First Trust
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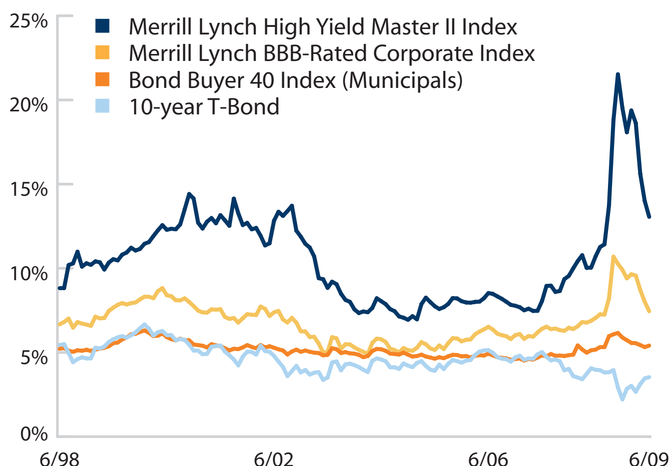
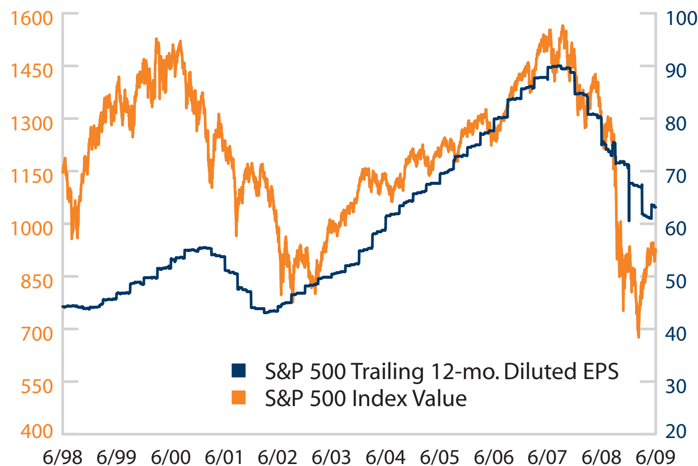
Mr. Carey has appeared throughout the United States and Canada as a guest on television and radio programs. These programs include: Bloomberg TV, CNBC and Canada's Business News Network and on Chicago's WBBM Newsradio 780's Noon Business Hour. He has been quoted by several publications, including *The Wall Street Journal, The Wall Street Reporter, Bloomberg News Service, and Registered Rep.*

Narrowing credit spreads lowers the cost of capital for companies



Source: Bloomberg



Source: Bloomberg

Credit spreads have come in

The Federal Reserve garners a lot of media attention and rightfully so. While most people are aware that the Fed moved aggressively to lower the federal funds target rate to 0-0.25% to counter the financial crisis on Wall Street, the vast majority are probably unaware of what transpired in the credit markets.

As the financial crisis deepened in the second half of 2008, the availability of capital, either by way of lending institutions or the capital markets, was becoming ever more scarce. In order to secure it, companies were forced to pay more for it. As you can clearly see in the chart above, the yields on high yield corporate bonds, which are inherently more risky than higher-grade corporate bonds (yellow line), skyrocketed above the 20% level. By some estimates, it was as if the market was pricing in the possibility that three out of 10 companies would not be able to cover their obligations. Historically, the default rate on high yield debt has not exceeded 13% during recessionary periods.

When corporations pay up for capital it cuts into earnings and depresses stock valuations. This crisis began in July 2007. Since then, the S&P 500 declined for six consecutive quarters until Q2'09 (S&P 500 bottomed on 3/9). The 9th also marked the bottom for high yield debt (yielding 20.73%). The best news is that Moody's has lowered its default forecast for U.S. speculative-grade debt (high yield) from a peak of 14.5% by 12/09 to 12.9%. The rate stood at 11.0% in June.

Stock prices have recovered ahead of earnings

The combination of contracting credit spreads and an anticipated fourth quarter recovery in GDP could drive corporate earnings higher. Even rising unemployment has a silver lining in that such cost-cutting removes some of the drag on earnings, at least in the near-term.

Corporate bond issuance totaled $753 billion in the first five months of 2009, up 53.9% over the same period a year ago, according to Thomson Reuters. That is a signal that the credit crunch has abated.

The Q2'09 edition of the *Investment Manager Outlook* (released June 24), a survey of investment managers conducted by Russell Investment Group, says that money managers are most bullish on Emerging Market Equities (74%), High Yield Bonds (66%) and Corporate Bonds (66%). With respect to U.S. equities, managers are most bullish on U.S. Small-Cap Growth (57%), U.S. Large-Cap Growth (54%) and U.S. Small-Cap Value (54%). This survey not only reveals an appetite for risk here in the U.S., but also abroad. While the U.S. has traditionally been viewed as a global growth engine, it is time, in our opinion, to add the emerging markets to the ranks.

While the Q2'09 earnings growth estimate for the S&P 500 is -34%, according to data from S&P and Bloomberg, it is an improvement over the 60% decline in earnings in Q1'09. With a big chunk of the $787 billion stimulus package not due to kick in until 2010, those investors still a bit apprehensive may want to gradually increase their exposure to equities over the last half of 2009.

Continued

A little humor to help take the edge off

"Doctor, every morning when I get up and look in the mirror I feel like throwing up. What's wrong with me? He said, 'I don't know, but your eyesight is perfect.'" (Rodney Dangerfield)

Sometimes reality hurts. Investors have witnessed their 401(k) accounts slashed to "201(k)" accounts twice this decade. And that stings. The only thing worse than enduring a bear market is missing out on the recovery.

"I remember the time I was kidnapped and they sent back a piece of my finger to my father. He said he wanted more proof." (Rodney Dangerfield)

The S&P 500 posted a total return of 36.9% from its low on March 9 through June 30. Since World War II, stocks have recouped roughly one-third of their bear market losses in the first 40 days after the market hits bottom, according to Sam Stovall, chief investment strategist at Standard & Poor's Equity Research. The S&P 500 was up 34.0% over the first 40 trading days (3/9-5/5). How much more proof does one need? If we are truly in the next bull market, and if Stovall's stat is accurate, we are on pace for a gain of around 100% in the S&P 500. That is the approximate gain posted in the previous bull market from 10/9/02-10/9/07.

"A doctor gave a man six months to live. The man couldn't pay his bill, so he gave him another six months." (Henny Youngman)

The Obama Administration is pushing Congress hard to finish a first draft of the health care reform bill before members leave for their August break. Rumor has it the Administration does not want health care reform to spill over to the next election cycle in 2010. The cost estimate for insuring an additional 47 million people is around $1 trillion over a 10-year period. Congress has to find a way to pay for it.

"I know a guy who called up the Home Shopping Network. They said 'Can I help you?' and he said 'No, I'm just looking.'" (George Miller)

Consumers did a little more than just look in the first half of 2009. While retail sales fell at nearly a 20% annual rate in the last six months of 2008, sales were up at a 3.4% rate through the first half of this year. Next up is the back-to-school shopping season.

"I have enough money to last me the rest of my life, unless I buy something." (Jackie Mason)

The U.S. household saving rate rose to 6.9% in May, the highest since 1993, according to the Bureau of Economic Analysis. The rate was zero in April 2008. Bank deposits grew by 1.7% in May, the ninth-biggest gain since 1973. Rising unemployment is likely a contributing factor to the surge in savings. If the economy begins to recover in Q4, as forecasted, we would expect the saving rate to moderate.

"I love to go to Washington, if only to be nearer my money." (Bob Hope)

The U.S. budget deficit hit a record $1.08 trillion in June, according to the Treasury Department. The Obama Administration has projected a $1.84 trillion deficit by the end of the fiscal year in September. It is forecasting a $1.26 trillion deficit for the next fiscal year. The Bush Administration's tax cuts are set to expire at the end of 2010. With deficits this large additional tax increases are inevitable. For those with the means, there is still plenty of value in the municipal bond market.

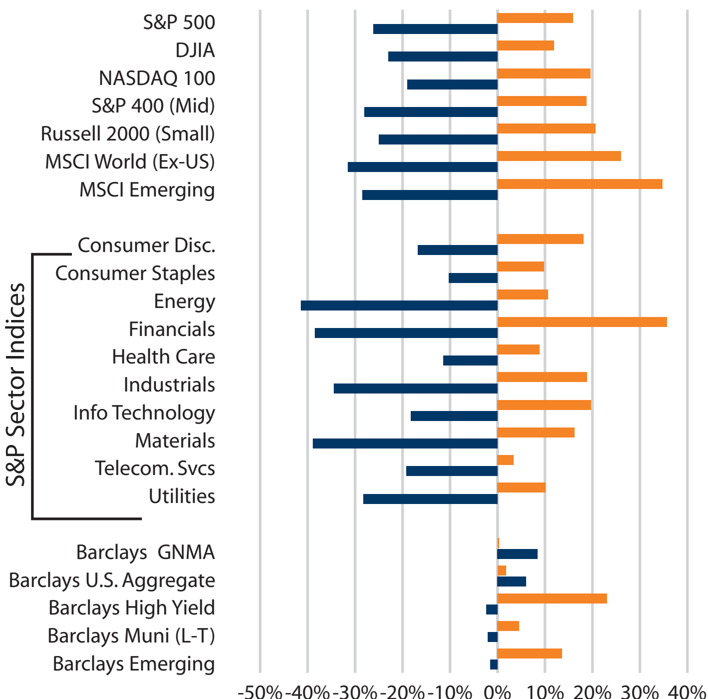
"I saw a sign at a gas station. It said 'help wanted'. There was another sign below it that said 'self service'. So I hired myself. Then I made myself the boss. I gave myself a raise. I paid myself. Then I quit." (Steven Wright)

Unemployment hit 9.5% in June, the highest level in 26 years, according to the Labor Department. Economists acknowledge it will likely move above 10% and remain high even after economic growth turns positive. Remember, unemployment is considered a lagging indicator, while the stock market is forward-looking 6-9 months.

"Once when I was lost I saw a policeman and asked him to help me find my parents. I said to him, 'Do you think we'll ever find them?' He said, 'I don't know kid. There are so many places they can hide.'" (Rodney Dangerfield)

Taxable Money Market funds yield only 0.12%, on average, according to iMoneyNet.com. Jeremy Siegel, market historian and finance professor at the University of Pennsylvania's Wharton School, is forecasting an annualized return of 8.0% (after inflation) for the S&P 500 over the next ten years, according to *Kiplinger*. He sees it up 10-12% in 2009.

Total returns for Q2 and past 12 months (6/30/09)



A Look Ahead:

The outlook for earnings (year-over-year comparison in $)...

	Q3'09E	Q3'08	**Q4'09E**	Q4'08	**2009E**	2008
Financials	**2.15**	-1.66	**2.40**	-2.96	**7.42**	-2.18
Information Technology	**4.00**	5.07	**5.08**	4.40	**16.18**	19.12
Health Care	**6.67**	6.76	**6.75**	6.78	**26.76**	26.91
Consumer Staples	**4.53**	4.62	**4.63**	4.36	**17.99**	17.36
Consumer Discretionary	**2.44**	1.44	**2.96**	0.30	**8.73**	6.02
Industrials	**3.42**	5.40	**3.69**	4.72	**13.84**	20.89
Telecom. Services	**1.97**	2.41	**1.93**	2.29	**7.91**	9.92
Energy	**6.40**	16.84	**6.76**	9.35	**22.77**	54.02
Utilities	**3.81**	3.86	**2.45**	2.58	**12.05**	12.51
Materials	**1.11**	3.86	**1.47**	1.22	**4.81**	14.35
S&P 500 Index	**17.27**	18.09	**19.05**	12.42	**57.96**	68.64
S&P 400 Index (Mid-Cap)	**9.18**	12.42	**9.84**	9.26	**35.12**	45.17
S&P 600 Index (Small-Cap)	**3.63**	4.54	**4.00**	3.36	**12.87**	17.42

Source: Thomson First Call/Baseline (7/13/09)