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July 2, 2012

Second Quarter Commentary:
The Economy and the Markets: Status at Half-time

Dear Client,

Stock market volatility increased during the second quarter, as nervous traders vacillated between optimism and pessimism about the prospects of a resolution to the euro-zone debt crisis. Several less-than-rosy reports on the U.S economy also contributed to investors' unease.

After reaching its apex for the year on April 2, the S&P 500 Index[1] promptly declined 10% over the course of April and May. Just when it appeared that stocks were headed for more losses, however, the S&P 500 rallied 6.6% in June and remains in positive territory (up 8.3%) year-to-date through June 30. Meanwhile, the bond markets once again confounded many prognosticators by rallying strongly. During the quarter, the yield on the 10-year Treasury fell from 2.22% to an all-time low of 1.47% on June 1, before falling back to a still-low 1.67% by quarter end.

Whether stocks hold onto their recent gains will depend, as always, on the health of the economy here and abroad. Trends in three geographical areas deserve particular attention:

- **Euro-Zone Woes**. The debt crisis in the euro zone and fears about its impact on the global economy are likely to continue for some time. The simple truth is that there is no easy or quick solution to a problem that has been decades in the making. Getting 17 separate nations to agree on a solution will require compromise and time. While it's possible the situation there could unravel further, I believe the euro-zone's problems are for the most part already priced into the market.

- **China's Growth Slows**. As the world's second-largest economy and the second-largest consumer of oil, what happens in China does not stay in China. In recent months, China's manufacturing activity has slowed and its first-quarter GDP growth fell to "only" 8.1%, triggering concerns about a ripple effect on the global economy. In response, China recently announced it was cutting interest rates and continuing other economic stimulus efforts, which should be viewed as a positive sign that the Chinese government will take steps necessary to promote economic growth.

- **U.S. Pessimism Flows**. Just when it looked as if job growth and the U.S. economy might finally be gaining some real momentum, lackluster hiring in April and May and a slowdown in consumer spending raised concerns about another summer slowdown. Likewise, first-quarter GDP growth, which came in at 1.9%, did little to incite optimism among economists or investors.

Despite some signs that U.S. economic growth may be slowing, there are some positive developments that deserve equal attention, including:

- **Hopeful Signs on Housing.** Construction of single-family homes rose 3.2% in May to the highest level in more than two years, while new construction permits hit their highest levels since October 2008. Sales of new single-family homes rose 7.6% in May and are up 16% from a year ago. Median sales prices in May also showed a gain for the first time in seven months, although nationally, home prices remain well below their 2006 peak. If the housing market continues to heal, that could lead to more job growth and more demand for durable goods, which in turn could lead to more hiring.

- **Lower Gasoline Prices**. Just a few months back, consumers were doing their best to deal with gasoline prices of $4 per gallon or more. Since peaking at a national average of $3.94 in early April, however, prices have plummeted to a national average of $3.41. In fact, gasoline prices are now below $3.00 a gallon in South Carolina, which, unfortunately, is not the case in our area. But the overall impact of lower gasoline prices is a huge boost for our consumer-driven economy and if prices stay low, I believe we will see a positive impact on retail sales later this year.

As I look ahead to the remainder of this year, I won't be surprised to see more market volatility in the coming weeks and months. So far, the U.S. economy has managed to continue its slow-growth trajectory, but the euro zone, China, high unemployment in the U.S., and the impending expiration of several tax incentives at the end of this year (what's being called the "fiscal cliff") will all continue to weigh on market psychology. However, if we see progress toward a resolution of these challenges, a more optimistic mood could take over.

As always, I thank you for your business and remain available to discuss any concerns you may have about your portfolio. I also want to wish you a happy and safe Independence Day holiday with friends and family.

Sincerely,

Mike Ovshak, CFP®

[1] All indices are unmanaged and investors cannot invest directly into an index. Past performance is not indicative of future results. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. Diversification does not assure a profit or protect against a loss in declining markets.