Advisor Economic Update October 2011

Markets ended the third quarter with losses amidst the on-going financial crisis in Europe. Markets have essentially predicted a default by Greece (their one year bond yields jumped to more than 60% last month). This, alone, is not a major concern to world markets. However, there are concerns over a domino effect and whether or not certain countries such as Spain or Italy would be able to weather the storm.

The Dow Jones Industrial Average (Dow), Standard & Poor's 500 (S & P 500), and Nasdaq composite were down 6.03%, 7.18%, and 6.36% respectively, during September. Smaller companies, as measured by the Russell 2000 index, were down about 11.65%. For the quarter, the Dow, S & P, and Nasdaq indices were down between 12-15%, compared to the Russell 2000 and Dow World Index (ex-US) down around 20-22%.

The third quarter is statistically not a good one, but this also helps set up the fourth quarter, which is statistically the best performing quarter of the year. This is based on S & P 500 data for the last 12 years, which is not an indicator of future results. However, on the assumption that history repeats itself, significant drops in the market are often followed by strong rebounds.

Bonds, as measured by the 10-year Treasury were higher, with yields dropping to 1.92% compared to 2.2% in the previous month. This is due in part to Operation Twist, where the Federal Reserve is buying long-term Treasuries to drive yields lower and help stimulate growth.

Corporate earnings continue to grow and according to Bloomberg, U.S. companies are trading at an average 10.2 times 2012 forecasted earnings, a ratio that is low compared to other periods of economic contraction. Bulls will argue that this is an indication that stocks are undervalued, in particular since forecasted earnings have already been reduced. Bears will argue that a double-dip in Gross Domestic Product (GDP) will further reduce earnings and stock prices.

Most recently, manufacturing data indicated expansion in September at a slightly higher rate than the previous period. In general, economic data has reflected slow growth and modest improvement, despite "high" unemployment and debt issues in Europe. The relationship between debt in Greece and our stock market may be overstated. If domestic markets can "disconnect" from any "Greek tragedy," and "reconnect" with economic fundamentals, we believe that the U.S. stock market can align with corporate earnings for slow, long-term growth. As always, please call us with any questions, concerns, or to schedule a meeting.