

Weekly Investment Commentary

Market Correction Presents Potential Buying Opportunity

June 13, 2011

Once again, disappointing economic data caused stock markets to sag last week, with the Dow Jones Industrial Average falling 1.6% to 11,952, the S&P 500 Index declining 2.2% to 1,271 and the Nasdaq Composite dropping 3.3% to 2,644. Investors also witnessed a rebound in the US dollar, a rally in bonds and a rise in oil prices.

Equity markets have now endured six consecutive weeks of losses and, in some ways, the current correction in markets is reminiscent of the mid-year correction that occurred in 2010. The drivers of this year's downturn are somewhat similar to those that caused last year's: a slowdown in manufacturing caused by overproduction; falling demand levels; higher oil prices; and concerns over both European debt issues and Chinese policy tightening.

A key difference between the 2010 correction and what we are seeing now, however, is the degree of the downturn. So far, equity markets have fallen only about half as much as they did last year. This comparison, of course, leads to the question of how much further the current correction will run. In our view, the answer will be largely determined by the degree to which the economy will either accelerate or decelerate, and while the current economic data continues to be weak, we are expecting to see a rebound in the third quarter of this year.

We are aware that the economy faces many risks, but we maintain our view that the United States should see moderate and sustained levels of growth over the coming months. Indeed, despite the recent downturn in the tone of economic data, monetary policy remains extremely accommodative, corporate profits are strong, inflation is low and the labor market is slowly improving. Additionally, credit conditions and lending standards remain healthy. Both business and consumer loan demand are growing and the money supply is rising as well — two factors that were not evident last year and which suggest that financial conditions have come a long way since the recent credit crisis. Together, all of these factors should help the economy continue to grow, albeit at a pace less than that typically associated with economic recovery.

We have said it several times, but it bears repeating — the key indicator for the future of the economy remains the jobs picture. After several months of impressive gains, we have seen a recent stall in jobs growth. The May employment data was disappointing, and we have also seen the level of jobless claims rise since late April. Typically, jobs growth tends to be robust in post-recessionary periods, but that has not been the case in the current recovery. The recent weakness of this data has been one of the principal catalysts for the downturn in investor sentiment. The business sector remains cautious about ramping up hiring plans and manufacturing data remains spotty. However, profits have been moving higher and corporate balance sheets are flush with cash. We do expect that hiring levels will rise in the months ahead and we are calling for stronger levels of jobs growth in the second half of 2011.



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Given that investors have recently been through the worst financial crisis of a generation followed by a tepid economic recovery, it should not be surprising that sentiment levels are depressed and that investors remain quite risk averse. Over the past couple of months, investors have been selling stocks at a relatively rapid clip as the flight-to-quality trade has again emerged. The combination of still-strong corporate earnings and a downturn in equity prices has made stocks more attractive from a valuation perspective. To us, this scenario represents a potential buying opportunity, particularly for those who share our view that the economy should see a reacceleration in the months ahead. We would caution that volatility levels will likely remain elevated and that additional corrective or sideways action could persist, but we also believe this could be an appropriate time for investors to take on more risk in their portfolios.

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