

After modest returns during the first quarter, equities markets sprung back to life during the second quarter. The large cap oriented S&P 500 returned 6.28% during the quarter, leading the S&P MidCap 400 which returned 5.84% and the S&P SmallCap 600 which returned 5.18%. During the quarter, growth oriented stocks narrowly outperformed value with the S&P 500/Citigroup Growth Index returning 6.63% versus the S&P 500/Citigroup Value Index return of 5.95%. Medium and small cap style indices also saw growth outpace value during this time frame. Within the S&P 500 sectors, Energy lead the way with an astounding 14.32% return during the second quarter, followed by a 10.18% return in Technology stocks. The worst performing sectors were Utilities and Consumer Staples with returns of -1.11% and 2.11% respectively.

The government's latest release concerning economic growth, showed that GDP during the first quarter advanced slightly more than the preliminary estimates. The final estimate showed growth of 0.7%. This is a marked slowdown both on a quarter-to-quarter basis as well as a year-over-year basis. Estimates for the second quarter suggest possible gains in the 3% range and similar for the remainder of the year.

The employment market continues to add jobs with official total of 427 thousand net jobs added during the first quarter and an estimated total of 444 thousand added during the second quarter, with the resulting unemployment rate remaining at 4.5%. Despite this fairly healthy employment market growth, productivity growth has been slow of late (only 1% during the first quarter) which suggests that there may be potential inflationary pressures to deal with. It's now been over a year since the Federal Reserve Open Market Committee last raised the target Federal Funds rate (currently at 5.25%) and current inflationary readings are fairly low, at least if food and energy prices are excluded.

Volatility was notable in both the equity and bond markets during the last quarter. In our last letter to you we noted that 10 year Treasury bonds were yielding about 4.5% which wasn't too compelling compared to the estimated returns on stocks going forward. Since that time, the yield on the 10 year rose above 5% (a fairly significant move) due to a drop in the market price of these issues. Of course, this more attractive yield provides more competition for stocks and helped to increase the volatility of those markets. In fact, as a proxy for the equities markets, the S&P 500 had 10 days in which the value of the index changed more than 1% in a single day.

Adding to the stock market volatility was the fact that the last quarter saw rapid action in the mergers and acquisitions arena, especially by private equity firms. Private equity firms refer to privately held firms that manage pools of capital for investors. These firms can invest in both publicly and privately held businesses. During the last quarter there were a number of deals that closed, including the IPO of private equity firm The Blackstone Group and since the end of the quarter we have also heard news of the proposed IPO of KKR, also known as Kohlberg, Kravis, Roberts and Co. The fact that rates on longer maturity bonds have increased suggests that the cost for financing the purchase of a business by private equity may be increasing. This has likely hastened the rate of these buyouts and we are likely to see continued action in this area.

The jury is still out as to how well second quarter corporate earnings growth will be. First quarter growth was 8.3% which was the lowest growth in 5 years. Currently analyst estimates suggest that second quarter growth may be only around 3.8%. Some of our research providers think that this is likely too low an estimate while others think it may be reasonable for large companies but is still too high for small and medium sized companies.

Thankfully we only take cues from generalized data such as this and potential investments are reviewed with a range of possible economic outcomes in mind. We will continue to review the markets for what we think are attractively priced investments with good growth prospects.

I've been able to contact most of you during the last quarter to discuss your investment objectives. For those of you who haven't provided us with an email address, please send me an email at [bhutchens@hutchco.net](mailto:bhutchens@hutchco.net) so that we may better communicate with you.

On the personnel front, Michael O'Neil has left the firm and we have hired two other professionals, David Minor and Kevin Walsh. David's responsibility will be research and Kevin's will be marketing and client service. David has a Masters in Economics from Fairleigh Dickinson University. David is President of Innovation Capital Research and co-founded Gilder Technology Group. Kevin Walsh is a graduate of Bowdoin College and has been an institutional marketing and client service professional since 1990. Both David and Kevin are long time associates of ours and we hope you will have the opportunity to meet them in the near future.

As always, we appreciate your business and the continued trust that you place in us.

Sincerely,