Quarterly Market Commentary – Q2/2010

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Presented by Allen Financial

Volatility returns to markets

The second quarter brought renewed volatility, as markets continued to trade on fears of a global slowdown and worries over the worsening European debt situation. Markets ended the quarter to the downside, with major U.S. indices trading sharply lower on the last two days of the quarter. European markets were hardest hit, and there were ripple effects across global markets.

The MSCI EAFE lost 13.97 percent for the quarter, and it has lost 13.23 percent for the year. The broad U.S. market, as measured by the S&P 500 Index, lost 11.43 percent for the quarter and is now down 6.65 percent year-to-date. The Dow Jones Industrial Average lost 9.36 percent for the quarter and is off 5 percent for the year. We have now broken below the S&P 500's February lows and are back to the levels seen in October of last year.

Bonds are a bright spot . . . again
Bonds made strong gains during the quarter, helped in large part by a significant reduction in interest rates. The yield on the 10-year bond moved from 3.83 percent at the beginning of the quarter to 2.95 percent at the end of the quarter. This sizeable move pushed bond prices higher, as investors sought protection in U.S. bonds in the face of the Greek credit problems. The Barclays Capital Aggregate Bond Index gained 3.49 percent for the quarter and is higher by 5.33 percent for the year.

The returns for the Aggregate Index have told two stories. At the beginning of the year, spreads narrowed and credit-sensitive bonds, such as corporate and high-yield, saw strong gains. During the recent quarter, spreads began to widen on perceived fears of a larger debt contagion, while gains were seen in interest rate-sensitive investments, particularly U.S. Treasuries.

Greece and the other "PIIGS"

Greece took center stage on the global news front as the severity of its debt crisis came to light. The nation had reached the end of its borrowing capabilities and was threatening to default on its outstanding debt. While Greece took most of the heat, other "PIIGS" nations—namely, Portugal, Italy, Ireland, and Spain—also began to raise the alert over difficulties in refinancing their own debt. This prompted the European Union, led by German Chancellor Angela Merkel, to provide a comprehensive aid package. The end result was a bailout of roughly $1 trillion in order to avoid widespread default.

This bailout, however, did not come without cost. Significant austerity measures were imposed upon Greece in an effort to help prevent further problems caused by perceived fiscal imprudence. The resultant cuts in budgets, benefits, and public services led to widespread unrest across the country. While Greece has been the most significant concern for markets, there could be a larger crisis looming. The outstanding debt of Greece is roughly $285 billion, while the total combined debt of the PIIGS nations is $4 trillion. Roughly $3 trillion of this debt is held by European banks, and ongoing concerns over this huge liability have helped pushed many of these bank stocks sharply lower. Global markets have continued to be cautious over the potential for further fallout from the debt crisis, which could add to volatility in the coming months.

The recovery continues, but how strong will it be?

The market's dramatic move higher through most of 2009 was fueled by anticipation of an improving economy—and this thesis did indeed prove correct. We began to see an inventory rebuilding cycle, as companies realized that their low inventory levels were not sufficient for their ongoing business needs. This was evident in the robust manufacturing numbers. Evidence also suggests that companies will continue to build inventories and fuel growth in the near term. Industrial production has ticked higher for the past three months—it was up 1.20 percent in May after a 0.70-percent increase in April. This has also prompted strength in factory orders, a sign that the economy continues to improve for the time being.

This recovery, however, is showing signs that it is not as strong as past recoveries, particularly given the depth of the recent recession. Recent remarks by the Federal Reserve help to support this notion; the Fed has continued to cite high unemployment, modest income growth, and tight credit as a caution to growth prospects, saying, "Financial conditions have become less supportive of economic growth on balance." Because the Fed's outlook can be interpreted as being less optimistic, we believe this continues to support the argument that interest rates will remain low. We may even see short-term rates at or near zero percent through 2011.

There are also signs that the housing market is turning down again after recent strength in the first half of the year. Following the expiration of the $8,000 tax credit, we have seen home sales slide considerably. While this was to be expected, the level of only 300,000 new homes sold in May was far below the 446,000 level sold in April. In fact, this is the lowest level of new home sales since the Census Bureau began recordkeeping in 1963. Existing home sales also fell to 5.66 million units in May, from 5.79 million units in April. This will no doubt continue to put downward pressure on house prices, as inventories remain persistently high. *Source: Bloomberg*

Many economists also point to a less followed metric from the Economic Cycle Research Institute for some insight into the future health and direction of the economy. The readings for the Weekly Leading Index have been pushing lower recently, down 6.90 percent for the week ending June 18, following a 5.80-percent decline the week before. Market analysts argue that these readings signal the impending slowdown of the economic recovery.

The gross domestic product (GDP) numbers also show signs that the recovery is slowing. First-quarter GDP estimates were lowered to a 2.70-percent annualized growth rate, from the initial reported estimate of 3 percent. And it is quite possible that we will see lower GDP figures for the second half of 2010.

Investing in this “new normal”
Equity markets have definitely become more volatile recently, amid concerns about the European debt situation and the slowing economic recovery. This is an environment in which investors need to be vigilant about risk, positioning portfolios to take advantage of the potential for a slower growth environment. Investors may want to seek market returns as well as income to help cushion some of the volatility and preserve capital. Income-producing stocks with strong fundamentals may make sense for investors, as could diversification within fixed income to help provide an ongoing income stream. Also, with the current turmoil in Europe, a focus on domestic holdings could prove to be more beneficial in the near term.

Disclosure: *Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and*

involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. All indices are unmanaged and investors cannot invest directly into an index. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The Dow Jones Industrial Average is
a price-weighted average of 30 actively traded blue-chip stocks. The Barclays Capital Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Barclays Capital government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

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Two from Allen Financial Receive Rotary Honor

Peter Van Alstine and Scott Fletcher of Allen Financial Group were recently named Paul Harris Fellows through their membership in the Camden Rotary Club.

The Paul Harris Fellow recognition was created in memory of Paul Harris, the founder of Rotary. It is the practice of many clubs to award Paul Harris Fellowship to select members in appreciation of his or her service to the club.

"Service to our local community – and through Rotary, to the world community – is important to us," said Gil Fifield, president of Allen Insurance and Financial and a long-time member of the Rockland Rotary. "We congratulate Peter and Scott and their families on this important honor."

Van Alstine, right, and Fletcher, left, join a number of their Allen Insurance and Financial colleagues as Paul Harris Fellows. Allen, the employee-owned insurance and financial services company based in Camden, maintains a strong relationship with Knox County Rotary Clubs and can claim members in each of the area clubs: Camden, Rockland and West Bay. Twenty percent of the Allen Agency's 60 employees are Rotarians; members attend Rotary functions on company time.

Both Peter and Scott are financial advisors with Allen Financial Group. Scott is a Certified Financial Planner. Peter is a Certified Public Accountant.

Rotary International is an organization is 32,000 service clubs and 1.2 million members worldwide, bringing together business and professional leaders to provide humanitarian service and to build goodwill and peace in the world. Members meet weekly for breakfast, lunch or dinner. Meetings are social events as well as opportunities to organize work for their service goals. Rotary was founded in Chicago in 1905 and is headquartered today in Evanston, Ill. Rotary's flagship program is the eradication of polio. Other programs focus on issues of hunger, poverty, and illiteracy.

Weekly Market Update: June 30, 2010

Allen Insurance and Financial is pleased to provide weekly market commentaries for those interested in general market news and performance data. Click to read more. (PDF, new window)

Healthcare Reform: Interim Final Rules on a Patients' Bill of Rights

The Departments of Treasury, Labor (DOL) and Health and Human Services (HHS) have issued interim final rules related to the provisions of the Patient Protection and Affordable Care Act (PPACA) regarding pre-existing condition exclusions, lifetime and annual limits, rescissions and other patient protections. Most of these provisions are effective for plan years beginning on or after **September 23, 2010**.

Plan sponsors should become familiar with these requirements in order to determine whether the new rules apply to their plans and whether their plans must be amended accordingly.

This Allen Insurance|Financial Legislative Brief describes the provisions of PPACA regarding these rules, as well as the clarifications made by the interim final rule. Please this document for more information. (Word document opens in a new window)

Stay Current With Tides from Maine Boats, Homes & Harbors

Midcoast Maine and Penobscot Bay Tide Charts

Weekly Market Update: June 21, 2010

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Health Insurance For Mariners Made Easy

The following article by Gene McKeever was published in the June 2010 issue of WorkBoat magazine.

We're all probably sick of hearing about health insurance. But what if I told you about a major medical health insurance program for vessel crews that is very affordable, portable, and has a $5 million lifetime limit? You think it sounds crazy? Well, it has been available for about a year now.

This is not an infomercial. I am an insurance person who works with vessels, shipyards, boatyards, tug-and-barge operations as well as tall ships and historic ships. I don't sell health insurance of any kind. I was made aware of this very sound health insurance product and I'm merely passing along useful information.

When crews are under contract with a vessel and are in service of the ship, they have maintenance and cure. This takes care of injury and illness that occur while on such duty.

But what does a crewmember have when he or she is not on duty? What health insurance does their family have?

Crew health insurance may be the answer. It's available to individual crewmembers as well as groups such as a vessel crew or fleet crew. It can be paid for by the individual, set up as a payroll deduction, or paid for by the vessel owner.

Vessel owners who pay for the crew's health insurance are finding that they're getting more loyal mariners who return trip after trip because they receive a health insurance benefit paid for by the vessel owner.

Here's the hard-to-believe part. The monthly premiums I've seen have run from between $99 and $260 or so a month per crewmember. I'm told that the premiums are low because they're based on international medical care rates and because there is no need to duplicate health insurance coverage while "in service of the vessel" because the crew is covered under the vessel's maintenance, cure and wages.

Keep in mind this health insurance is for mariners who work in international waters (meaning three miles or more offshore). This includes most mariners in U.S. coastal waters including the Great Lakes.

Contact Gene McKeever: 207-230-5822.
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The federal government has extended the eligibility for the Cobra subsidy for terminated employees through the end of May.

In addition, Maine has added a newly eligible category of individual under it's "Mini-Cobra" provisions. Those eligible for the subsidy will now include permanently laid-off individuals, where in the past there had to be an intent of the employer to re-hire the individual in the near future.

Please find more details of the federal subsidy in the attached article. As more information and forms become available, we will provide you with information here.

Latest Market Commentary

We are in the midst of an improving economic environment, but it has not been a strong recovery thus far.

More

New Health Care Tax Credit

The IRS has broken down the process to determine if your business will qualify for the new health care tax credit into three simple steps. Try it and see if you are eligible!

Small Business Tax Credit