

## Investment Commentary

September 27, 2010

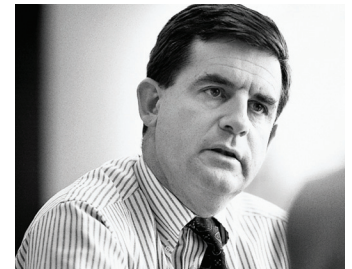
Last week marked the fourth consecutive week in which stock markets posted gains, with the Dow Jones Industrial Average climbing 2.4% to 10,860, the S&P 500 Index advancing 2.1% to 1,149 and the Nasdaq Composite rising 2.8% to 2,381. With these gains, the S&P is now up around 3% for the year, while the Dow is up 4% and the Nasdaq 5%.

Investors are questioning whether the improved tone of equity markets in recent weeks is merely a reflection of stocks moving to the upper end of their trading range or if this trend is a reflection of real underlying changes. Certainly, the macro backdrop does seem improved when compared to one month ago. Economic data has moved from “bad” to “less bad” (if not to “good”), and the rhetoric from Washington, DC has recently focused on some pro-business and tax policies. Optimism is growing that with the upcoming midterm elections, investors may be seeing some more equity-friendly policies in the works. From our perspective, we are leaning more toward the positive side of the market debate and remain optimistic that the economy will avoid a double-dip recession, meaning that stocks should be able to continue to grind higher.

In perhaps the most notable headline last week, the National Bureau of Economic Research told us (rather belatedly) that the recession ended in June of 2009. The “Great Recession” marked the longest reported recession since the Great Depression, and over the 18 months of its existence, it resulted in an annualized decline in gross domestic product of 2.8% and a loss of 7 million jobs.

In other economic news, the Federal Reserve commented last week that it remains committed to doing what it can in terms of using its balance sheet to reflate the economy. Mirroring recent statements from the Bank of England and the Bank of Japan, the Fed made it clear that low growth levels are not acceptable, nor are deflation risks, and that the central bank stands ready to begin the next phase of quantitative easing. In its statement, the Fed admitted that it believes inflation levels are too low, limiting its ability to promote stable prices. This was a significant statement, as until now the Fed was more focused on the slow pace of growth and high unemployment. These concerns obviously still remain, but by explicitly adding deflation risks to the list of problems, the Fed has made it clear that additional policy action is needed.

Although the downside risks to the economy seem to have eased over the past month, there is little reason to expect high growth rates to resume soon, suggesting that the Fed’s work is not finished. The world’s developed economies seem to have settled into a period of positive but weak growth marked by high unemployment and high deficits. In this environment, the Federal Reserve is under pressure to help the economy break out of this phase. The prospects for additional quantitative easing measures have already prompted a decline in the value of the dollar and the lowering of private-sector borrowing costs.



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It appears the Federal Reserve is also trying to restore confidence among consumers and corporations. Much of the slow growth that is plaguing the economy is due not only to the structural problems of ongoing deleveraging, but is also a result of the fact that companies and households are unwilling to spend in the current environment. The central bank is hopeful that by using its balance sheet to reflate the economy, confidence levels will improve and spending will resume.

The global economy seems to have decoupled to some extent, with the developing world still doing well and the developed world stuck in a soft patch. We do not expect this soft patch to result in a renewed recession, however. The United States appears to have stabilized into a low-growth environment and Japan has become more aggressive in terms of promoting growth. The European debt crisis has worsened recently, however, and that region is still struggling. Looking ahead, we believe the US economy will continue to struggle, but we are optimistic that the actions of the Federal Reserve and other policymakers will help to restore some measure of confidence.

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