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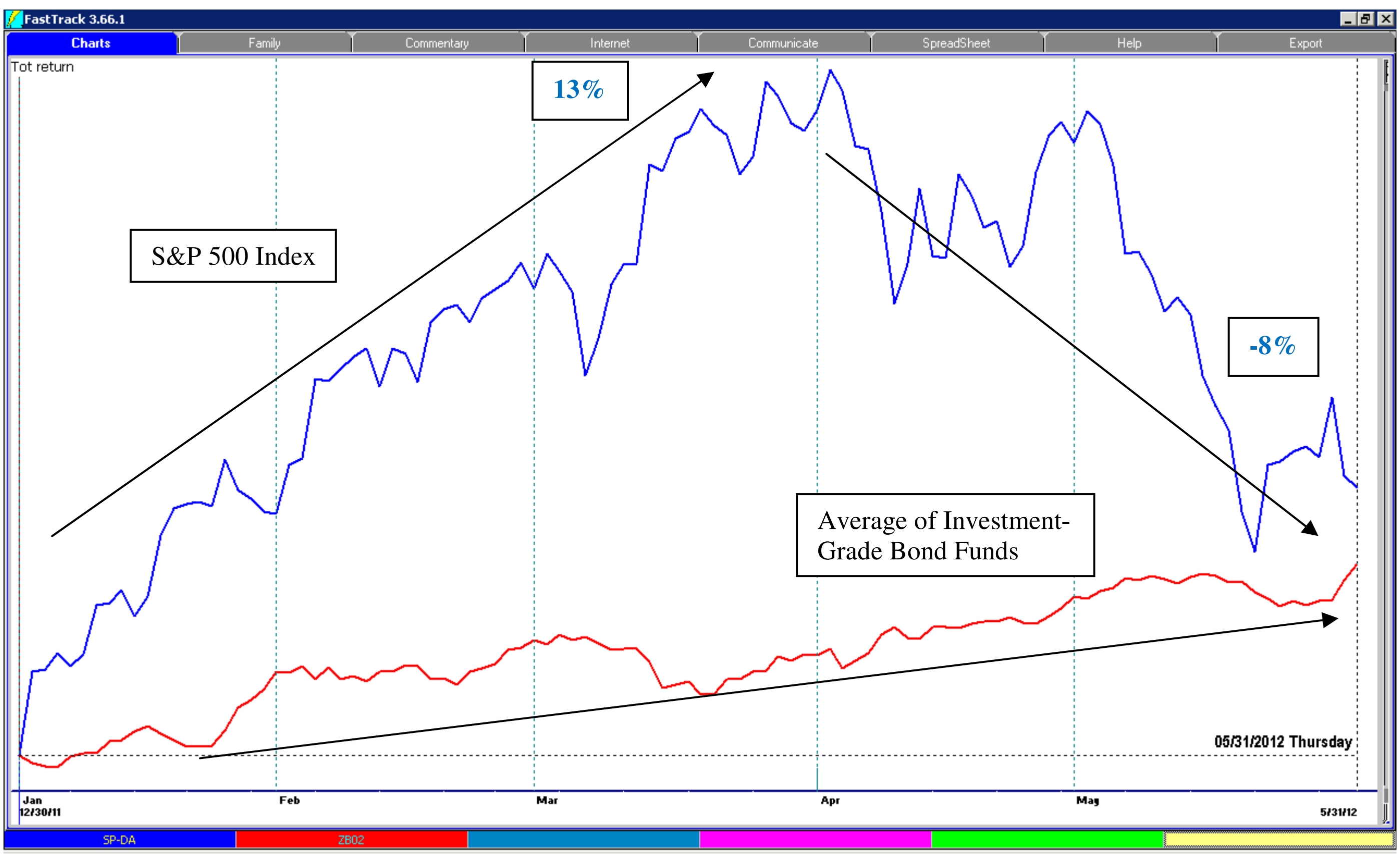
Markets On a Yo-Yo

May Market Review From Your Portfolio Management Team—June 14, 2012

As we mentioned in an earlier update, the U.S. stock market fired out of the starting gate in 2012, sporting one of its strongest first quarter gains in 15 years—rising over 12%. While this might have lead to some optimism about the rest of the year, investors have gotten used to a pattern of returns where prices move strongly in one direction (up or down) and then promptly reverse. Stocks cannot seem to maintain a trend for more than three or four months at a time. It is as though the market is stuck on a yo-yo, with steep drops and explosive rallies reversed back to the starting point.



The chart above shows the yo-yo performance of the S&P 500 stock index (blue line), with the strong upswing in the first quarter followed by a fairly sharp downswing in May. Below the nauseous stock return, we see the much calmer returns from investment-grade bond funds. Granted, their returns were pretty sedate in the first quarter—rising only 2%. However, when stocks fell back nearly 8% in the second quarter, these bond funds were able to post a positive gain of almost 2%.

As of month-end (May 31), the broad stock index was up 5% with the average return of these bond funds up over 3%--not a bad place to hide from the ongoing storm in the stock market.

Europe continues to weigh on the U.S. stock market, with concerns over Greece now spilling over to Spain, and even Italy. On top of that, we have gotten some economic numbers recently which suggest that our economy may be slowing down a bit—and it was moving fairly modestly before that—so we don't have much room to slow before we slip back into recession.

The ongoing uncertainty has stocks held hostage to relatively quick spurts of rallies and sell-offs that reverse whenever the next news item is released. And this is the reason we continue to favor the more sedate, but steady returns we are finding in the bond market. Clients in Income, Income & Growth, and Conservative Growth will generally find over 70% of their assets in various bond funds, with modest allocations to stock-oriented funds. Clients in the more aggressive strategies—Core Equity and Tactical Growth—will find some stock funds in their portfolios, but the allocations are less than 50%.

We are monitoring the positions, as well as the general market environment for signs that stocks may be ready to break out of this 'Yo-Yo' pattern and embark on a new trend (hopefully up). Until that time, we will continue to attempt to make the up and down journey as calm as possible.

Please let us know if there is anything we can include in these updates that will help in your understanding of what is happening in the portfolios.