April 2009 Market Commentary

March Madness: March has been another month that has built on this crisis' ongoing theme – volatility. After losing nearly 8% by March 9th, in just one day, March 10th, the market recouped nearly all March losses. The market then continued up and produced the strongest 10 day trading gain since 1938. Equities advanced three consecutive weeks for the first time in a year while oil experienced six straight weeks of gains, the longest winning streak in 11 months.

Global stocks continued March's theme by achieving their best monthly performance in more than six years, and commodity prices also rose signaling expectations of increased demand. While the threatened bankruptcy of General Motors and Chrysler scared investors a bit, the markets showed less panic than in recent months with a relatively small loss on the day of announcement followed by an up day.

Optimism appears to be based on more than just hope. A slew of recent data – including stronger-than-expected reports on housing sales and retail as well as orders for big-ticket manufactured goods – has led many economists to declare that the worst of the 15-month, housing-led recession is over. Bernard Baumohl, chief global economist of the Economic Outlook Group in Princeton, New Jersey declared, "We have seen in the last few weeks enough meaningful indicators that show the economic contraction has slowed ….. The odds have increased markedly that we are approaching an inflection point in the economic cycle and that the worst of the recession is behind us."

Are we really at the bottom? While investors seem optimistic – as seen by recent market gains – belief that we're past the worst is hardly universal. Escalating job losses, severely depressed asset values, weak consumer confidence, falling incomes, squeezed corporate profits are all painfully apparent issues. However, there are enough positive signs that discussions on the timing of the economy bottoming are focused on the near term, and we seem to have moved past fears that our economy will completely implode.

The growing belief that the recession will end within a few months may signal that the stock market has already hit bottom. As I've mentioned in a couple previous market commentaries, historically, the market starts its recovery about four to six months before the economy recovers. However, as we've seen over the past decade, anything can – and will – happen. And, regardless of where we are, we will experience many more significant bumps along the way.

Short Term Challenges are plentiful. Corporate profits, which have declined over 80% in the past 18 months, will continue to be dismal in the near term. Toxic bank debt appears to be more contained, and plans are firming up. However, much of the problem still needs to be resolved and there will be more surprises. Unemployment is also widely expected to increase which will continue to create many difficulties.

The potential bankruptcy and forced restructuring of U.S. automakers will create negative headlines. The process of transforming these companies into leaner, globally competitive companies is likely to be ugly with plenty of recriminations to smear around. Along with the car companies, corporate bankruptcies are a theme that will be with us for a while. Nine major retailers have gone under in the last six months, and more companies across the U.S. will follow them to the grave.

Result: Whether or not we've hit the bottom, high volatility in the market is likely to continue.

Longer Term Outlook: Expectations have been so dire and so much bad news is priced into today's valuations that I believe the market represents good long-term value, even after its recent run-up. Furthermore, I believe that our economy is so strong and diversified that recovery is not only inevitable, but ongoing strong performance after recovery is also very likely. However, recent government actions come at a substantial cost.

Government Spending: The inevitable result of the extraordinary and controversial government spending is probably an ugly combination of higher taxes and less money to spend on programs and services ranging from roads to education to defense. Interest will claim much more of the budget. Payments already account for 4.2% of federal outlays. By 2013, they're expected to be about 11% and headed higher.

Inflation is also expected to cause future problems. All that cash the Federal Reserve is pumping into the system will likely create another period of excess as consumer spending recovers and the slack in the economy is absorbed. The Federal Reserve will likely raise short-term rates, and inflation is expected to be running at about 4% by 2011. Long term inflation will likely tick up, although not to the levels of the 1970s.

Long-term US growth will likely be dampened by higher government spending, higher taxes and increased regulation. Obviously, no one knows what affect all of this will have, but negative consequences are likely as none of these trends have historically had a positive economic affect.

In light of these challenges, are the equity markets dead? Should they simply be avoided in preference of less risky or guaranteed assets that may not provide returns, but don't pose the risk of securities? I believe the answer is a resounding no for several reasons – even if we're not out of the woods.

First, by our measures, equity markets are substantially undervalued even when applying very pessimistic assumptions. **Second**, betting against the US economy has never been profitable, and I don't believe the challenges mentioned above – although substantial – are large enough to significantly change this equation. The US is still the dominant leader in nearly every field of industry, and we have a proven ability to innovate and adjust to circumstances. **Third**, the world is developing at a record rate. Even if US growth rates continue to slow as has been predicted for years, the globe is increasingly interconnected. Countries want what the US has to offer. We will continue to contribute to and receive value from overseas growth. **Lastly**, I believe inflation is coming. As a long term investment, stocks have been a great inflation hedge unlike bonds.

Equities are a long term investment, and I believe still present excellent long term investment potential. Bad news is out there as it always is. Good news appears to be increasing. Valuations are very low which I believe represent a great buying opportunity. And, long term, I believe equity markets provide excellent opportunities to benefit from expectations of tremendous global advancement and a continued means to participate in the most dynamic economy of the world.

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