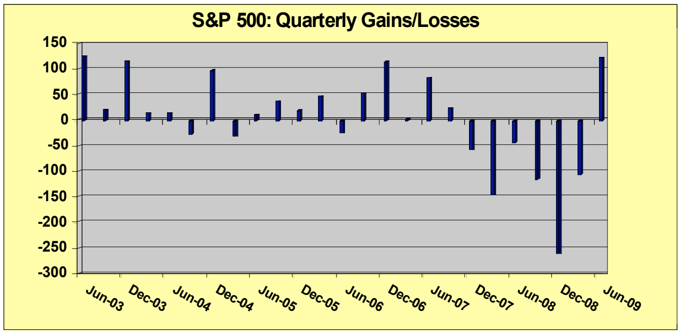
June: An Up Quarter at Last

Market Summary June 2009

June normally is a month of rising temperatures, but its effect in the capital markets this year was that of a cool-down. Nevertheless, the month provided something not seen since September 2007: the conclusion of an "up" quarter for the S&P 500 Index. It was, in fact, the best quarter for the S&P 500 since June, 2003 (see chart).



One further distinction: The S&P 500's tiny but welcome advance of 0.2% in June marked the first time since December 2006 that the index had ended a quarter with a third consecutive monthly gain (9.4% for April; 5.3% for May). The S&P 500 gained 15.2% for the full quarter (15.9% with dividends included).

Aggregated indices prospered across categories during the second quarter, despite muted June returns and the effects of conflicting interests assumed to exist in their constituent assets. This was a rising tide to lift all boats (almost), at least during the earlier weeks of the quarter.

The "almost" qualification acknowledges the notable exception of long U.S. Treasury bonds, which had the lowest return of any asset category for the second quarter, suggesting a resurgence of inflation fears as well as factors not yet known.

Bonds: Best and Worst in Performance

Bond indices bracketed performance data for the second quarter, providing the highest as well as lowest return among benchmarks tracked for this
newsletter. Generally, bond indices gained in proportion to their riskiness. Accordingly, the very junky Barclays Ca-D U.S. High Yield Index led all asset categories in the second quarter with a very plump gain of 55.1%. The Barclays Capital U.S. High Yield Index followed suit with a 23.1% gain. The U.S. Treasury Long Bond Index, which offers safety of principal but a yield vulnerable to inflation, brought up the rear with a drop of 7.1%.

As might be expected from such a barbell-like configuration among the data for specialized bond indices, the broader benchmarks wound up in the middle, with mixed and decidedly unspectacular returns. The Barclays Capital U.S. Aggregate Bond Index rose 1.8% in the second quarter; the U.S. Treasury Bond Index fell 3.0%; the Global Treasury Index dropped 3.7%.

June returns for fixed-income were far blander than the quarterly numbers. Bonds did not come near providing either the leader or the laggard in performance last month. The Barclays U.S. Aggregate Bond Index rose 0.6%; the U.S. Treasury Bond Index fell 0.2%. Riskier categories continued to fare better in June, as the U.S. High Yield Index gained a healthy 2.7%. The wildeyed Ca-D U.S. High Yield Index cooled to end the month with a modest 0.5% gain. The U.S. Treasury Long Bond staged a slight rebound, finishing the month with a 0.8% gain.

Consistent with a renewal of inflation fears, Barclays Index for TIPS with 10+ year maturities gained 2.4% in June.

Stocks: Quarter Good; Month Less So

As with fixed-income assets, stocks provided very strong returns for the second quarter, despite a flat final month. Gains for U.S. stocks generally showed a strong negative relation to capitalization, and strong positive correlation to growth (as opposed to value) orientation.

As had the S&P 500, the Dow Jones Industrial Average overcame a weak June (-0.4%) in posting a strong quarterly gain (12.0%). The Russell 1000 Index rose 16.5% for the quarter and 0.2% in June. The Russell 1000 Value Index rose 16.7% for the quarter and dropped 0.7% in June; the Russell 1000 Growth Index rose 16.3% for the quarter and 1.1% for the month.

Mid-caps performed spectacularly during the first two months of the second quarter, and also held on during June. The S&P 400 Index gained 18.8% for `1`qthe quarter and 0.6% for the month.

The story in small-caps was stronger still: The Russell 2000 Index gained 20.7% through the second quarter, and returned a very presentable 1.5% in June. As with the large-cap Russell index, the growth component of the Russell 2000 Index did the heavy lifting:

the Russell 2000 Growth Index returned 23.4% for the quarter and 3.2% for June; the Russell 2000 Value Index gained 18.0% for the quarter and lost 0.3% in June.

International Stocks followed the general scenario of a strong quarter with a weak final month, but broke the U.S. pattern of smaller-caps out-performing through the June chill. The MSCI EAFE Index gained 25.4% for the quarter, despite dropping 0.6% in June. The smaller-cap MSCI Emerging Markets Index soared 34.7% for the second quarter with a slightly larger loss of 1.3% in the final month.

The June cool-down effect (it does not merit the word "swoon") also was very evident in the Goldman Sachs Commodity Index, which roared loudly enough through April and May to wind up with a 19.2% gain for the quarter, overcoming a rather meek 0.6% return for June. The Goldman Sachs Natural Resources Index returned 18.2% for the quarter and a very rough -8.4% for June.

REITS also were part of the June cool-down, falling 3.5% for the month, but producing a 31.5% gain for the quarter. As of the end of June, the index was down 13.1% for the year-to-date and down 45.3% year-over-year.

Unemployment Still Grim

Economic data continues to suggest that energy is building in the economy to launch a recovery, but on an ever-receding time horizon. Private sector jobs fell by 467,000 in June, according to the Bureau of Labor Statistics. The unemployment rate was set at 9.5%, up 0.1%. The number of persons put out of work in the current recession (beginning December 2007) rose to 7.2 million. Altogether, 14.7 million persons are seeking jobs.

Turnaround in Manufacturing?

The Institute of Supply Management (ISM), in its monthly survey of manufacturers, reports that activity contracted in June for the 17th consecutive month. The rate of contraction continued to slow, however, as the June figure of 44.8% was 2 percentage points higher than that for May (50% or more indicates growth). The index apparently bottomed in December at 32.9 and has risen every month since. Non-manufacturing activity increased a full 3 percentage points in June, to 47.0.

The ISM claims that a level of manufacturing activity sustained above 41.2% indicates economic growth. The rate was slightly above that in May and 3.6 points above it in June. The June rate of activity, if annualized, would correspond with a 1.1% growth in GDP, according to the Institute. So far, however, no one but the ISM seems to find the survey indicative of anything other than manufacturing activity.

Less dubious is the ISM's contention that the survey's consistent finding that customers of manufacturers are running lower and lower on inventoried goods logically must result in new orders. Inventories dropped 6.5 points in the June survey, to 43.5%, The ISM reported that the most potent number in the June survey was that for manufacturing production, which rose 6.5 points to an expansionary 52.5%. The nine previous monthly figures had indicated contraction.

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