Wall Street's Late Summer Blues

Beyondbond

As of August 25, 2006

A wrap of the earning season, shaky housing data, and a lower-than-expected durable goods report sent the markets into a gloomy and languid lull. With many traders and money managers still on summer vacations, only around 1 billion shares changed hands on the New York Stock Exchange and 1.3 billion shares were traded on the Nasdaq. Compared with last week's rally, the Dow gave back 0.85%, the S&P 500 dropped 0.55%, and the Nasdaq fell 1.09%. Oil prices ended higher at $72.51 a barrel after the forecast of a possible tropical storm heading toward the Gulf of Mexico. Moreover, the 10-year Treasury note gained 3/32 in price and yielded 4.79%.

Earlier this week, the National Association of Realtors released the biggest slump in two years in July existing home sales while the inventory of houses on the market spiked to a whopping 40% increase from a year ago. The same thing happened to new single-family home sales which fell 4.3% in July (a 22% drop from a year earlier). These big drops on housing data might give people an illusion that the market has hit the bottom line. However, historically, the housing market usually has a much longer business cycle than the others. This slowdown wave on the housing market is probably only in the third inning. On a bit brighter side, Commercial and multi-family REITs might be a silver lining through this cloudy U.S. housing market.

Contrary to the dull view that lies ahead of the U.S. housing market, International housing markets, which combine Asia and Europe, provide a more promising picture for the investors for the next two years. Annual market cap of the real estate companies in Asia is $350 billion and in Europe, it is $200 billion. International housing markets have not only a bigger total market cap than U.S. housing market ($400 billion) but also 1-2-year slower business cycles. Take as an example, the housing market in China, which is unlikely to slowdown before the 2008 Olympic games. Nevertheless, a recession in the markets has always been observed from many hosting countries after the Olympics. Investors should carefully weigh this concern.

By sector, financial, especially brokerage ($XBD) has the most significant decline. We may start to see more substantial decreases in earnings from the top-tier brokerage firms. It is mainly due to the low M&A activities and the slowdown in private equity.

On the fund side, large cap index (S&P 500) with a yield of 1.70% outperformed small cap index (Russell 2000), which has a yield of 0.6%. Looking at the Hedge

Eric Chen, Ph. D.
610.565.6891
echen@beyondbond.com

Chiung Chiu
Financial Analyst
646.313.3331
cchiu@beyondbond.com

Fund Benchmarks, many of them have been signaling a market without directions. Yield-to-date performance of Dow Jones Hedge Fund Equity Long/Short for this quarter is only 1.3%.

Although there were lack of market makers and excitement in the markets this week, the coming economic data such as Consumer Confidence Index, Gross Domestic Product, and Unemployment rate should be able to wake the markets up and cause big swings. When there are opportunities to take profits, investors need to get out and/or sell short before this summer ends.