

Advisor Economic Update Third Quarter 2010



The last quarter saw markets moving in a see-saw fashion with large upswings in July and September, surrounding August, which saw a significant drop. However, the bulls eventually won and equities closed the quarter higher with the Dow Jones Industrial Average (Dow), Standard & Poor's 500 (S & P 500), and Nasdaq composite up 10.37%, 10.72% and 12.31%, respectively.

Bond yields, as measured by the 10-year Treasury ended the quarter at 2.51% compared to 2.95% in the previous quarter.

The generally lower interest rates translates to higher bond values for almost all fixed sectors, and is due in part to significant fund flow into U.S. Treasuries. Fund flow to fixed income in general was estimated at \$87 billion in the third quarter of 2010, according to the Investment Co. Institute. This has contributed to concerns over a bond bubble. In contrast, according to Morningstar, the third quarter saw stock fund withdrawals of \$43 billion.

A combination of improving economic data and expectations of additional Federal stimulus helped fuel higher values, but this has been mitigated somewhat by economic and political uncertainty both domestically and internationally. Some of the uncertainty relates to decisions that need to be made on tax law, including determining the estate tax exclusion amount and deciding on changes or continuance of the Bush tax cuts. The uncertainty may also create a dilemma for corporations, many which are flush with cash, as they determine whether it is best to use cash for dividend payouts or stock repurchases.

According to Standard & Poor's, corporate cash holdings are at record levels and some analysts' think that this could be a partial catalyst for a stock rally. At this point, we feel that chances of a double-dip recession are waning, as we have seen improvement in economic data and the Federal Reserve has expressed the possibility of additional stimulus, if needed. Corporate earnings will be key and may hinge on consumer spending, so unemployment and labor markets may also be scrutinized.

The fourth quarter is statistically good. We are hopeful that improving economic fundamentals along with stronger corporate balance sheets will help the economic recovery continue. In the meantime, we continue to monitor client accounts and will make changes/adjustments as needed.