RBC Wealth Management™

PRIVATE CLIENT EQUITY RESEARCH

*RBC Wealth Management, a division of RBC Capital Markets Corporation, Member NYSE/FINRA/SIPC.*

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**For Important Disclosures, see pages 2-3.**

# Monthly Market Commentary

## Worst of Times or Turning Point?

U.S. stocks closed down eight out of the last nine days of June. Our technician, Bob Dickey, opined that the June 30 declines had broken major index support levels, which extends the risk of further decline “another 5% to 10%.” The Dow Industrials closed the second quarter down 10%, its first quarterly decline since the first quarter of 2009. Key negative factors driving the market drop included the European contagion, weak employment conditions, and a fragile housing market. Personally, the 24/7 submarine television coverage of the oil spill locks me in a state of diminished expectation initiated by the likelihood of higher taxes, greater regulation, and budget deficits as far as the eye can see.

New trading strategies appear to heighten volatility at the expense of individual and institutional fundamental investors. Today roughly 70% of trading volume is attributable to computerized fast-trading firms attempting to scalp part of the spread or through a discovery algorithm, a front-run of major institutional order flow. A *Wall Street Journal* article on June 30 zeroed in on the high-frequency strategy of “gaming, where the high-speed firms’ computers detect a large buy order and instantly start buying, expecting to quickly sell it back at a higher price.” Another remarkable advantage to the fast traders is “the instantaneous glimpse into the future” through direct feeds to exchange data, turning the market into “something nearer to a casino.” Mother Nature doesn’t equip hyenas with night vision goggles or advance maps to wildebeest bivouac locations; should we allow such a predatory leg up to compromise the investment process?

Contrary to most cable TV producers’ predilection, not all of the news is bad. In “Prevailing Over the Aftershocks,” our recent quarterly strategy report, we isolate several stabilizing forces: low interest rates, expanding U.S. and global economies, rising personal net worth, increasing corporate profits, rebounding capital spending, and rebuilding businesses inventories. The June reading of the Institute for Supply Management Manufacturing index fell but remained in expansion mode or, as the director of the survey stated, “We are now eleven months into the manufacturing recovery, and given the robust nature of the recent growth, it is not surprising that we would see a slower rate of growth at this time. The manufacturing sector appears to be solidly entrenched in the recovery.”

Valuations are currently attractive at under 13 times 2010 estimated earnings for the S&P 500, the lowest ratio this year and below the long-term average multiple of about 18. By most technical measures the current market is “oversold.” It is likely in the days ahead that institutional asset allocation models will focus on the ample valuation opportunity the current 7.8% S&P500 earnings yield advantage features over competing assets, such as the 10-year Treasury currently yielding less than 3%.

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| | | | Investment Banking | |
|---|---|---|---|---|
| Rating | Count | % | Count | % |
| Buy (TP/O) | 641 | 51.16 | 188 | 29.33 |
| Hold (SP) | 557 | 44.45 | 126 | 22.62 |
| Sell (U) | 55 | 4.39 | 8 | 14.55 |

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