

WEEKLY MARKET WRAP

MAY 15 – MAY 21, 2010

This week saw a severe market correction that has been anticipated for many months. Ironically, forces from Europe triggered the selling, while the domestic picture continues to improve. When the U.S. faced its moment of truth over a year ago, the Federal government and Federal Reserve acted swiftly and in a unified manner. This cannot be duplicated by the European Union as it is merely a loose economic/financial federation that has adopted a single currency, but lacks so much more in terms of political and institutional unity. Now the market has lost confidence in the ability of the E.U. to manage the immediate challenges let alone change its stifling legacy policies to enable future growth and reduced borrowing.

In addition to the shortcomings of the European Union, the Gulf oil leak and the major financial reform legislation coming out of Washington have been given a vote of “no-confidence” by the markets. Further, there has been almost a perfect storm of other events that have undermined investors. These include the Greece bailout, China’s bank lending slowdown, the “flash-trading crash” of May 6, the high levels of unemployment in the U.S., the prospect of both higher taxes and higher interest rates ahead. Since the market has grown over 80% since the bottom in March of 2009, many investors were surprised that no correction had taken place.

On the other hand, there are a number of developments that have created a positive backdrop in the U.S. Specifically, domestic earnings have rebounded nicely in the first quarter of 2010. Furthermore, the market valuations are considered attractive, companies are beginning to reinvest, productivity remain good, there is ample cash and liquidity and interest rates remain low. All of these positive factors should not be ignored, however at the present time, they are being overshadowed by large international (financial and political) events. If the U.S. can continue to grow jobs over the summer, investors will again focus on the good news here at home that could provide leadership for renewed market strength.

The biggest political news of the week concerns the banking reform legislation passed by the Senate. This has attracted a great deal of attention as the debate and maneuvering played out. In the end, a massive, far-reaching bill was produced that addressed many concerns, but failed to resolve the issue of “too big to fail.” Now both houses must produce a unified bill that must address and correct the many deficiencies that either caused or became exposed during the financial crisis of 2008/09.

Inflation statistics were released during the week that showed both the PPI and CPI were in good shape. The PPI for April was down 0.1%, while the CPI also declined 0.1%. For now, inflation seems well contained. Of concern to the markets though, was the April Index of Leading Economic Indicators (LEI) that declined by 0.1%. This was the first lower reading of the LEI Index in 13 months and followed a very strong increase in March. The markets

will watch the LEI closely in the months ahead for clues on the sustainability of the U.S recovery.

A number of bell-weather companies reported earnings this week. Generally, the numbers were good and the outlooks reported were encouraging. In the technology space, Hewlett Packard turned in a great performance with earnings up 26% and revenue up over 12%. Dell also reported, but their results indicated lower margins. Both companies see a strong PC and enterprise upgrade cycle underway that should drive earnings in the future. The machinery giant, Deere, also reported an excellent quarter with earnings up 42% and revenue up 6%. The company is replenishing dealer inventory in anticipation of strong demand for productivity from farmers. Wal-Mart and Target also reported good quarters; however Wal-Mart reported slowing domestic sales. Both Home Depot and Lowes reported good results for the quarter but Home Depot was able to post earnings per share up 30% while Lowes showed only a 5% increase.

For the week the Dow lost 4.0% to 10,193, the S&P declined 4.2% to 1,088, the Nasdaq fell 5.0% to 2,229 and the Russell 2000 finished down 6.5% to 649. The 10 year Treasury note began the week at 3.45% and ended at 3.20% due to heavy buying from global investors seeking a safe haven.

Have a great weekend!