Investment Commentary

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Stocks dipped last week in the face of some disappointing consumer confidence and retail sales figures, with the Dow Jones Industrial Average falling 0.5% to 9,321, the S&P 500 Index declining 0.6% to 1,004 and the Nasdaq Composite slipping 0.7% to 1,986.

We continue to believe that the recession is coming to an end and that US gross domestic product (GDP) growth will be positive in the third quarter. Based on historical patterns, a recession of the current magnitude would typically result in GDP growth levels of between 6% and 8% over the next 12 months, but with the economy still facing deleveraging and credit issues, we expect growth to be, at best, half of those levels. In the near-term, economic growth will benefit from an end to inventory liquidation and ongoing fiscal stimulus, but a sustained recovery will be difficult to achieve without jobs creation. By our analysis, the leading economic indicators are suggesting that we may start to see some growth in jobs by the end of this year, which would be good news.

The Federal Reserve met last week, and indicated that it remains optimistic that the policy measures already in place are helping to produce better economic conditions. With a modest economic recovery looking likely, the Fed also indicated that it is beginning its "exit strategy" by ceasing its Treasury-purchase program by the end of October. Looking ahead, we do not expect the Fed to begin to raise rates for at least several more months, even if we do see a recovery in the labor market.

As the global economy appears to be getting back on track, investors are beginning to rotate toward more risky assets. With cash essentially offering a 0% return and Treasuries appearing expensive, equity markets and corporate bonds are looking more reasonably priced, which has helped fuel the rally we have seen in recent weeks. With stocks up close to 50% from their lows early in the year, many investors are becoming more concerned about the larger role that governments have been playing in the financial markets. More regulations, the likelihood of higher tax rates (particularly on higher income individuals and possibly on businesses), and increased regulations all appear to be on the horizon, and typically act as drags on stock prices.

The resilience that stocks showed last week in the face of some disappointing economic news is impressive, but absent a sustained economic recovery, it will be difficult for equity markets to continue to move higher. We believe that the broader trend for stocks will continue to be up, but we do expect to see continued volatility and occasional setbacks. Looking ahead, we also expect that leadership in the equity markets will rotate away from the lower quality, more cyclical areas of the market and into higher quality names as the markets begin to price in an economic recovery.

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