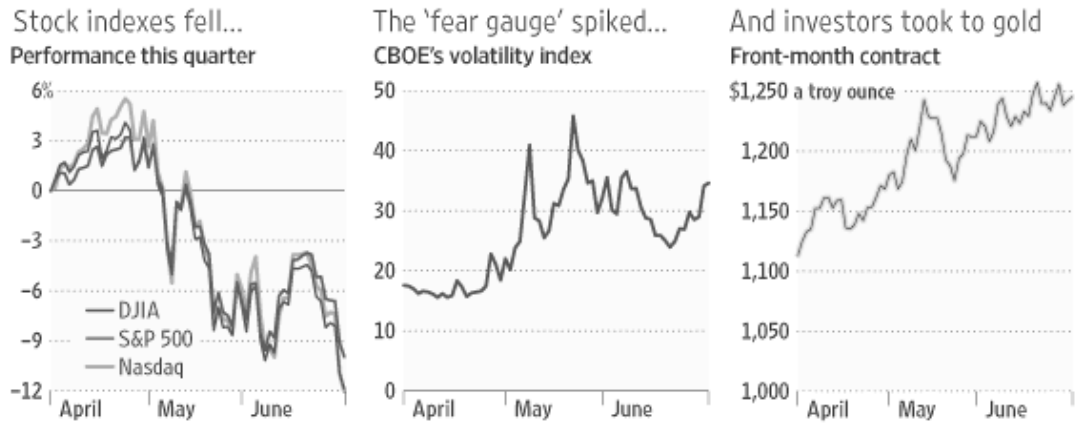
July 1, 2010

The Wall Street Roller Coaster

Here we are, exactly half way through the year, and if you happen to keep an eye on the market, as we do, believe me, it has been quite a ride. The powerful bull that began its run in March 2009 seems to have lost momentum. Last quarter, the Dow lost 10%, S&P 500 and NASDAQ each skid 12%. Since logging the April peaks, the Dow is off 13%, S&P 500 more than 15%, and NASDAQ almost 17%. In recent weeks, the market often failed to hold ground in the final trading hour. Benchmark indexes have persistently closed below their 200-day moving averages on lackluster trading volume. We have also seen the price of gold march to new record highs and market volatility return to the forefront of investors' minds.



Welcome aboard the Wall Street roller coaster! The ride started domestically with the "flash crash" on May 6th which proved more than enough to spook investors' confidence about the health of the market (see the first spike in the CBOE's volatility index above). Since then, the market has had difficulty finding its footing

Overseas markets—both developed and emerging—have decided to hop on the roller coaster ride as well. The PIIGS's debt crisis is indeed contagious. Protests in Greece over austerity measures, for instance, turned deadly, literally. The EU, with reluctance from the stronger members, finally put forward a rescue package worth €750 billion (US $955 billion).

BP, which has seen its stock price plummet to a 14-year low, has yet to effectively contain and capture the oil gushing into the Gulf of Mexico. The biggest manmade environmental disaster in U.S. history not only has devastated the wildlife and its habitat, tourism, and the fishing industry, but possibly the jobs of some top executives. Estimated overall costs to BP could top $20 billion. Whether BP will need extra capital, after axing its dividends, is still questionable.

In China, now the third largest economy in the world, a collapse is possibly brewing in the red-hot real estate market. In the last quarter, the Shanghai Composite Index lost 25% and has corrected over 30% since its peak set in last August. A bigger plunge may still lie ahead. Dong Tao, chief economist for Credit Suisse non-Japan Asia, said in May that "China's economy may head toward a double dip when the property market makes a sharp correction, while the European crisis leads to a drop in export orders."

Both events are very ominous, and reports show that most of China's first quarter GDP growth was a direct result of the government stimulus spending. Once the adrenaline/morphine of government stimulus stops flowing into China's economic blood vessels, what will happen?

Given the situation, both at home and overseas, the market volatility will probably stay with us well into the fall. Like a roller coaster ride, the train always ascends slowly and gently, levels off at the top, and then plunges toward the ground. There may be another short-term rally (the gradual climb), which will provide a good opportunity to take some gains in preparation for the ultimate thrill ride. So sit tight and buckle up!

Henry Yu