Teton Wealth Management, Inc.

Registered Investment Advisor

Market Recap – 2nd Quarter 2010

June 30, 2010

Wall Street's bulls got stampeded during the second quarter, with bad news overseas and economic frustrations at home conspiring to push global stock markets into a full-fledged correction. But while the selling was occasionally feverish, market veterans were quick to discount speculation that Europe's sovereign debt problems represented a second credit crunch or could rival the 2008 collapse of Lehman Brothers in spurring another downturn.

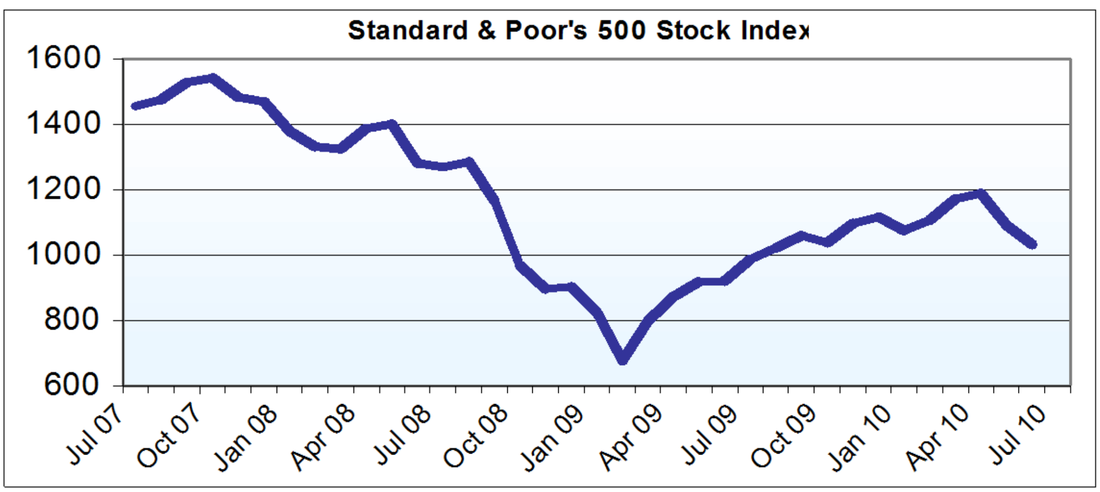
In fact, despite the losses, stock and credit markets remain in much better shape than they were in following the disasters of late 2008. U.S. corporations spent much of the quarter reporting truly spectacular earnings growth and even the consumer economy showed signs of life. If anything, Europe's woes only demonstrated the underlying strength of the dollar and the ongoing recovery of the global economy.

U.S. Equity Markets

After spurring a yearlong rally, investors were spooked by the Greek debt crisis, and some fled the markets entirely, fearing a repeat of 2008's dire events. No stock market segment was immune to the sudden downswing in investor sentiment. The Dow Jones Industrial Average, reflecting the performance of 30 top U.S. corporations, shed 9.96% during the quarter; counting dividend payments, the blue chip index still lost 9.36%. Other benchmarks fared worse. The Standard & Poor's 500 stock index shed 11.89% (11.42% after dividends), while the NASDAQ Composite—formerly the leader in the post-recession market rise—plunged 12.04%.

Year to date, all three indices ended the second quarter in negative territory. The Dow had lost 5% of its value, the S&P 500 was down 6.65%, and the dividend-poor NASDAQ had given up 7.05%.

Still, the losses only took the edge off the spectacular gains that stocks enjoyed during the 13-month rally's initial phases. Even counting the recent retreat, the Dow industrials ended the quarter up 49% from their March 9, 2009 low. The S&P 500 was 52% higher and the NASDAQ held onto a stunning 66% advance.



Widespread market losses came in spite of, rather than because of, earnings reported during the quarter. Companies generally reported revenue that inched higher while operations remained lean, a formula that translated into rich profits. On average, first-quarter earnings announced this spring by members of the S&P 500 increased by a record-breaking 54%. Factor in falling share prices, and stock valuations also slid, with the price-to-earnings ratio (P/E) for the S&P 500 falling to 12.3 by quarter's end. Yet while second-quarter earnings may not rise at quite the same breakneck pace, consensus opinion on Wall Street is for companies to report profit growth of 27%, with only the communications and utility sectors expected to report flat or falling profits.

Global Equity Markets

Though much of the bearish mood in U.S. markets sprang from overseas events, foreign stocks generally fared no worse than their U.S. counterparts, while shares in China and a few other bright spots actually did quite well. The MSCI EAFE Index, a leading gauge of blue chip stocks in the developed markets of Europe, Australasia, and the Far East, fell 10.92% during the quarter in local currency terms. Translated back into dollar terms for U.S. investors, however, the EAFE's second-quarter decline steepened to 13.75%, thanks to the sharp appreciation of the dollar against the euro and other currencies.

Some European markets did suffer disproportionate losses, with Greek stocks plunging 40.42% in dollar terms amid fears that the small nation might default on its massive debt. Other countries viewed as similarly suspect—including Spain, Portugal, Italy, and Ireland—also featured plunging stock prices, which fell from 16% to 21%, again in dollar terms. Outside of Europe, Australian stocks dropped nearly 19% and Asian equity markets retreated by 5% to 10%.

Emerging markets, though traditionally more volatile than those in developed countries, held up better this time. The MSCI Emerging Markets Index fell 8.29%, while Chinese shares ended the quarter down a relatively mild 6% despite speculation that the country's housing markets were about to crash. Brazilian and Russian stocks tumbled 16%, but India shed just 2%, and Indonesian and Colombian stocks edged up roughly 3%.

The Bond Market

As Europe's economic outlook darkened, the popularity of U.S. Treasury bonds surged anew; defying expectations of a fixed-income slump as improving conditions drew investors into riskier but higher-yielding assets. While this flight back to Treasuries helped ensure a market for the $300 billion in new debt the U.S. government issued between April and June, it hurt other bond markets. Foreign governments—especially in Europe—and corporations found it more difficult to borrow as the quarter wore on, spurring comparisons to the dark period immediately following the September 2008 collapse of Lehman Brothers.

But renewed global hunger for Treasury bonds helped the Federal Reserve keep U.S. interest rates at record lows. The Fed's monetary policy committee voted twice during the quarter to keep overnight lending rates floating between zero and a quarter of a percentage point (0.25%). And with economic recovery still seeming grindingly slow—and inflation not yet a concern—Fed Chair Ben Bernanke and his fellow government bankers currently expect this interest-rate environment to persist for "an extended period."

In fact, Europe's pain—and the risk of a second global credit crunch—pushed the Federal Reserve to reopen extraordinary liquidity programs it had closed earlier in the year. Working with the Bank of Japan, European Central Bank, and other monetary authorities, the Fed authorized massive temporary lines of credit that the world's banks could tap in a crisis. But by mid-June, only $6.64 billion had been used, compared with $583.1 billion of outstanding credit in December 2008.

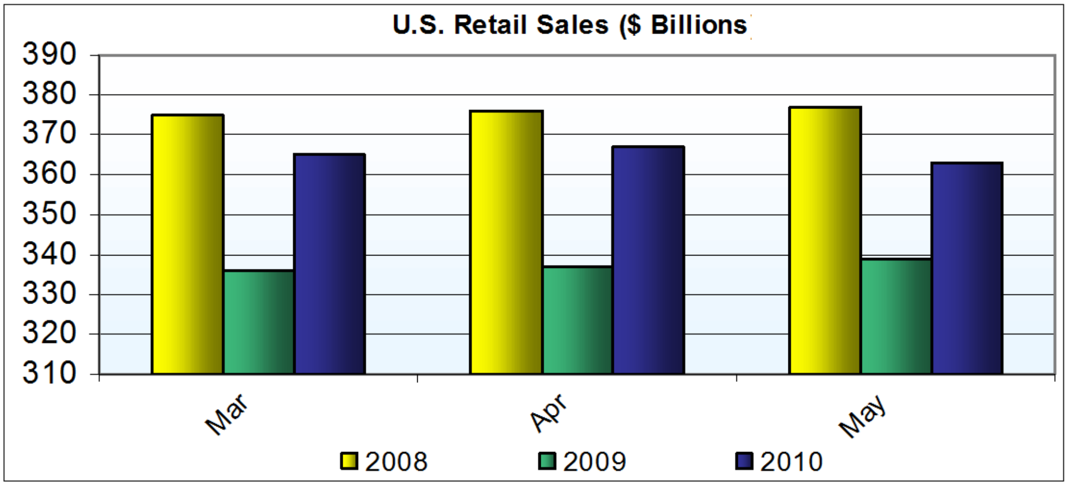
Investors' risk aversion, though it helped Treasuries, left high and low-grade corporate borrowers starved for capital. Few wanted to take a chance on owning the debt of any entity that might be forced to default on its obligations. This applied to corporate and foreign government bonds alike, and corporate and sovereign borrowers had to offer higher interest rates to attract skittish investors. The spread between Treasury and high-quality corporate yields surged to roughly two percentage points. Lower-grade or "junk" borrowers had to pay a full seven percentage points above Treasury rates on average.

The Economy

While many believe that the long recession that began in December 2007 has technically ended, that may be cold comfort in the face of continued credit market disruptions, slack hiring, pensive consumers, and the ongoing housing slump. The tone of the quarter may best be summed up by two statements the Federal Reserve's Open Market Committee issued, in which it said housing starts remained "depressed," bank lending continued to "contract," the economy remained "slack," and recovery would be "gradual." By June, the Fed admitted that the euro scare had hurt the already weakened global economy: "Financial conditions have become less supportive of economic growth on balance, largely reflecting developments abroad."

GDP

Even before world markets corrected in mid-April, there were signs that the road out of recession would not be smooth. With government stimulus programs ending, the annualized rate at which gross domestic product (GDP), the widest gauge of U.S. economic activity, expanded in the first quarter slowed to 2.7% from 5.6% during the final three months of 2009. Companies also reined in capital expenditures as the new year dawned. Still, economists and investors had expected decelerating GDP growth, and second-quarter results will be the real test of the economy's resilience. Forecasters predict growth of about 3.2% when the numbers are released in the third quarter.

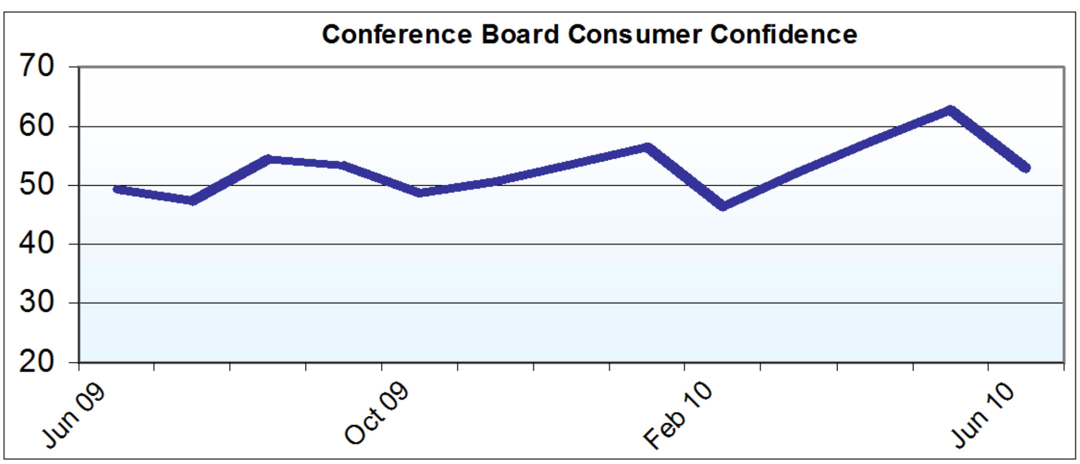


Retail Sales

With family finances still beleaguered, a revival of retail spending seemed unlikely. And though U.S. households bought 7% more in May than they did a year earlier, they still spent $14 billion less than during the heady spring of 2008. Credit remained tight, and millions of Americans either had less money to spend or felt less enthusiastic about parting with it. Scattered bright spots included vehicle sales, online retail, and filling stations.

Consumer Confidence

Consumer optimism finally recovered to pre-recession levels early in the quarter, but the new market downturn soon darkened the already fragile American mood. By late June, the Conference Board's consumer confidence index had backtracked to the somewhat gloomy levels of March, and opinions about the current economic situation could only be characterized as dismal. Only 17.2% of those surveyed believed business conditions would improve by the end of the year, while 14.9% expected the environment to get worse.

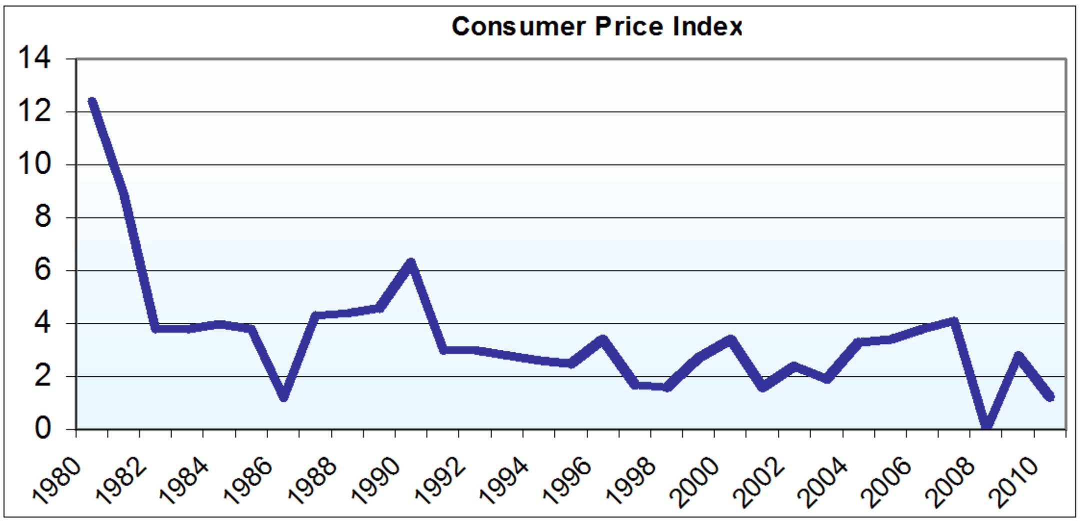


Unemployment

The job market continues to be a primary source of angst, and it was largely a shrinking of the potential work force—with many job seekers giving up hope—combined with a short-term upswing in U.S. Census Bureau hiring that pushed down the unemployment rate to a 12-month low of 9.5% in June. With roughly 7.5 million jobs vaporized by the recession, few rejoiced in the news.

Inflation

Low interest rates and massive stimulus spending have yet to erode the dollar's purchasing power, and inflation remained extraordinarily mild throughout the quarter, with consumer prices edging up 2% in the 12 months that ended in May—or just 0.9% factoring out the volatile food and energy categories. If anything, the push toward austerity in both inflation-wary China and the debt-weary nations of Europe revived fears that the world economy could be flirting with outright deflation.



Amid lukewarm economic data at home and the explosion of anxiety abroad, the persistent absence of inflation came as welcome news to investors worried that any fresh shock would drive the global economy into a recessionary relapse. As long as prices remain stable, the Federal Reserve can act as needed—as it did this quarter, reviving its swap program in a show of support for the European Union. Meanwhile, though many investors ignored the trend, U.S. companies have restored their profit margins and emerged from the recession with leaner business models and sharper focus. While earnings are unlikely to continue to rebound at the first quarter's record-breaking rate, profit growth is persisting. Coupled with lower share prices in the wake of the correction, all the pieces are in place for the long term. All smart investors need to do is stay the course.

Richard Bloom, CFP – July 15, 2010

Performance Indices

Asset Class	Index	2Q10	Year To Date	1-year	3-year annualized	5-year annualized
Large Cap US Equities	S&P 500	-11.42%	-6.65%	14.43%	-9.81%	-0.80%
Small Cap US Equities	Russell 2000	-9.92%	-1.95%	21.48%	-8.60%	0.37%
International Equities	MSCI EAFE	-13.75%	-12.93%	6.38%	-12.94%	1.35%
Emerging Markets	MSCI EM	-8.29%	-6.04%	23.48%	-2.22%	13.07%
Fixed Income - Taxable	BC Aggregate Bond	2.92%	4.77%	8.71%	7.25%	5.46%
Municipal Bonds	BC Municipal Bond	2.03%	3.31%	9.61%	5.50%	4.40%
Multi-Strategy	60% S&P 40% BC Bond	-5.59%	-1.79%	12.82%	-2.73%	2.04%