MONTHLY ECONOMIC UPDATE

July 2011

MONTHLY QUOTE
"The large print giveth, but the small print taketh away."
– Tom Waits

MONTHLY TIP
How big is your rainy day fund? Ideally, you should build an emergency fund that should equal 6-9 months of current living expenses. It is a worthwhile goal to pursue.

MONTHLY RIDDLE
Michael introduces Levi to his friends, stating that Levi's father is also the son of Michael's father. But Michael is an only child. So how are Michael and Levi related?

Last month's riddle:
Tim says he heard that you can find $200 stuffed between pages 147 and 148 of a romance novel at the library. What detail convinces you that he is wrong?

Last month's answer:
Pages 147-148 would not be facing pages; page 148 would be printed on the back of page 147.

THE MONTH IN BRIEF
June was looking pretty bleak … but then economic indicators turned surprisingly positive and Greece passed austerity measures that could help it avoid default. The month concluded with a powerful Wall Street rally. Still, the S&P 500 lost 1.83% for June. Most of the month's data substantiated that we were seeing a soft patch. While politicians butted heads over the debt ceiling, the real estate market flashed weakness and the commodities sector suffered a collective hit. Even so, Wall Street's mood has improved as we head into the next earnings season.[1]

DOMESTIC ECONOMIC HEALTH
Consumers weren't spending very much, and they weren't feeling too confident either. Personal spending was flat in May (after ten straight months of gains) and actually decreased 0.1% in inflation-adjusted terms. Both of the major consumer confidence polls went south for June: the Conference Board's survey dipped 3.2 points to 58.5, and the University of Michigan's final June consumer sentiment survey retreated to 71.5 from May's 74.3 mark.[2,3,4]

Consumer inflation moderated and unemployment increased. The May edition of the Consumer Price Index rose 0.2%; core CPI was up 0.3%. Food prices were up 0.4% and energy prices were up 0.6%, but even so this was the smallest monthly increase in inflation in seven months. Year over year through May, consumer inflation was 3.6% (and core inflation was 1.5%). The Producer Price Index advanced 0.2% in May; the preceding two months had seen increases of 0.7% and 0.8%. Annualized wholesale inflation was 7.3% - the highest wholesale inflation rate since the summer of 2008. The nation's jobless rate ticked up to 9.1% in May.[5,6,7]

On the bright side, the Institute for Supply Management's twin PMI indices signaled that the pace of expansion had accelerated in both the service and manufacturing sectors. ISM's May service sector index increased 1.8% to 54.6, with a 4.1% boost in new orders. The recently released June manufacturing index was a pleasant surprise: defying expectations of analysts, it rose from 53.5 to 55.3. The Conference Board's index of leading indicators bounced back from an -0.4& showing in May to go +0.8% in June as eight of ten indicators improved. Durable goods orders had increased by 1.9% during May, and May's 0.2% dip in retail sales was shallower than analysts had expected.[2,8,9,10,11]

In Washington, there was much argument over the federal debt ceiling but little agreement. While hiking the debt cap is all but inevitable, Congress elected to take the NFL/NBA approach and sustain the dispute. Meanwhile, Standard & Poor's warned that it would cut the U.S. debt rating from AAA to D if the debt cap wasn't raised by August 2; Moody's threatened a cut to somewhere in its Aa category.[12]

GLOBAL ECONOMIC HEALTH
The International Energy Agency surprised the futures markets in late June when it announced a plan to release 60 million barrels worth of crude from global reserves. In the big picture, the move has a chance to tame inflation pressures (especially in Europe) and aid the dollar.[13]

Speaking of Europe, reassuring news emerged from the EU as the Greek government embarked on actions to service its debts and stay in the euro. Yet Greece is not out of the woods by any means – the possibility of default still looms, and Standard & Poor's said it would regard a proposed rollover of privately held Greek debt led by French banks as a "selective default".[14]

New manufacturing index data indicated that Asia's economies were muddling through a soft patch as well. In June, India's benchmark PMI had its biggest one-month fall since November 2008, reaching a nine-month low of 55.3. Taiwan's PMI went below 50 for the first time in nine months (meaning sector contraction), and South Korea's PMI slipped to its lowest level in seven months. China's official PMI fell to 50.9 for June – a 28-month low.[15]

WORLD MARKETS

Some benchmarks went positive in June, others negative. According to Morningstar calculations in U.S. dollar terms, major Asian benchmarks did okay - Sensex, +2.34%; Nikkei 225, +1.26%; Shanghai Composite, +0.68% (yet Australia's All Ordinaries went -2.70%). In Europe, the big indices mostly retreated: DAX, +1.11%; CAC 40, -0.62%; FTSE 100, -0.74%; STOXX 600, -2.92%. To our north, Canada's TSX Composite went -4.41%. The key MSCI indices also lost ground in June (World, -1.73%; Emerging Markets, -1.86%).[16,17,18]

COMMODITIES MARKETS

It was another rough month for the majority of commodities investors. Oil slipped 7.1% in June, a drop aided by the IEA's surprise call for nations to tap into petroleum reserves. Gold had its second down month in a row (its May-June performance was -3.5%) but remained +5.71% on the year despite a -2.19% month that left prices settling at $1,502.30 on June 30. When the Department of Agriculture said that America had greater inventories and acreage of corn (and other key crops) than estimated, ag futures took a big hit. Wheat lost 21.0%, corn 17.0%, soybeans 6.0% and rice 1.4% in June. Even the dollar lost some ground: the U.S. Dollar Index went -0.21% last month, wrapping up June at 74.54.[19,20,21]

REAL ESTATE

What can you say about a real estate market which features reduced sales activity during the prime homebuying season? There isn't much positive to report when assessing the May data: existing home sales were down 3.8% while new home sales were down 2.1%. In annual terms, new home sales had improved by 13.5% with the average price better by $1,400;existing home sales were down 15.3% year-over-year with the median price retreating 4.6%.[22,23]

Speaking of home prices, the April edition of the Case-Shiller/S&P home price index actually showed a 0.7% overall price gain across 20 metro markets – but there was a 4.0% annualized dip in prices to take any celebration out of that small monthly advance. The good news is that pending home sales really rebounded in May: the National Association of Realtors said home sale contracts were up 8.2% from April's seven-month low and up 17.0% from the June 2010 trough.[24,25]

Freddie Mac's June 30 Primary Mortgage Market Survey showed descents in average interest rates on the four common mortgage types compared with its June 2 survey: 30-year FRMs, -0.04% to 4.51%; 15-year FRMs, -0.05% to 3.69%; 5/1-year ARMs, -0.19% to 3.22%; 1-year ARMs, -0.16% to 2.97%.[26]

LOOKING BACK...LOOKING FORWARD

Early in June, bears were groaning. By the end of the month, the bulls were back in charge. In fact, June 27-July 1 represented the best week for the Dow and S&P 500 since mid-July 2010. Still, it was a negative month for stocks.[27]

% CHANGE	Y-T-D	1-MO CHG	1-YR CHG	10-YR AVG
DJIA	+7.23	-1.24	+27.01	+1.82
NASDAQ	+4.55	-2.18	+31.49	+2.84
S&P 500	+5.01	-1.83	+28.13	+0.79
REAL YIELD	6/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO

10 YR TIPS	0.75%	1.15%	2.54%	3.52%

Sources: online.wsj.com, bigcharts.com, treasury.gov, treasurydirect.gov - 6/30/11[1,28,29,30,31]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

So with this newfound momentum or at least interest in equities, we find ourselves in July – traditionally a pretty good month on Wall Street, powered by anticipation of 2Q earnings. Since 2000, July has been a little less positive than in previous stock market cycles: the *Stock Trader's Almanac* notes that the Dow and S&P have respectively averaged July gains of 1.24% and 0.16% in the last 11 years, with the NASDAQ averaging a 0.45% loss for the month. That is the recent history. The current reality is that we still have concerns about a flagging world economy, severe debt problems plaguing multiple EU countries and no agreement yet on the federal debt ceiling. Let's hope that earnings season casts its spell on the collective mind of Wall Street, with 2Q results impressive enough to make stock market performance in July 2011 correspond to Julys of decades before.[32]

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