



## February 2010



### January Correction

What happened? That question is naturally on the minds of many investors as stock prices suddenly reversed course mid-January. What started out so promising degraded into a 6.6% decline for the S&P 500 from its recovery high on January 19. The short answer to the question is that the market was hit with a triple dose of uncertainty – increased bank regulation, a slowdown in China, and a possible default by Greece on its bonds.

Right after the special Senate election in Massachusetts, President Obama proposed a new bank regulation, which he says is designed to decrease the odds of future bank bailouts by separating the “less risky” traditional loan and deposit business from the “more risky” business of proprietary trading of securities. However, the proprietary trading business provided the big banks with capital to help weather the problems in their traditional loan business, caused by lax credit standards and excessive leverage. The proposed regulation raises the risk that the banks will actually reduce their loan business, however, investors do not expect the legislation to get through the Senate.

The slowdown in China and the liquidity problems in Greece are another matter altogether, as they are both very real. China is aggressively reducing the flow of credit to its real estate market so as to prevent a bubble in property prices, but the risk is that it will go too far and provoke a major slowdown in the total Chinese economy. The fear of such a slowdown is understandable, but the actual risk is most likely overblown. It may result in lower commodity prices in the near term, but the Chinese economy should continue to grow in excess of 6% annually. The problem with Greece is more serious, as a default would raise fears of a chain reaction of defaults in other countries with serious budget difficulties, similar to the Asian Financial Crisis in 1997. Then, Thailand defaulted and raised fears of worldwide economic meltdown as the crisis spread throughout Asia and into Russia. The European Union and Greece will most likely find their way through the current crisis with some type of solution, but it may take longer than most investors expect.

There is an old Wall Street adage that says, “As goes January, so goes the year.” Before anyone gets too anxious about that view, keep in mind that the S&P 500 declined 8.6% in January 2009 and ended the year much higher. We had expected that stock prices could see a correction in January. Markets that have difficulty in January typically bottom in February or March. So we look for the market to end its correction relatively soon and resume its uptrend.

	01/31/2010	12/31/2009	12/31/2009	MTD Change	YTD Change
Dow Jones Industrials	10067.33	10428.05	10428.05	-3.46%	-3.46%
S&P 500	1073.87	1115.10	1115.10	-3.70%	-3.70%
Nasdaq Composite	2147.35	2269.15	2269.15	-5.37%	-5.37%
Russell 3000	1155.48	1199.83	1199.83	-3.70%	-3.70%
2-Year Treasury Yield	0.83%	1.14%	1.14%	-0.31	-0.31
10-Year Treasury Yield	3.61%	3.84%	3.84%	-0.23	0.23