COROMANDEL WEALTH MANAGEMENT

Special Economic Update
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Wow—are we on a rollercoaster? If you've been feeling like the stock market has been much more volatile lately, guess what? You're right!

Nothing rattles investors quite like the storm after the calm. After its low in March 2009, the market rose as smoothly as an escalator. Over the previous 12 months, the typical daily swing averaged just 1.4%. Then came May 6th—the day when the market fell almost 1000 points, or 9.6%, before rebounding and ending the day up being down "only" 3.2%. On May 7th the Dow swung 3.3%; the day after that 4.2%, and since then the market has continued bouncing back and forth almost like a ping pong ball. ***(Source: WSJ, May 7, 2010, A1)*** Over the previous 12 months, the typical daily swing had averaged just 1.4%. ***(Source: WSJ, May 15, 2010, B7)***

If you feel shaken, that is understandable. Volatility is back. May 2010 was a bad month for equities with the S&P 500 falling 7.9 %.

Market volatility isn't bad in itself—it is your reaction to it that matters the most. Many psychological experiments have shown that the stress induced by watching a volatile market may lead you to try to lock in your gains, especially your winners, often before you should. Yet the stock market is no more or less predictable today than it ever has been before.

For example, on Thursday, May 27th, the Dow increased 284 points, its second-best day of the year. Oil had its best one-day gain since last September. The rally was sparked primarily by China's promise not to unload European debt and by the perception that the market had overshot and the US economy remained relatively healthy.

Yes, the thousand-point drop of the Dow Jones Industrial Average in less than an hour was heart-stopping, but the decline at the end of the day was only 347 points, and the thousand point drop was less than 10%. It wasn't even half the 22.6% drop that the index experienced on October 9, 1987 (see chart for comparison). Resist the temptation to react impulsively to the market drop. ***(Source: Investment News, May 17, 2010, Page 10)***

While we've all heard a number of explanations for such a significant drop and rebound, we're still waiting for the government to officially announce their specific reasons (and hopefully ways to prevent this from happening again). We will keep you informed.

Many investors have been taken from one extreme to the other during much of the past decade, celebrating as stocks soared to unprecedented highs and suffering as equities endured some of the steepest declines on record. For example, after declining 37% in 2008, the Standard and Poor's 500 Composite Index continued to drop sharply in the first 9 weeks of 2009. It reached a low on March 9, 2010—55% below the peak of October 2007, representing the largest-to-point decline in 70 years. Then, after hitting its bottom in March, the market turned its decline into a breathtaking rally. From that day until the end of the year, the S&P 500 soared 68%. For the full year, the index advanced 26% (all S&P returns include reinvested dividends). ***(Source: Insight – American Funds, Spring 2010)***

The steady advance in the broader stock market since early March 2009 had to end eventually. No market advance in history has proceeded without periodic pullbacks. With all of the talk of the potential collapse of the European Union (EU) and Euro, a major oil spill in the Gulf of Mexico and the Chinese government's efforts to cool its nation's red-hot economy, it is easy to worry, but this decline does not necessarily mark the beginning of a new Bear market. Instead, it appears the market is in a routine correction, declining from an overbought condition after an 80% advance over the last 14 months.

Let's compare today's situation with the last time the S&P rushed to 1100 on the way down. Last time, interbank lending and general credit conditions were in severe distress, whereas today they are still well within their normal zones. Last time, the worst of the economic shocks were ahead of the market, whereas today domestic fundamentals are solidly improving, as many companies have experienced better-than-projected first quarter corporate earnings. Also, the S&P 500 is now at 14 times current year-ahead projected earnings (P/E), which reflects the price decline plus the higher-than-expected earnings. This is usually a positive indicator.

It's true that today we face a very mixed bag of economic data:

- Unemployment still remains high at almost 10%.
- Inflation appears not to pose a problem, with the Consumer Price Index over the last 12 months ending April 30, 2010, increasing only 0.9%, the smallest year-over-year increase since 1966.
- Housing statistics were mixed—some good news, some not so good. Housing starts were better than expected, coming in above 0.8% in April. However, building permits, an indicator of future growth, fell -11.5%, probably due to the expiration of the First-Time Homebuyer's Credit on June 30, 2010.
- Another area of concern is North and South Korea. North Korea has been accused of sinking a South Korean warship in March, prompting the US and South Korea to plan a joint military exercise.
- Some investors are worried that the US economy could be headed for another downturn.
- The debate over the restructuring of our financial system has put many investors on edge, anxious about how these changes might affect Wall Street. ***(Source: Bob LeClair's Finance & Markets Newsletter, May 22, 2010)***

Europe's Credit Problems

Another cause for our current volatility is Europe's recent credit problems, especially Greece, Portugal and Spain. However, Greece accounts for less than 0.6% of the global economy. Its debt is huge relative to the size of the Greek market, but isn't significant in a global context. ***(Source: Personal Finance, May 26, 2010)***

The real fear is contagion. Many investors are worried that a Greek default would soon spell trouble for Portugal and Spain, who are also heavily indebted. Even more worrying is the question of whether these problems could spread to Europe's larger core markets, such as the U.K. and Italy. The credit freeze that followed the Lehman Brothers' bankruptcy is still fresh in many investors' minds, and they worry that Europe's debt crisis could spiral out of control with similarly dire consequences for the global economy.

Recognizing these risks, the EU announced a trillion-euro bailout to support the region's weaker economies. The package includes money for a stabilization fund and provides monies to countries that are unable to issue bonds at reasonable rates in the private market.

The Dow celebrated Europe's one trillion dollar bailout plan with its biggest 1-day jump in over a year, rebounding 4.4% on Monday, May 10th, from the selloff the week before that. ***(Source: Barron's, May 17, 2010, Page 9)***

The EU will also monitor the fiscal condition of countries using the Euro far more closely. This will force countries in the Euro-zone that require stabilization funds to take concrete steps to reduce their deficits and spending. While many economists believe that this stabilization package should be more than sufficient to address the credit contagion in Europe's periphery, many investors are convinced that longer-term fiscal problems still need to be addressed and solved.

Many investors are worried that the incident that occurred in Europe could happen here in the United States, too. Just look at the numbers. Greece has a budget deficit of -9.9% of GDP, Spain is -8.8% and Portugal is -7.6%. How about the US? We're at -9.4%! This is certainly a concern! ***(Source: Bob LeClair, May 22, 2010)***

Conclusion

The significant volatility over the last several weeks illustrates continuing confusion about the economic environment, concern about the instability of the European economy and fear that this might also affect other global economies, including the United States! Wall Street has also become more jittery thanks to the SEC's fraud charges against Goldman Sachs and the progress of the financial reform bill. This volatility also reflects many investors' current lack of trust and confidence in Capitol Hill.

Have the economy's boom-to-bust cycles shortened significantly, or does our mood just make it seem that way? One minute we are basking in the glow of job growth and reawakened consumerism, and the next we are pondering a slowdown brought on by Europe's spending cuts and China's credit constriction. But despite the sensationalist headlines, the stock market hasn't crashed; the S&P 500 is down less than 10% from its highs, well within historic norms for market pullbacks. The European credit concerns haven't caused a global credit crunch or economic slowdown. Meanwhile, although China's economy appears to be slowing, it is still estimated to grow more than 9% this year. ***(Source: Kiplinger's Personal Finance, May 26, 2010)***

Given the recent volatility and the returns on equities, many investors' concerns about equity investing are understandable. In fact, the recent volatility may have changed the way some investors think about their portfolios and diversification. However, it would be wise not to make too many drastic changes at this point before you consider the following general rules of thumb:

1. **When investing in equities you should maintain a long-term view.** This approach requires holding enough money in liquid assets to cover personal expenses for the next couple of years, along with an ability to look beyond the short-term and maintain a steady hand during times of volatility. An adequate emergency fund should help prevent you from being forced to sell your portfolio during a Bear market.

2. **Remember the old adage; "Be fearful when others are greedy, and greedy when others are fearful."** This important guiding principal could be seen during 2008 and 2009. Those who sold their stocks in fear when the market was at its worst simply turned paper losses into real ones. Those who bought during this period may be looking at healthy gains. Many investors that simply held through it all are essentially back to where they were before the crisis began. Whether 2009 was a good year or not is merely a matter of perspective.

3. **Practice patience.** Many money managers think that times like now provide a potential buying opportunity. Among the various reasons optimists think this is a passing storm are that the Federal Reserve is committing to exceptionally low benchmark interest rates for months to come, the Central Bank recently boosted its forecast for economic growth, and many companies are reporting stronger profits than expected. In addition, profit forecasts for most of the companies in the S&P 500 stock index have been little changed over the past 2 weeks, according to Thompson Reuters. ***(Source: WSJ, May 24, 2010, C2)***

4. **One of Sir John Templeton's "Rule's for Investment Success" was "Do not be fearful or negative too often".**

Once again as we have mentioned in this report, it is not time to panic. The recent market turbulence reminds us that it is always a good idea to re-evaluate your current financial situation and confirm that your risk tolerance, goals and needs are still appropriate.

P.S. Remember—the stock market is one of the few things that people don't buy when it goes on sale!

About Coromandel Wealth Management

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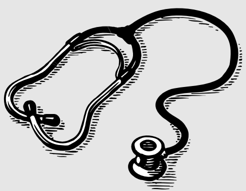

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