

# Investment Commentary

SEPTEMBER 28, 2009

After advancing 8 of the previous 10 weeks, stocks experienced a correction last week, with the Dow Jones Industrial Average losing 1.6% to close at 9,665, the S&P 500 Index declining 2.2% to 1,044 and the Nasdaq Composite falling 2.0% to 2,091. Nevertheless, barring disastrous market activity over the next few days, September should mark the seventh consecutive positive month for stocks.

The Federal Reserve met last week and kept the benchmark Federal Funds target rate unchanged at a range of between 0% and 0.25%, but indicated that economic conditions have continued to improve. The Fed also retained the message that "economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period." As such, we have no expectation that the Fed will begin tightening policy any time soon.

We believe that while the broad financial crisis is largely over, the economic crisis is only halfway through. While we do believe the recession has ended, we would argue that the recovery has only just begun and will likely require a period of years to return the United States to trend levels of economic activity. This means we are likely to see continued high levels of unemployment and ongoing deflationary pressures for some time. To be sure, conditions have clearly improved on a number of fronts, and even recent consumer confidence figures have surprised to the upside, reflecting both the reality of better economic growth and improved expectations for the future. Nevertheless, the economy still faces a number of headwinds. State and local governments remain deeply troubled and are faced with the choice of raising taxes, reducing spending or some combination of the two. Additionally, global trade policy remains a concern, as there has been increasing noise about enacting protectionist trade policies, which we believe would hurt overall global economic growth. This is an important point given that even before the recession began, we were seeing a shift in global consumption patterns away from the United States and Western Europe and toward emerging markets. That trend has only accelerated over the past couple of years and spending patterns in the emerging markets are having an increasingly large effect on overall global growth. Finally, we would also point out that commercial banks are still experiencing credit contractions despite their improved ability to raise capital and their reduced reliance on government funds and guarantees. We would argue that a healthy commercial banking system is one of the prerequisites for a sustained economic recovery and an ongoing equity bull market, and if the contraction in bank credit persists, we would have to adopt a more cautious outlook.

Against this backdrop, it would come as no surprise to us if stocks struggle in the near term, and volatility is likely to remain an ongoing issue. Over the longer-term, however, a combination of supportive monetary policy, low inflation and positive economic growth, combined with reasonable valuations, suggest that stock prices should continue to grind higher.

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