Monthly Investment Update

August 2, 2011

The Markets in July

Down to the wire: uncertainty about default, debt, and political infighting affected equities markets both here and abroad. Despite a strong initial week that gave the S&P 500 its biggest percentage gain since mid-2009, all four domestic indices ended the month in the red. The small caps of the Russell 2000 were hit the hardest, while the Global Dow also suffered.

Global anxiety paradoxically proved to benefit long-term U.S. Treasuries, though short-term debt suffered in the month's final week as August 2 and the potential for default loomed. The dollar resumed a decline that had been interrupted by Eurozone uncertainty. The weaker greenback helped nudge oil prices up around $100 a barrel once again; it also sent gold to a string of new records, ending above $1,600 an ounce.

Market/Index	2010 Close	Prior Month	As of 7/29	Month Change	YTD Change
DJIA	11577.51	12414.34	12143.24	-2.18%	4.89%
NASDAQ	2652.87	2773.52	2756.38	-0.62%	3.90%
S&P 500	1257.64	1320.64	1292.28	-2.15%	2.75%
Russell 2000	783.65	827.43	797.03	-3.67%	1.71%
Global Dow	2087.44	2134.29	2088.82	-2.13%	0.07%
Fed. Funds	0.25%	0.25%	0.25%	0 bps	0 bps
10-year Treasuries	3.30%	3.18%	2.82%	-36 bps	-48 bps

The Month in Review

- Despite warnings that the United States' AAA credit rating was in danger of a downgrade, Washington spent much of July in hand-to-hand combat. Debate over an increase in the debt ceiling morphed into a battle over how to begin tackling the deficit. As tax increases were taken off the table, the main issues became whether to revisit the issue in six months or try to get through all of 2012; when, where, and how deeply to cut spending; and whether to link any increase to a balanced budget amendment, the findings of a new congressional committee, or various deficit proposals.
- Anxieties about sovereign debt overseas eased a bit after European leaders agreed to a second bailout for Greece. The hope is that the new aid package will keep the contagion from spreading to other countries such as Portugal, Ireland, Italy, and Spain, which have suffered

from soaring interest rates caused by rating downgrades. According to the agreement, bondholders will exchange their Greek bonds for ones with later maturity dates and possibly lower interest rates--a move that credit agencies have suggested in the past might be considered a "selective default."

- U.S. economic growth during the second quarter was a scant 1.3%, according to the initial estimate from the Bureau of Economic Analysis. Even more discouraging was the downward revision to the estimate for Q1. It put the figure at 0.4%--essentially flat, and substantially lower than the earlier 1.9% figure.
- Unemployment nudged upward slightly to 9.2%. The Bureau of Labor Statistics said private-sector industries were basically flat, while government employment continued to trend down.
- Consumer inflation fell for the first time in a year in June, while the Bureau of Labor Statistics said wholesale inflation also was down.
- Housing news was mixed. The National Association of Realtors said sales of existing homes were down for the third straight month in June, and according to the Commerce Department, new home sales fell 1% during the month. However, home prices measured by the S&P/Case-Shiller index turned up as summer began and the Commerce Department said housing starts rose 14.6%.

Eye on the Month Ahead

At this writing, Congress has just approved a debt ceiling measure that takes default off the table, but probably ensures that the uncertainties over tax and spending policies will continue until after the 2012 election. This reality combines with renewed solvency concerns in Europe and anemic U.S. economic growth to alarm investors and revive speculation about a double dip recession. While economic risk is certainly escalating, the odds of a return to recession over the next few quarters are countered by a number of areas of support, including strong corporate profits, a weakening dollar that supports higher exports and a Fed that will keep interest rates suppressed as long as employment is weak and inflation is contained. Even so, the rally in stocks that many expected in the second half of the year is now being challenged by a spate of disappointing economic news.

Hopefully, there are silver linings emerging from the rancorous political debate that will encourage corporations to begin investing some of their large cash positions and reenergize economic growth through higher employment. It should now be clear to everyone that government at all levels is tapped out, and though reduced government spending will be an economic drag, perhaps there will be less government interference. The private sector has the capital to take over its traditional role as the primary driver of economic growth, and that would be very positive for the economy and the markets. Government needs to encourage the forces of free market capitalism, if risk taking and stronger economic growth is to resume.

Key dates and data releases for August: manufacturing, construction spending (8/1); deadline for increase in debt ceiling, auto sales, personal income/spending (8/2); factory orders, U.S. services, Treasury auctions of 3-year, 10-year, and 30-year securities (8/3); unemployment/payrolls (8/5); labor productivity/costs, Federal Reserve Open Markets Committee announcement (8/9); international trade (8/11); retail sales, business inventories (8/12); international capital flows (8/15); housing starts, industrial production (8/16); wholesale inflation (8/17); consumer inflation, home resales (8/18); options expiration (8/19); new home sales (8/23); durable goods orders (8/24); second estimate of Q2 gross domestic product (8/26); personal income/spending, FOMC minutes (8/30).

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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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