plain you would think nothing was wrong with it. In fact, nothing is wrong with it. It is unusual, though. Study it, and think about it, but you still may not find anything odd. What is missing from it?

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