

BCA Market Perspective © July 2009

Strong Second Quarter, But Uncertainty Remains

Like a tsunami downgraded to a tropical wave, investor fears look to have gone dormant. Shown by the best stock performance in any quarter since 1998, investor psychology may be manic once again.

The Standard & Poor's 500-stock index posted a +15.9% gain for the quarter, but was edged out by small-cap stocks (+20.7%). The international developed country index climbed nearly 26%. Even the moribund commercial publicly-traded real estate index (REIT) gained 31.7%, even as commercial property values continued their declines and banks made it nearly impossible to refinance. High-yield or low quality bonds rose +18.9%.

Some have characterized the second quarter as a junk rally, meaning that it was low quality companies that staged this whopping comeback during the period that began in the later part of the first quarter. Another view is that, while unemployment in both the U.S. and Europe is increasing, the rate of change is slowing. Thus, the expectation is that an inflection point may be nearing, perhaps in early 2010.

Still others look to China and India as the engines of prosperity that will pull the developed countries along. If this is the case, it shall be history in the making. It is true that China's economy is growing at an annual rate of 8 percent and needs industrial and services capital from the rest of the world. While NAFTA drew attention in 1992 as North America's economic model, China has captured the bulk of investment and intellectual capital since that time. Globalization and increasing world competition have all but passed by Mexico, the point being that this country is not going to lead the U.S. out of its recession. And what about our auto industry that no one talks about anymore?

The fact remains that the health of the banking industry, without which capitalism cannot exist, remains uncertain. Sure, various government sponsored programs, along with the private sector, are slowly chopping away at low quality asset backed mortgages. But the time and money needed to heal this problem is unknown. However, recent market enthusiasm or mania suggests that such a recovery is coming sooner than later.

In the "BCA Market Perspective" published in April 2009, it was noted that narrowing credit spreads pointed to a stock market recovery. This tightening of spreads continues, supporting the belief that the market has moved into the next phase of improving investor confidence, which always leads the actual economic recovery.