

ECONOMIC & MARKET UPDATE: JULY 5, 2011
"ECONOMIC DOLDRUMS OVERSHADOWED BY FINANCIAL MARKETS"
CHRIS MAXEY, SENIOR ANALYST
www.Evermaywealth.com

Economic Data - Previous Week

Date	Series	Actual	Survey	Prior	
6/27	Personal Spending	0.0%	0.1%	0.3%	Gas price declines weigh on spending report
6/28	S&P/CS Home Price Idx	-0.09%	-0.20%	-0.26%	Home price declines continue on seas. adj. basis
6/28	Consumer Confidence	58.5	61.0	61.7	Current and future expectations fall on weak labor
7/1	UMich Confidence	71.5	72.0	71.8	Weak labor and high gas prices pull down optimism
7/1	Construction Spending	-0.6%	0.1%	-0.6%	Heavy supply, lower govt outlays weigh on report
7/1	ISM Mfg Idx	55.3	51.8	53.5	Inventory build boosts headline manufacturing index

Economic Data - Upcoming Week

Date	Series	Actual	Consensus	Previous	
7/6	ISM Non-mfg Idx	--	53.7	54.6	Growth in services sector expected to remain stable
7/8	Nonfarm Payrolls	--	100K	54K	Forecasts muted as job market struggles continue
7/8	Unemployment Rate	--	9.1%	9.1%	Elevated claims data points to little improvement
7/8	Wholesale Inventories	--	0.7%	0.8%	Inventory growth by wholesalers to persist
7/8	Consumer Credit	--	\$4.00B	\$6.25B	Falling auto sales to weigh on credit in May

Source: Bloomberg

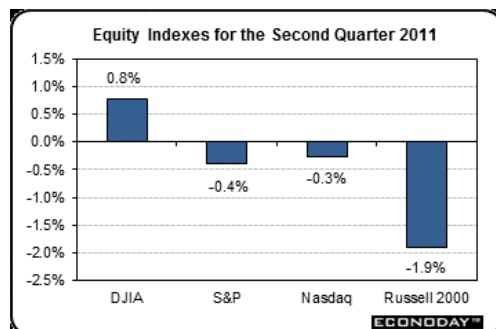
QUARTERLY LOSSES ALL BUT FADE AWAY IN FINAL WEEK

Global stock markets decided all was right with the world once again last week, resulting in the Dow Jones Industrial Average jumping 5.4% and the S&P 500 Index increasing 5.6%. When all was said and done, it was the best week in nearly two years for equity markets.

Ignoring the intra-quarter volatility, equity markets finished mostly flat in the second quarter. The Dow Jones Industrial Average rose 0.8% in the quarter while the S&P was down a modest 0.4% (on a price return basis).

Several important events came into play during the final week of the quarter, including changes to bank capital requirements, Greek austerity measures and better than expected domestic manufacturing figures. Oddly enough, all indications were that domestic economic activity was mixed, at best. Perhaps investors are buying into the notion that economic activity is stabilizing before a second half rebound.

Consumer data entered the fray last week to mixed results. Personal income was up 0.3% in May, but concerns about the stagnating recovery resulted in no gains to personal spending. With income and spending little changed, the personal savings rate also held steady at 5.0%. The personal savings rate spiked in 2009, but fell after consumers were confident enough to dip back into their savings accounts.



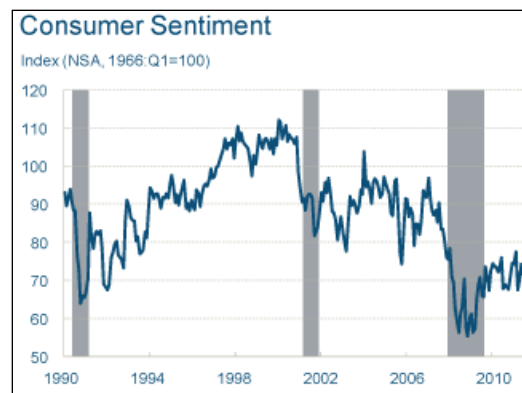
Source: Econoday

EVERMAY



Source: Wall Street Journal

Concerns about the economic outlook resurfaced later in the week when the University of Michigan Consumer Sentiment Index dropped from 74.3 to 71.5. Consumers reported being more optimistic about the current state of the economy, but their expectations for the pace of the recovery are deteriorating.



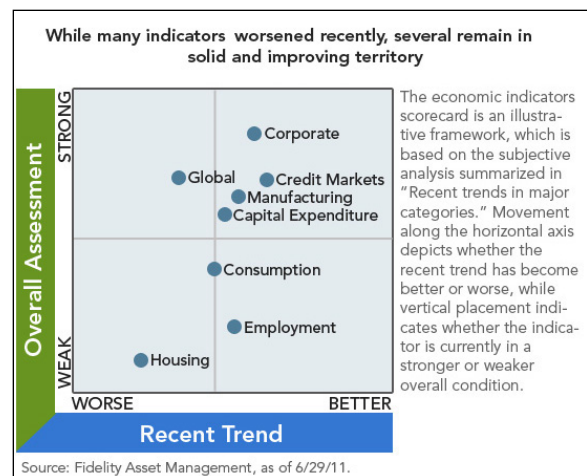
Source: Federal Reserve Bank of Cleveland

Concern about inflation is abating as well, after one-year-ahead expectations reached a peak of 4.6% in April. In the most recent survey, consumers' expectation of year-ahead inflation was 3.8%.

As we mentioned earlier, equity markets rallied in the last week of June, erasing most of the losses sustained in the second quarter. Entering the second half of the year, there is reason to believe the rally will continue as the economic recovery firms.

The first reason is that economic indicators are becoming "less negative". The Citigroup US Economic Surprise Index fell to its lowest point since 2008 in early June. Since then, economic releases have disappointed to a lesser degree and the index is heading in a more positive direction. Of course, one reason indicators are no longer surprising to the downside is that economists ratcheted down expectations after sustained disappointments. Regardless, that is a common phenomenon as recoveries take hold and expectations grow ahead of reality.

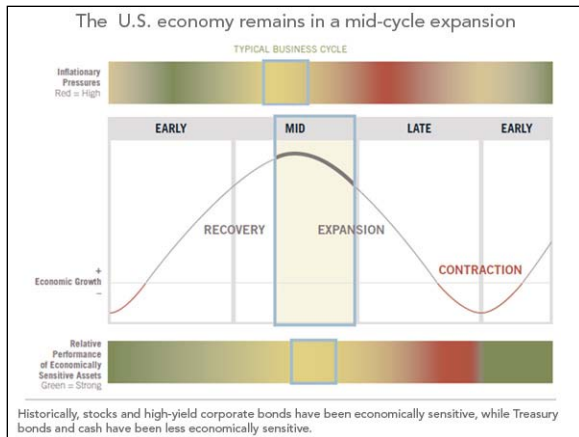
There is apparent strength in several areas of the economy. Research from Fidelity Asset Management shows that while some key areas of the economy (housing and employment, in particular) are struggling, there are a number of positive data points. Fidelity's economic indicator scorecard shows strong and improving data in manufacturing, corporate earnings and capital expenditures.



Source: Fidelity Asset Management

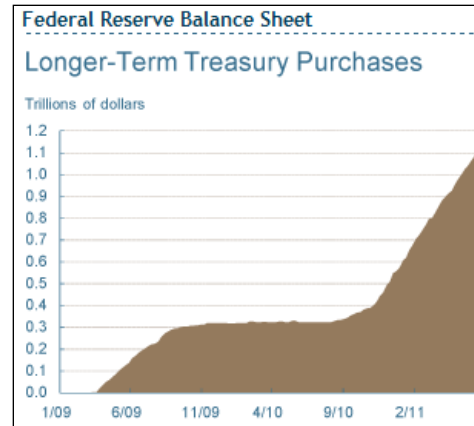
EVERMAY

Furthermore, Fidelity believes we are in the mid-cycle expansionary phase of the recovery, a period when economically sensitive asset classes such as stocks perform well, but with greater volatility.



Source: Fidelity Asset Management

Another reason risky assets struggled recently was the impending conclusion of asset purchases by the Federal Reserve, widely dubbed QE2. The Fed “officially” ended QE2 at the end of June, but that does not mean asset purchases are over. The Fed has stated it will maintain the size of its balance sheet by reinvesting maturing securities. That could translate into more than \$300 billion of asset purchases in the next year, providing a natural liquidity mechanism for the markets.



Source: Federal Reserve Bank of Cleveland

Admittedly, major pitfalls remain for the US in the second half of the year, including negotiations to raise the debt ceiling and a stubbornly weak labor market. In the meantime, there is reason for optimism.

The final point to consider is that markets tend to perform best in the final two years of the presidential cycle.

From 1900 to 2009, year 3 and year 4 of the presidential cycle outperform years 1 and 2 by a wide margin. In fact, average annualized performance in year 3 is 12.6% and year 4 is 7.5%, based on research from Ned Davis.

MANUFACTURING POSTS DIVERGENT RESULTS

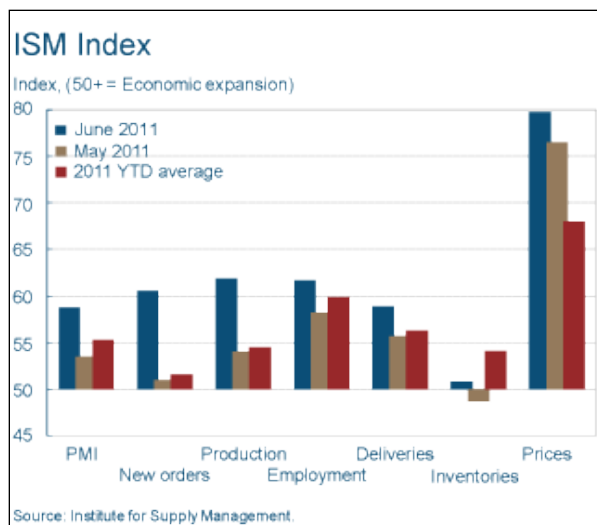
Domestic manufacturing received a surprise reprieve in the month of June. The headline ISM PMI rebounded from 53.5% in May to 55.3% in June, surprising many economists. While the headline figure was a welcome improvement, the underlying trends were not especially strong and domestic strength shielded global weakness



Source: Econoday

EVERMAY

The main factor behind the overall gain was a 5.4% increase in inventories. In June, 23% of manufacturers reported higher inventory levels. That was slightly higher than May but well below the 27% of manufacturers facing increased inventories in April (following the earthquake in Japan). It is tough to tell whether recent inventory growth is a result of supply chain issues easing in Japan or whether manufacturers believe demand is likely to pick up in the year's second half.



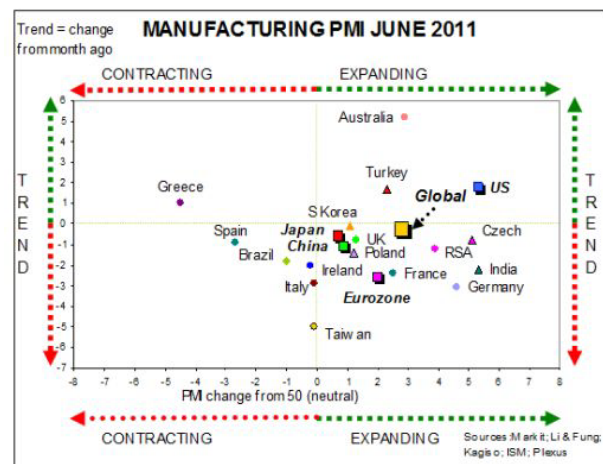
Source: Federal Reserve Bank of Cleveland

The second area of disappointment was the new orders index. After plummeting by 10 percentage points to 51.0% in May, new orders rose a modest 0.6% in June. While 34% of manufacturers indicated that new orders were better, the percent of manufacturers replying that new orders worsened jumped from 16% in May to 23% in June.

One positive take away from the June ISM report is that the impact of higher prices is finally beginning to ease. After peaking at 85.5% in April, the prices index fell to 68.0% in June (above 50% indicates higher prices). Manufacturer prices continue to rise, but the

report indicates the level of those increases is moderating.

Global manufacturing did not fare quite as well as the US in June. From Europe to Japan to numerous emerging market economies, manufacturing activity steadily slowed according to several reports released this week.



Source: Investment Postcards from Capetown

Obvious blame for the recent slow patch in manufacturing lies with supply disruptions from the earthquake in Japan. However, those disruptions alone do not fully explain the dip into contractionary territory for some of the larger emerging economies, such as Brazil and Taiwan. China, as another example, registered its lowest PMI reading in 28 months.

It would be easy to say global activity is slowing, which is partially true, but there is also a seasonal aspect to consider. Manufacturing tends to slow between May and August, before accelerating in the fall. That effect is readily apparent in the globally aggregated PMI, which showed a similar pattern of slowing last year.



Source: FT Alphaville

THE WEEK AHEAD

Economic data will rule the airwaves this week, especially the nonfarm payroll report on Friday. Economists are not overly confident that June was the month where employment growth finally kicked into high gear – a sentiment which is supported by relatively weak initial claims reports over the last four weeks.

Central bank meetings will garner considerable attention this week as well. Central banks from Australia, Sweden,

Poland, Malaysia, UK, Eurozone and Mexico all meet. The European Central Bank alluded to the possibility of another 25 basis point rate hike last week and there is a strong likelihood that emerging market economies will also tighten policy rates.

June turned out to be a challenging month for many manufacturers, with the US being the primary exception. Economists will closely watch manufacturing figures throughout the rest of the summer to determine whether this was a temporary blip of strength for the US or the start of renewed strength in the sector.

On Thursday, retailers will report same store sales for June. Several companies to watch include Gap, JC Penny, Nordstrom, Saks and Target.



Disclosure Information

Some part of the information contained herein was prepared for Evermay Wealth Management, LLC by employees of Fortigent, LLC. This information is not meant as a guide to investing, or as a source of specific investment recommendations, and Evermay Wealth Management, LLC and Fortigent make no implied or express recommendations concerning the manner in which any client's accounts should or would be handled, as appropriate investment decisions depend upon the client's investment objectives. The information is general in nature and is not intended to be, and should not be construed as, legal or tax advice. In addition, the information is subject to change and, although based upon information that Evermay Wealth Management, LLC and Fortigent consider reliable, is not guaranteed as to accuracy or completeness. Evermay Wealth Management, LLC and Fortigent make no warranties with regard to the information or results obtained by its use and disclaims any liability arising out of your use of, or reliance on, the information.

This report is for illustrative purposes only. Past performance is not indicative of future results. The information contained in this report has been gathered from sources we believe to be reliable, but we do not guarantee the accuracy or completeness of such information, and we assume no liability for damages resulting from or arising out of the use of such information. The performance numbers displayed herein may have been adversely or favorably impacted by events and economic conditions that will not prevail in the future. The indices discussed are unmanaged and do not incur management fees, transaction costs or other expenses associated with investable products. It is not possible to directly invest in an index.

Not FDIC Insured No Bank Guarantee May Lose Value