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Capital Management

2nd Quarter 2011 Market Review and Outlook

By Brian Bush

July 2011

Second Quarter 2011 Market Review and Outlook



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Mr. Bush joined Stephens in 1989. He is an investment advisor representative with Stephens Capital Management, a division of Stephens and is dedicated to providing investment counseling and wealth management services to individuals and families, trusts and estates, not-for-profit organizations, and private company pensions and profit sharing plans.

In the words of Yogi Berra, the second quarter of 2011 was like “Déjà vu all over again”. One year ago markets were rocked by Greeks rioting in the streets over austerity measures imposed by their government and investors feared a European debt contagion would spread across the globe. There was concern that economic growth was slowing and the U.S. was about to enter a rare double dip recession. One year later, investors faced many of the same questions. Would Greece default? What impact would that have on banks across Europe and the stability of the European Union? Was this the first of several sovereign debt dominos with Portugal, Spain and Ireland not far behind? Was the slowdown in the economy a result of the earthquake in Japan and the resulting supply disruptions or was the economic recovery coming to a premature ending?

As a result, investors had to endure an extremely volatile quarter with the S&P 500 rising 2.8% in the month of April before plunging 7.3% over the next 45 days. After six straight down weeks the announcement that Germany intended to take part in a new aid program for Greece and some encouraging economic reports led to a dramatic rally in the last week of June with the S&P 500 closing down 0.4% for the quarter.



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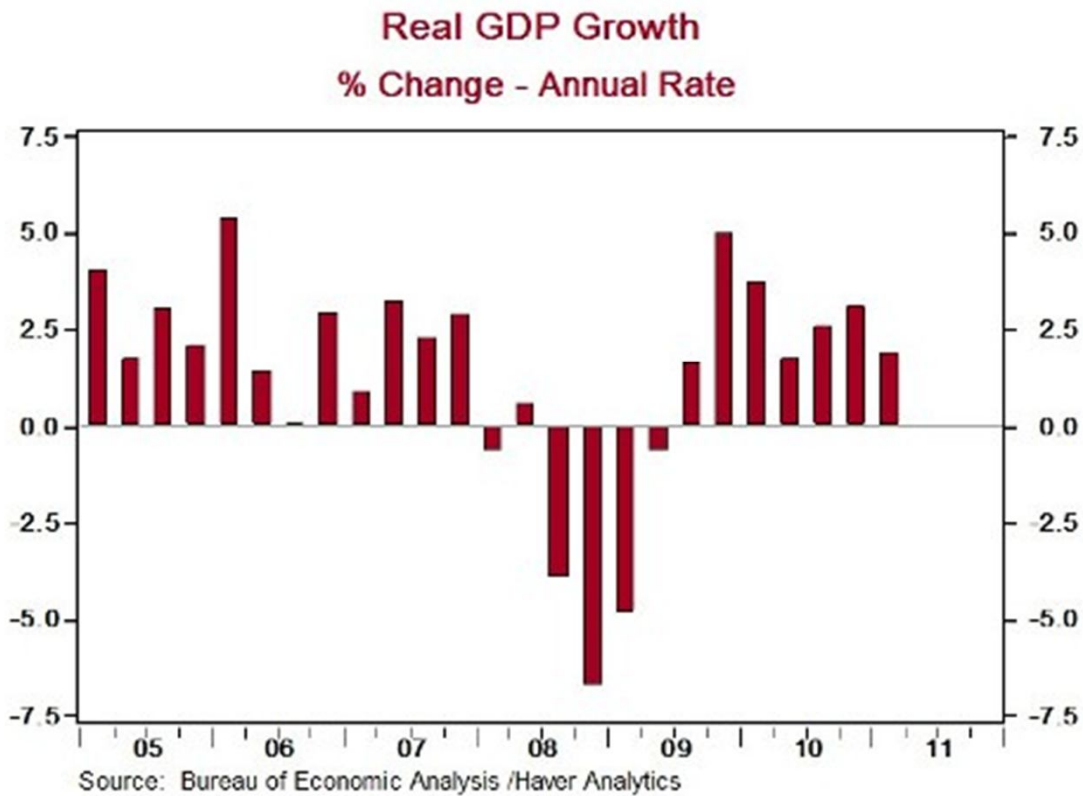
Bond investors generally enjoyed positive returns during the second quarter, as a flight to quality and signs of economic weakness led many investors to flee to the safety of U.S. Treasuries causing interest rates to fall even further. The Barclays US Aggregate Bond Index closed the quarter with a positive return of 2.29%.

In our view the underlying fundamentals of the stock market remain positive. To begin with, the ISM Manufacturing Index increased to 55.3 in June versus 53.5 in May signaling that the supply disruptions from the Japan earthquake may have been a primary contributor to the weakness in the economy and are already abating.

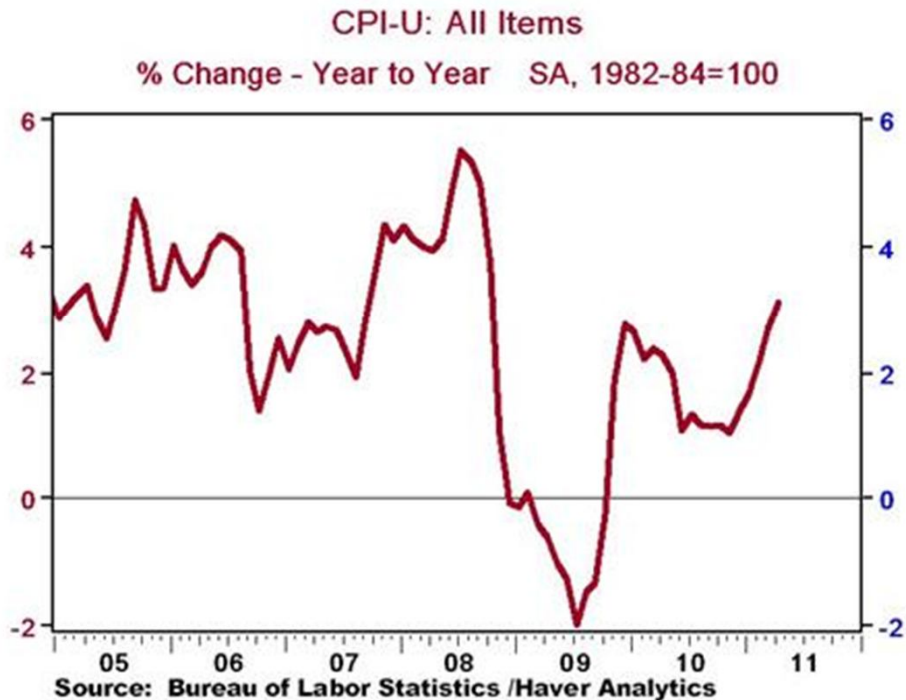
ISM Mfg: PMI Composite Index
SA, 50+ = Econ Expand



Real GDP growth for the first quarter was revised up slightly to 1.9% and while estimates of 3-4% GDP growth for 2011 may prove to be too high, we believe it is unlikely that the U.S. economy will re-enter a recession this year.

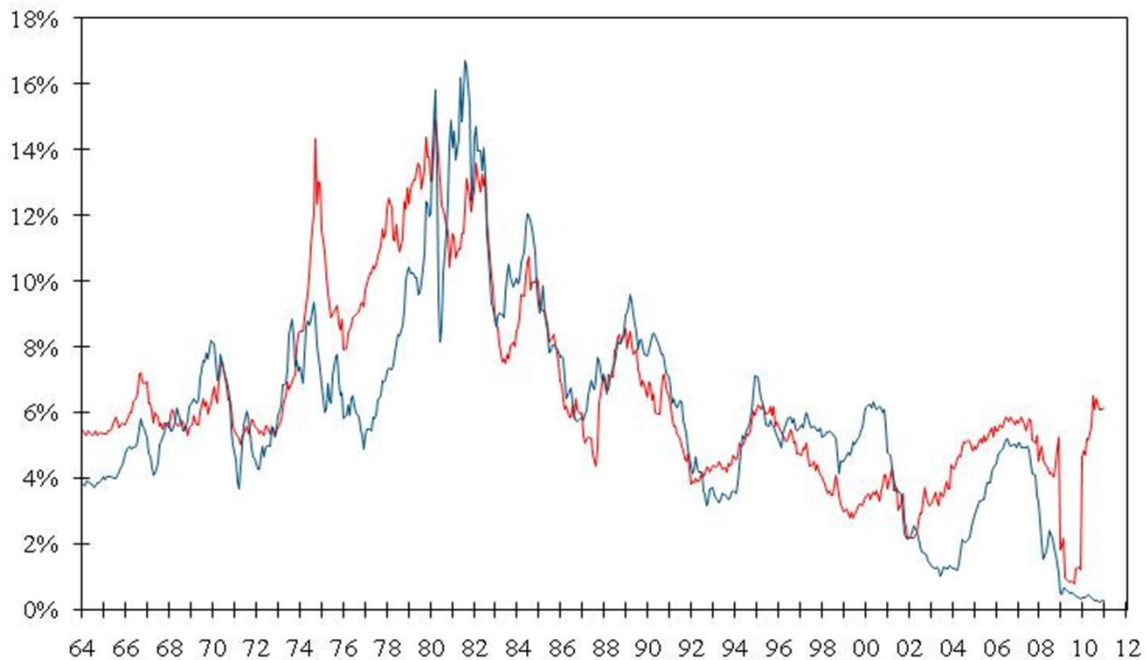


We remain concerned that The Fed has not articulated a well defined exit strategy for the monetary stimulus it has injected into the financial system over the past two years. The consumer price index has increased at an annual rate of 5.1% during the first five months of 2011. However, our inflation model indicates that inflation should trend lower over the remainder of the year which should give the Federal Reserve room to continue its accommodative monetary policy.



Most importantly, analysts are forecasting a record \$97.81 in earnings for the S&P 500 for 2011. The historic spread between the earnings yield of 7.31% and the interest rate on the one-year US Treasury of 0.18% supports maintaining a positive bias toward equity securities.

S&P 500 E/Y vs. 1 Year Treasury



■ S&P 500 Earnings Yield ■ 1 Year Treasury

Source: Stephens Capital Management

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The recent volatility in equity markets clearly triggered a rise in investor anxiety. According to the Investment Company Institute, investors withdrew \$21.1 billion from U.S. stock funds during the second quarter. Much of that money found its way into bonds with investors dumping \$43.2 billion into fixed income during the quarter. Investors still traumatized by the losses they sustained during the financial crisis during 2008 and 2009 are much like a herd of cattle holding their noses to the air in case the wolf pack begins to close in again. It is easy to become fixated on the problems of the day. Housing prices are down, unemployment is high, the federal budget is unsustainable and many European nations have yet to deal with the fiscal issues plaguing their countries. Investors were confronting many of these same problems a year ago prior to the S&P 500 rising 22% in the last six months of the year. Mark Twain said, “ history doesn’t repeat itself, but it does rhyme”. If Mr. Twain is correct, give me all the Déjà vu I can stand.

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