Lassus Wherley ...a view from the top
Building Better Futures
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# And for Our Next Act We Have………..

## Food for Thought

Too many moving parts are what we have these days. If you turn away for a second, you miss the breaking news that creates another up or down movement in a very volatile market. We continue to hear all the discussions about whether we really are in a bull market or if we are going to experience a true double-dip recession driving the markets back down.

Since the peak in the market in late April, back when everything looked rosy for the economy, the markets have been trying to sort out the possibility of a so-called "double dip." A double dip would mean that the economy had relapsed or gone back into recession. While we understand these concerns, given the recent economic releases that signal a possible slowing in the rate of economic growth, we believe we will muddle through the current "soft patch."

The concerns about the economy center on three main factors: a possible spill-over to the US of the debt problems in Europe, the recent relatively weak jobs reports and the risk that the economy will not be able to make the transition from an economy supported by federal government stimulus spending to a self-sustaining period of growth. There is no doubt that these are serious issues.

First let's deal with the European debt crisis. We all understand that there are certain countries in Europe with very high levels of debt on their balance sheets. Investors have grown wary of holding the debt of Greece, Spain and Portugal due to fear that the bonds issued by these countries could decline dramatically in value or even potentially default. Since no one really knows how much of this debt is held by European banks, the European banks have become wary about lending to each other. Recently we have seen signs that the situation may not be as bad as originally thought because European banks have borrowed less than expected at the temporary lending facility put in place by the European Central Bank. The other piece of good news out of Europe recently was that Spain was able to sell €3.5 billion ($4.28 billion) of a five-year government bond. This was a good sign that investors were still willing to buy these bonds and the country was able to obtain financing in the bond market.

The next topic is the overall jobs picture. After several months of strong non-farm payroll reports, we have had two reports back to back which have questioned just how many new jobs are being created in the US. In May, this report indicated that only 43,000 new private sector jobs had been created. In June, there were 83,000 new private sector jobs added. While new job creation is important to the economy, keep in mind that these numbers are very volatile and subject to revisions. Also, the waters are muddied this year by the impact of the short-term hiring and firing of census workers. After a recession as deep as we experienced in 2008-2009, we would expect that it would take some time for unemployment to revert back to pre-

recession levels. A painfully slow jobs recovery is hard news to swallow but we continue to look for a trend of more jobs being added. Unfortunately, it will probably be at a very slow pace.

And the third issue is that we need to get to the point where the economy is bolstered by stronger current demand and is not just moving forward based on pent-up demand. The path from an economy supported by federal government stimulus to one which is self-sustaining will not be a smooth or necessarily easy one. There remain, however, more reasons than not to believe that the transition will be made.

We don't expect that the economic recovery will proceed in a straight line. The economy often softens a bit several months to a year after coming out of recession, and it can look like a possible double dip. This is not an unusual situation. We may experience a soft patch as various fiscal stimulus measures are rolled off (such as the $8,000 new home buyer tax credit), but we don't expect that the economy will roll over and quit. Economists' consensus forecasts are still anticipating real GDP growth of about 3% over the next year. On the margin, while there may be some reduction in these growth forecasts over the next few months, we would expect they will remain positive for the year.

## So…….What Are the Positives and Negatives in the Current Economy?

**Let's start with the positives:** Consumers have been gradually increasing their spending. Personal income growth for May was a positive 1.6%. We see consumers remaining cautious but would note that for the most part, consumers with jobs have begun to return to more normal spending patterns than those we saw in the depths of the recession.

We have seen a strong, broad-based rebound in manufacturing production over the past year. The most recent ISM Manufacturing Index indicated that some of the momentum in manufacturing may be slowing, but the index remains strongly positive with a reading of 56.2. (Readings above 50 indicate an expansion.)

Businesses have been catching up on investments in capital equipment and software that were postponed in the downturn. The recovery which started last fall has been fairly widespread in terms of sectors and geographic reach.

**Now for the negatives:** Private sector hiring has weakened in May and June compared to the 218,000 new private sector jobs that were created in April.

Housing weakened in May after the end of the $8,000 federal tax credit on April 30th. We would expect this sector to enter a soft spot if indeed Congress does not extend the June 30$^{th}$ deadline to September 30$^{th}$. We still believe that demographic trends will support the trend toward new household formation. (We know of several young people who have recently taken the big step and moved out of their childhood home into that first apartment.)

## More Thoughts on the Economy

The easy money which the Fed continues to supply should allow the economy to weather the current housing-led "soft patch" and make the transition from the sharp recovery phase to a more sustainable, although lower, level of activity. We expect that continued fiscal stimulus will be called for if the recovery seems to falter seriously.

At this point, the European sovereign debt crisis has not been severe enough to derail our recovery but will remain a concern until the publication of the results of the stress tests on European banks are released on July 23rd.

Economists have recently indicated that they had lowered their growth forecast of the US economy as a result of the debt crisis in Europe. We expect that the situation will continue to evolve over the next few months.

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Thank you, as always, for the great questions you send our way. Here are some of the recent questions with our responses:

**Question:** *How has the oil spill in the Gulf of Mexico impacted the economy?* **Answer:** The economic impact of the Gulf of Mexico oil spill remains largely regional. Those most deeply and directly impacted have been the individuals employed in commercial fishing, recreation and tourism and deepwater drilling and their suppliers in the coastal counties of Alabama, Florida, Louisiana and Mississippi. Our hearts go out to these people, many who have taken severe hits already from Hurricane Katrina.

So far, there has been no serious disruption of energy supplies or problems with marine transportation having to navigate around as a result of the oil spill. The way that the oil spill **has** impacted all Americans, both consumers and businesses, is on the level of confidence. We are all impacted to some degree by the hit to confidence which this disaster has created.

**Question:** *How do all these statistics affect the stock market and should I be worried?* **Answer:** Any evidence that: 1) European banks' holdings of Greek, Spanish and Portuguese debt are not going to cause another financial crisis and 2) that jobs are continuing to be created in the private sector should be well received by stock markets. Stocks have gotten a lot cheaper than they were back in April, as the markets have backed up and bonds have gotten a lot more expensive. The S&P 500 is trading at about 13 times estimated 2010 earnings per share while the US Treasuries are trading at levels last seen in the depths of the financial crisis in 2008.

Stock prices should be supported going forward by increasing dividend payments on the part of cash-rich corporations. In 2010 to date, 136 companies in the S&P 500 have either increased their dividends or initiated a new dividend while only 2 companies have either cut or suspended their dividend. This compares to 157 dividend increases and 78 cuts or suspensions in all of 2009. This is definitely good news.

Second-quarter earnings season is beginning and analysts are looking for operating earnings of $18.50 for the S&P 500. Analysts have been slightly reducing their estimates in recent weeks. This is a good sign, as that increased degree of skepticism, combined with much lower stock prices, could actually set us up for stronger markets. Of course, that assumes earnings come in near expectations and that managements' comments on the outlook going forward are relatively positive.

So…………..it is an evolving never-ending story. We do believe that there are many indications of a more positive move in the stock market. However, as always, we remain somewhat cautious and continue to hold more hedge strategies funds "just-in-case."

**Question:** *I read something the other day that stated that any money I need for the next several years I should have in cash. Is that true, and if so do I need to increase my cash holdings?* **Answer:** When

looking at how much cash is enough, there are several things to consider, including emergency funds which really are comprised of funds with many possible objectives.

You always need to have funds available for those unexpected happenings. We all have them and if you don't have an emergency fund you could end up increasing your debt, having to pay late fees because you can't make ends meet, selling investments when you don't want to or you may not be able to pay for really important things. I call these the what-ifs. What if your heater dies in the middle of the winter and you don't have the dollars to pay to get it fixed? Or what if your car breaks down and you have to have it to get to work and can't afford to get it fixed?

In today's environment, another reason for having an emergency fund is to pay basic living expenses for a period of time if you lose your job or have to take a cut in pay. This is an important part of the emergency fund calculation and planning today.

A third reason for maintaining cash is when you are utilizing it for ongoing basic living expenses.

The dollars needed really depend on the needs of the family. The basic rule of thumb has been 3 to 6 months' worth of living expenses. However, this depends on your overall spending needs. In the current environment, short-term bonds are another way to provide for dollars when they are needed. These funds provide some level of income but are still available to use when additional cash is required. At this point we are still maintaining about 50% of the bond investment in short-term funds that provide more safety while still generating a reasonable return vs. cash which is returning very little at this point in time. If you need further information concerning your cash needs, please let us know.

## Looking Forward

Keep those questions coming in. If you are wondering about something, the odds are pretty good someone else may also be thinking about the same topic. When you ask—we get the chance to share our thoughts on the topic with others. Please let us know if you have any questions or concerns. We are definitely enjoying the month of July so far with the rally last week. Have a great summer!

*Diahann*

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