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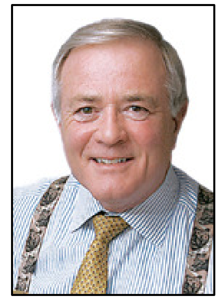

William Rutherford

June swoon? Is sell in May and go away still applicable?

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May was a bad month for stocks. The S&P dropped 1.4 percent for its worst loss in nine months. Since World War II, June has been flat as often as it has been up, making it the third worst month of the year.

So, should investors sell and go away? Should they find better returns somewhere else? Can they find better returns somewhere else? What about risk? These are all questions investors should be asking themselves.

Why is the market behaving so badly? Or is it? Through June 3, the S&P was up 3.4 percent year to date, and up 22 percent on a trailing 12 months. To be sure, the market was up more in the first quarter of this year based on year-to-date numbers, but gave back some of its gain in the second quarter. The market did the same thing last year.

Earnings season is over, so people tend to worry about the next season. Besides, after such a run-up, it is not unusual to have a pullback.

Data revealed weakness for the first quarter this year, as it did last year. Weakness reappeared relating to jobs, construction and manufacturing. Commodity prices were elevated. Higher prices for gasoline and groceries have slowed consumer spending, and confidence. Private-sector job growth was weak, and state and local governments now have slashed about 850,000 jobs so far this year.

In addition, the market has had to absorb uprisings in the Middle East and the impact on oil prices. Then there is concern over sovereign debt in Europe, our own debt crisis and the earthquake and tsunami in Japan with its resultant effect on our supply chain.

More concerns include the end of Quantitative Easing II and the worry about what happens when the Fed stops supporting the markets. Add weak retail sales and one has a toxic cocktail for the markets.

What is to be done? On a macro level, governments must wrestle their financial problems to the ground. In Europe that is sovereign debt. The PIIGS (Portugal, Italy, Ireland, Greece and Spain) all have existing or incipient debt issues.

Greece debt is the most pressing and needs to be resolved soon. It needs restructuring – a euphemism for default. This will shake the markets, but mostly Greece's creditors, who happen to be European banks. Another bailout may be on the way, but tough decisions would only be deferred.

Spain may not be far behind. But then neither is the U.S. Congress seems paralyzed to carry out any meaningful progress on our own debt. Posturing and brinkmanship are the order of the day.

As Gretchen Morgenson reported in the New York Times, regarding a new paper written for the Peterson Institute for International Economics by Joseph Gagnon and Marc Hinterschweiger, "that government debt will grow to dangerous and unsustainable levels in most advanced and many emerging economies over the next 25 years – if there are not changes in current tax rates or government benefit programs in retirement and health care – is virtually beyond dispute."

They went to further state that while government debt problems have occurred in the past, never have so many governments had debt problems simultaneously. Clearly, our men and women in Washington need to face up to their responsibilities.

Other than deficit resolution, what is to be done at the macro level? If the government were to allow U.S. companies to repatriate their cash from overseas, companies would have nearly a trillion dollars to put to work in the U.S. or distribute to shareholders. Microsoft adds nearly $100 million each day to its overseas cash hoard.

Fewer and more stable regulations would help businesses, particularly small ones. Who will invest when the rules can and do change? When Boeing was penalized for moving a plant, an arbitrary government action harmed business.

Housing, as I have often written, needs to be revitalized. That leads back to the banks and the government. The housing industry must be reconstituted, and that does not require bailouts so much as a better process for home financing.

Banks have started to loan in the commercial sector; now they need to do the same in the housing sector. Because banks won't loan in the housing market, more homes are at risk, which puts banks' balance sheets at risk and causes the government to say the banks need more capital before they can loan. And around and around the music goes.

At the investor level, one should have patience and a diversified portfolio – one that can capture growth when it resumes, is defensive in this soft patch, makes an allowance for inflation and captures some income from dividends. It is a complicated formula, but the best one for an investor in these markets.

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