

# Investment Commentary

SEPTEMBER 14, 2009

After a couple of weeks of declines and sideways movements, equity markets posted strong gains last week, reflecting additional good economic news and investors' willingness to continue moving money out of cash and into higher risk assets. For the week, the Dow Jones Industrial Average rose 1.7% to 9,605, the S&P 500 Index advanced 2.6% to 1,042 and the Nasdaq Composite climbed 3.1% to 2,080.

We have been suggesting for the past several weeks that the current recession is in the process of coming to an end. Initial unemployment claims have fallen to last January's level, manufacturing data has picked up, residential building permits have increased and the Leading Economic Index series has now advanced for four consecutive months. The economy is still in the midst of a deleveraging phase, but this should not preclude a mild economic recovery and expansion of consumer spending. Households should continue to reduce their debt burdens over the coming years, and consumer spending levels will tend to advance before we see recoveries in credit and employment conditions.

It is important to emphasize, however, that the current recovery is likely to fall short of a typical post-recession recovery. Credit markets remain impaired, state and local governments still need to cut spending, tax levels are likely to rise, the commercial real estate market remains troubled and a number of homeowners still have mortgage balances that exceed the value of their homes. We are also unlikely to see improvement in the labor market even as the broader economy begins to turn around, since companies remain reluctant to hire and overall growth levels are likely to be modest. We expect the unemployment rate to continue to rise, probably peaking in the very low double digits.

For its part, the Federal Reserve has continued to indicate a willingness to leave interest rates at historically low levels for an extended period of time. The Fed has begun to discuss its strategy for removing some of the stimulus it has enacted (such as its plans to discontinue its Treasury purchase program), but the central bank has been moving slowly in this regard. Deflation fears have eased over the past several months, so it makes sense to us that the Fed has started to discuss its "exit strategy," but we do not expect the Fed's overall policy stance to change any time soon.

An environment of economic recovery, low inflation and accommodative monetary policy should be a good one for the equity markets. Investors have been moving money out of cash, which is basically returning 0%, and into other asset classes. This trend still has a way to go, which should provide a tailwind for the markets as well. Additionally, reasonable valuations, improving corporate profits and discipline around capital expenditures are all positives. Markets remain unpredictable, and a correction could still occur at any point, but we believe the path of least resistance continues to be up.

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