

May 2010

## Portfolio Commentary

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Our stormy outlook for May turned out to be what seemed like something closer to hurricane season. The tumultuous month began with continued concern of Greece contagion spreading to other European countries and an intra-day stock market plunge of nearly 1000 points. While the precipitous drop was initially rumored to be the result of a "fat fingered" trade, regulators are now citing heavy selling of E-mini S&P futures contracts which caused a chain reaction of electronic trades and market orders pushing the market lower and lower. The stock market recovered the majority of the intra-day downturn, closing the day down 347 points, but the Dow Jones still ended the month down 7.92%, posting the worst May since 1940. Flight to quality, a shift away from risk assets into Treasuries, resulted in lower Treasury yields across the curve. The one-year T-bill ended the month yielding .31% and the two-year note ended the month yielding .76%, 20bps lower for May. Libor continued its trend higher, demonstrating the stress on European banks and their unwillingness to lend to each other. 3-month Libor rose 19bps to .536 on May 28th, the highest level in the past 11 months.

The \$145 billion bailout of Greece, designed to restore confidence, provide timely aid, and help ensure stability in European markets did little to calm investors fears as Greeks took to the streets protesting tax increases and wage cuts. The market's concern the bailout may not be sufficient was quickly apparent as concern mounted that Spain and Portugal were the "next shoe to drop" and the euro was in a free fall as talks swirled around whether the currency would even survive. The European Union proceeded to announce a nearly \$1 trillion rescue package in efforts to stave off the sovereign debt crisis threatening the stability of financial markets world-wide. In addition, the European Central Bank (ECB) said they would buy euro-zone government bonds to "ensure depth and liquidity" in attempts to counter the sovereign debt crisis and defend their common currency. The U.S. Federal Reserve reopened swap lines with other central banks to make sure they had ample access to dollars. The initial euphoria over these announcements was short lived as economists warned the rescue plan doesn't address the region's underlying economic weakness and saddles the euro zone with massive debt. The ongoing Euro saga will not be resolved anytime soon and only time will tell if these countries will implement tough spending cuts and debt reduction.

Trepidation surrounding the Euro upheaval and its impact on the U.S. recovery overshadowed any positive economic data in the U.S. The ISM manufacturing survey highlighted strength in manufacturing rising to 60.4 (greater than 50 signals expansion), the 9th consecutive month of growth. Construction spending, consumer spending, and pending home sales were all encouraging, beating expectations. Retail sales rose for the 7th straight month and consumer confidence rose to 73.7% in May. However, data released later in the month helped spur concerns about the U.S. recovery. The Empire Manufacturing survey dropped to 19.11 from 31.86, the Chicago PMI fell to 59.7, and jobless claims remained elevated. Bottom line, the economy is still fragile and risks due to the Euro uncertainty will most likely keep the Fed on hold longer than originally anticipated.

Horizon has seen two repercussions of the Euro zone turmoil which should be positive for client portfolios. One repercussion is wider credit spreads and commercial paper levels. The second is elevated Libor rates, providing some much needed extra yield to short term investors. We have been able to take advantage of higher commercial paper levels and continue to monitor Libor-based products such as floating rate agency and corporate bonds.

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