



Monthly Investment Update

June 3, 2011

The Markets

Equities spent most of May in a gradual but relentless decline that reversed much of April's strong gains. Concerned about slowing economic growth, investors rediscovered risk aversion, punishing the Global Dow and the small-caps of the Russell 2000 the most. After surmounting the 1300-1340 trading range where it had been since February, the S&P 500 had trouble staying there until May's last trading day, while the tech-heavy NASDAQ regained dominance over the Dow (at least for the month). Concern about Greece's ability to avoid restructuring of its debt helped send bond buyers into the reassuring arms of U.S. Treasuries. A sell-off in commodities at one point brought oil prices back below \$100 per barrel, gold below \$1,500 an ounce, and silver prices down more than 20%, though all had partly rebounded by month's end.

Market/Index	2010 Close	Prior Month	As of 5/31	Month Change	YTD Change
DJIA	11,577.51	12,810.54	12,569.79	-1.88%	8.57%
NASDAQ	2,652.87	2,873.54	2,835.30	-1.33%	6.88%
S&P 500	1,257.64	1,363.61	1,345.20	-1.35%	6.96%
Russell 2000	783.65	865.29	848.30	-1.96%	8.25%
Global Dow	2,087.44	2,255.22	2,178.04	-3.42%	4.34%
Fed. Funds	.25%	.25%	.25%	0 bps	0 bps
10-year Treasuries	3.30%	3.32%	3.05%	-27 bps	-25 bps

The Month in Review

- The Bureau of Economic Analysis reported that economic growth slowed during the first quarter from 3.1% in Q4 to 1.8%. Despite 244,000 new jobs, the unemployment rate edged upward to 9%, according to the Bureau of Labor Statistics (BLS).
- Higher food and energy costs pushed up the annual consumer inflation rate to 3.2%--the highest level since October 2008, according to the BLS--and wholesale prices rose 6.8% from a year ago. Energy prices also resulted in the highest monthly U.S. trade deficit since June of last year.
- Uncertainty about Greece's fate was aggravated by the arrest and resignation of the head of the International Monetary Fund, a key component of the European Union's bailout mechanism. Reports that Greece's austerity measures weren't sufficient didn't help; neither did the European Central Bank's warning that any attempt to restructure the country's debt could have dire consequences.
- The Federal Reserve laid out its game plan for unwinding quantitative easing (QE2) by the end of June, as scheduled. Before it begins raising short-term interest rates post-QE2, the Fed will first stop reinvesting the proceeds of maturing holdings into Treasury bonds.

- The housing market continued to suffer. Both new home sales and housing starts were down almost 24% from the same time last year, sales of existing homes dropped nearly 13% over the year, and home prices experienced a double-dip downturn as the Standard & Poor's/Case-Shiller index returned to 2002 levels.
- The U.S. hit the current \$1.4 trillion ceiling on the level of debt the Treasury may issue to pay the nation's existing bills. A series of accounting measures, including a decision to halt investments in two federal employee pension funds, may buy time for Congress to come to some agreement on whether to raise the debt limit.

Eye on the Month Ahead

Investors who “sold in May and went away” will get to see whether they guessed right as the Fed heads into the last month of its QE2 bond purchases; the rest will be trying to gauge how well the economy will fare without that support. The economic data and consumer confidence has shown signs of growing weakness over the past few weeks, much like the “soft patch” we experienced last summer, and the withdrawal of monetary stimulus is worrisome. But while the stock market is beginning a sell off that is also reminiscent of last summer’s steep correction, the economic backdrop is probably stronger than it appears. Much of the weakness in the recent data stems from the transitory effects of the catastrophe in Japan and the extraordinary storm and flood destruction in the U.S. Japan’s manufacturing growth is already starting to rebound. The effects should generate a rebound in global growth, the U.S. included, in the third quarter.

The longer term problems regarding our government’s fiscal mess won’t be resolved in this election cycle, although the long-term trend toward smaller government at every level has started. Meanwhile, we expect Fed policy to remain accommodative to continue to heal the banks and stimulate growth in the private economy. Translation, the Fed needs for the wealth effect from the financial markets (mainly stocks) to support the economy as consumers and the government continue to deleverage. However, bond holders will be challenged to make money in an environment in which rates on interest-bearing investments will remain below the inflation rate. We also expect the ongoing dilemma in rescuing (read, debt restructuring) Europe's periphery economies will inhibit growth in that important region for many years, but many of the emerging countries have resilient economies with growing consumer classes.

Although the summer is likely to be a rocky ride in the financial markets, we expect far less distress than last summer, and continuing gains in stocks overall as the year progresses and visibility increases. We agree with the majority of our research sources that continue to favor stocks and commodities over bonds and cash.

Key dates and data releases: auto sales, manufacturing, construction spending (6/1); productivity/labor costs (6/2); unemployment/payrolls, services sector (6/3); consumer credit (6/7); Federal Reserve "beige book" (6/8); international trade (6/9); import/export prices, Treasury budget (6/10); wholesale inflation, retail sales (6/14); consumer inflation, industrial production, international capital flows (6/15); housing starts (6/16); quadruple witching options expiration, leading economic indicators (6/17); home re-sales (6/21); Federal Reserve Open Market committee announcement (6/22); new home sales (6/23); final Q1 gross domestic product (GDP), durable goods orders, corporate profits (6/24); personal income/spending (6/27); home prices (6/28).

Data source: All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Past performance is no guarantee of future results. Equities data reflects price changes, not total return. The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. Market indexes listed are unmanaged and are not available for direct investment.

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