July 5, 2012

2012 2nd Quarter Recap

As we approach the summer months we are reminded that while it is safe to swim, it is also important that we understand the risks. In the first quarter of 2012 we experienced extremely positive equity market returns but were quickly reminded in Q2 that we are a global economy and exposed to the risks associated with global events. The European Union's troubled financial markets and economies are proving to be an ongoing burden to the global markets.

On the European front, Leaders made progress last weekend at their Brussels' Summit by demonstrating a long term commitment to the Euro. They have agreed on bailout terms and on the foundation for a banking union (eliminating the link between sovereign and banking debt and essentially recapitalizing the EU banking institutions). The EU will officially appoint the European Central Bank (ECB) as the governing body for the banking community. The move will provide stability to the region and the troubled banking sector. This progress resulted in a significant market rally, as the S&P gained +2.5% in the last day of trading in June!

While the S&P rallied on the last day of the month, it returned -3.29% for the quarter due to the aforementioned stress. Year to date, however, the S&P has returned +8.31%. The outlook for the equity markets for the balance of the year will be contingent upon developments in Europe and less on the strong fundamentals of the domestic economy. While the growth of the U.S. economy (as measured by the change in real GDP) is running at a moderate 1.9%, the leading economic indicators showed significant improvement in June according to the American Institute for Economic Research (AIER). The exception to this is the unemployment situation, which remains problematic at 8.2%.

It was no surprise that the EU stress took a toll on the EAFE (Europe/ Asia/ Far East) Index, which was off -6.88% for the quarter. This theme was echoed in the Emerging Markets where the Index was down -7.7% for the quarter.

Index	Index Close	Q2 Total Return (%)	YTD Total Return (%)
S&P 500	1,362.17	-3.29	8.31
DJIA	12,880.09	-2.51	5.42
NASDAQ	2,935.13	-5.06	12.66
MSCI EAFE	49.95	-6.88	3.22
MSCI Emerging Markets	39.17	-7.7	4.37
Barclays Bond Aggr.	111.30	1.97	2.11

In the bond market, a flight to quality caused the yield on the 10 year Treasury bond to fall to 1.62%, from 2.22% at the end of Q1. This resulted in a 1.97% positive return in the Barclays Aggregate Bond Index for the quarter.

As fiduciaries to our clients, our primary goal is preservation of capital with a focus on income. We remain concerned about interest rate risk on bond portfolios and the potential impact longer duration bonds will have on your diversified portfolio when interest rates begin to rise. Consequently, we have been defensive with respect to managing interest rate (duration) risk. In order to generate interest income, we continue to recommend exposure to high yield and foreign bonds.

We are also investigating an increase to our alternative strategy allocation to help manage market risk. Currently, we use alternative investments (real estate, commodities, MLP, and long-short funds) as a hedge to the traditional markets. Given the extreme market volatility experienced recently and the aforementioned interest rate risk, we have been engaging in research to potentially increase the allocation to alternative investments. We will be addressing this with our clients in the months to come.

Most importantly, we hope you enjoy your summer and the time with your families!

Best Personal Regards,

Locust Capital Management, LLC