

March 31, 2010

The Recovery Continues

The stock market continued its rally during the first quarter of the year as improving economic conditions and better than expected corporate earnings fueled the advance. The rally continues to be broad based with almost all market sectors doing well. The S&P 500 experienced its best first quarter performance since 1998 and has now generated positive returns in the last four quarters. Before this, the S&P 500 had declined for six consecutive quarters; the first time that had happened since 1969-1970. The bond market appears to be running out of steam as higher yields are beginning to materialize, resulting in lower bond prices.

The economic data we are seeing suggests the economy is gaining momentum and growing at an increasing rate. Consumer spending is rising and consumer prices are flat. Consumer confidence numbers are also rising. The ISM manufacturing survey rose in March as the manufacturing sector is showing improvement at an accelerating rate, fueled in part by strong export demand. The U.S. economy added 162 thousand jobs in March with most being in the private sector, as initial unemployment claims fell. This was welcome news as the lack of job growth has been a drag on economic growth.

After a market rally as strong as the current one, there is often a fear that we have risen too far and too fast. However, there are two important things to keep in mind: We are still 25% below the all time closing high from back in 2007; and, more importantly, the aggregate annual earnings of the S&P 500 companies are 79% higher today than they were just one year ago. This illustrates how the market can rise and not become over valued. It is really all about corporate earnings. An expanding economy produces higher earnings and higher stock prices.

While the economy is in the early stages of recovery, it is always good to remember that no two economic cycles are the same. We have said for the past year that we expected this recovery to be slow and have some fits and starts. This still seems to be the most likely course. The stock market, also, will experience good times and bad. Since the rally began a year ago, there have been four pullbacks of at least 5%. This is normal and should not be a cause for alarm. In general, this part of the economic cycle is a profitable time to own stocks. We expect interest rates to move higher as the economy improves. We have been, and expect to continue, keeping bond maturities short to better take advantage of higher rates in the future.

Wabash Capital