

# Weekly Commentary

## July 12, 2010

### The Markets

Wall Street investors are sure a fickle crowd these days.

After dropping 16% between April 23 and July 2, the S&P 500 recouped one-third of that loss last week and rose 5.4%, according to Bloomberg, July 10. Stocks rose on news that U.S. retail sales grew at the fastest pace in four years in June and a bullish report from the IMF projected an upwardly revised global economic growth rate of 4.6% in 2010, according to CNBC, July 8. Rising optimism that second quarter earnings reports might be better than expected also supported stock prices last week, according to MarketWatch, July 7.

Although the market jumped dramatically, has much changed in the past week? Maybe, maybe not.

Wall Street observers have a tidy tendency to explain every movement in the market with an explanation that seems, on the surface, to be reasonable. Last week's bullish reports on retail sales, world economic growth, and some earnings pre-announcements all seem like logical explanations for the big rise in the market. However, between April 23 and July 2, when the market dropped 16%, we were reading reports that retail sales were weak, economic growth was slowing, and we might be heading for a double-dip recession. Now, a week later, the economy seems to have turned a corner, right?

In reality, the truth is probably somewhere in between. The economy may not have been as bad as the 16% market swoon suggested and it may not be as good as last week's 5.4% pop suggests, either.

It's good to know what market observers are ascribing to the market's weekly moves, but as financial advisors, we have to filter their tidy explanations with a dose of skepticism.

<b>Data as of 7/9/10</b>	<b>1-Week</b>	<b>Y-T-D</b>	<b>1-Year</b>	<b>3-Year</b>	<b>5-Year</b>	<b>10-Year</b>
Standard & Poor's 500 (Domestic Stocks)	5.4%	-3.3%	22.6%	-11.1%	-2.4%	-3.1%
DJ Global ex US (Foreign Stocks)	4.7	-7.1	18.2	-12.2	2.0	0.3
10-year Treasury Note (Yield Only)	3.1	N/A	3.4	5.2	4.1	6.0
Gold (per ounce)	0.6	9.5	32.6	22.3	23.3	15.6
DJ-UBS Commodity Index	2.4	-8.8	10.6	-9.6	-4.3	2.3
DJ Equity All REIT TR Index	5.5	8.7	72.3	-9.0	0.0	10.1

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

**DOES THE LARGE U.S. BUDGET DEFICIT MATTER?** Below is a chart of our annual budget surplus/deficit for the past few years.

Year	U.S. Surplus/(Deficit) in millions
1998	\$69
1999	126
2000	236
2001	128
2002	-158
2003	-378
2004	-413
2005	-318
2006	-248
2007	-161
2008	-459
2009	-1,412
2010	-1,500 (projected)

Source: Office of Management and Budget

Notice how our budget deficit has soared over the past three years as the recession took its toll. Surprisingly, it was just nine years ago that we ran a budget surplus of \$128 billion. On a cumulative basis, the national debt is \$13.2 trillion, according to the Treasury Department. So, should we be concerned that our annual deficit and national debt are rising dramatically?

Without meaning to be glib, deficits don't matter until they do. Just ask Greece.

Currently, financial markets are relatively unconcerned about our debt level. Investors' lack of concern shows up in the fact that interest rates on government bonds are near historic lows and the spread between interest rates on inflation-protected Treasury bonds and regular bonds is a mild 2.3%, according to MSN, July 9. If investors were concerned about our debt level, they'd send interest rates skyrocketing (as happened in Greece) and inflation might rear its head if the government cranked up the printing press to monetize our debt.

Investors are not alarmed at our large debt level because they still have *confidence* that our country will weather the storm. However, investors could lose confidence if, for example, we experience some new shock or a "failed" Treasury auction. If that happens, confidence could dissipate rather quickly and throw our economy into disarray.

Nobody knows if this will happen or not, but we continue to monitor interest rates and inflation expectations as early indicators to help determine if confidence is slipping.

### **Weekly Focus – Think About It**

“Our ordinary mind always tries to persuade us that we are nothing but acorns and that our greatest happiness will be to become bigger, fatter, shinier acorns; but that is of interest only to pigs. Our faith gives us knowledge of something better: that we can become oak trees.”

--E.F. Schumacher

Best regards,  
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