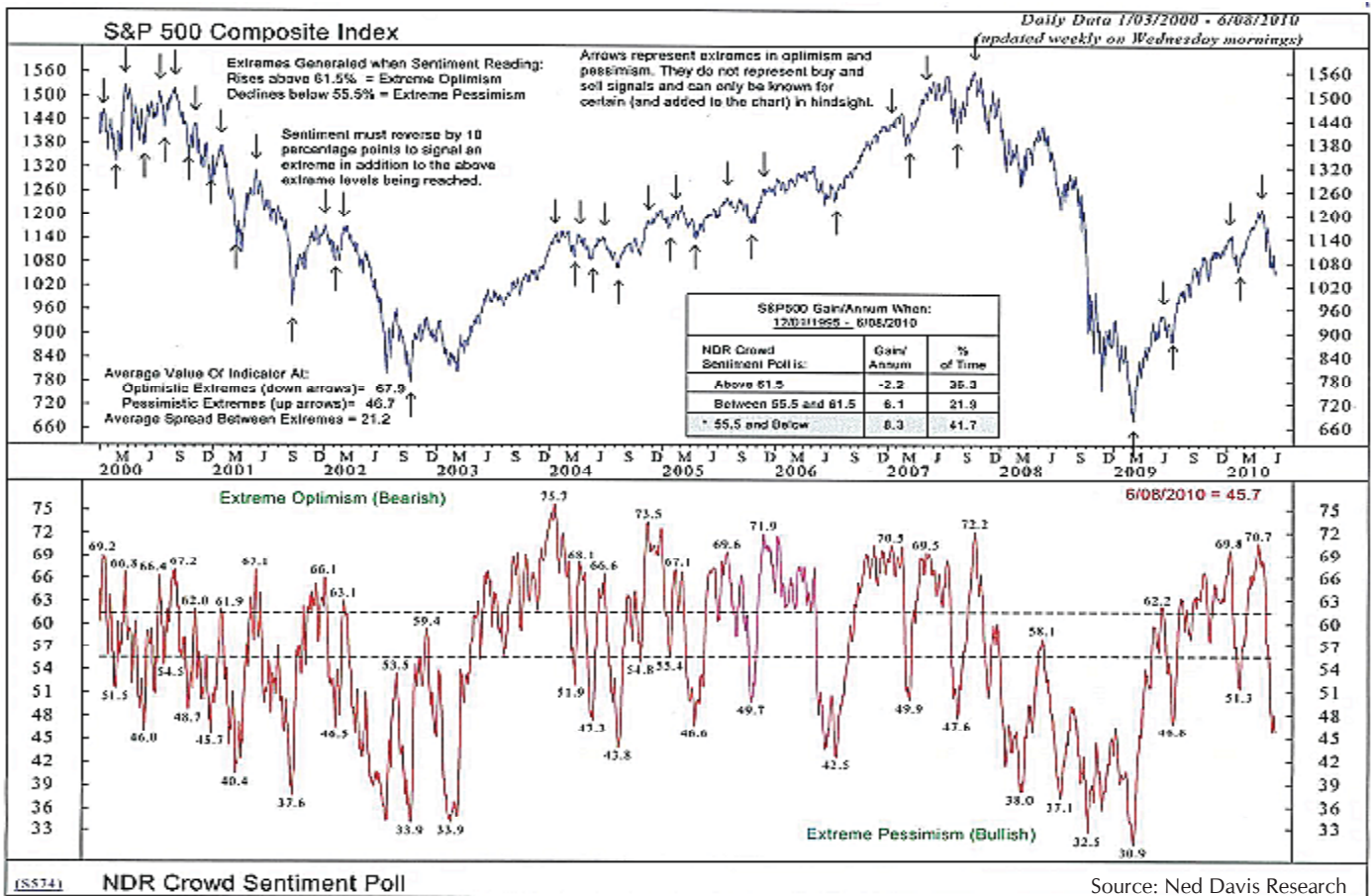


### JUNE, 2010 MARKET COMMENTARY

Recently the US equity market marked its first official correction (10%+) since the market recovery began in March 2009. A number of events came together to cause the recent downturn: in late April, short-term sentiment measures reached overly optimistic levels just as concerns about bank funding resurfaced; European debt concerns spread; China took further steps to moderate their economic growth; and new financial regulation was debated in the US Senate. This combination has created concerns that the recent recovery in global growth may be compromised, so investors have moved quickly to de-risk portfolios. Though the return of market volatility is not surprising in the current atmosphere of uncertainty, the conditions that typically lead to major market tops – excessive valuations, long periods of economic expansion, restrictive interest rates, and bullish investor and consumer sentiment – are not currently present. The following briefly outlines our thoughts on the markets within the context of the factors that we believe are important to financial markets; sentiment, valuation, credit markets, and leading indicators.

### Sentiment

Sentiment measures have become much more constructive in recent weeks as market volatility has returned. Our favorite measure from Ned Davis Research aggregates a large number of surveys into one measure shown below. While the measure certainly paints a better picture than it did one month ago (from a contrary perspective), we have to recognize it can deteriorate further before an extreme point is reached. Technical readings suggest the equity market is more oversold than at any time since the bottom in March 2009.



## Valuation

The trend in corporate earnings has been very supportive of equities. First quarter earnings came in above expectations on 12% year-over-year revenue growth against easy comparisons. Wall Street strategists are now estimating \$80 in earnings for this year and \$93 for next year, while the analysts that cover the companies in the S&P 500 are looking for a more optimistic \$82 and \$98. On the more conservative numbers, the S&P 500 trades at 13.6X this year's estimates and 11.7X next year's number, both well below normal levels, suggesting that investors are putting little credibility in these numbers. From a longer term perspective, the S&P 500 trades at about 15X trend-line earnings of \$73 compared to the 80 year average of 16.7X. In contrast, the market traded at 23X trend-line earnings as it topped out in 2007-08.

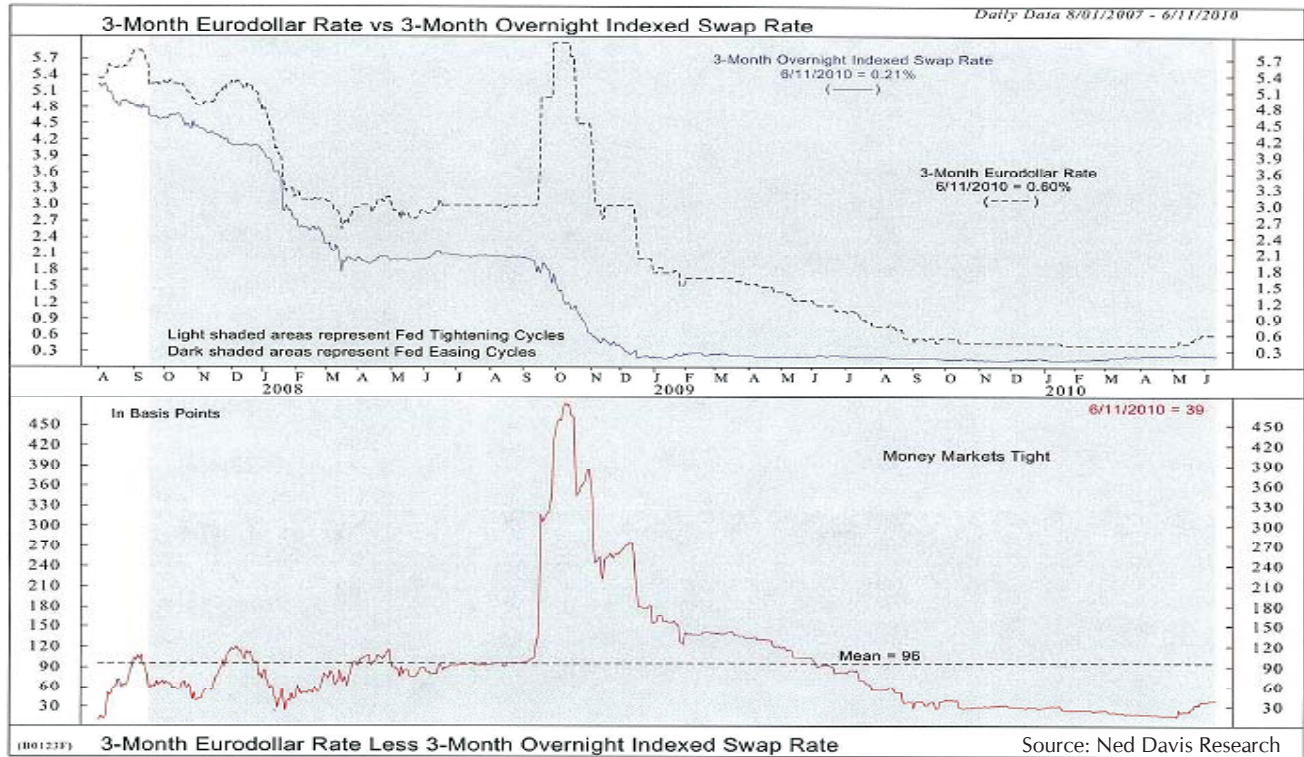
We continue to expect a trend of declining earnings estimates. Analysts' estimates approaching \$100 for next year on the S&P 500 seem optimistic to us in the moderate recovery scenario to which we subscribe. Currency translation will certainly have an impact, while the economic impact of recent events has yet to fully play out in earnings estimates. We are more comfortable thinking about \$85 as a likely point for 2011 earnings estimates as long as the global economy does not slow too sharply. Companies in the S&P 500 reported almost \$20 in earnings during the first quarter. Annualizing this \$20 number for 2010 implies 6% earnings growth next year. The S&P 500 currently trades at 12.5X this estimate of 2011 earnings compared to longer-term averages of closer to 15-16X. It appears the market is currently discounting something closer to \$70 in earnings. We will continue to monitor trends in earnings estimates closely as we move into reporting season for 2nd quarter earnings over the next month.

Markets in Europe currently trade at 10.5X 2010 estimates, representing a larger than normal 25% discount to the US. In contrast to the US, European markets should get support from the weaker currency as the decline in the euro adds to European earnings growth to help offset the impact of tightening fiscal policy. Emerging markets currently trade at 11X expected earnings.

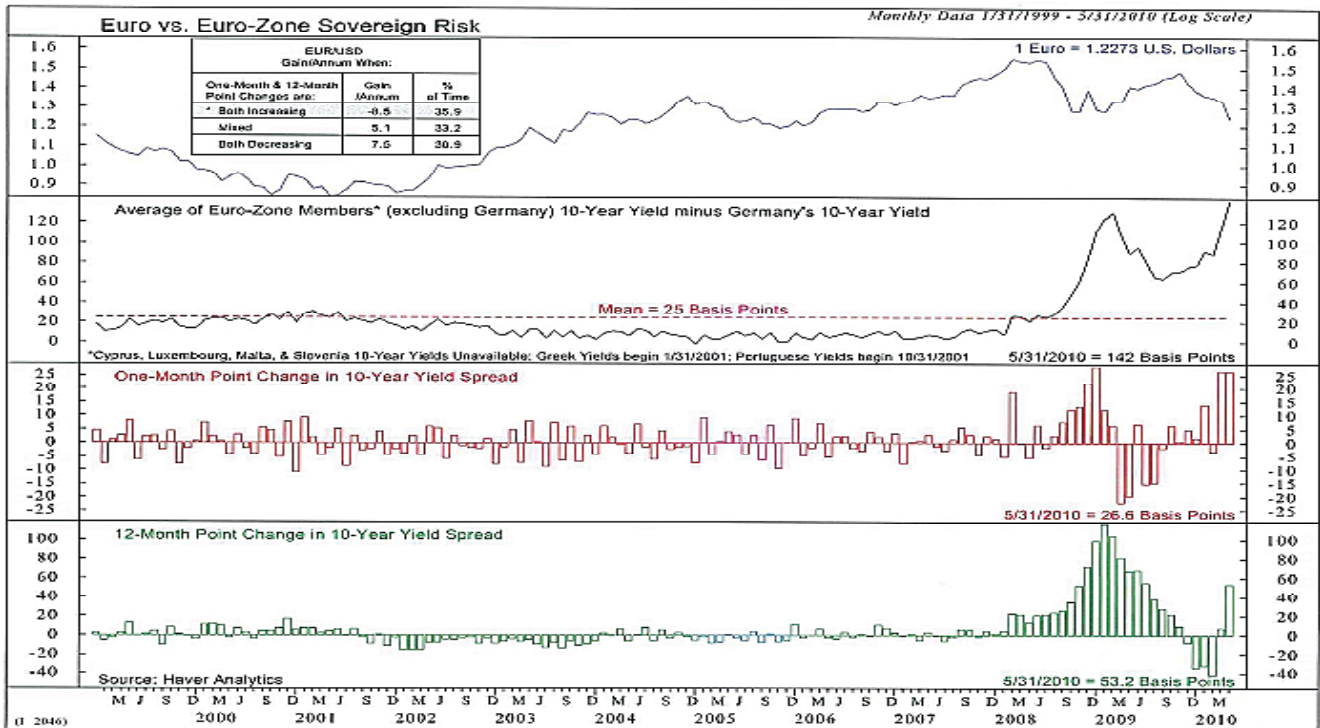
## Credit Markets

One of the primary offsets to the recent concerns about economic growth is that interest rates have come back down to their lowest levels this year, with the 10-year Treasury yielding 3.2%. While spreads on investment grade and high yield bonds have widened recently, borrowing rates remain at low levels for corporations with access to capital markets. The concerns about problems in Europe spreading globally will likely keep central banks from raising rates for an extended period of time. Even Chinese officials mentioned last week that their policy moves to tighten would be more gradual given the uncertainty created by the issues in Europe. Inflation fears have also moderated with these concerns, as well as with the significant drop in the prices of many commodities – oil is down about \$15 in the past month.

Measures of overnight lending rates and spreads have reappeared on traders' screens after falling out of focus as the financial contagion from 2007-09 moderated. These overnight bank lending rates are a good measure of the short term liquidity situation in funding markets for banks. These rates have moved up significantly off their recent lows but remain in check at this point.



Policy makers in Europe were slow to produce a proposal to deal with the situation in Greece, but were very quick to announce massive support for the peripheral countries. In so doing, they reaffirmed a global regime of low interest rates and liquidity abundance that will act as an offset to the fiscal retrenchment across the developed world. They created an almost \$1 trillion safety net for other peripheral countries at risk. The ECB will have to continue with bond purchases until stresses abate. One worrisome trend to monitor along with short-term funding rates and US credit spreads, will be spreads on bonds in peripheral European markets. These spreads are currently wider than they were after the announcement of bond purchases.

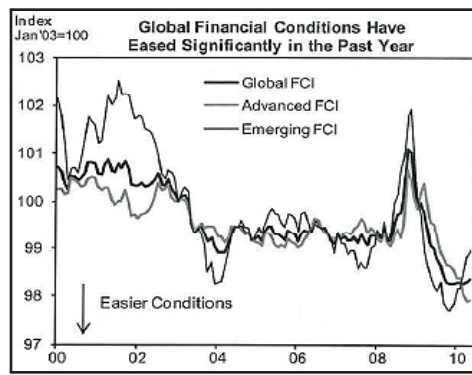


Source: Ned Davis Research

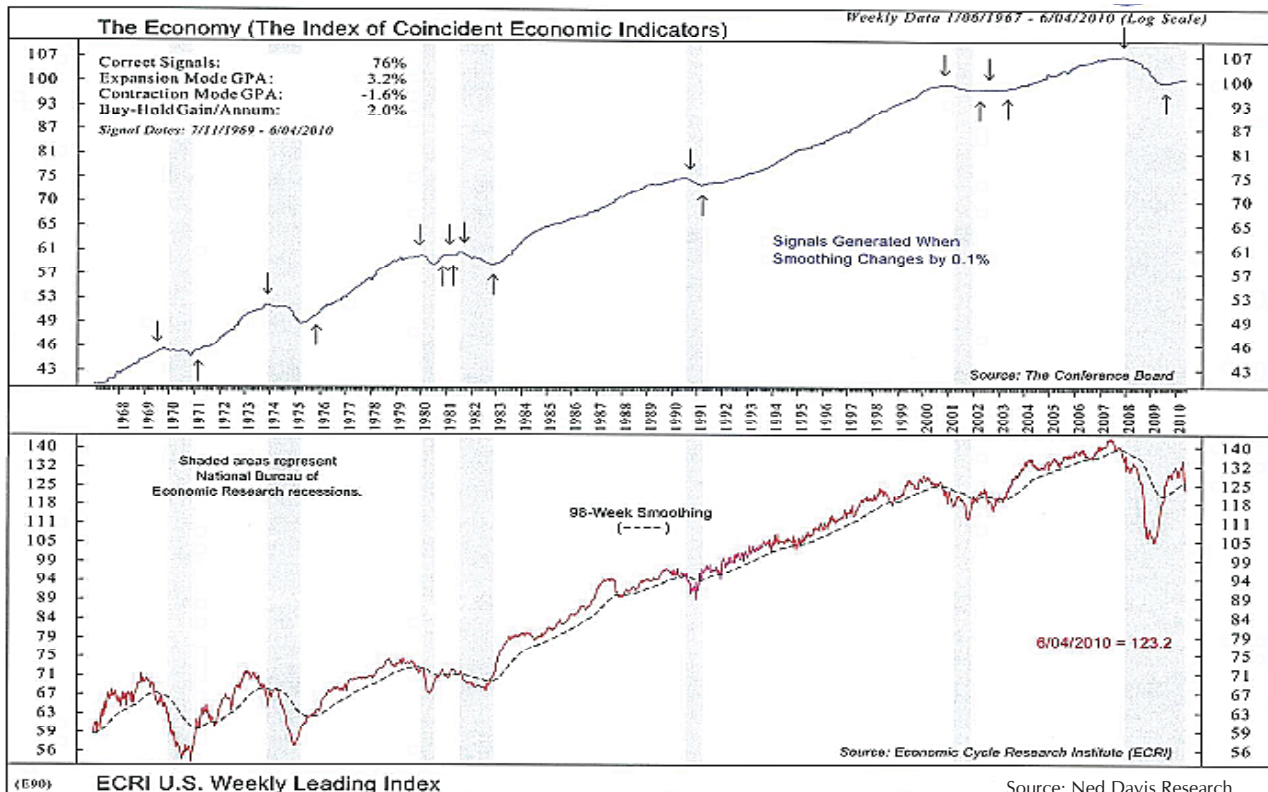
**Leading Indicators**

Recent economic reports from the US, Europe, and China have turned mixed after fairly consistently beating expectations over the past year. Over the past couple of weeks, reports on US unemployment and Leading Economic Indicators were below expectations, fueling concerns about a slowdown. At this point, we believe that signs still point to a modest global recovery. It is normal for leading indicators to begin peaking at this point in the cycle and that usually coincides with a bout of increased market volatility. We are faced with a number of issues that will lead to more muted growth than is typical after severe economic recessions. However, the only double-dip recession this early in an economic cycle in post-war US history occurred in 1981 when Paul Volker raised rates dramatically to combat inflation. The current steep yield curve suggests that the risk of this happening in the near future is modest without a major shock, such as a geopolitical event or Europe spinning out of control.

Several economic indicators we track closely continue to signal economic growth and fairly easy financial conditions. The Ned Davis Research Economic Model is describing the best economic environment since 2003. Goldman Sachs' measures of financial stress show very different conditions than existed in 2008. The Weekly Leading Index from Economic Cycle Research Institute shows growth that is likely to slow going forward but is not yet signaling anything more severe.



Source: GS Global/ECS Research



At the end of the day, the key question we and our clients face is if this current equity downdraft and widening of short-term credit spreads is the harbinger of either a further major drop in the financial markets (and a double-dip recession), or one of the many corrections we are bound to have for the foreseeable future in the face of a number of uncertainties. For several reasons, our current thinking is that the current market volatility more likely falls in the later camp. The economy is in the early-to-mid stages of a cyclical recovery as opposed to the end of a long period of economic expansion, as was the case in 2008. Second, US financial institutions are better capitalized and major central banks have a playbook to enhance liquidity if necessary. Third, while widening recently, spreads remain well below levels experienced in 2008. Fourth, unlike 2008, equity markets are less expensive today on an absolute basis than they have been historically.

*The views expressed in this paper are those of Lowe, Brockenbrough & Company, Inc. and are subject to change with market conditions. This is for informational purposes only and is not designed to provide individually tailored investment or tax advice. We encourage clients to consult with their tax advisors for retirement, estate or tax planning strategies.*

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