



February 15, 2010

The stock market, yet to find a firm footing in 2010, continued to convulse this past week with three double-digit moves that hinged on the plot twists and turns in the latest act of the ongoing Greek debt drama, the most recent involving the supporting role played by American financial firms. By week's end, despite plenty of scripted sound bites – and very little in the way of substantive solutions – out of the meeting of European leaders in Brussels, investors seemed to be at least satisfied that Greece would not be allowed to fold, driving all three major indexes into the black for the first time since the week ending January 8th.

Regarding Greece and the other countries in the euro zone that have high debt levels and low growth prospects, the main issue for investors remains one of contagion: the fear that any one nation's default would weaken the euro, lead to higher borrowing costs, and slow the recovery for other member countries. Even so, while a number of solutions are being considered, including loaning Greece money or having its debts guaranteed by a third party, Germany, in particular, has not publicly rushed to the rescue because it does not want to set a bad precedent: If the stronger euro zone members are always there to bail out over-leveraged countries, what incentive will Greece have to rein in its profligate spending and shore up its finances?

Late in the week, the news for all of Europe was bleak as gross domestic product (GDP) growth for the fourth quarter slowed to 0.1% for both the euro zone and its 16 member nations as well as for the 27-member

	Key Market Data		
	Week ending		
	2/12/10	2/5/10	Change
Dow Jones Industrial Average Index	10,099.14	10,012.23	+0.87%
S&P 500 Index	1,075.51	1,066.19	+0.87%
NASDAQ Composite Index	2,183.53	2,141.12	+1.98%
10-Year Treasury Note Rate	3.691%	3.546%	+0.145 pct. pts.
NYMEX Crude Future (Barrel)	\$74.13	\$71.19	+4.13%
Euro/U.S. Dollar	\$1.3618	\$1.3665	-\$0.0047

European Union. The International Monetary Fund forecasts GDP growth of 1% for the euro zone in 2010, compared to 3.1% for the United States.

In China, where GDP is expected to grow at 10% or more in 2010, the central bank continued to put the brakes on its economy – and inflation – by requiring banks to set aside more money in reserve, making less cash available for credit and investment, the second such move in the last five weeks. Any pullback from China will affect the global economy because of the vast amounts of commodities it buys to fuel manufacturing.

Benjamin Bernanke, the chairman of the Federal Reserve, was invited to report to the House Financial Services Committee and give, in essence, an update on the state of the Fed's strategy. As might be expected, he offered few specifics and no new timetable for the Fed raising its rate. However, he did discuss in some detail one of the exit strategies being considered, raising the interest rate on the \$1.1 billion in excess

reserves the Fed is holding and paying 0.25% interest on – money that banks have parked at the Fed to support any liabilities but are not obliged to keep there. The thinking is that higher rates may give the banks incentive to leave the money with the Fed rather than put it back into the economy where it might trigger inflation. However, as some pundits observed, there's no history of using the excess reserve as a tool for monetary policy and no certainty about how high the rate would have to be to entice banks to leave their money there.

The Commerce Department reported that wholesale inventories fell 0.8% in December to \$383.57 billion (an increase of 0.5% had been forecast) which signals that businesses are still cautious about restocking their shelves (restocked inventories typically signal higher output and lead to new jobs). Wholesale inventories account for about one-quarter of the nation's total inventories, with factories and retailers holding the rest. Sales at the wholesale level rose 0.8% to \$341.16 in December following a 3.6% uptick in November. The Commerce Department also reported that retail sales were up 0.5% in January to a seasonally adjusted \$355.8 billion.

On Wednesday, the Congressional Oversight Panel that's examining the \$700 billion spent by the Troubled Asset Relief Program (TARP) reported that 2,988 of the nation's 8,100 small banks may have to sharply reduce lending because of losses on commercial real estate loans. That does not bode well for the recovery as the small businesses and entrepreneurs they lend to are a key engine of economic growth.

Having recently declared an "impasse," Senator Christopher Dodd (D, Connecticut), chairman of the Senate Banking Committee announced that negotiations to come up with a bipartisan plan for financial regulation had recommenced, though there was no progress on the major sticking point: the fate of the

consumer financial protection agency that Republicans are against.

Lastly, though the trade gap climbed in December, it was nonetheless considered to be a relatively positive sign for the global recovery as both imports and exports rose. The gap reached a seasonally adjusted \$40.2 billion, up from \$36.4 billion in November, as exports rose 3.3% and imports 4.8%. The wider than expected deficit means that the recently reported GDP rate of 5.7% for the fourth quarter will most likely be revised downward to 5.5% or 5.6% at the end of this month. For all of 2009, the trade gap decreased by 45% to \$390.7 billion, further evidence of last year's global slowdown.

The broader view

Two weeks ago, the Labor Department announced that the unemployment rate had unexpectedly dropped to 9.7% in January from 10% in December. This past week, however, there was plenty of evidence of just how tough it will be, and how long it will take, to get that rate back to the pre-recession neighborhood of 5%.

First there was the release of the annual Economic Report of the President, an overview of the nation and Mr. Obama's policies. The report put the average job rate for 2010 at 10% before dropping to 9.2% in 2011 and 8.2% in 2012. An estimated 95,000 new jobs a month would be created in 2010, but that is barely enough to keep up with the number of new job seekers added to the economy.

Then on Thursday, *The Wall Street Journal* released a survey of 55 economists who believe that about one-quarter of all of the jobs lost in the recession are gone forever and need to be replaced with new jobs in different industries.

Finally, there was proof that politicians will continue to joust and jaw regardless of what the public thinks of them. On Thursday, the Senate Finance Committee offered a

bipartisan, \$85 billion package to stimulate the economy and promote jobs. Within hours, Harry Reid (D, Nevada), the Senate Majority Leader, surprised both parties with a very different, \$15 billion version that focused on four job initiatives that he wants to fast track and bring to the floor on February 22, catching both the Republicans and some members of his own party off guard and putting the fate of the bill in jeopardy. This goes a long way toward explaining why, in a recent *New York Times*/CBS poll, only 15% of the respondents said they approved of the way Congress was handling its job, with 75% disapproving and 10% having no opinion. In fact, though only 46% of people approved of the way President Obama was doing his job (vs. 45% who disapproved and 9% who had no opinion), he came off far better than Congress as a whole or, for that matter, either party. For example, 60% of the 1,084 respondents believed that the president understood the needs of people like themselves compared to 42% who thought the Democrats in Congress understood them

and 35% who felt the Republicans in Congress did.

A look ahead

Though the earnings season is not officially over, there has been one notable trend: companies that have beaten expectations have not been rewarded, share-wise, while those that have fallen short have been punished. At the beginning of last week, according to Bespoke Investment Group, the shares of the former have risen just 0.46% while those of the latter have fallen 3.70%. Further evidence of heightened expectations and disappointment – investors want revenue, not cost-cutting – will continue this week as the final numbers come in. In other impending reports, there will be new figures for housing starts and building permits, industrial production and capacity utilization, and both the producer and consumer prices indexes. On Wednesday, the minutes of the last Federal Open Market Committee meeting on January 26-27 will be released and sifted for new clues about what the Fed will do next, and when.

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Standard & Poor's offers sector indices on the S&P 500 based upon the Global Industry Classification Standard (GICS[®]). This standard is jointly maintained by Standard & Poor's and MSCI. Each stock is classified into one of 10 sectors, 24 industry groups, 67 industries and 147 sub-industries according to their largest source of revenue. Standard & Poor's and MSCI jointly determine all classifications. The 10 sectors are Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunication Services, and Utilities.

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