VANTAGE CONSULTING GROUP
3500 PACIFIC AVENUE VIRGINIA BEACH, VA 23451 (757) 491-1200 FAX (757) 422-5378

# Market Review

June 2012

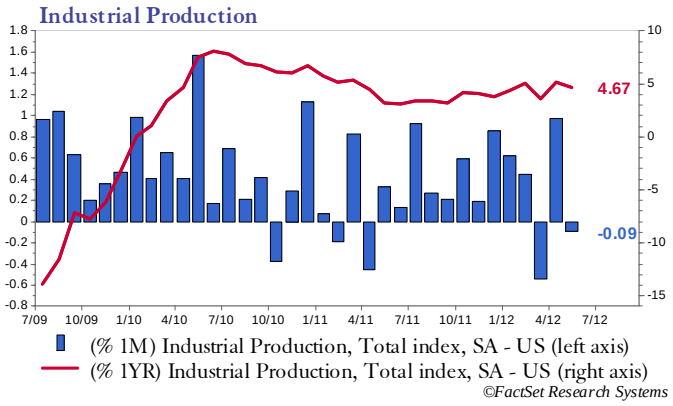
## *Economic Review*

The third estimate for U.S. first quarter real GDP remained unchanged from last month's second estimate of 1.9%. This reflected a downward revision to imports and an upward revision to non-residential fixed investment offset by downward revisions to exports, personal consumption expenditures, and private inventory investment. Real GDP had increased at an annualized rate of 3% during the fourth quarter.

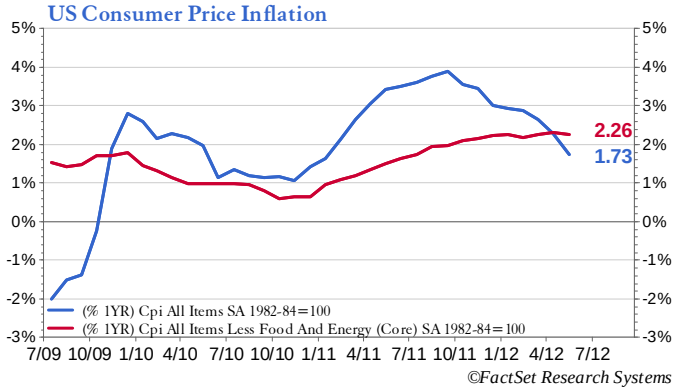
| Comparison of Q1 2012 GDP Component Revisions | | | |
|---|---|---|---|
| Component | 3rd Revision | 2nd Revision | Difference |
| GDP | +1.88 | +1.86 | +0.02 |
| Consumption (C) | +1.74 | +1.9 | -0.16 |
| Investment (I) | +0.84 | +0.81 | +0.03 |
| Government Spending (G) | -0.80 | -0.78 | -0.02 |
| Exports (X) | +0.58 | +0.98 | -0.40 |
| Imports (M) | -0.48 | -1.05 | +0.57 |
| GDP = C + I + G + (X - M) | | | |

*Source: St. Louis Fed*

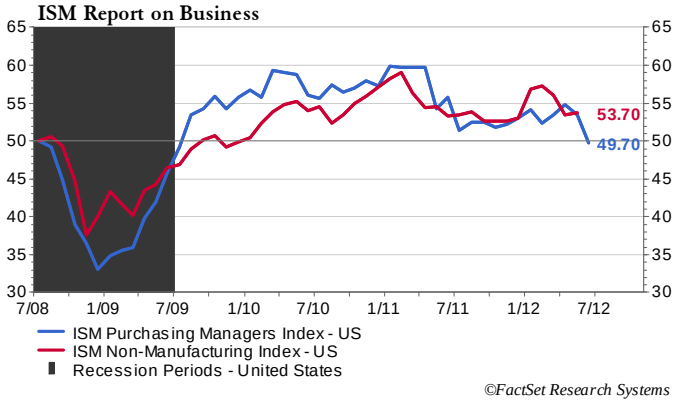
Industrial production edged down 0.1% in May on a monthly basis after having gained 1% in April. On an annual basis, industrial production rose 4.7%. Capacity utilization declined 0.2% to 79%, 1.7% below its long run (since 1967) average. The Conference Board's Consumer Confidence Index declined from 64.4 in April to 62 in May. Real consumer spending increased 0.1% in May while real disposable income increased 0.3%. The personal saving rate increased to 3.9% in May.




The Consumer Price Index (CPI) declined 0.3% in May, the largest drop since December 2008, as falling gas prices offset other increases. Over the twelve months, the CPI increased 1.7%. The Core CPI (i.e. excluding volatile food and energy prices) rose 0.2% for the third straight month, while the annual Core CPI rose 2.3%.




The US ISM Manufacturing Index contracted for the first time since July 2009. The index registered 49.7 in June, a decrease of 3.8% from May's reading of 53.5. The collapse in the index was unexpected by analysts who had anticipated a slight decline to 52. The New Orders Index declined 12.3%, registering 47.8 and indicating a contraction for the first time since April 2009. The ISM Non-manufacturing Index fell to 52.1 in June from the prior month's 53.7 and lower than the estimation of 53.7. A reading above 50 indicates expansion, and below 50 indicates contraction.




Various Federal Reserve officials including Janet Yellen and Ben Bernanke gave dovish speeches days before their June meeting. The Federal Reserve downgraded its outlook and extended its $400 billion Operation Twist through year end and will swap an additional $267 billion (approx. $45 billion/month) in short term securities with longer term debt to stimulate growth. The twist seeks to flatten the yield curve without expanding the Fed's balance sheet. Extension of the twist allows the Fed to maintain their accommodative stance through year-end while giving time to monitor the U.S. and international macroeconomic situation before

making a decision on another round of quantitative easing. The next FOMC meeting is on July 31st.

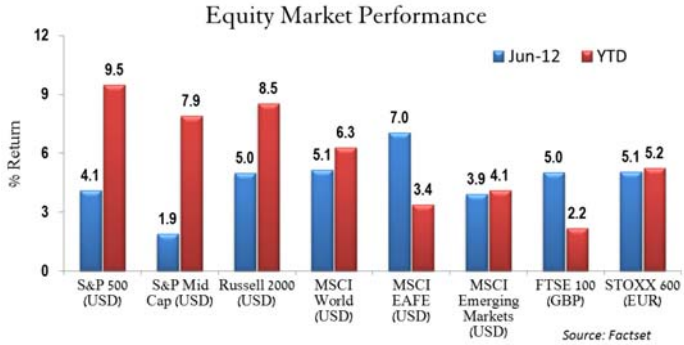
The European Central Bank (ECB) left interest rates untouched early in the month, and Spain received €100 billion in a bank bailout. The Greek elections were won by pro-bailout and pro-austerity parties, bringing some optimism to the markets. EU leaders met in a late month summit to tackle the European debt situation and surprised the markets by giving an outline of proposals. The proposals included a plan for an EU banking union with the ECB involved in a supervisory capacity over Euro area banks. This could allow the European Stability Mechanism (ESM) to eventually inject capital directly into banks and break the dependence between banks and their sovereigns. Additionally, a proposal was made to ease repayment rules for loans to Spanish banks and help reduce borrowing costs for Italy. The aid to Spanish banks will be provided through the European Financial Stability Fund (EFSF) until ESM is available, and the bailout will not be senior to Spain's sovereign debt. This announcement brought relief to the markets and caused a strong rally in Spanish government bonds. The EU leaders also agreed to a €120 billion stimulus package. It was also agreed that Ireland, which has already accepted a bailout, will have access to the same terms offered to Spain. There was no action on Eurobonds during the summit.

The Chinese Central Bank surprised global markets by cutting interest rates for the first time since 2008, in a bid to spur the world's second largest economy. The Chinese economic growth slowed to 8.1% in first quarter of 2012, down from 9.2% in 2011. The latest economic data from China indicated a further deceleration of economic growth. The Chinese manufacturing PMI contracted further in June, dipping to 48.1 from 48.4 in May.

Moody's cut Spain's debt rating three notches, from A3 to Baa3, while Fitch also downgraded Spain's sovereign debt by three notches to BBB and placed it on negative outlook. Moody's also downgraded fifteen global banks, including five from the US.

## *Equity Markets*

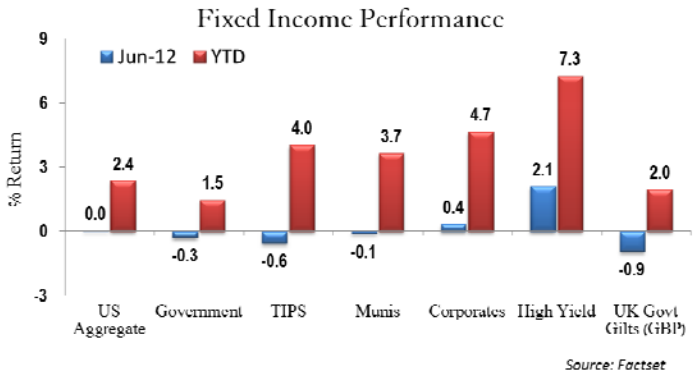
Equity markets proved resilient in June as global economic growth concerns and the ongoing European debt crisis were offset by global central bank actions and optimism over the EU summit. The S&P 500 gained 4.1% in June and is down -2.75% for the quarter. International markets fared better than domestic markets for the month but not for the quarter. MSCI EAFE, measured in US dollars, gained 7% in June but lost -6.9% over the quarter.




Gains across all equity markets in June masked the volatility experienced during the month. The equity markets got off to a rough start in June when weak May payroll data combined with the ongoing European debt saga, set a risk-off tone, leading the S&P 500 to decrease -3.25% and reach a June low of 1267. Weak global economic reports further fanned deflationary concerns, but equity markets surged close to 6% during the following weeks on hopes that global central banks would intervene. Equity markets reacted favorably to the pro-Euro election result in Greece but were soon kept in check by a downbeat forecast from the Federal Reserve. Finally, the news out of the latest EU summit to stem the Eurozone crisis, especially recapitalizing Spanish banks, led to a broad based rally, especially in financials. The S&P 500 rallied 2.5% while the VIX was down 13.3% in a single session.

## *Bond Markets*

Fixed Income had a relatively poor month. Treasury yields rose across the curve which steepened slightly in June as 2 year yields closed 4 bps higher at 0.3%, 10 year yields finished 9 bps higher at 1.65% and 30 year yields ended the month 11 bps higher at 2.76%. Led by financials, credit spreads narrowed 11 bps in June with significant tightening post the Greek election results and the European Summit.



The 10 year Treasury rallied with yields falling to a new all-time low of 1.44% in early June after the poor US labor report dampened investor risk appetite. Yields quickly reversed on global central bank and monetary policy intervention and stabilized to a narrow range between 1.58% and 1.68% for the remaining eighteen days of the month.

**Benchmark Yields**


The UK 10 Year GILT yield climbed 16 bps in June to close at 1.73% and the German 10 year Bund yield rose 38 bps closing at 1.59 %.

## *Currency*

The US Dollar Index fell 1.71% against a basket of six currencies in June, the biggest monthly decline since October 2011. The index dropped 1.43% on the final day of the month to close at 81.63. The New Zealand Dollar and the Mexican peso were among the strongest currencies appreciating 6.97% and 6.7% against the US Dollar. The Japanese Yen was among the weakest currencies in June and depreciated 1.73% against the US Dollar.

The Euro gained 2.63% against the US Dollar in June and closed at 1.2690 USD/EUR while the British pound appreciated 1.9% and closed at 1.5685 USD/GBP.

## *Commodity Markets*

The S&P GSCI Commodity Index gained 1.2% in June, with all the gains coming on the last trading day of the month. The Index was down 4.2% through 28th June, before surging 5.63% on the final trading day after news of the deal at the EU summit. Except for energy, all GSCI sub-indices rallied in June. Agricultural and Softs sub-indices led the rally with 15.61% and 7.82% gains respectively.

**S&P GSCI Commodity Spot Index**


Prices of agricultural commodities climbed steadily in June on expectations that hot, dry weather would reduce crop yield. Global demand also continues to remain strong with June prices of corn, wheat and soybeans appreciating 25.4%, 14.4% and 13.9% respectively, among the biggest gainers in commodities. Reports of smaller than expected inventories and the hot weather in the U.S. also boosted natural gas prices by 14% in June.

**Corn - Spot Price - Central Illinois No 2 Yellow ($/Bu)**


Crude oil prices declined 2.1% on slumping demand and disappointing economic data from the U.S. and Europe. Gold climbed 2.56% while silver lost -0.73%.

Soybeans, wheat and cocoa lead the 24 commodities in the S&P GSCI Index for the year with returns of 25.3%, 10.4% and 9.4% respectively. Coffee, natural gas and cotton had the worst performance year to date with returns of -27.1%, -25.1% and -16.4% respectively.