

# PMFA MARKET PERSPECTIVES

December 2009

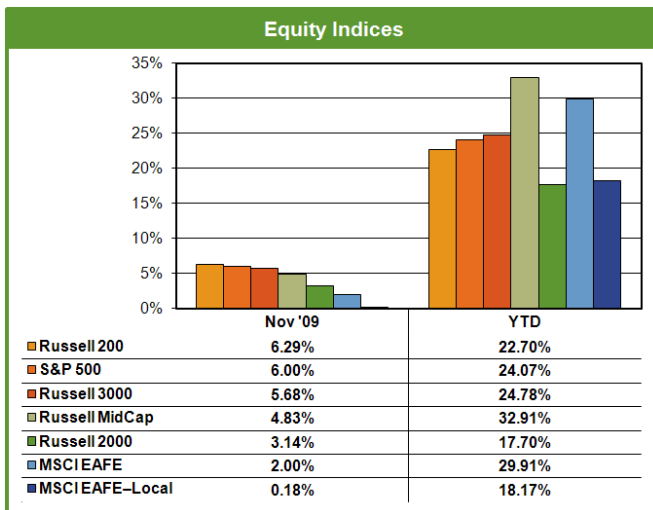
plante moran  
FINANCIAL ADVISORS

## Capital Markets

Beyond an ignition source, fire needs only three components to thrive: oxygen, heat, and fuel. The combination of these components supports a sustainable flame, while excesses of these may often result in an uncontrolled blaze. Economic growth is very similar, as it also has essential elements needed to flourish, including productive labor and capital markets, and price stability. A contraction within or the existence of uncertainty surrounding any of the economy's fuel sources may potentially squelch the flame of economic growth. This was clearly illustrated with the 2008 financial crisis and credit crunch which resulted in a recession, smothering the embers of growth. As a result, very accommodative policy action was instituted in a variety of ways to provide both fuel and oxygen in an effort to rebuild the economic growth fire.

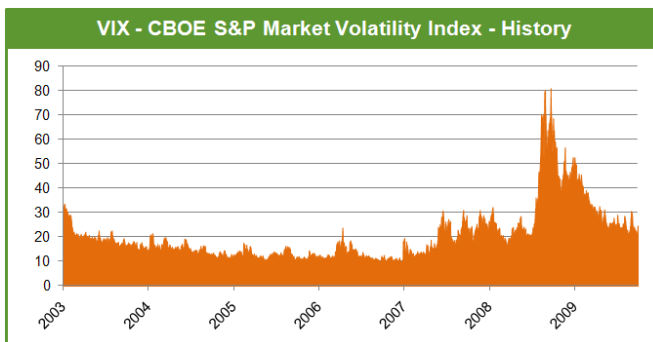
Today, these accommodative measures have provided fuel for risk-oriented investments, equity markets in particular, which have rallied significantly off of low March levels. Cheap money has become a major fuel source that has induced investors to take on investment risk, as short-term interest rates available today are very low and may remain this way for some time. Shifting winds in the form of increasingly positive economic indicators have also provided oxygen to these flames. While risk aversion has subsided, the potential risks surrounding this recovery should not be overlooked. The considerable slack in the economy, the potential for constrained consumer spending, and a growing deficit all may effectively act as a fire hose that stifles the intensity of the recovery. The Fed has made it clear that their expectation is to keep monetary policy accommodative for the near term to feed these early flames. Moreover, the government will continue to focus on stimulus efforts to boost spending and combat the uncomfortably high unemployment rate. Eventually, these interventionary actions will slowly be reversed, and the question surrounding how sustainable the economy will be without these extraordinary monetary and fiscal policy efforts will be answered.

October proved to be just a slight hiccup in the otherwise upward trend for equity markets. After a brief period of profit-taking, equities recorded another positive month in November. Exceptionally low interest rates, which have served to support asset prices, in combination with glimmers of hope on the economic front, have led to a reduction in risk aversion. These have helped to push forward the rally in risk assets that commenced in March.



Source: PMFA

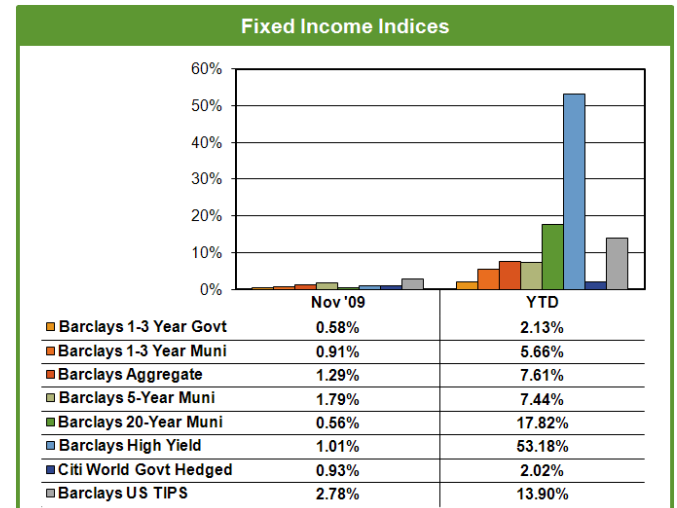
Larger-cap stocks outperformed smaller-cap issues for the second consecutive month; however, they trail their smaller-cap counterparts on a year-to-date basis. The weakening Dollar during the month contributed significantly to international equity returns for a U.S.-based investor. Since the beginning of the year, the falling greenback has contributed in excess of 11% to MSCI EAFE returns for a U.S. investor.



Source: PMFA, Yahoo Finance

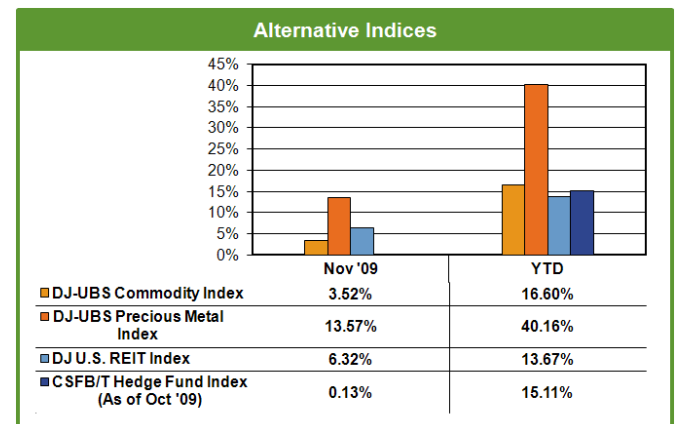
Meanwhile, volatility levels remain elevated in historical terms but currently sit a far cry from the peak reached a year ago. Substantial rallies, like the one risk markets have experienced lately, often overshoot fair valuation levels before eventually correcting. Assuming earnings

growth can take over from price/earnings multiple expansion as the driver of returns, the current rally may continue to have legs. This is far from certain in our view as any curveballs or unexpected setbacks along the way may lead to a potential pullback. This reinforces the need to maintain an appropriate asset allocation strategy and rebalance accordingly in the context of one's preferred level of risk.



Source: PMFA

Thus far in 2009, a substantial amount of cash has gone into "credit-oriented" fixed income investments. High demand for such investments has caused substantial narrowing of spreads, resulting in substantial gains year-to-date in several bond market segments. November results continued that trend. TIPS also showed significant strength for the month as real yields declined by over a quarter percent. Municipal bonds posted positive performance for the month, which was a reversal of their negative returns in October.



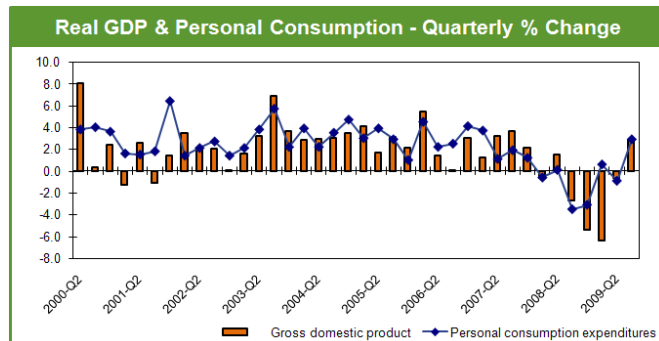
Source: PMFA

The Gold rally continues to make headlines by reaching new peaks on a seemingly daily basis. On December 2, it surpassed \$1,200/oz., benefiting tremendously from U.S. Dollar worries and longer-term inflation concerns. This surge accounted for much of the 13.6% surge in the Dow Jones-UBS Precious Metals Index as well as the more moderate rise in the broad commodities index. Real estate investment trusts also rallied in November, although year-to-date, it lags most other risk assets.

## Economy

### GDP

According to the Preliminary Estimate from the Bureau of Economic Analysis, the economy grew at a 2.8% annualized pace in the third quarter. Although this was 0.7% below the Advance Estimate, Q3's positive result remains the first sign of growth after a year of contractions. While highly recognized economic indicators have recorded some positive marks over the last few months, the shape of any recovery is still highly uncertain in our view. Given the depth of this economic contraction, history suggests that we should expect a sharp recovery. It is very difficult to accept history blindly as a reliable indicator this time though, as we still see many headwinds that appear likely to complicate a sharp snapback in economic growth.

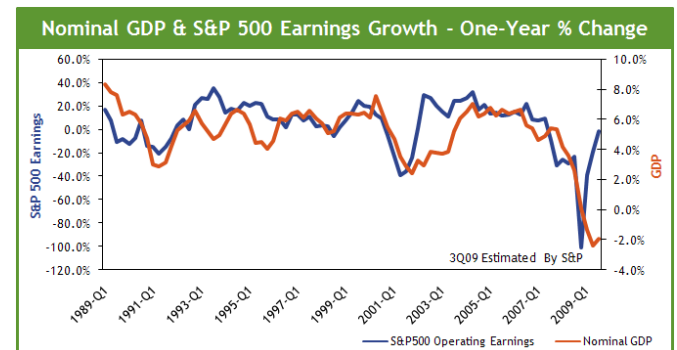


Source: PMFA, Bureau of Economic Analysis (BEA)

Government stimulus efforts were behind much of the growth over the quarter. Consumer spending and housing both increased, aided by two Federal government programs: "Cash for Clunkers" and the First Time Home Buyers Credit. Growth was also evident in inventories and exports, two areas of the economy which had been negative for over a year. On a positive note, the consumer has shown some resilience in spending in recent months, although consumer sentiment remains low.

Corporate earnings were positive as compared with the second quarter and are nearly positive on a year-over-year basis. Low interest rates and lower labor costs

have been supportive to corporate profit margins, but costs can't be cut indefinitely. In our view, growth in revenues needs to take over as the main driver of earnings growth before a recovery in profits can be called convincing. Revenue growth has historically followed Nominal GDP (Real GDP + Inflation) growth closely. Given our expectations related to below-average Nominal GDP growth in the near term, sources of sustainable growth in corporate earnings remain fragile at this point.



Source: PMFA, BEA, Standard & Poor's

### INFLATION

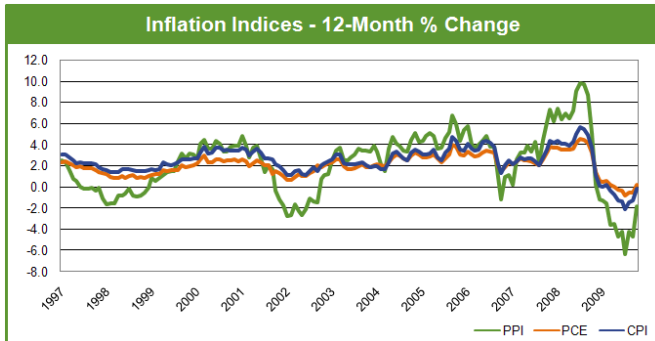
Inflation indices rose in October, and the 12-month change in the consumer indices edged near or into positive territory. These indices appear to be stabilizing as extreme volatility in energy prices over the past few years has diminished. Major contributors to the increase over the month were energy and used car prices. Lower inventories of used cars (a consequence of the "Cash for Clunkers" program) have led to rising prices in used cars and trucks for the past three months.

Index	Period Ending October 2009	
	One-Month % Change	One-Year % Change
<b>All Items</b>		
CPI	0.1%	-0.2%
PPI	0.3%	-1.9%
PCE	0.3%	0.2%
<b>All Items Excluding Food and Energy</b>		
Core CPI	0.3%	1.7%
Core PPI	-0.6%	0.7%
Core PCE	0.2%	1.4%

Source: PMFA, BEA, Bureau of Labor Statistics (BLS)

Core measures, which exclude food and energy prices and tend to be more volatile, were also generally positive, with the exception of the Producer Price Index. Core CPI has ticked upward over the last three months and stands at 1.7% on a year-over-year basis. Rising

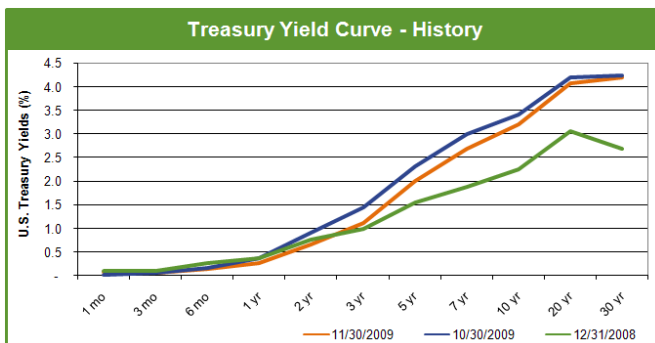
price worries in the near term remain contained, and we expect inflation to remain moderate until the excess slack in the economy has been better absorbed. However, longer-term inflation appears poised to become a more substantial concern as the global economy makes its way through recovery.



Source: PMFA, BEA, BLS

## INTEREST RATES

The yield curve flattened in November as shorter-term rates rose from their October lows and longer-term Treasury yields fell. The 10-year Treasury yield ended the month at 3.21%, a decline of 20 basis points. This is its lowest point since May and continues to aid the housing market by keeping mortgage rates near historical lows. The three-month Treasury yield had a fractional rise of three basis points but ended the month at just 0.06%.



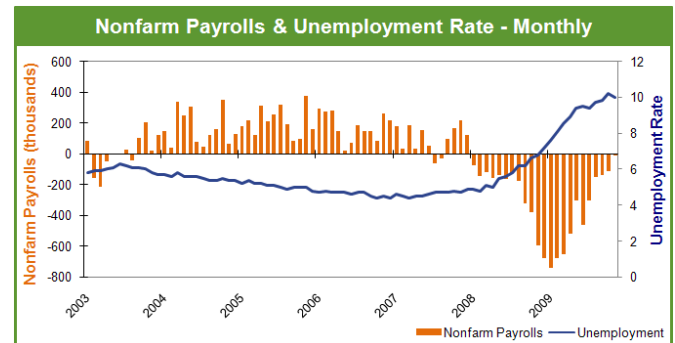
Source: PMFA, U.S. Treasury

The Federal Open Market Committee (FOMC) will meet in mid December and reevaluate their outlook on the state of the economy. The outlook conveyed in the Fed's minutes from their early November meeting was more upbeat, citing that "economic activity was picking up as anticipated." Also discussed by the FOMC was the continued development of "several tools that could help support a smooth withdrawal of policy accommodation in the appropriate time." Cognizant that the current Fed funds rate of 0-0.25% is extremely accommodative, the FOMC continues to monitor the

appropriate timing to introduce more hawkish rhetoric. Cautious not to repeat mistakes from the past, the Fed may be slower to raise the funds rate or reduce the money supply via the unwinding of more unconventional policy actions for fear of inducing a double-dip recession.

## EMPLOYMENT

The employment situation showed unexpected improvement in November. The unemployment rate ticked down to 10.0% after jumping 0.4% in October to 10.2%. Meanwhile, job losses totaled just 11,000, well below the consensus expectation of a decline of 125,000. In addition, the October estimate of job losses was positively revised by nearly 80,000 jobs.



Source: PMFA, BLS

Beyond this being the lowest tally of monthly job cuts since the recession began, other positive signs included increases in hours worked and wage gains. Since the outset of the recession, employers have cut aggressively to control costs and align their labor force with reduced demand. As both the ISM service and manufacturing indices suggest that the expansion is continuing, the job market should continue to exhibit signs of improvement.

### Gratuitously Unnecessary Perspective of the Month

#### 30 Years Later, the Airwaves Still Aren't Safe for Grandmas

To the chagrin of grandmas everywhere, 2009 marks the 30<sup>th</sup> anniversary of the perennial holiday favorite, "Grandma Got Run Over by a Reindeer." The song was originally released in 1979 by the husband-and-wife duo of Elmo Shropshire and Patsy Trigg, who divorced just a year later. Although the song was slow to catch on, it hit the national charts in 1984. In 2005, the song sold on 200,000 CDs, was downloaded 40,000 times through Sony and 6,000 times through iTunes, and was downloaded more than 100,000 times as a ringtone.

Source: [www.songfacts.com](http://www.songfacts.com)

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