



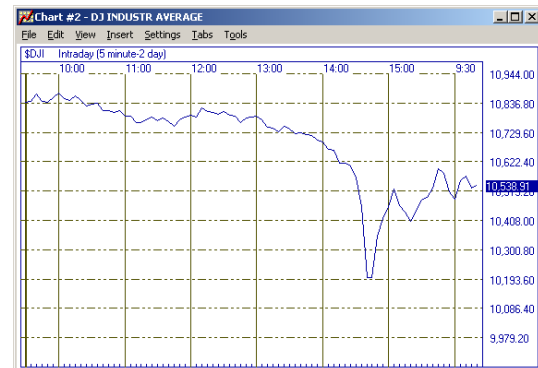
Friday, May 7, 2010

## Market Finally Slips

Fears of a debt contagion in Europe got the attention of US investors this week. As of Friday morning the NASDAQ is off 7.2% the S&P 500 is down 6.2% and the FTSE All US Index is down 6.5%. The S&P Europe 350 is down 11.6% for the week and 16% over the past 30 days. Worried Bond investors flocked to the relative safety of US Treasuries driving intermediate and long-term bond indices up 2.2% and 5.6%, respectively, for the week. Concerns that severe fiscal problems in Greece, and growing pressures in Portugal, Spain, Ireland, and Italy might cripple the European recovery along with reports a few forecasts that China is months away from a burnout started a selling wave that grew throughout the week.

To make matters worse, the real selling intensity of yesterday's panic was not driven by fundamental factors, but rather by technology, possibly triggered by no more than an errant trade entry. The voracious selloff briefly erased more than \$1 trillion in market value as the Dow tumbled 9.2% for its biggest intraday percentage drop since 1987. The SEC and Commodity Futures Trading Commission are looking into what "unusual trading" occurred to contribute to the plunge.

A chart of the Dow Jones average yesterday shows that selling was orderly until about 2:25 PM when the average fell abruptly. For the next 15 minutes it was a wild ride as 27 US stocks with at least \$50 million in market value dropped more than 90%. In that few minutes more than \$1 trillion in market value was erased and the Dow average tumbled 9.2% by 998.5 points, its biggest intraday percentage loss since 1987.



Almost as fast as they declined, averages bounced back without fundamental news, making it clear that there was an aberration. The snowball effect occurred when orders generated by computers were sent to markets where there were no human investors willing to match them. Trades in Procter & Gamble, took that stock down 37% for the biggest intraday drop in the Dow Industrials. NASDAQ authorities today have indicated the trades would stand, but the company believes the deep discount trades were erroneous.

The SEC and exchange authorities will likely find that the pendulum has swung too far for computerized trading. But, given the complexity and interconnectedness of market systems complicated further by the increasing velocity made possible by a dizzying array of ETFs representing indexes and market baskets of all descriptions, solutions promise to be elusive. However, if confidence in the markets is to be maintained, a solution must be found.

Today's news on employment improved the mood of equity investors early this morning, but the selling soon resumed. Payrolls jumped a surprising 290,000 last month and follow a revised 230,000 increase in March. The increase was the largest in four years according to Bloomberg and suggests an improving trend in employment and hope that the recovery is becoming self-sustaining.

Unfortunately, the number seen by the average consumer, the Unemployment Rate, rose to 9.9% from 9.7%. This statistic is going to be very sluggish in coming down because the improving economy will

bring an increasingly large number of workers back into the job market who had earlier left the market altogether due to lack of prospects. Those re-entering will likely outnumber the jobs available for some time keeping the Unemployment Index near double digits. The underemployment rate, which includes part-time workers who want a full-time position and people who want work but have given up looking, increased to 17.1% from 16.9%. The report also showed an increase in long-term unemployed Americans (27 weeks or more) rose as a percentage of all jobless, to a record 45.9%.

Government payrolls will blossom by an estimated 970,000 temporary workers as the Census Bureau hires to count the population. The biggest growth spurt is expected in April and May and then it will dwindle as the job winds down.

Manufacturing to replace inventory and for export have provided the greatest stimulus to new private jobs so far and that trend continues. The report showed that manufacturers added the most workers since August 1998. The view that the domestic recovery is becoming sustainable, even without growth in exports, is taking hold.

Earlier in the week, the Institute for Supply Management's announced that their factory index rose to 60.4, the highest level since June 2004. The report marked the ninth consecutive month of growth. Factory orders also rose an unexpected 1.3% in March, matching February's results. It is hoped that continued strength in manufacturing will fuel recovery in the service industry and the consumer gains confidence.

Growth in nonfarm business productivity slowed to an annualized 3.6% in the first quarter following a 6.3% surge in the fourth quarter of 2009. The decline is largely due to slowing output and GDP growth, largely expected, according to Bloomberg.

With 439 of the S&P's 500 companies reporting earnings for the first quarter, 319 of them are up an average 89% higher than last year and 39% ex-financial companies. More than 76% of companies surprised analysts with their earnings. For the year corporate earnings are projected to rise 31% this year, the most since 1995.

The question on investors' minds is whether the US economic recovery is sustainable in the face of potential slowing in Europe and China. Will these slowdowns be modest enough to avoid recessions and will emerging markets be able to pull up the slack? Will the US consumer continue to show more confidence and increase spending? GDP may increase 3% this year according to economists which compares to 1% on average for European Union countries.

What has been suggested for months likely suggests the most probable outcome; that our recovery will be very slow by historical measure. We were due for a stock market correction and sluggishness may persist for some time as investors wait out reports to confirm or deny the health of recovery. As for the market's valuation after yesterday's slump, the S&P 500 trades at 13 times forecast profit for the next 12 months. That is about 30% below its 10-year average of 18.4 according to Bloomberg data.

There is little reason at this point to believe that the recovery is in doubt. But considerably more patience will be required before the Great Recession is but an ugly memory.

Information provided in this Brief has been prepared from sources believed to be reliable, but it is not guaranteed by Beacon Investment Management and is not a complete summary or statement of all available data necessary for making an investment decision. Past performance does not guarantee future results. Information provided is intended only to inform and does not constitute a recommendation to buy or sell. The opinions expressed reflect the judgment of the author as of this date and are subject to change without notice.