

U.S. Market Outlook

U.S. stocks were severely strained in the second quarter, with the S&P 500 index down 11.4% in U.S. dollar terms. Despite strong earnings and guidance from the first quarter, stocks were down on a host of macro concerns both internally and from abroad.

Economic data from the U.S. pointed to an economic recovery that has slowed from the levels seen in the first quarter. Housing and employment data were generally weaker than what had been hoped for. Housing prices and new home construction failed to meet expectations and the expiry of fiscal aid in the form of tax credits appeared to weigh on the data this quarter. On the employment front, new job formation remained elusive as companies continued to focus on cost reduction and not expansion. Inflation has not emerged as a concern at this time, while talks of deflation have reemerged as companies struggle to find pricing power. These factors among others have led many economists to lower their forecasts for growth in the U.S. for the remainder of the year.

The risks to the U.S. economy have clearly increased over the past several months. Sovereign debt issues, a persistently weak unemployment picture and an anemic housing market have all taken their toll on what, just a quarter before, looked like a healthy recovery picture.

Despite these risks, there exist several key reasons to be positive on the U.S. markets going forward. Firstly, the valuation for U.S. equities has again become attractive. The most recent reading shows the S&P 500 trading at around 13 times forward earnings, below the historic average. In addition, corporate profitability remains high and even with a European impact factored in, the profits generated by U.S. businesses remain strong.

Weighing these factors, we feel the U.S. markets will generate positive returns for the remainder of the year as we enter into the second half of 2010. The risks appear to be well known and although we could still see some volatility over the coming months, we feel that by the end of the year, U.S. stocks will be higher.

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