



Markets Extend Gains

April 25, 2010

What a difference a year makes! A year ago at this time, we were just beginning to climb out of the hole that was the Dow at the 6,500 level. The market had begun to reverse course due to relief that the largest U.S. mega-banks – Citigroup, Bank of America, Wells Fargo and JP Morgan Chase – were not going to have to be “nationalized”.

Since then, a number of positive things have encouraged the market upward. Corporate earnings have continued to grow. A majority of the hotly debated TARP money has been repaid, with interest, to the U.S government. And the job market, which is usually the last thing to recover as an economy rebounds from a recession, is now showing gains in the most recent monthly statistics.

The result of all this good news is that the market has powered forward to heights that most observers felt it would take far longer to achieve again. The first quarter of 2010 saw the S&P 500 post a strong 5% gain, which brings its return over the last 12 months to an astonishing 50%! International markets also achieved gains in the first quarter, giving them 12-month returns that even surpass the S&P.

On the fixed income side of things, the Fed continued to give guidance that they are not inclined to raise rates any time in the immediate future. This proved to be a further catalyst to the bond market, with most classes of fixed income generating returns in the 2% range for the quarter. Our preference for exposure to the high yield bond market again worked out quite well, as these “junk bonds” made another 4% in the first quarter, bringing their 12-month gains to over 40%.

All of this has brought joy back to the investment community, for investors and advisors alike. How could it not, when the market seems to go up on a daily basis? Even for market professionals, we see certain days start out poorly because of some “bad” news, but the market has just been shrugging it off and erasing morning losses by the end of most days.

There was a bit of a market pullback in January when China indicated it would take measures to slow its economic growth, and proposals were put forth to impose tighter regulations on the U.S. financial industry. Well, those proposals are taking shape, and it appears at this moment that there may be enough bipartisan support to make them law. Nevertheless, that hasn't put a damper on the on-going party on Wall Street. Neither has renewed worry that the debt crisis in Greece is spreading to larger portions of Europe. That fear was trumped this week by reports of a dramatic increase in new home sales.

However, while no one can complain about such a positive market, one has to wonder if we've come just a little too far too fast. Yes, the economy appears to be heading in the right direction again. As a result, the likelihood of a "double dip" recession occurring is lessening by the day. Although, it's not like we're hitting the cover off the ball. Things are improving, but given the amount of government stimulus that was spread around, we *should* be seeing improvement – and maybe even more than we've seen.

As we alluded to in our last communication to you, it will be interesting to see how things progress when the stimulus programs have run their course. For this recovery to be complete, what we will ultimately need to see is an upturn in consumer spending and a sustained growth in employment. We're not suggesting that we won't get there. After all, it's these two areas that are always last to show signs of improvement, which makes sense, right?

Consumers don't feel comfortable spending unless they feel secure in their jobs (or even have them in the first place). Employers don't begin hiring again until they see growth returning to their own businesses. But even before they start hiring again, employers will typically renew spending on machinery and equipment, with the thought of maximizing their existing workforce before new hiring takes place. Fortunately, such spending is on the rise again, lending credence to the belief that a full-fledged recovery is, indeed, in the works.

The big test that's looming on the horizon will be when the Fed sees enough stability to warrant raising rates again. Such a move will, without question, pose a threat to the housing market, as higher mortgage rates will certainly discourage would-be home buyers. We're not quite there yet, though, so let's continue to enjoy the ride while it lasts. You should know quite well that we are not in the business of trying to time the markets. However, we're always in favor of making strategic changes to a portfolio allocation if clear longer-term trends suggest them to be warranted.

As always, we look forward to hearing from you if you have any comments or questions about your portfolio.

Warm regards,

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President