

# Market Comments



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### Stocks Rebound as Bonds Rally

The stock market continues to recover from the selling in May and June as it remains in an uptrend that began on July 7, driven primarily by stronger than expected earnings. Nearly 340 companies in the S&P 500 have reported earnings. The aggregate earnings growth is slightly more than 45% compared to the second quarter of last year. More importantly, 78% of the reporting companies have topped expectations while just 16% have missed estimates. The remaining companies matched analyst expectations. However, revenue growth has not been nearly as robust as reporting companies have increased their revenues by about 10% year over year.

The upside in corporate earnings reports is somewhat surprising given that second quarter GDP came in at 2.4%, below expectations of 3.0 - 4.0%. Subsequent data has reinforced slower near-term economic growth as factory orders, pending home sales, and personal income and spending showed mixed results. The current challenge for corporations is to show continued growth in sales and earnings as third quarter GDP expectations are ratcheted down to around 2%. So far, the leading stocks in the market seem to be up to the task as they are experiencing significant growth from foreign markets.

The financial markets have found themselves to be in the unusual position that recent data supports both the stock and bond markets at the same time. Our economy has entered a period of inconsistent and uneven economic growth where it sometimes appears that we are reentering an expansionary phase. At other times, it appears that we are reentering a recession. Stocks are supported by low interest rates, robust earnings growth, reasonable valuations (a P/E ratio on forward earnings of about 12.0x), and strong corporate balance sheets (cash balances of roughly 10% of total assets). Bonds are supported by GDP growth below expectations, high unemployment levels and low inflation.

Some analysts would go so far as to say that the bond market is in a bubble as bond prices have rallied to historic highs. Consider that at a 2.89% yield on the U.S. 10-year note, fixed income is priced at the "P/E multiple equivalent" of 34.5% (the inverse of 2.89%) against the S&P's P/E multiple of only 12.0x. For this reason we have purposely kept our bond maturity levels relatively shorter-term in nature. If we saw the Fed embark on a new round of quantitative easing that we expected to result in higher GDP growth, we would consider expanding our allocation to stocks as the stock market would outperform bonds at that point. But until then, we will maintain our current asset allocations, keeping our bond maturities relatively short and continuing to focus on the leading quality stocks in the market.

	07/31/2010	06/30/2010	12/31/2009	MTD Change	YTD Change
Dow Jones Industrials	10465.94	9774.02	10428.05	7.08%	0.36%
S&P 500	1101.60	1030.71	1115.10	6.88%	-1.21%
Nasdaq Composite	2254.70	2109.24	2269.15	6.90%	-0.64%
Russell 3000	1192.96	1116.78	1199.83	6.82%	-0.57%
2-Year Treasury Yield	0.55%	0.61%	1.14%	-0.06%	-0.59%
10-Year Treasury Yield	2.91%	2.95%	3.84%	-0.04%	-0.93%