



Insights from Northern Trust

Commentary from David Murdock, Western Region Managing Director

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The Streak Continues

Last week, everyone anxiously watched as the Duke Blue Devils overtook underdog Butler in the men's NCAA basketball tournament and the University of Connecticut Huskies defeated Stanford in the women's basketball championship. Impressively, the UConn women Huskies have now built a 78-game winning streak and are the first team to complete consecutive undefeated seasons – quite a streak indeed.

Stocks continued their streak as well after logging six weeks and five straight quarters of positive returns, with the Dow Jones Industrial Average (DJIA) up 0.64% on the week and the Standard & Poor's (S&P) 500 up 1.38%. The tech-heavy NASDAQ ended up 2.14% after Apple reported that it sold more than 300,000 iPads in the United States on the first day the device was available.

The DJIA reached the 11,000 mark intraday on Friday before settling a few points below this important psychological level. At the same time, the Chicago Board Options Exchange's Volatility Index (VIX) closed at its lowest point level in 29 months. The VIX, otherwise known as the "fear index," ended the week down 11.12% to 16.14, marking its lowest close since October 2007. The equity market's direction of least resistance remains higher with the likelihood that the blue chips will complete their 11k run very soon. This threshold is an important juncture, as the Dow was last at this level in September 2008 right before the Lehman Brothers collapse precipitated a second and substantial leg down in the financial crisis and the ensuing global recession.

International stocks, however, skipped last week's advance as the Europe, Australasia and Far East index of large capitalization stocks in developed foreign markets dropped 0.5% (0.9% in U.S. dollars) including a whopping 9.9% decline (in local currency) in Greek shares.

Here in the United States, the service sector is growing at the fastest pace since May 2006 and manufacturing the most since 2004, as evidenced by the just-released Institute for Supply Management non-manufacturing index, which rose 2.4 points to 55.4. With the "inventory boost" to the manufacturing sector now mostly behind us, this data provides further confidence that headline gross domestic product will mark additional increases, since the non-manufacturing survey should be less affected by the inventory cycle. Coupled with pending home sales that rose 8.2% in February,



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we feel that ongoing strength in consumer spending can propel final demand and provide support for sustained economic advances.

Employers are starting to hire again, with the Bureau of Labor Statistics (BLS) March employment report showing an increase in the payroll count of 162,000 jobs. However, further investigation shows that 48,000 of those jobs were temporary census workers hired by the government. The March figures also benefited from a generous 81,000 adjustment from the BLS's birth/death computation. Initial unemployment claims reported for the week rose unexpectedly by 18,000 to 460,000, the most in two months. Additionally, the previous week's claims were revised up by 3,000, while continuing claims fell the most this year, down 131,000 to 4.55 million. With an unchanged unemployment rate of 9.7% and the U-6 "underemployed" statistic inching up to 16.9%, the figures demonstrate an improved but still-struggling labor market.

Gold continued its winning streak, ending up 3.2% on the week to \$1,161.10 an ounce, but still shy of the \$1,217.40 record it notched on December 3, 2009. Oil and copper ended at levels not seen since 2008, boosted by improving economic growth prospects and increased demand. Oil prices rose to an 18-month high ending the week at \$84.92 per barrel, while copper settled up 1.3% at \$3.63 a pound.

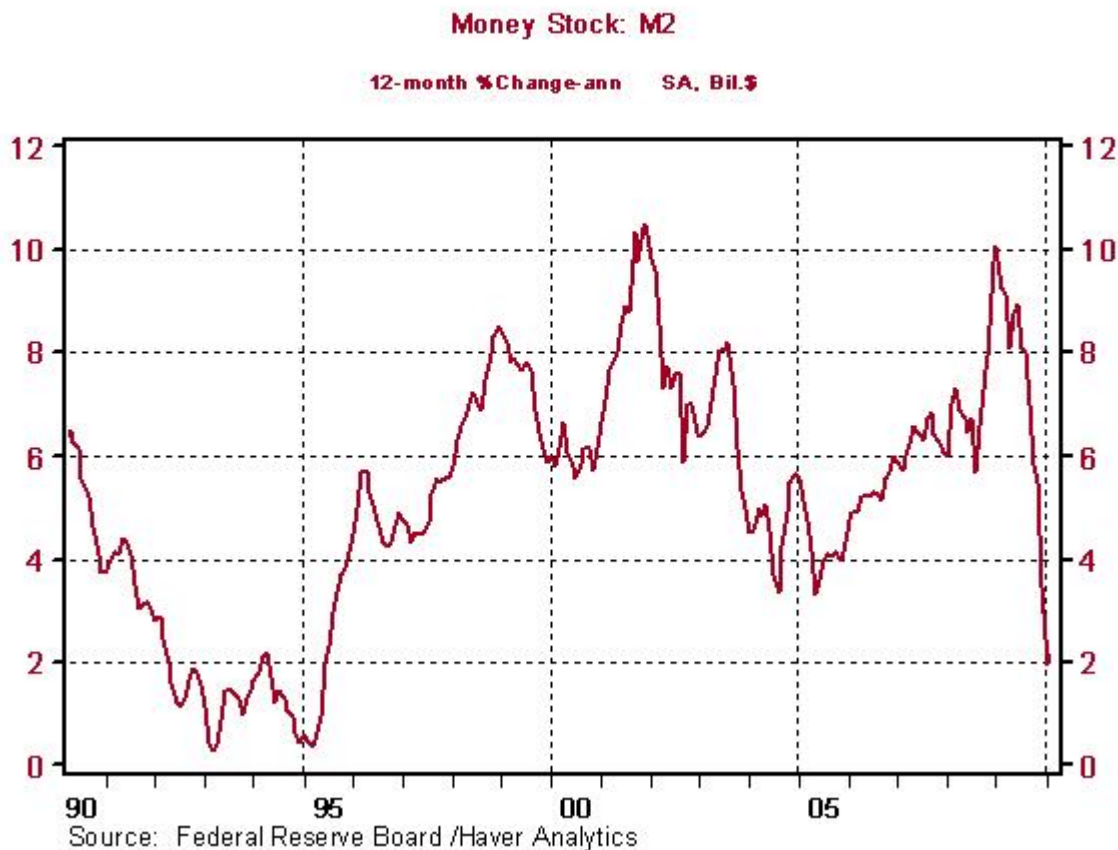
Optimism over speculation that Greece might receive a financial bailout from the European Union or the International Monetary Fund pushed Greek government bond yields slightly lower by the end of last week. However, fears over sovereign debt risk have continued with bond ratings firm Fitch reducing Greece's debt rating to BBB-, just one notch above junk status. So far, the chaos surrounding the Greek debt crisis has been contained, but the crisis itself has not been resolved. With the markets getting nervous about debt burdens in Portugal and Spain, the euro remains under pressure relative to the dollar, yen and gold.

Despite this Greek drama, central bankers are playing their part to support the global economic recovery with continued accommodative monetary policy. This week the major international central banks met and reiterated their previous decisions on interest rates. The Bank of Japan, the Bank of England and the European Central Bank all left rates unchanged at historically low levels, while the Reserve Bank of Australia increased its benchmark rate by 0.25% in recognition of that country's relatively more robust growth trajectory.

Federal Reserve officials also remain worried about raising interest rates too soon during the early phase of this economic recovery, as noted in their recently released March meeting minutes. A few committee officials also noted that "at the current juncture the risks of an early start to policy tightening exceeded those associated with a later start" and elected to keep the fed funds rate at its current low level. Although the committee uniformly believed an economic recovery was at hand, many pointed to potential headwinds and ultimately were reluctant to change the Federal Open Market Committee statement language.

Inflation data remain restrained and have helped reinforce the Fed's decision to remain on hold as the staff reduced their forecast for future inflation. Northern Trust Chief Economist Paul Kasriel states that inflation growth typically lags money supply growth by about three years. As illustrated below, money supply growth is increasing a pathetic 1% over the past 12 months, using the M2 measure. This is the result of banks in today's deleveraging environment being reluctant to lend and borrowers not having a big appetite for credit.





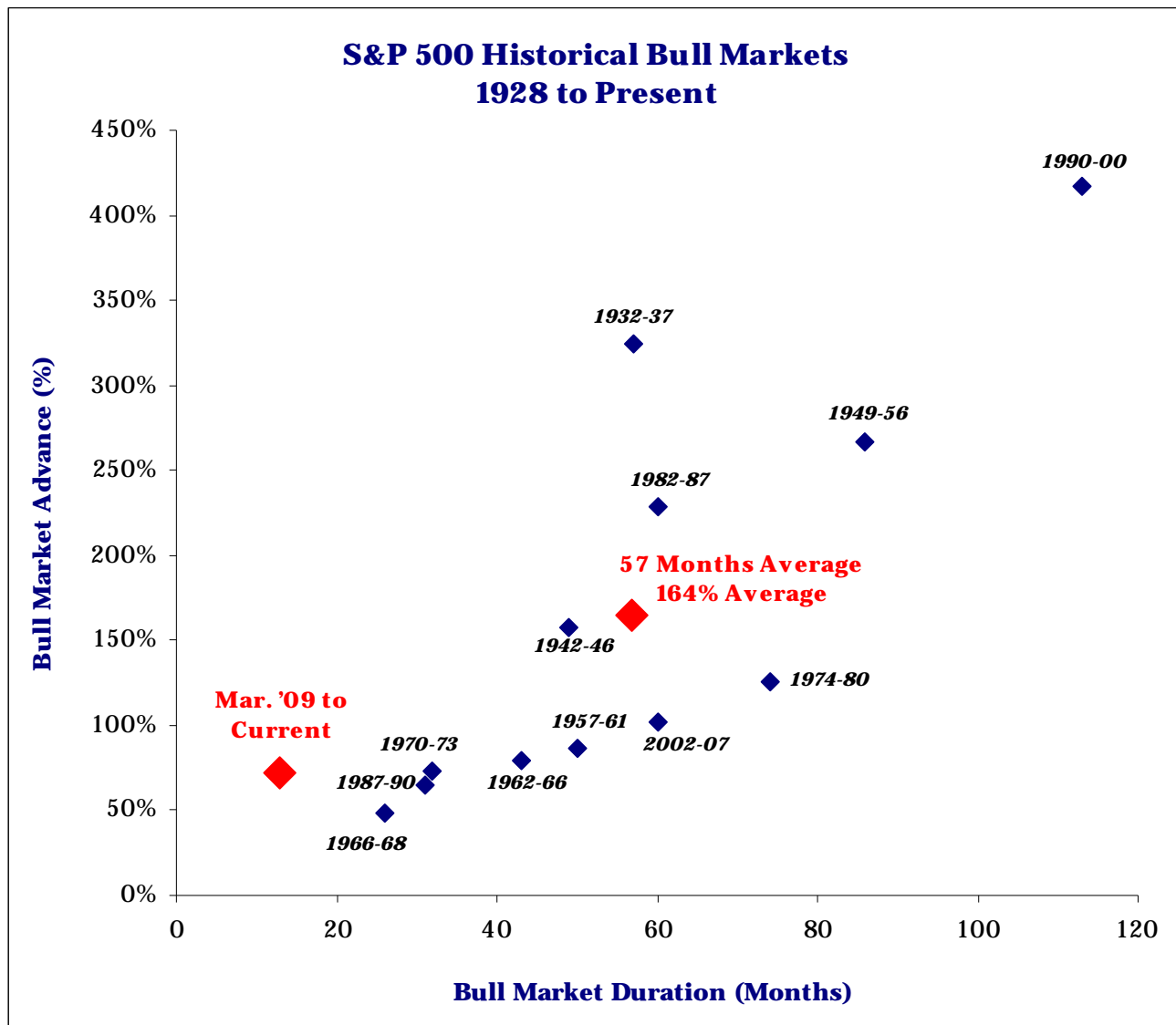
The bottom line is the economy is clearly recovering, and both the public and private sectors are adding jobs. While this has encouraged optimism among investors and pushed them into riskier assets, it does make it more difficult for the government to attract buyers as the United States continues to issue the massive amounts of Treasury bonds needed to fund our deficit spending. Against this backdrop, yields on 10-year Treasuries touched 4% last week before settling at 3.88%, with economists' forecasts varying widely as to the ultimate direction of rates. Where Treasury yields wind up might dictate the pace of economic recovery as well as potentially the direction of the stock market, given that a strong economy could probably withstand a spike in interest rates whereas a shaky economy might not.

Stock buyers have seen data pointing to increasing orders and record productivity, which should bode well for future corporate profits. Earnings releases will begin to arrive in bulk starting this week, kicked off by Dow component Alcoa, as investors wait to see if stellar expectations will prove true against year ago results. With consensus expectations of operating earnings for the S&P 500 at \$80 per share and a 17-times ratio, this implies the index could move to a level of 1,360 or a gain of 13.9% from levels today.

Doubters are abundant, yet experienced professionals know that rising markets can persist in climbing a "wall of worry." Even as the magnitude and speed of this market's ascent from the March



2009 lows might prompt one to wonder about its sustainability, historical bull market statistics after recessions suggest we might have more upside to look forward to.



Source: Strategas

The economic recovery is broadening and the recovery process is becoming more entrenched. Improving global economic fundamentals, rising consumer and business confidence, reviving consumer spending, the business-cycle inventory recovery, as well as our forecasted delay of monetary policy rate increases, combine to support our risk-taking stance in client portfolios.

David Murdock holds designations as a Certified Financial Planner[®], a Chartered Life Underwriter, and the Certified Investment Management Analyst[®] program.



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