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At Long Last, the Markets Take a Turn for the Better

Equity markets and risky fixed income assets enjoyed solid gains during the second quarter amid indications that the worst of the financial crisis and economic recession might be behind us.

With hints that the rate of economic decline was at least slowing, US stocks enjoyed their biggest quarterly gain since the fourth quarter of 2003, rebounding strongly from the depths of their twelve-year low reached in early March of this year. As seen in the accompanying table, the Wilshire 5000 Broad Market Index rose 16.8% for the quarter, with large caps (S&P 500) advancing 15.9% and small caps (Russell 2000) rising 20.7%. The broad index is up 4.5% for the first half of 2009, but most indices remain off about 40% from their October 2007 highs.

Among styles, growth and value performed similarly for the quarter while growth has outperformed substantially year to date. Among the S&P 500's sectors, financials rebounded strongly, up 35.1% for the quarter while telecoms were up only 1.9%. Year to date, information technology (+24.1%) and industrials (-7.7%) were the best and worst performing, respectively. Among the Dow Industrials, second quarter performance ranged from Bank of America (+94%) and American Express (+71%) to Chevron (-2%) and WalMart (-7%). Year to date, American Express (+25%) and IBM (+24%) led the winners while Caterpillar (-26%) and General Electric (-28%) were the worst of the laggards.

Global stock markets also rose amid hopes for recovery. While most developed markets performed well, emerging markets --- which lagged significantly last year--- performed the best, reflecting expectations for greater long term growth prospects. Russia, China, India, and Brazil were among the best performers, up 30-60%. The MSCI-EAFE (developed markets) Index rose 25.4% for the quarter and 8% year to date. Respective returns were 34.7% and 36.0% for the MSCI-Emerging Markets Index.

In the fixed income markets, the continued thawing in the credit markets led to losses in US Treasuries as investors began to shun them in favor of more risky assets. Reflecting their loss of safe haven status, yields on the benchmark 10-year US Treasury note rose to 3.52% at quarter-end, up from 2.69% at the end of the first quarter and 2.25% at year-end 2008. While ten year Treasuries suffered a market value loss of over 6% during the second quarter, all other sectors posted hefty gains. Investment grade corporate bonds returned about 11% during the quarter as the yield differential between them and Treasuries narrowed from 6% to 3.3% over the three months. High yield ("junk") bonds returned 23% for the quarter as yield spreads over Treasuries narrowed dramatically from 17% to 11%. In a sign that investors are concerned about long-term inflation, the yield curve steepened during the month. The Barclays Aggregate Index was up 1.8% and 1.9% for the quarter and year to date while respective returns for the Merrill Lynch High Yield Index were +22.5% and +29.0%.

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Among other asset classes, private real estate returns are not yet available but real estate investment trusts surged nearly 29% for the quarter although they are still off over 12% for the year. Composite hedge fund returns were generally in the high single digits for the first six months of 2009. Reflecting some signs of economic stabilization, commodities rose about 12% and the price of oil rose 41% during the second quarter.

Going forward, the equity markets will need more solid evidence of an economic bottoming in order to maintain or extend their recent gains. Stock prices had already drifted lower during the final weeks of June amid concern that the market may have gotten ahead of itself. With quarter-end price / earnings ratios close to historic norms, the market may have little room for error. When the unemployment rate for June shot up to a 25-year high of 9.5%, it was a stark reminder that the economic fundamentals remain fraught with uncertainty.

TOTAL RETURNS | SECOND QUARTER, 2009

INDEX	SECOND QUARTER 2009	YEAR TO DATE	TRAILING TWELVE MONTHS
US EQUITY MARKET			
Dow Jones Industrial Avg.	+ 12.00%	- 2.00%	- 23.00%
Standard & Poor's 500 (Large Cap)	+ 15.93%	+ 3.16%	- 26.21%
NASDAQ Composite	+ 20.00%	+ 16.40%	- 20.00%
Wilshire 5000 (Broad Market)	+ 16.79%	+ 4.45%	- 26.40%
Standard & Poor's Mid-Cap 400	+ 18.75%	+ 8.47%	- 28.02%
Russell 2000 (Small Cap.)	+ 20.69%	+ 2.64%	- 25.01%
GROWTH VS. VALUE			
Russell 1000 (Large Cap) Growth	+ 16.32%	+ 11.53%	- 24.50%
Russell 1000 (Large Cap) Value	+ 16.70%	- 2.87%	- 29.03%
Russell Midcap Growth	+ 20.67%	+ 16.61%	- 30.33%
Russell Midcap Value	+ 20.94%	+ 3.19%	- 30.52%
Russell 2000 Growth	+ 23.38%	+ 11.36%	- 24.85%
Russell 2000 Value	+ 18.00%	- 5.17%	- 25.24%
INTERNATIONAL EQUITY			
M.S.C.I. - E.A.F.E.	+ 25.43%	+ 7.98%	- 31.35%
M.S.C.I. - Emerging Markets	+ 34.73%	+ 36.01%	- 28.07%
FIXED INCOME			
Lehman Brothers Aggregate Index	+ 1.80%	+1.90%	+ 6.05%
Merrill Lynch High Yield Index	+ 22.50%	+ 29.00%	- 3.60%
REAL ESTATE			
NAREIT - Equity Real Estate Investment Trusts	+ 28.85%	- 12.21%	- 47.50%
HEDGE FUNDS			
HFR Fund-Weighted Composite Index	+ 8.84%	+ 9.41%	- 10.18%