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June Swoon Tests Wobbly Bulls

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We are only midway through 2011 and the market already has experienced not one, not two, but three bear market tests. These were prompted by the Arab spring, Japan's nuclear meltdown and most recently the June swoon as Greek debt woes resurfaced and the Fed's QE2 stimulus program came to an end. In each of the tests, the speed of the rebound was surpassed only by the pace at which Wall Street ran for cover by slashing their economic forecasts. In the first two weeks of June, the S&P 500 plummeted nearly 6% — inspiring a wave of bearish calls from a fearful Street — before embarking on a consumer discretionary-led bounce back of almost 4.5% in the final two weeks of the month.

There is little doubt that a summer rally driven by strong second quarter profits — the ninth-consecutive quarterly positive surprise — would cause the Street to reinstate its previous forecasts. Sadly, wobbly bulls are likely to be whipsawed by volatile markets. For a little history, recall how Margaret Thatcher reportedly said to George Bush Sr. at a particularly trying time during the Gulf War, "Don't get wobbly on me, George." Related to the markets, many investors are fair-weather bulls; when the times get tough, they bail.

Investors with conviction build wealth faster; for those investors who aspire to maintain their discipline, here are our observations and judgments as to why they should stay the course and remain fully invested:

- Greece has no choice but to accept all austerity and privatization plans.
- The euro crisis has most likely been fully discounted by the market; at this point, only a worst-case scenario will have a sustained market impact.
- There will be no further stimulus (QE3) by the Fed (though, admittedly, the poorly thought out release of strategic oil reserves was a stealthy stimulus gesture).

Nine out of Ten Market Segments Are Positive Through the First Half of 2011

Index	Wgt	Jun-11	YTD	2010	2009	2008	2007	2006	1 year	3 years	5 years	10 years
Equity												
S&P 500	10%	(1.7)	6.0	15.1	26.5	(37.0)	5.5	15.8	30.7	3.3	2.9	2.7
S&P 400 Midcap	10%	(2.2)	7.9	24.9	35.0	(37.3)	6.7	9.0	37.5	6.1	5.1	6.5
S&P 600 Smallcap	10%	(1.9)	7.0	25.0	23.8	(32.0)	(1.2)	14.1	35.6	6.8	3.4	6.7
U.S. REITs	10%	(3.7)	8.4	23.5	21.0	(41.5)	(20.2)	30.2	29.3	0.2	(2.4)	7.4
EAFE	10%	(1.2)	5.3	8.2	32.5	(43.1)	11.6	26.9	30.9	(1.3)	2.0	6.1
Emerging Markets	10%	(1.2)	(0.2)	9.8	93.5	(59.3)	59.1	56.6	19.5	(0.3)	12.2	18.7
Average		(2.0)	5.7	17.7	38.7	(41.7)	10.2	25.4	30.6	2.5	3.9	8.0
Fixed Income												
Corporate	10%	(0.9)	3.2	9.0	18.7	(4.9)	4.6	4.3	6.3	8.6	7.0	6.3
U.S. Treasury 20+	10%	(2.3)	1.7	9.4	(21.4)	33.7	10.2	0.9	(3.2)	5.0	6.8	6.7
Global Aggregate	10%	0.1	4.4	5.5	6.9	4.8	9.5	6.6	10.5	6.0	7.1	7.4
High Yield	10%	(1.0)	5.0	15.1	58.2	(26.2)	1.9	11.8	15.6	12.7	9.3	9.0
Average		(1.0)	3.6	9.8	15.6	1.9	6.5	5.9	7.3	8.1	7.6	7.4
60/40 Portfolio		**(1.6)**	**4.9**	**14.5**	**29.5**	**(24.3)**	**8.8**	**17.6**	**21.3**	**4.7**	**5.3**	**7.8**

Source: FactSet

- The U.S. debt limit will be raised; $4 trillion in spending cuts will be passed.
- We are in the third year of a multi-year bull market driven by a synchronized global economic expansion and rising middle classes worldwide.

The fundamentals fully support either a summer rally and/or fourth quarter rally driven by:

- Accelerating manufacturing, with the Chicago Purchasing Managers' Index surging to 60.1%, and the ISM Index reaccelerating to 55.3% in the past month.
- Retail sales excluding motor vehicles powering ahead to reach all time peak levels in May.
- Durable goods orders up 9.7% over the past year.
- Corporate profits in 2011 on target to reach the highest levels ever.
- Global trade picking up the pace, as U.S. exports reached an all-time monthly high in April.

While these alone make the case for being fully invested in the market from a global perspective, unemployment remains a nagging question. Fortunately, if we look ahead and assume that some political foresight prevails, the unemployment

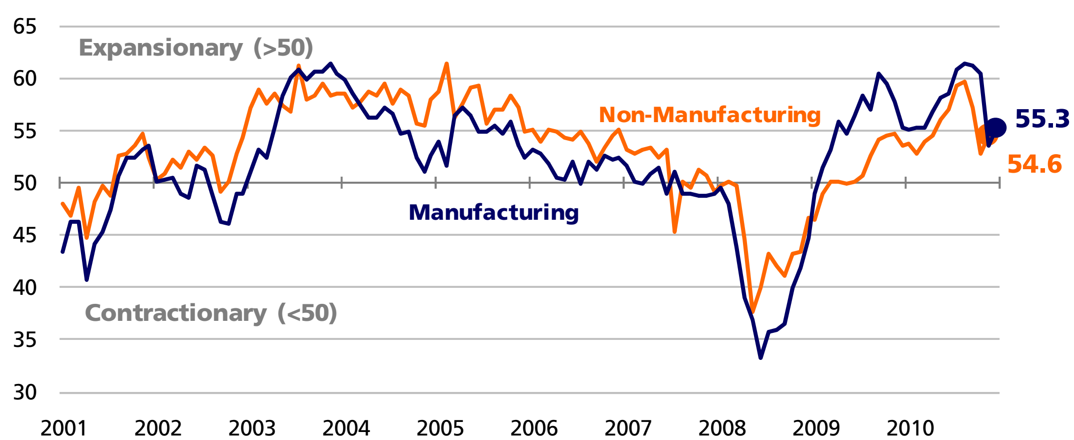
First Quarter Earnings Surprised the Market; Expect More of the Same in the Second Quarter

Sector	Reported			Earnings Growth			Earnings Surprise		
	Actual	/	Total	Percent	Positive	Negative	Percent	Positive	Negative
Energy	41	/	41	41.7%	25	15	4.0%	24	14
Materials	30	/	30	55.4%	24	4	12.5%	25	4
Industrials	60	/	60	32.7%	49	7	9.0%	20	12
Consumer Discretionary	79	/	79	10.4%	53	22	5.2%	51	21
Consumer Staples	41	/	41	6.0%	28	12	1.9%	23	13
Health Care	52	/	52	6.2%	44	8	7.6%	46	5
Financials	82	/	82	15.0%	50	22	11.1%	55	19
Information Technology	75	/	75	25.2%	51	19	9.0%	56	11
Telecommunication	8	/	8	0.5%	3	4	4.4%	2	2
Utilities	33	/	33	0.1%	19	14	1.1%	14	16
S&P 500	500	/	500	19.0%	347	130	7.1%	338	118

Note: Earnings Growth is the percentage change in the cumulative share weighted EPS Earnings from that of a year ago. Surprise Percent is the share weighted average of the ratio of actual company earnings vs. the consensus estimate.

Source: Bloomberg, Standard & Poor's

American Manufacturing Continues to Astound the Markets

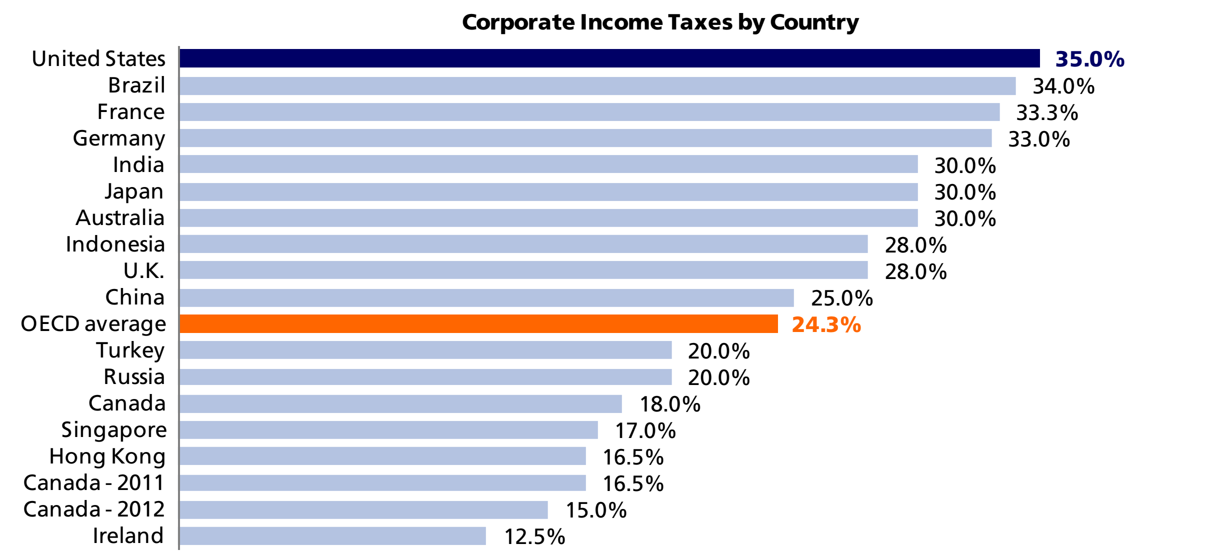


Source: Institute of Supply Management, Federal Reserve, FactSet problem could be turned around on a dime with pro-growth policies such as:

- Immediately ratifying the three outstanding trade deals with South Korea, Columbia and Panama.
- Cutting corporate income taxes from 35% (the highest rate among Organisation for Economic Co-operation and Development members) to a competitive 20%.
- Reducing the tax rate on the repatriation of profits to 5% to encourage the free flow of capital in a global economy.
- Easing up on new regulation. Markets recognize that excessive regulation tends to push jobs overseas; health care rocketed last month as investors anticipated possible changes to Obamacare, while financials rise and fall with every news release about proposed regulations.

June was in fact a boon to the disciplined investor, as markets delivered their best weekly performance in two years during the final week of the month, propelled by exceptionally strong fundamentals. Market fundamentals, contrary to consensus, are still increasing, and broad global diversification is the only clear path to the final destination.

Pro-Growth Policies Are Required in a Competitive Global Economy



Source: Bloomberg, CIA World Factbook