

Review for the 2nd Quarter 2010 and future outlook

Putting lipstick on European PIIGS

Putting ‘lipstick on a pig’ is a commonly used phrase to indicate an attempt to make something look better than it actually appears. The phrase was famously used most recently in the 2008 U.S. Presidential campaign. The so-called ‘PIIGS’ is a new term that highlights the structural difficulties facing five European ‘euro-zone’ members: **P**ortugal, **I**reland, **I**taly, **G**reece and **S**pain. The second quarter saw a return of volatility and a stock market decline—owed in part to a group of European PIIGS.

Greece and ‘sovereign-debt’

The volatility originated with the Greek debt crisis earlier this year. As the quarter got underway, the markets acted like the crisis was contained and in late April the Dow Jones Industrial Average hit its highest point since the Lehman Brothers bankruptcy of September 2008. However, as the quarter progressed, the situation in Greece deteriorated and there was concern it would spread—and became known as the ‘sovereign-debt crisis in Europe’.

The ‘flash-crash’

Stock markets declined across the board in the second quarter. The Dow Jones Industrial Average ended down 10% at 9974.02 and the S&P 500 index fell 12% to 1030.71. Markets in Europe and China also ended lower. As if that was not enough, on May 6th, the Dow Jones plunged about 700 points in only eight minutes. It took several days for markets to recover the loss but traders and the media called the event a ‘flash crash’. The exact cause of the flash crash remains unknown but investor confidence was shaken once again.

BP and oil prices

British Petroleum’s fatal Gulf of Mexico accident (and ongoing oil spill) in late April turned into one of the big stories of the quarter. The uncertainties of the disaster weighed heavily on investor confidence and it continues to consume the media and political scenes. Concerns about overall economic weakness and the potential for a ‘double-dip’ recession caused oil prices and commodity prices to remain relatively steady to modestly lower. Crude oil prices closed the quarter down 9.7% at \$75.63 a barrel and December futures contracts closed down 1.5% to \$90.08 a barrel.

Our outlook: the glass is half full

In the short term, the worry is that problems with European banks will leave the markets trapped in uncertainty. The good news is that the European Union's largest banks will undergo 'stress tests' that will hopefully reassure investors about their fiscal health. The results are scheduled to be released on July 23rd.

It will take some time for the events of the second quarter to work their way into the real economy but by one measure stocks already look attractive. The average price earnings ratio of the S&P 500 for estimated earnings is currently about 13.5 compared to the typical 16. As of this printing, U.S. companies are preparing to release their earnings reports. Any positive reports will pressure stocks higher.

Recommended summer reading

One of the best books about the recent financial crisis is Michael Lewis's "The Big Short". What makes this book so easy to read is that Lewis tells the story through the eyes of three quirky hedge fund managers and a bond salesman. All of these people saw the coming crisis—along with the fraud—and figured out how to make a fortune. The "Big Short" tells a human story while explaining complex subjects with a simple and easy to understand approach. Other books from the same author include "Liar's Poker" which exposed the corrupt culture at Salomon Brothers and "The Blind Side", a story about American football (Sandra Bullock starred in the movie and won an Oscar).

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We look forward to continue serving your investment management and financial planning needs. Please contact us if you have any questions, if you'd like to schedule an account review or learn more about our comprehensive planning services.