

GRAnderson Wealth Management Group Presents

Quarterly Economic Update for 2Q 2008

Quote for the quarter. “Shut out all of your past except that which will help you weather your tomorrows.” – Sir William Osler

The quarter in brief. It was an odd and volatile quarter for the investor, and a trying one for the American economy. The economic troubles from the first quarter continued: record-shattering oil and gasoline prices, falling real estate prices, and a credit crisis that wouldn't cease. Were we seeing the depths of a recession? Would we see an upturn from here? The Dow barely averted a bear market as the quarter drew to a close; in May and June, some economic indicators began to subtly improve.

Domestic economic health. In April, the markets performed extraordinarily well. The S&P 500 had its best month in nearly 4½ years, and the S&P 500, NASDAQ and Dow Jones Industrial Average gained between 4.5-6% for the month.¹ On April 30, the Federal Reserve made its seventh interest rate cut since September, bringing the federal funds rate down to 2.0%.² Stock markets in Europe and Asia posted great gains (the Nikkei 225 shot up 11%, India's Sensex 30 11%, and the Hang Seng 13%) as oil and gas prices set or flirted with records.³ But the consumer was feeling squeezed: oil prices rose 12% for the month, retail gas prices began to spike, and mortgage rates climbed back over 6%.³

In May, the Dow lost 1.4% worth of ground while the S&P 500 and the NASDAQ respectively gained 1% and 4.5%.⁴ The dollar began to recover from its fall and winter depths, and the Fed hinted that its rate-cutting measures were coming to a halt. On the commodities front, oil futures peaked on May 22 at a new record of \$135.09 a barrel on the NYMEX; oil prices gained 13% during May.⁵ Precious metals had a down month, and many agricultural futures fell sharply. Bits of good news began to emerge in the housing sector: new home construction and housing starts increased. The first wave of economic stimulus checks sent disposable incomes up by 5.7% in May (the biggest one-month increase since 1975) and overall income up 1.9%.⁶

Overseas, Asia's stock markets fell 0.3% and Europe's stock markets 2.8%, in a month in which most of the world's central banks considered how to battle rising inflation.⁷

You've probably heard that this June was the worst June for the Dow since 1930.⁸ Oil prices ended June at precisely \$140 per barrel, having already flirted with the \$143 mark.⁹ America's housing market showed signs of increased sales activity, if not quite recovery. The Fed left interest rates unchanged at 2% and released the final 1Q GDP calculation: 1.0%.¹⁰ Fed chairman Ben Bernanke said interest rates were “well positioned” and spoke of the Fed's commitment to a “strong and stable” dollar.¹¹ In fact, during the second quarter, the dollar gained 0.3% against the euro and 6.5% against the yen.¹²

Major indexes. The bull run of April gave way to the swoon of June – as the quarter ended, investors hoped for pleasant surprises in the upcoming earnings season and a 3Q rebound. Energy stocks performed extraordinarily well in the second quarter; financial stocks didn't. Note the small gain for the NASDAQ.

% Change	2Q 2008	Y-T-D
DJIA	-7.44	-14.44
NASDAQ	+0.61	-13.55
S&P 500	-3.23	-12.83

Source: CNBC.com, 6/30/08¹³

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

Global economic health. Policymakers worldwide had one eye on the U.S. markets, the other on the inflationary pressures within their own economies. The European Central Bank has long had a 2% target for inflation, so May's 3.7% reading and June's 4.0% reading were cause for worry.¹⁴ In Asia, inflation pressure remained much greater: by June, the latest figures had inflation running at 7.7% in China and 1.5% in Japan (the highest inflation rate in

a decade).^{15, 16} The inflation rate was 8.9% in Thailand (nearly quadruple what it had been at the start of the year), 11% in Indonesia, 6.5% in Vietnam and 5.5% in South Korea.¹⁷

The European Commission reduced its growth forecast for the EU to 2.0% in 2008 and 1.8% for 2009 (compared to 2.8% in 2007). The EC also projected 6.8% unemployment and 3.6% inflation for 2008 (a 50% rise over 2007's 2.4% inflation.)¹⁸ Also, the Bank of Japan cut its growth forecast for the next 12 months from 2.1% to 1.5%.¹⁹

World financial markets. In Europe, the quarterly losses were mild; in Asia, they were more significant. If you think what American investors went through in this quarter was rough, you can always look at China: the Shanghai Composite index fell 21% in 2Q 2008. The Hang Seng (Hong Kong) was down 3.3% for the quarter, and India's Sensex posted a 14% decline. The bright lights here were Japan's Nikkei 225 (up 7.6% in the second quarter after an 18% loss in the first quarter), Canada's TSX (up 8.4% in 2Q), and the MSCI Latin American Emerging Markets index (up 10% for the quarter). As for Europe, the DAX fell 1.8% for the quarter, the FTSE 100 dropped 1.3%, and the CAC 40 in France declined 5.8%.²⁰

Commodities markets. Oil prices gained 39.9% in the second quarter. As the quarter ended, oil prices were up 45.9% for the year. The amazement doesn't stop there. Look at the rest of these quarterly gains: heating oil, 37%; gasoline futures, 33.9%; diesel, 31.4%; corn, 24.5%; oats, 27.4%; soybean oil, 26.5%; soybeans and soybean meal, 32.1% and 33.6%; cocoa, 36%. Coal topped them all, with a 69.6% gain for the quarter (at the end of 2Q 2008, Central Appalachian Coal futures were up 143.4% for the year). Precious metals eked out gains, even with the dollar showing renewed strength in May and June. Gold prices had gained 9.7% on the New York Mercantile Exchange for the first quarter; for the second quarter, they rose 0.3%. Silver went up 0.1%, copper 1.7%, platinum 1.3% and palladium 2.4%.²¹

Housing & interest rates. There were some positive signs here. New home construction rose 8.2% in April (the biggest jump in two years), with building permits up 4.9%.²² The pace of new home sales also rose by 3.3% in April.²³ Existing home sales rose 2% in May, with the inventory of unsold homes shrinking by 1.4% (although the median resale price 6.3% lower than in May 2007).²⁴ The National Association of Realtors' Pending Home Sales Index (the number of home sale contracts signed) rose by 6.3% in April.²⁵ However, May 2008 foreclosure filings were up 48% from May 2007 totals (according to RealtyTrac).²⁶ Housing starts fell 3.3% in May; building permits also declined.²⁷

While average interest rates on 30-year FRMs had finished the 1Q of 2008 at 5.85%, the downward trend was reversed by quarter's end.²⁸ By the last week in June, 30-year FRMs were averaging 6.45%, with 15-year FRMs averaging 6.04%, 5-year ARMs averaging 5.99%, and 1-year ARMs averaging 5.27%.²⁹

Third quarter outlook. Are things stabilizing, as certain manufacturing, retail and housing indicators have hinted? Possibly. The pessimists are looking at the stock market, inflation and oil prices and seeing 1980 again. But it is not 1980, it is 2008, and the American economy really looks pretty good right now in comparison to those times. The economy is much healthier today than it was then: GDP is still in the plus column, we have 4% inflation instead of 14%, and 5.5% unemployment instead of 10%.³⁰ In short, this is not time to panic. This year has posed definite challenges for America and for the investor; the wisdom is in riding them out, and in taking advantage of the market rebound to come. Look for additional investment information in GRAnderson Wealth Management Group's newsletter next quarter.

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The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks. The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. It is not possible to invest directly in an index. NYSE Group, Inc. (NYSE:NYX) operates two securities exchanges: the New York Stock Exchange (the "NYSE") and NYSE

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