

# Investment Commentary

NOVEMBER 23, 2009

Stocks were mixed last week, with markets reaching new highs for the year early in the week before suffering a setback. By week's end, the Dow Jones Industrial Average had inched up 0.5% to 10,318, but the S&P 500 Index and Nasdaq Composite were both down, falling 0.2% to 1,091 and 1.0% to 2,146, respectively.

One of the highlights last week was data showing a decline in unemployment claims. While the unemployment rate has continued to climb, the pace of job losses has been moderating and we believe the unemployment rate will start falling in the first quarter of 2010, which should help business and consumer confidence. An additional factor that should help drive the recovery would be a rebound in capital spending. Since the recession began, much of the focus has been on consumer spending levels, but capital spending has also suffered a significant downturn. At present, we believe conditions are in place for a rebound on that front. Credit markets remain troubled, but have been improving, corporate profits have been advancing and productivity measures have recovered. Additionally, we expect that when the employment backdrop stabilizes, consumer demand will pick up, which should help businesses spend more. Together, improving employment and capital spending levels should act as tailwinds for the broader economy.

On a related subject, we have recently seen a noticeable increase in merger and acquisition (M&A) activity. Normally, M&A activity picks up during the second half of expansions, but in the current cycle, it has been happening sooner. Many companies have excess cash on their balance sheets and are struggling to grow organically, which has fueled an upturn in deals. We expect these trends to continue over the next couple of months, and we should see continued high levels of M&A announcements.

Although signs of economic recovery have continued to emerge, we do not expect the Federal Reserve to alter its course any time soon. In public remarks last week, Fed Chairman Ben Bernanke reiterated his forecast for modest economic growth in 2010. He highlighted the ongoing risks posed by a weak labor market, which is dragging down household spending, and weakness in bank lending, which is acting as a constraint on businesses — especially small businesses that do not have ready access to the capital markets. Given Fed officials' continued focus on the downside risks to the economy, we expect the central bank will maintain a near-zero interest rate policy for some time to come, unless there is an unexpected upsurge in inflation.

Turning to the markets, while stocks have continued their robust gains recently, technical factors have been looking less favorable. Volume has declined and momentum levels have weakened, which call into question the sustainability of recent gains. While we would not be surprised to see some consolidation or corrective action, we continue to believe that the combination of modest growth and accommodative monetary policy presents an attractive long-term backdrop for stocks.

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