Q2 2011 Commentary

We were very pleased to see a big rally on Wall Street in the last week of the second quarter of 2011. The second quarter was very challenging. Stocks slumped around the world as investors weighed the possibility that the recovery was losing steam, at least in the short term. The end of quarter rally was the best weekly performance of the major averages in the last two years, but it was preceded by a tedious seven week decline that I am sure tested the patience of many money managers.

We have witnessed a lot of global turmoil this year. If you look back to the first half of the year: Middle East countries in crisis, Japanese earthquake, Greek-Europe debt crisis, much higher oil and commodity prices, all at the same time many countries are overcoming the affects of a global recession, we are lucky to be where we are today.

We hit a rough patch in May as negative economic news (manufacturing slowing, continued struggles in housing market, employment, and supply disruption from the Japanese earthquake), hit the market. Many had misinterpreted the negative impact on the global supply chain the Japanese earthquake had on the global economy, albeit now proving to be a temporary effect. The end of the Federal Reserve's second quantitative easing was also factored in as economists debated if the inadequate job growth to date and the tepid growth of our economy requires continued monetary policy accommodation.

On the employment front, the second quarter began nicely as private sector hiring during April was at the fastest pace in five years, bolstering sentiment that the economy could keep growing at a modest pace despite high gasoline prices. May and June employment figures were much lower. The market took this as a sign that the recovery was losing steam, and the ensuing seven week, "Temporary Time Out.", or gradual sell off began. A slight positive note on the employment front is that employers have stopped cutting workers, but companies are not hiring either.

As we have mentioned here in the past, it is hard to fuel a recovery when you have two major fueling components of recovery, housing and the consumer, still lagging. It will take strong, sustained employment gains to inspire households to spend freely. Housing had been a major driver in economic recovery cycles in the past, but is has been absent here in this recovery. Economists say it could take years for the housing market to return to health, and it will take faster growth, strong employment gains and improvements in consumer confidence to make that happen.

Second quarter earnings, to be reported in the coming weeks, should continue to be positive and robust, but all eyes will be looking for what companies project for their forward looking guidance and outlook.

So, yes, we hit a rough patch, but the fundamental driver of the markets in our view is earnings, and earnings have been robust. There has been no breakdown in company fundamental data in the stocks we own. We need to be patient in that there are still some important tailwinds, including still-easy monetary and fiscal policies, high levels of liquidity, strong profit growth and reasonable valuations. The recent easing of oil prices is also a positive factor. On balance, we expect these positive forces to win out, but that may take some time.

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