Commentary

The first quarter signaled a continuing trend toward economic recovery. The extremely low interest rate environment worldwide is very favorable to equities, and all three major domestic markets performed well. There is a growing optimism in the market.

The economy is clearly on the mend, and initial reports of fourth quarter 2009 GDP growth in excess of 5 percent were a pleasant surprise. Consumer confidence is on the rise, with consumer spending having increased now for five consecutive months. We are thus seeing encouraging signs of consumer revival, and the manufacturing sector is similarly demonstrating considerable improvement from a year ago. One of the themes we have mentioned in the past few commentaries is the need for consumer spending to pick up, and it now appears that it is happening.

Fourth quarter 2009 earnings, reported in the first quarter of 2010, were impressive, as nearly 75 percent of the companies in the S&P 500 exceeded estimates. The question now is whether earnings growth can be sustained. We think so, given the market developments mentioned above, and we feel that first quarter earnings should be robust. Corporate balance sheets are healthy, and that may spur some merger activity, which we would view as a positive.

Occasionally, Washington injected political uncertainty into the market. Proposals for new financial regulations, for example, and the recently passed healthcare legislation prompted increased volatility in the market. The market remained resilient when the new health care legislation passed, however, despite predictions that it would have downside pressure.

One ongoing concern is the housing market, which continues to wane. We foresee additional pressure there as the tax credit for new home purchases expires. Banks might be in better financial shape than they were a year ago, but credit remains tight, and, as a result, there is less financing for home purchases. A more encouraging sign is that housing prices were stable (if not up slightly). Unemployment has also improved, but the jobs picture will likely remain tenuous for the next year as employers refrain from hiring additional employees until absolutely necessary.

As we move into the second quarter, we will be focusing on companies that have superior earnings growth and at the same time will be keeping an eye on the Federal Reserve in anticipation of a rising interest rates. We do not expect rates to be raised until late in the year at the earliest, but we recognize the increasing pressure for the Fed to raise rates to prevent a bubble-like environment of the sort that put us in the recession in the first place.

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