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Q2 2011

Equity markets ended the quarter essentially flat after swinging in wide moves throughout the quarter. The Dow was up 0.8% for the quarter, and the S&P fell slightly at -0.4%. The Dow started the quarter off strongly in April with a 4% rally, but it was then down 7% though mid-June as weaker economic data and the debt problems in Europe weighed on investor sentiment. It then rallied strongly during the last week of the quarter as there were some new economic data points that indicated that the domestic economy might be firming up. Commodities, crude oil, Treasuries, and the dollar were also very volatile during the quarter.

On the last day of the quarter, the DJIA rose 153 points on the strength of the Chicago Purchasing Managers Index. It came in at 61.1 versus 56.6 in May. The next day, the national PMI for June rose to 55.3 from 53.5 in May. These stronger numbers were welcome after the downward trends in the economy brought on by high unemployment, weak bank lending, lower income growth, depressed home prices, and high household and government debt levels. There were also some signs that the component parts shortages due to the Japanese tsunami were beginning to ease.

In the middle of June, the Chairman of the Federal Reserve, Ben Bernanke, gave a speech referencing the "frustratingly slow" pace of economic improvement. He said "We don't have a precise read on why this slower pace of growth is persisting. Some of these headwinds may be stronger and more persistent that we thought". We attribute the slow pace of improvement to two issues: the explosion of debt that needs to be unwound combined with the uncertainty generated by Washington surrounding taxes and regulations. Small business owners have been very clear that they are reluctant to hire when they don't know how much a new employee is going to cost them.

Initial unemployment claims have been over 400,000 for the past thirteen weeks, and a drop below 400,000 would be very positive for the market. As employment improves, households can continue to reduce their level of indebtedness which reached a level of 127% of annual income in the third quarter of 2007, up from an average of 84% during the 1990s. Households had worked this level down to 112% by the first quarter of this year, but it is still too high. This is one reason that household formation remains at the lowest level since WWII. While these numbers seem grim, we think that as they improve we will see a big boost to our economy.

Corporate profits have remained strong even in the face of high commodity prices due to continued strong overseas growth. China is still experiencing growth with less inflation due to the government's efforts to gradually increase rates and discourage speculation. Germany's manufacturing has picked up, and Japan has seen an increase in capital spending growth of 4.2% during the second quarter. Hopefully the debt problems in the Eurozone will be a wake-up call for Washington during the current debate over raising the debt ceiling.
We will be contacting you to set up a quarterly meeting, or please give us a call if you know when you would like to get together.

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