

## What's Up with These Volatile Markets?

We know that the recent market volatility may be unsettling, but the fundamental path of recovery has not changed. In fact, this volatility may provide opportunities.

There's always *something* for markets to worry about. At the moment, the list of worries is longer than usual and has resulted in a significant "correction" in many global equity markets. Markets are contending with issues that could hinder profit prospects, like the sovereign credit crisis in Europe, increased global tensions (Korea, the Middle East), a horrific oil spill in the Gulf, a reduction in policy stimulus in many parts of the world, the likelihood of higher taxes in the years ahead, and a high level of regulatory action in a number of industries (financial services, healthcare, energy etc.). Sometimes the markets can "climb a wall of worry" and sometimes they can't. Right now, they can't.

We knew that *this* recovery was never going to be easy. It takes longer to bounce back from "credit" recessions" like the one we just experienced. We also expected that some of the demand that was created in the "recovery" of 2009 was caused by fiscal stimulus rather than "organic" growth; that demand is now beginning to fade.

Here's a summary of our market outlook: After a dismal 2008 and early 2009, the market bottomed out in early March 2009. From that point through the end of April 2010, the S&P 500 Index rose an impressive 83%. Since then we've experienced a correction of about 14%. Despite the rally, the S&P 500 remains about 30% below the high-water mark it reached in October 2007. The Dow's high of 14,000+ was also reached in October of 2007, but it closed at about 9930 on June 8, 2010.

Our investment committee believes that this elevated volatility could persist for several more months. It is now too late to sell but too early to buy. Despite the headwinds, however, we do not think that we have entered another bear market. We are watching the markets with an eye to taking advantage of opportunities that will present themselves.

In terms of our market positioning, as many of you know, we have been cautious with our asset allocations in most client accounts – especially recently. Our equity weights are below long-term targets, and our fixed-income allocations are relatively conservative. Because we expected equities of domestic companies to perform better than equities of companies outside the US, we have been holding a higher percentage of US equities than normal. This has reduced our exposure to currency fluctuations as well as the poorer performance of the euro zone economies. As a result, we are well positioned to take on a bit more risk if the markets decrease further and the volatility stabilizes a bit. We are constantly reevaluating economic and market conditions, but at this point we think it likely that we will be increasing equity exposure.

Our basic outlook remains the same. While we think that the euro debt crisis and other issues warrant caution, we don't expect the world to dip in to another recession in the near term. And even if the world muddles along with slow-to-modest growth, equities seem reasonably

attractive at current or slightly lower valuations. Therefore; it makes sense to watch for the right time to take our equity allocations back toward their long-term targets.

We think the serious problems in the European economies are unlikely to be solved anytime soon. In fact, we think that the euro is unlikely to survive the decade in its current form. Since last fall, we have been avoiding European bonds and have been limited exposure to European equities. But while the euro may be reshaped someday, Europe is here to stay. We are monitoring the euro and European equities, watching for attractive prices for funds of high-quality European companies such as Daimler, Nestle, Unilever, Roche, and Novartis.

Please feel free to reach out to your advisors whenever you have concerns about the market.

**IMPORTANT NOTES:**

This commentary represents the opinion of Contango's Investment Committee as of June 8, 2010, and is subject to change with market conditions. This is not intended to be construed as advice pertaining to an individual portfolio. Please consult with your advisor regarding your particular circumstances prior to making any investment decisions.

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