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July 2010 Market Recap

Presented by Investment Partners, LTD

Markets enjoy a strong month

Equity markets posted a significant turnaround in July, erasing all of June's losses. The S&P 500 Index returned 7.01 percent, though it is still slightly negative for the year, down 0.11 percent. The Dow Jones Industrial Average gained 7.23 percent for the month and moved into the black for the year, up 1.87 percent.

Markets have experienced back and forth trading for much of 2010, though July's rally was welcomed by investors. International markets had a strong month, with the MSCI EAFE Index returning 9.48 percent, as investors moved their focus beyond the government debt issues that have weighed heavily on European markets.

This year, markets have seemed to reflect one of two mindsets: embrace risk and drive equities higher or avoid risk and push equities lower. Recently, the focus has been on the former.

Interest rates remain historically low

Interest rates continued to hold at historic lows, indicating that markets saw little immediate concern for inflation; we believe that bond markets actually look to be more concerned with deflation in the near term. The 10-year bond yield, after dropping from a 4-percent level in April, held at historically lower levels, around 3 percent, for most of July. The 2-year yield has also dropped since April, ending July at a historic low of 0.55 percent. This has proven to be an accommodative environment for bond investors, and the Barclays Capital Aggregate Bond Index returned 1.07 percent for the month. Credit-sensitive bonds, including high-yield, showed gains for the month, and tax-sensitive investors in municipal bonds also saw positive returns.

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MARKET COMMENTARY (CONT.)



Source: Bloomberg

Recovery slows; where are the jobs?

It is fairly evident in recent economic data that the strength of the ongoing economy has diminished and that the recovery has slowed. Gross domestic product growth has been slowing for the past two quarters, posting an annualized rate of 2.40 percent for the second quarter. As the effects of the stimulus begin to wind down, the economy needs to see signs of organic growth in order for it to strengthen further.

Of concern during this recovery has been the absence of the consumer. At roughly 70 percent of the overall economy, consumer spending must increase to support future growth. But consumers appear to be saving more in lieu of spending, as seen by June's personal income savings rate of 6.40 percent. The consumer has also shown a lack of confidence in the economic outlook, as consumer confidence has declined for the past three months and was at 50.40 in July.

A catalyst for the weakening consumer has been the recent rollover in the housing market. The sharp month-over-month decline in pending home sales of 29.90 percent in May, and a further 2.60-percent decline in June, comes after the large drop in new homes sales after the home-buyer tax credit expired. A drop in pending home sales has typically foreshadowed a drop in existing home sales, and, given the magnitude of the decline in the former, the drop in the latter could be substantial if it holds true again. Though this decline could be short-lived, it creates a cycle that likely will have an adverse impact on consumers' outlook and thus their planned future expenditures.

One particularly challenging reality of this recovery has been the lack of job growth throughout most sectors of the economy. The unemployment rate has hovered at or above the 9.50-percent range for the year, and changes have been more a result of workers entering or leaving the workforce as opposed to a significant increase in hiring. Unfortunately, it doesn't seem likely that there will be much of a decline in the rate, given that initial jobless claims continue to be reported at or around 450,000 per week. Claims will likely have to fall below 400,000 in order to see the unemployment rate begin to drop.

MARKET COMMENTARY (CONT.)

Markets and the economy

It is interesting to see global equity markets rally in the face of deteriorating fundamentals in the economic outlook. No doubt we've seen strong company earnings, as three quarters of all companies reporting have beaten analyst estimates. This optimism has likely fueled the recent stock rally, as investors ignored risk for the time being. Many think the rally could persist, if markets continue to ignore risk and technical indicators continue to support higher equity prices. Moves higher could also create buying pressures, as those who short the market may liquidate, helping to drive near-term price action. But at some point we believe that markets must reflect the fact that slowing economic activity will begin to impact companies, particularly in the absence of a strong consumer.

In short, investors should pay close attention to risk. Recent history has shown that markets can move sharply lower in the face of a deteriorating economy. There are many variables that can impact potential outcomes, including future government policy, tax policy, and the resiliency of the private sector. Given that the recovery is still chugging along, albeit rather slowly, it is likely early to sound the alarm bells. Nevertheless, as mentioned in previous outlooks, it is wise to keep a steady focus on risk, so you are positioned appropriately for what may be an uncertain future.

***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 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 MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. 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 nondiversified portfolio. Diversification does not ensure against market risk.*

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