

C *Economic & Market* Commentary

Dow 10,000 Milestone or Tombstone

One again, the popular media has focused our attention on the weighted average of 30 stocks. Granted, it has a certain wow-wee characteristic, but in terms of importance to the long-term investor, it is a non-event.

The breadth of the market is quite narrow, as the number of rising stocks continues to shrink. The issue is and has been, will Corporate America be able to meet (or beat) earnings expectations in the coming years, and how should those earnings be valued in terms of today's market. Currently the markets are rewarding the larger growth companies over almost everything else. This has produced a widening performance divergence amongst stocks in the S&P 500 list. At some point the gap will narrow, the leaders will either come down to meet the laggards or the laggards accelerate their pace and catch-up. This will likely begin when investors rediscover the quality growth characteristics found in companies outside the new "nifty-fifty".

My view has been, and continues to be, that the global economy is on the mend, but without a significant increase in inflation. We have been successful in addressing these market issues over the last 9 months, by modestly adjusting the asset allocation, maturity weighting of the bonds and sector selection of the stocks. As the global economies gave evidence of this mending, we took profits on most of our allocation to long-term U.S. Treasuries, and increased stock allocations.

While the long-term downward trend in interest rates remains intact, the run-up in interest rates during the first quarter has had a negative influence on bond prices and has hurt portfolio performance. Real interest rates (market rate – inflation rate) are still quite high by historical measures, and unless inflation heats up, interest rates should ease later this year.

As interest rates ease, and the global economies come on stream, we should see a broadening of market participation within the popular averages. This should bode well for client portfolios, as we are positioned to take advantage of lower interest rates, and sustained global economic growth.

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