

July 15, 2009

COMMENTARY

Economic data generally improved in the second quarter, and optimism regarding the global and domestic economy emerged. GDP dropped a lower than expected 5.5 percent in the first quarter, which was better than the 6.3 percent decline in the fourth quarter. In addition, expectations for second quarter GDP are a loss of 2.5 to 3.0 percent, another solid improvement over the prior quarter. Both manufacturing and services activities improved during the quarter. The Institute for Supply Management (ISM) Purchasing Managers Index (a proxy for manufacturing activity) improved from 36.3 in March to 44.8 for June. The ISM's services index jumped from 40.8 in March to 47.0 in June. Although readings below 50 indicate declining activity, both indices are approaching their highest levels in 12 months.

The Conference Board's Consumer Confidence Index ended the quarter much higher than it started as the overall mood of US consumers improved. The index began the quarter at a level of 26.9, the second worst monthly reading in 40 years. By June the index climbed to 49.6, just below the level in September of last year before the financial crisis surfaced. Consumer spending, which accounts for about two-thirds of the US economy, increased in the most recent survey. However, consumers have been reluctant to spend aggressively since they face rising unemployment and a tight lending market. Consumers have been saving at relatively high levels and are not likely to resume normal spending activities until the employment outlook improves or at least stabilizes.

Housing prices continued to slide during the quarter. The most recent Case Schiller Composite 20 home index dropped 18.1 percent from April 2008 to April 2009. Although the annual decline was large, the month-to-month rate of decline improved and was barely negative in the most recent month. Home prices have started to stabilize as conventional mortgage rates are hovering at historically low levels and housing affordability remains at a record high level. Mortgage application volume for purchases has steadily increased since bottoming in late 2008 and is a sign that buying activity is improving. Application volume slowed temporarily in early June as inflation concerns pushed rates higher for several weeks. Mortgage rates declined later in the month, but remained above May's lowest levels.

Perhaps the biggest setback to the economy has been the mounting job losses. In February, when the \$878 billion American Recovery and Reinvestment Act (ARRA) was enacted, the Obama administration estimated that the act would save or create 600,000 jobs by the summer. Recently it is estimated that the stimulus program has saved only about 150,000 jobs while almost 2 million people have lost their jobs since February. The larger than expected 467,000 payroll decline in June further highlighted the fact that job losses remained high and the economy was still fragile. It has taken a while for the stimulus funds to flow through the economy with only about 15 percent of the legislated stimulus being distributed. Although it has taken longer than many hoped to get the stimulus funds working, increased spending in the upcoming quarters is expected to provide additional support needed to keep the economy from deteriorating.

EQUITIES

US Equities posted their best quarterly performance since the fourth quarter of 1998 as measured by the S&P 500 index. Stock prices started moving higher in early March and prices continued moving higher in April and May before flat-lining in June. Stock prices were beaten down during the first two months of the year reflecting a long and deep recession. In March, economic data began a pattern of “better than expected”, and signs that the recession was abating kept stock prices moving higher throughout the quarter.

Although every major equity index was positive in the second quarter, investors exhibited a preference for beaten down stocks as well as those that were well capitalized and had strong balance sheets. Microcap stocks, the smallest publicly traded stocks, posted the best domestic equity performance after increasing 25.0 percent. Microcaps rallied strongly because earlier in the year prices had fallen to levels that reflected a low probability of survival for many companies. However, as mending of the recession became more likely so did the likelihood of their survival and prices jumped in response. Other beaten down asset classes, such as Financials and real estate (REITs), posted relatively strong returns as well. The S&P 500 Financials sector posted a gain of 35.1 percent, and the Wilshire REIT index was up 31.7 percent. The same “risky” asset classes that investors discarded in 2008 became the top performers in the second quarter. While observing the outperformance of “risky” assets, we would not categorize the market’s resurgence as a “junk rally”. Equity returns were primarily attributed to high quality companies. For example Morningstar assigns a financial health score to companies, and only a small portion of the Morningstar US Market Index’s 16.0% quarterly return was owed to companies with below average scores.

Information Technology was the second best performing sector in the second quarter and clearly the leader for the first six months of 2009. The S&P 500 index increased 3.2 percent for the first six months of the year, while the Information Technology is up 24.1 over the same period. The sector is generally made up of companies with strong balance sheets that include high levels of cash and low levels of debt. Investors have preferred the sector because it is currently viewed as relatively safe since the strong balance sheets reduce the need for borrowing. In general, the sector is viewed as adequately funded to survive even a deep and prolonged recession. It is also positioned for growth when the economy improves and business and consumer spending picks up again.

International stocks outperformed US stocks in the second quarter as the global economy improved, and the US dollar declined versus most major currencies. Global stimulus efforts seem to be bearing some fruit evidenced by improvements in manufacturing activity in the Euro zone and strong growth in China benefitting major trading partners, such as Australia and Japan. The US dollar, which had been a safe-haven for nervous investors, declined during the quarter as investors increased their appetite for risk. The weaker dollar accounted for about 8.0 percent of the MSCI EAFE’s 25.4 percent quarterly return. The MSCI EAFE index was boosted by strong returns among Financials, which account for about one quarter of the index.

Emerging market equities grabbed the top spot for the second quarter in a row. The major emerging markets, Brazil, Russia, China, and India were all among the top performers. The MSCI EM index jumped a whopping 34.7 percent in the quarter and each country bested the index in the quarter. As investor appetite for risk increased they directed funds to countries and markets with higher growth rates. China and India were both able to sustain significant growth despite the slow global economy and were rewarded with strong cash flows into these markets. Russia and Brazil benefitted from an increase in commodity prices, and prices of resources stocks jumped handsomely.

FIXED INCOME

As the prospect for a global recovery improved, the fixed income market responded as one would expect: safe investments struggled and riskier investments flourished. The 10-yr. Treasury started the quarter with a yield of 2.71 percent, and by June 10th the yield had reached 3.98 percent. A combination of higher inflation expectations and an increased desire for risk pushed Treasury prices lower and yields higher. Inflation concerns softened by quarter end, and the yield on the 10-yr Treasury finished June at 3.53 percent. The returns were negative for the Barclays Capital Intermediate Treasury index finishing the quarter down 2.14 percent.

In contrast, spread products posted strong positive returns for the quarter. Municipal bonds, investment grade corporate bonds, convertible bonds, high yield and bank loans all posted strong returns as investors snapped up the bonds trading at cheap levels. The Barclays Capital High Yield index rose an impressive 23.1 percent in the second quarter, and Morningstar's Bank Loan category increased 16.5 percent over the same period. The fixed income market clearly reflected optimism that defaults were not going to be as bad as projected earlier this year.

2009 MARKET OUTLOOK

Stock and non-Treasury bond prices rose in recent months as a collapse of the global economy became less likely. Economic data remain mixed, but in general the global economy appears to be on the mend. We believe asset prices now reflect a slow and steady economic recovery over the coming quarters.

Although stock prices have risen recently, they still remain well below September 2008 levels. We believe stocks could mount another solid rally over the next year if the economy continues to improve. We became more bullish during the quarter observing significant improvements in the credit markets and stemming of the previously deteriorating economic data. It is important to remember the markets are forward looking and historically rebound as early as nine months in advance of the end of a recession.

We continue to work diligently to help you achieve your investment goals. Please call us if you have any questions.

Very truly yours,

AKT WEALTH ADVISORS, LP INVESTMENT COMMITTEE

Darin Richards
Doug Davison

Scott Barchus
Julie Robinson

Toby Daniels
Carl Pinkard

Charlie Zieky