

# PMFA MARKET PERSPECTIVES

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## Capital Markets

### *Lasting Scars?*

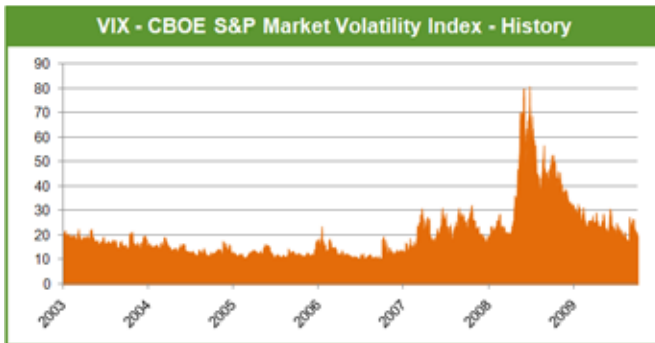
Prior to the days of child protection locks, bike helmets, and safety belts, my cynical side would suggest that it was amazing any of us were able to exit childhood safely. While we clearly survived, I suspect most of us looking back can easily recall wounds that were acquired along the way, many of which could have been avoided through better protection or, in some cases, a bigger dose of common sense that must be learned through experience.

Wounds may heal, but scars can remain. Both physical and emotional scars serve as lasting reminders of our previous pain. Beyond that, oftentimes the scars from deep wounds may be jarring enough to result in long-lasting changes in one's behavior or views. Whether the result is greater knowledge gleaned from our experience or motivation to avoid reliving an event, our scars have the ability to influence our actions. My left hand bears the scar of a cut some thirty years ago that resulted from a well-intentioned but poorly conceived attempt to cut a small piece from a large block of cheese. Even today, I sometimes recall that event when using a sharp knife and exercise care.

As we reflect on the events of the past few years, it's safe to say that the experience of living through periods of extreme uncertainty and volatility can also leave deep wounds. While those wounds may be healing along with the economy, there will undoubtedly be scars that remain. We expect that investors may find themselves scarred after experiencing the pain of a severe bear market, the second in just the last 10 years. For some, these scars may take the form of increased risk aversion. Within the business

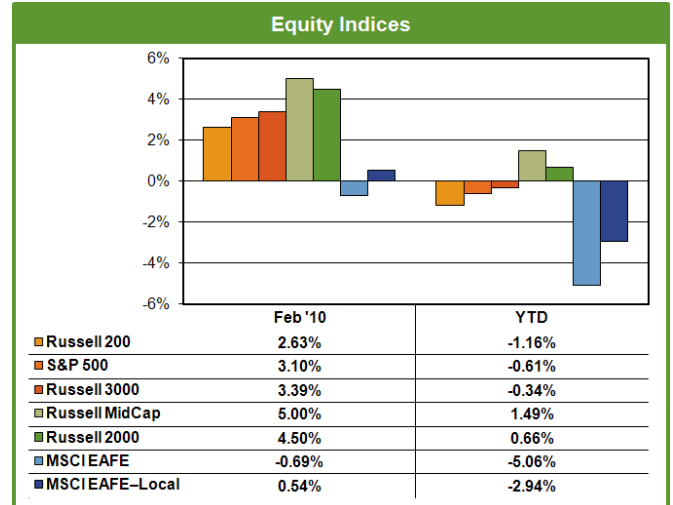
community, the severity of the recent downturn is clearly causing employers to operate very conservatively until the economic recovery appears to be convincing, causing ripple effects through the broader economy in the form of slow hiring growth and a hesitance to invest aggressively in facilities and equipment. Banks are still carefully conserving capital, while consumers continue to reduce their outstanding credit. We expect these scars, while difficult to measure, to act as inhibitors to a stronger recovery.

Market participants continue to make decisions within the context of both shifting expectations and fear sourced from uncertainty. Volatility levels, however, have receded notably, as the VIX has remained steadily below 20 for the past few weeks. While still well above trough levels that neared 10 in early 2007, the current levels of the VIX may be unsustainable given the significant sources of uncertainty on the horizon. We would not be surprised to see volatility ultimately increase from current levels as we look forward from here.



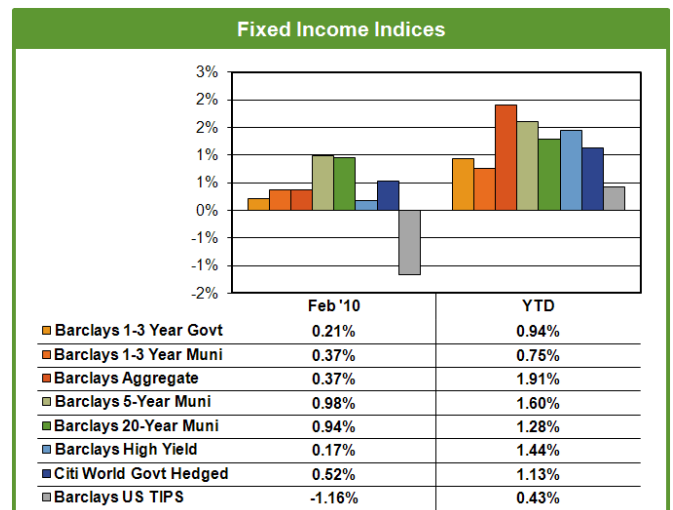
Source: PMFA, Yahoo Finance

Domestic equities rallied in February. While small and mid cap stocks claimed nominal gains in the first two months of the year, large cap stocks remain in the red through the end of February. A U.S. Dollar rally during the month led to negative returns for the broad international EAFE Index from the perspective of U.S.-based investors. As concerns over sovereign debt issues linger in Europe, further U.S. Dollar appreciation may result. Over time, however, our outlook continues to be for U.S. Dollar weakness specifically relative to emerging market countries with lower levels of debt and higher growth potential.



Source: PMFA

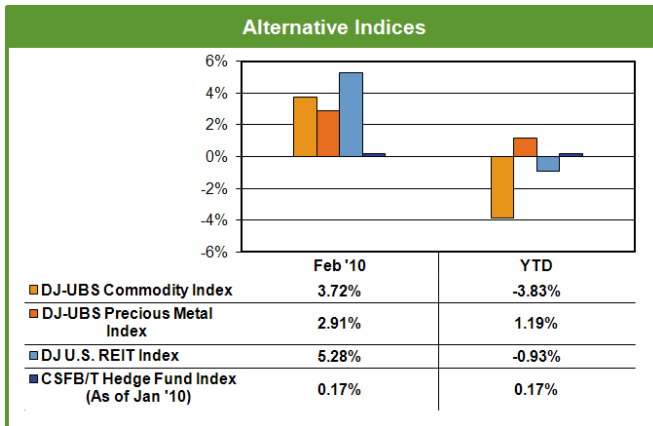
Fixed income markets generally performed positively during the month, with the exception of Treasury Inflation Protected Securities (TIPS). Real yields rose during the month, which was a detractor to TIPS performance. High yield bonds, after soaring in 2009, have been on a slower performance trajectory so far this year. Taxable and municipal bonds also posted fractionally positive performance during the month.



Source: PMFA

Risk assets in general were positive for the month, and alternatives were no exception. Commodities rebounded from January's decline but remain down for the year by nearly 4%. Solid returns in precious metals contributed to February's gain, as inflation and longer-term U.S. Dollar worries persisted. REITs nearly recovered their January losses with a return of over 5%. REIT valuations have been supported along with other risk assets for some time now on the back of an

improvement in the credit markets and appealing yields. We believe that the potential for further disruptions within commercial real estate remains elevated in the near term. Therefore, we continue to maintain a cautious outlook for this asset class.

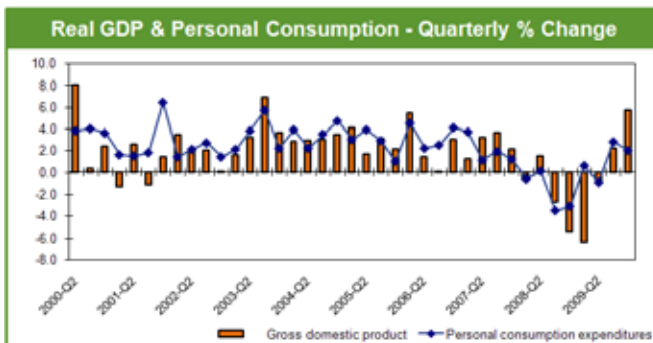


Source: PMFA

## Economy

### GDP

The second GDP estimate for the fourth quarter of 2009 came in at an annualized rate of 5.9%, more than double the third-quarter result. Estimated growth was raised 0.2% from the advance estimate, after upward revisions to business inventories, exports, and business investment in equipment. Offsetting those gains was a disappointing downward revision to personal consumption.



Source: PMFA, Bureau of Economic Analysis (BEA)

While GDP grew strongly in the fourth quarter, consumer spending growth slowed to a 1.7% annualized pace. Consumer confidence reached a 10-month low in February, as evidenced by The Conference Board's Consumer Confidence Survey®. Until the employment situation transitions from comparative stability to meaningful job creation,

pessimism among consumers is expected to persist, also keeping spending levels constrained.



Source: PMFA, BEA, The Conference Board

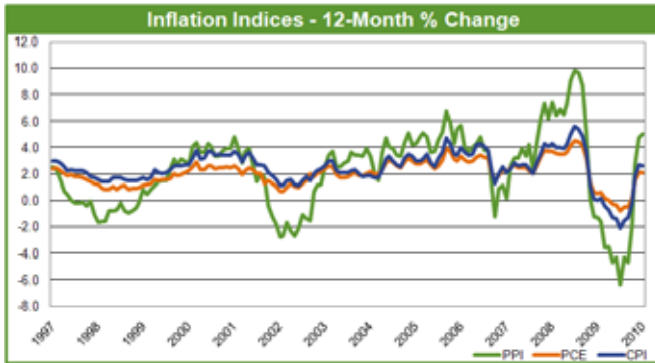
## INFLATION

Headline inflation indicators were up during the month of January, with CPI up 0.3% and the PCE deflator up 0.2%. The increase in CPI can be largely attributed to rising energy prices, with gasoline having a major impact. Core indicators, which exclude food and energy, were relatively flat. Producer prices moved sharply higher in January, potentially setting the stage for higher consumer prices down the road. On a year-over-year basis, both headline and core indicators continued to rise in January, building on the trend that started last November.

Index	Period Ending January 2010	
	One-Month % Change	One-Year % Change
<b>All Items</b>		
CPI	0.3%	2.6%
PPI	1.4%	5.0%
PCE	0.2%	2.1%
<b>All Items Excluding Food and Energy</b>		
Core CPI	0.0%	1.6%
Core PPI	0.3%	1.0%
Core PCE	0.0%	1.4%

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

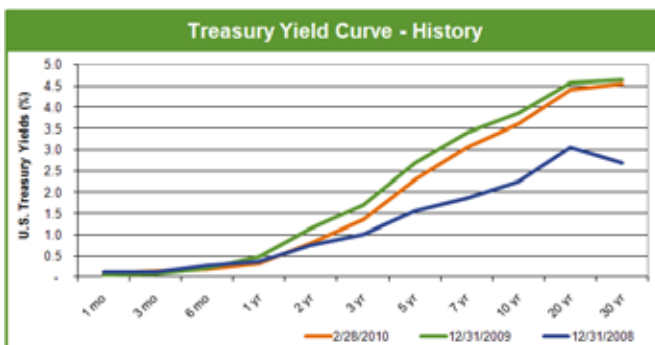
In the near term, we continue to expect inflation to remain muted assisted by the recent strength in the U.S. Dollar. High unemployment continues to constrain wage-driven price increases; productivity gains and limited job creation suggest that a meaningful pickup in wage rates is unlikely in the near term. We expect the excessive slack that remains in the economy should keep inflation at bay until we see substantial improvement in labor market conditions and much tighter production capacity constraints.



Source: PMFA, BEA, BLS

## INTEREST RATES

In February, the discount rate, the rate at which the Fed is willing to lend short-term funds to banks, was raised from 0.5% to 0.75%. Additionally, the discount window, or the duration that the Fed can lend short-term funds to banks, was reduced from 90 days to overnight. These moves were not suggestive of a tightening stance but simply signal the Fed's increased confidence in the health of global liquidity markets and an unwinding of the emergency actions put in place at the peak of the credit crisis. That move was just the next step in the Fed's gradual normalization of policy. The fed funds rate, in contrast, is expected to remain at currently low levels for "an extended period," as tightening too early could risk a derailment of the recovery.



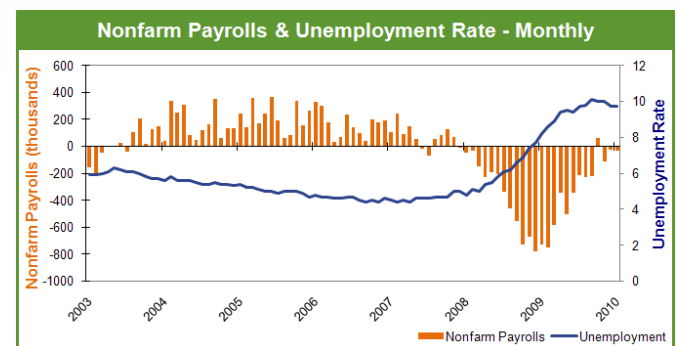
Source: PMFA, U.S. Treasury

The Treasury yield curve flattened slightly in February as a result of generally rising short-term yields and declining long-term yields. The three-month Treasury yield increased five basis points, ending the month at 0.13%. The 10-year Treasury yield slipped further in February, ending the month down two basis points at 3.6%.

## EMPLOYMENT

February unemployment beat expectations, remaining unchanged at 9.7% in February. While many

forecasters predicted the harsh winter weather to have a negative impact on the unemployment rate, that prediction was not realized. Nonfarm payrolls fell by 36,000 in February, well below the decline of 68,000 predicted by economists. While evidence continues to suggest that the labor markets are stabilizing, there is little evidence to suggest that meaningful job creation is occurring. That would seem to be a necessary step to provide a greater degree of confidence and spur both consumer spending and a sustained increase in investor appetite for risk.



Source: PMFA, BLS

While the household survey indicated that the number of employed increased by 308,000, many of these appears to be part-time jobs as full-time jobs remain harder to come by. We expect that high unemployment will continue to mute economic growth in the short term. Many unemployed have benefited from government stimulus efforts to prolong unemployment benefits. If unemployment benefits are normalized prior to significant job creation, the economic recovery could take much longer than is already anticipated.

### Gratuitously Unnecessary Perspective of the Month

#### All That and a Bag of Chips

Potato chips are America's number one snack food, so much so that they have their own national holiday on March 14. How much do American's love potato chips?

According to a Nielsen poll, Americans were projected to spend as much as \$173 million on potato chips for Super Bowl Sunday 2010. That's one day!

Looks like the old slogan "Betcha can't eat just one" was a masterpiece of understatement.

Sources: [www.comcast.net](http://www.comcast.net) & [www.holidayinsights.com](http://www.holidayinsights.com)

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