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# Market Update

## June 2008 Review

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### Worst June since the 1930s

The Dow Jones Industrial Average and the Standard & Poor's 500 Index experienced their biggest losses for the month of June since the Great Depression amid rocketing oil prices, inflation and ongoing financial market woes. The S&P 500 declined -8.6% in June; the worst monthly performance since September 2002 when it lost -11% and the worst June performance since 1930, when it dropped -16.5%. The Dow lost -10.2% for the month; its worst monthly performance since September 2002 when it tumbled -12.4% and the worst June performance since 1930, when it sank -17.7%.

The sell-off in the last week of June briefly sent the Dow to a level at least 20% below the October highs, meaning it met the technical definition of a bear market. The S&P 500 is perilously close to bear levels while the NASDAQ hit the technical definition of a bear market back in March, falling 24% off its October highs, but has partially recovered since. In the second quarter overall, the Dow declined -7.4%, the S&P 500 shed -3.2% and the NASDAQ managed to gain .6%. It was the third straight quarterly decline for the Dow and S&P. Year-to-date, the Dow is down -14.4%, the S&P 500 is down -12.8% and the NASDAQ is off -13.5%. The sell off in June was not confined to the U.S. markets, European and Asian markets also came under pressure. The MSCI EAFE Index declined -8.3% for the month, -3.5% for the quarter, and is off -12.7% for the year. Emerging market economies such as China and India, which are wrestling with the aftershocks of huge stock run-ups last year, are down -48% and -33.6% respectively for the year.

Triggering the domestic sell-off was a wave of unsettling news from the financial sector and escalating commodity prices. Further write-downs and disappointing earnings from both big and small banks further exacerbated investors' concerns about the lingering credit crises. Investors continued to shun financial stocks as the financial sector within the S&P 500 index was down -18.3% for the quarter. Financial firms are still raising billions in new capital to shore up their books and warning of fresh red ink to come – signs that the credit crises is far from finished.

Prices for food and other commodities continue to surge upward; putting further pressure on consumers' disposable income. Oil prices surged over 38% in the second quarter to close at \$140 a barrel, which has had a negative impact on the broader economy. More specifically, high oil prices have impacted earnings on the airline, transportation and automobile industries. Despite increased scrutiny by regulators and legislators, commodities remain a popular target for speculative buyers, which could drive prices even higher. U.S. consumer confidence fell in June to its lowest level in 16 years as consumers become more pessimistic about the future amid falling property values (erasing a significant amount of equity consumers had been tapping into to support their spending habits), rising unemployment, and higher food and fuel prices. Add in the uncertainty of a presidential election in November and it's no wonder consumer confidence is sharply off.

With inflation and economic growth competing for attention, the Federal Reserve Board held rates steady at 2% noting that although downside risk to growth remain, they appear to have diminished somewhat and the upside risks to inflation and inflation expectations have increased. Fed officials are concerned that rate increases may exacerbate the weakness in employment, financial markets and the housing sector. At

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the same time, the Fed has signaled that they are willing to act on inflation if needed. We anticipate that the Fed will keep rates on hold through the third quarter; as the economy and the credit markets are still too fragile.

The bond market was not immune to volatility in June either. The pessimism that loomed over the fixed income markets earlier in the year returned with a vengeance in June. Initially, it seemed that the strains of the credit crises were easing as investors began shifting from risk-free Treasuries to riskier types of debt. However, as the quarter was drawing to a close, investors pulled out of risky debt amid the possibility of further losses at investment banks, solvency of bond issuers and recessionary fears. Benefiting from a flight to quality, Treasuries posted modest gains in the month of June as the Lehman Brothers U.S. Treasury index returned 0.79% while the Lehman Brothers Corporate High Yield Index declined -2.8%. Risk premiums hovered around 11 percentage points over Treasuries for the month, which remains low when compared to the 20 percentage point spread levels in the early 2000s. However, a rise in default rates and stricter lending strategies will put additional pressure on spreads going forward.

Tighter credit conditions, further bank write-downs, the ongoing housing contraction and the rise in commodity prices are likely to weigh on economic growth over the next few quarters. From a historical perspective, the stock market typically hits bottom at the very moment when the world seems like it's coming to an end. We still do not seem to have reached a level of true panic leading to a round of last-ditch selling known as capitulation that traditionally paves the way for a market rally. The best news for the markets in the near term would be a downturn in commodity prices, which would take pressure off profit margins and inflation; giving central banks room to maneuver.

## **Definitions & Disclosures:**

An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

The MSCI Europe and Australasia, Far East Equity Index ("EAFE") is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Lehman Brothers U.S. Treasury Index covers public obligations of the U.S. Treasury; excluding U.S. Treasury Bills, U.S. Treasury TIPSs, STRIPS, and certain special issues.

The Lehman Brothers Corporate High Yield Index covers the U.S. Dollar denominated non-investment grade, fixed-rate, taxable corporate bond market.