Commentary

Financial markets staged remarkable improvements in 2009, coming back from the brink of disaster, thanks in large part to rescue efforts by governments around the globe. An unprecedented amount of monetary and fiscal stimulus helped fuel the market rebound from March lows. The Federal Reserve pledge to keep interest rates low for an extended period of time, and the massive government stimulus programs have helped mitigate the worst crisis to our financial system since the Great Depression.

What we hope to see in 2010 is a gradual economic recovery and the transition from a cost cutting themed recovery to one in which return to earnings and earnings growth are the primary emphases. This is very important, as most of the rally in 2009 resulted from cost cutting and job elimination, with firms focusing more on mere survival than on growing earnings. Corporate earnings must be robust for the current rally to continue.

The corporate sector is in relatively good fiscal condition. Businesses have cut costs, profits have increased, and balance sheets are generally more solid. A modest uptick in consumer demand should promote capital expenditures and hiring.

One issue to watch closely in 2010 is how the economy will fare when the government spigots turn off. The ability or inability of the private sector to pick up at that time and assume leadership in the economic recovery will be a major determinant of success. We will pay close attention to the Federal Reserve, particularly with regard to how it decides to proceed with interest rates.

I think we will see surprisingly positive retail sales figures and better than expected earnings from the fourth quarter 2009. Domestic manufacturing and industrial production have been on the rise since August, and inventory replenishment will continue to drive manufacturing activity. Many market strategists feel we will see an early year rally, based in part on the favorably low interest rate environment, and benefitting from the early stages of an economic recovery.

Less encouraging are real estate and employment, which remain weak. Real estate values have not stabilized. Housing sales, outside from foreclosure sales and sales supported by government programs, are weak. Similarly, the jobs picture has not improved as the national average unemployment rate is still around 10 percent. Productivity is near an all-time high, however, as employers are getting the most out of current employees. We need to see an improvement in the employment picture to fuel further recovery, but employers remain cautious with hiring.

Several issues we may face as 2010 and 2011 progress involve heightened financial market regulation, higher taxes, higher interest rates, and an emerging threat of inflation.

In summary, we see the liquidity-driven bull market continuing into 2010. There may be some bumps along the way, but, from a macro perspective, we see the market moving higher in 2010. Sectors that will lead the way should be technology, finance, industrials, energy, and commodities.

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