

MAY MARKET COMMENTARY

By Tom Crow

June 6, 2011

| Index | Month End | Gain (Loss) by Period | | | |
|-----------------|-----------|-----------------------|---------------------|--------------|------------------------|
| | | Month | Most Recent Quarter | Year-to-Date | Trailing Twelve Months |
| Dow Industrials | 12,570 | (1.9%) | 2.8% | 8.6% | 24.0% |
| S&P 500 | 1,345 | (1.4%) | 1.3% | 7.0% | 23.5% |
| Nasdaq | 2,835 | (1.3%) | 1.9% | 6.9% | 25.6% |

The markets finished May in the loss column coming off a strong April. Year-to-date numbers are still encouraging, but the S&P 500 is still having problems holding onto, or breaking out above the 1,350 level, and would have to climb almost 20% to reclaim the October 2007 highs.

The first few days of June were full of bad news which took the markets down significantly. Greece has been downgraded and now has a 50% chance of default. The US housing market appears to have slipped into a second recession. Manufacturing saw a greater-than-expected decline in May. Jobless benefit claims moved higher and the sour cherry on top...last month's unemployment figures.

After a few months of reports that looked a bit promising, May's numbers were back to awful. Only 54,000 net jobs were created last month. That is the worst number in eight months. Local governments cut 28,000 jobs...18,000 of which were in education.

Cities and counties have cut jobs for 22 months, shedding 446,000 positions since late 2008. The manufacturing sector grew at its slowest pace in 20 months. The unemployment rate ticked higher to 9.1%. Economists were expecting an increase of 175,000 jobs and a lower unemployment rate. To add further insult, March and April's employment numbers were revised lower by a combined 39,000. I did warn you last month to look out for those pesky revisions.

Gas prices are off their recent highs, but still about \$1/gallon higher than last summer. Wages are not increasing at a rate that even keeps up with inflation. Short and foreclosure sales are keeping pressure on home prices and keeping people from pulling equity out for big purchases. Economists who think consumer spending will spur on the recovery will have to keep pushing their forecast back. Meager GDP growth of only 1.8% isn't going to help.



The markets opened sharply lower on Friday in response to the dismal jobs report, and ended up bringing the S&P down over 3% for the week, barely reclaiming the 1,300 mark by the close. Then, on Monday, the S&P broke through what some technicians believe to be a critical support level where the April lows were set.

Despite all this, I do not believe we are seeing the beginnings of another, full-on bear market at this point. I draw some contrarian encouragement in the recent escalation of doom-and-gloom, total-economic-collapse, end-of-the-world-as-we-know-it "newsletters" that are piling up in my e-mail and snail-mail inboxes. The throng of experts piling on this bandwagon must mean a real turnaround can't be far off.

Last week, Moody's Investor Service followed S&P's lead on the US's credit rating threatening a possible downgrade if "substantial" deficit reduction doesn't occur. This comes on the heels of a week's worth of partisan posturing over the debt ceiling and whether or not it will be raised without some spending cuts.

In a beautiful bit of prose, Moody's said, "Although [we] fully expected political wrangling prior to an increase in the statutory debt limit, the degree of entrenchment into conflicting positions has exceeded expectations." I'll translate, and it will sound a lot like last month's Commentary. Both sides are now in full campaign mode. Moody's seems to be holding out hope for some resolution.

I am not as hopeful. At this point I believe the politicians are going to argue to a stalemate and try and use the damage it causes as fodder for their reelection bids. However, should the republicans acquiesce, as they did in the last debate over spending cuts, we'll raise the debt ceiling and be \$2 trillion further in debt before anyone knows what happened.

If the democrats cave this time, they'll be pointing fingers and naming names while reciting a list of all the critical services the republicans and the greedy "rich" folks "took" from them. It worked in the recent special election to fill a vacated senate seat in New York. A traditionally republican seat was taken by a democrat because folks were convinced the republicans were going to take away their free healthcare. I'm not even going to start on "free" healthcare.

This is really not that tough...Medicare and Medicaid combined make up the single, largest item in the budget. Social Security and Defense/War spending are a close second and third. I don't see any way we can expect to get deficit spending and the debt under control without talking about some serious reform in all of them.

Hey...it's summertime! Get out and enjoy it! We're not selling in May and going away, but we are certainly looking at a challenging market over the next few months. Between the US's tenuous hold on a recovery, the looming battles over the budget, the debt ceiling and spending cuts, and further weakness in Western Europe, fear and uncertainty will be the norm.

We'll be looking for opportunities and will be here if you need us. Talk to you again in about a month.