



## Insights from Northern Trust

### Commentary from John Leo, Chief Investment Officer, Illinois, Personal Financial Services

**July 6, 2010**

With the second quarter drawing to a close last week, the natural inclination is to take stock of the many events that shaped it. However, space constraints mean we must be content to review some of the more recent and relevant events which, unfortunately, included an 8.6% slide in stock prices in the two weeks leading up to this holiday weekend, along with a host of sobering economic data points.

It is this latter point that deserves the most focus. Yes, European sovereign debt woes are still concerning, and the messy process of financial services regulatory reform creates some understandable anxiety. But at the fundamental core of investors' wavering confidence is a growing unease about the health of the global economy. Will recovery in the developed economies prove self-sustaining? Will China's policymakers deftly manage to contain speculative real estate activity without compromising that important engine of global growth? Will disinflationary price pressures threaten the profit growth story and choke off the important contribution that corporate spending provides to the economy?

Clearly, many questions weigh on investors' minds today, and recent results have not helped rebuild confidence. The monthly U.S. labor report is always among the most anticipated of releases, and Friday's report of June data confirmed that the economy was losing some momentum as it closed the second quarter. Private payrolls expanded by 83,000 last month, short of expectations by about 40,000. Equally disappointing were the declines in the average workweek and average hourly earnings. The weaker results leaned toward the manufacturing sector, a trend that was highlighted earlier in the week by the drop in the Institute for Supply Management's manufacturing index in June to 56.2 from May's reading of 59.7. While the June reading still indicates manufacturing expansion, it is the sharp loss of momentum that grabs attention.

Other key economic releases last week included a downward revision of first quarter gross domestic product from a growth rate of 3.0% to 2.7%, a pattern we have seen in each of the prior two quarters. The June reading of the Conference Board's consumer confidence index sank sharply to 52.9 from May's 62.7, well below expectations, although still at a level consistent with modest economic growth. On the positive side of the ledger, the Case-Shiller home price index showed a 3.8% gain in home prices for April, the largest year-over-year increase since September 2006. And the Chicago Purchasing Managers Index came in near expected at 59.1, indicating a continuation of solid expansion in that region.



The negative tilt to the economic story had the effect of accentuating the anti-risk trade across global markets. Weak stock prices around the globe and further widening of European sovereign debt spreads were set in sharp contrast to further gains in U.S. Treasury prices – the two-year note hit all-time low yield levels near 0.60% while the 10-year note pushed below 3.00% and the 30-year bond broke below 4.00%. These are astounding moves when you consider the worries about inflation that occupied much of this year's first quarter – a concern that has all but disappeared for now.

Regarding stock price action, the weakness over the past two weeks is troubling when considered against the positives of the Standard & Poor's 500, which rose strongly through its 200-day moving average on June 15, and the June 19 announcement that the People's Bank of China would permit increased flexibility in its currency. These factors appeared to set the stage for the bulls to hold sway for some time, but the weight of the economic evidence has trumped these positive factors. For now, stock investors must wait for second-quarter earnings reports and management forecasts to re-frame their opinions about equity price prospects. Fortunately, that wait will not be a long one, as reports will begin in earnest next week.

Despite the downbeat assessment of recent data points and market moves, I remain encouraged as I watch the stars and stripes waving in the breeze on our front porch and am reminded of the powerful forces of freedom that have served our people and our economy so well for generations. In these early days of our country's 235<sup>th</sup> year, we should draw encouragement from the resilience our economy has shown in the face of many previous challenges.

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