

## **SELECTOR<sup>®</sup> Money Management** **2012 Second Quarter Review**

**The second quarter was as disruptive as the first quarter was constructive.** The high for the S&P 500 printed on the first day of the quarter was at 1422.38. The next week saw a quick -4.56% pullback before the index climbed back up to score its second highest mark of the quarter on May 1<sup>st</sup> at 1415.32. The next two weeks of May, equity markets dropped sharply, pausing with a brief rebound rally the third week before continuing their decline through the end of the month. On June 1<sup>st</sup> a poor jobs report was credited for the largest single-day decline of the year as the S&P 500 fell an additional -2.44%. The total correction decline for the S&P 500 from April 1<sup>st</sup> to June 4<sup>th</sup> measured at -10.94%, bringing that index all the way back to its opening numbers for the year.

**June was a kinder month as equities once again moved north, finishing with a very nice +2.41% rally for the S&P 500 on the final trading day of the second quarter.** Those prices were lower than the April and May highs but all of the major market equities indexes ended the first half of 2012 with respectable gains. The precise numbers for the most highly watched indexes follow. The S&P 500 Large Cap Index dropped -2.39% for quarter, but stood at +9.49% YTD. The S&P 400 Mid Cap Index fell -4.96% in the second quarter, ending +7.90% YTD. And the Russell 2000 Small Cap Index fell -3.70% in the second quarter to end up +8.53% YTD. International markets had a more difficult quarter. The EAFE Index declined -6.48% in the second quarter and stands at +2.96% YTD while the MSCI Emerging Markets Index retreated -8.10% in the quarter for a +3.93% gain for the year.

**While equity markets retreated in the second quarter, bond markets were strong.** The Barclays U.S. 20+ Year Treasury Bond Index was the best performer of any equity or bond index we follow, surging +10.36% in the quarter and up +4.27 YTD. TIPs bonds participated with a positive +2.77% move in the quarter, closing the first half with a gain of +4.04% YTD. Intermediate and shorter term Treasuries also rallied nicely, especially in the month of May. High quality corporate bonds held up nicely, with the iBoxx \$ Liquid Investment Grade Bond Index up +2.55% in the quarter, and up +5.72% YTD. After declining sharply in May, high yield bonds managed to recover in June and finished the quarter with a +1.69% gain, and up 6.21% YTD.

**Interestingly, the best performing equity sectors in the second quarter involved real estate securities.** The Dow Jones U.S. Select Home Construction Index gained +6.63% in the quarter and is the single best performing index of the year-to-date with a gain of +36.20%. The broader Dow Jones U.S. Real Estate Index was up +4.73% in the quarter and is now up +15.02% YTD. This is intriguing because the last two major missing pieces in the economic puzzle as the U.S. has slowly been recovering from recession have been the real estate and job markets. The stock market typically likes to anticipate improving fundamentals with front-running moves by the affected securities. Thus, the strong real estate securities performance in an industry that has only been taking baby steps in the right direction. But there are no 'job market' securities. Job markets data is always rearward-looking and equity markets have become hypersensitive to the monthly employment reports. We saw this in June with a weak May jobs report. We are seeing this again today, as equity markets respond negatively to a weaker than expected June report.

**From a technical perspective, there are three very different stories being told.** Domestic equity markets are in a long-term uptrend consistent with an ongoing secular Bull Market, and an intermediate-term trading range. This picture is consistent with their steady advance the first quarter, the May correction, and the June recovery rally. International equity markets are in a long-term trading range. At the end of the first quarter they were the hottest game in town and it appeared they were going to break through resistance and run. But instead they totally retraced their steps in the third quarter, actually trading lower than their opening prices of the year for almost four weeks before staging a rally. And bond markets are proving to be the steadiest performers for the second year in a row, in spite of record low interest rates.

**The second half of 2012 holds the trump cards as the Fed decides the if-and-when on QE3, and as the election action heats up.** The Federal Reserve historically abhors political posturing and equity markets typically prefer not mixing politics and business cycles, especially during cyclical economic recoveries. We see a compelling convergence in the third quarter that may have profoundly promising impact on financial markets.

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