

Investment Commentary

MARCH 15, 2010

Equity markets notched positive returns again last week, as the Dow Jones Industrial Average climbed 0.6% to 10,625, the S&P 500 Index advanced 1.0% to 1,150 and the Nasdaq Composite rose 1.8% to 2,368. Last week's gains marked the fourth time in the last five weeks that stocks were up, and equity markets have now recaptured nearly all of the losses incurred during the mid-January to mid-February correction.

The weekly advance can be attributed to some better-than-expected economic news. On Friday, US retail sales for February were reported to have grown at a 0.3% rate (0.8% ex-autos), suggesting that the severe winter storms will not have had as significant an impact on consumption as many feared. From our vantage point, it appears that real consumer spending will advance more than 3% in the first quarter. Among other positive news reported last week, tax revenues for February showed the first year-over-year increase since April 2008, largely due to an increase in corporate tax receipts.

We have been saying for some time that we expect the economy to be in a subpar recovery mode. Such a scenario, however, does not mean that the cyclical bull market needs to come to a close. As last week's data shows, there is still room for positive economic surprises. Likewise, we believe there remains ample upside potential for corporate profits over the coming months and quarters. The main risk to markets, in our view, is the possibility of the economic recovery failing to become self-sustaining. The key variable, of course, is the employment picture. With jobs still being lost on a monthly basis, it is understandable that pessimism and cynicism about the state of the economy continues to run strong. Most observers rightly believe that employment gains will need to occur before a self-reinforcing mechanism is in place to drive the economy. In our view, strong corporate balance sheets, improving profit margins and increases in business confidence mean that companies should ramp up their hiring efforts soon. Once positive employment conditions begin to clearly emerge, we expect the debate will shift to the path of Federal Reserve policy.

Looking ahead, we believe economic growth should continue to improve, which should provide a boost to investor confidence. Additionally, merger and acquisition activity has picked up strongly in recent weeks, as have corporate share buybacks, trends that help promote an equity-friendly environment. On balance, we continue to expect equity markets to endure ongoing periods of volatility, but reaffirm our belief that the cyclical bull market has further to run.

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