Market and Economic Commentary
October 2009

The third quarter closed on a generally upbeat note, with much of the economic data (including reports on industrial production, factory use, retail sales, and housing construction) pointing to a business cycle that has probably bottomed out. This is good news given that we have just experienced the worst recession in several decades. On the other hand, the economy is not exactly booming. In fact, the recovery now taking hold across the country is helping to reverse just a small portion of the carnage from the previous two to three years. Even so, the emerging upturn may have been enough to push gross domestic product up by more than 2% in the just-ended third quarter.

All things considered, this is the most favorable economic outlook since Lehman Brothers failed a year ago, and means the Fed will probably delay raising interest rates and shrinking the Fed's $2.1 trillion balance sheet until a recovery is secured. In that regard, the Federal Reserve has signaled that the U.S. economy's probable return to growth is insufficient to withdraw stimulus as they are still seeking to reduce the highest unemployment rate in a quarter century and has committed to complete their $1.25 trillion in purchases of mortgage securities. While the economy has picked up, the Fed's planned asset purchases will help ensure a gradual return to higher levels of resource utilization.

Sustainability seems to be the key issue going forward. We believe we're heading into the fourth quarter with enough positive momentum for the economy to grow by 2% or maybe more. However, we also realize that serious problems remain, including falling home prices, tight credit conditions, and high unemployment, all of which present a huge challenge.

Several quarters, in fact, may have to pass before the unfolding business upturn becomes widespread. For that to happen, we'll need home prices to rebound basically across the board and unemployment to decline sharply. Only then will the consumer, who is now the weakest link in the recovery chain, have the courage to spend the sums needed to get the economy moving forward strongly.

The next challenge will be the upcoming release of third-quarter earnings. Our feeling is that profits fell less precipitously in the third quarter than in the initial two quarters of 2009, but that it will be another quarter or two before there is a resumption of widespread growth. Profits should then improve further in 2010.

All in all, investors are smiling again, as six months of near-steady price gains have lifted stocks more than 50% off of their multiyear lows. On top of that, interest-rates are so low that stocks seem to be the only game in town. On the other side of the coin though, the market's remarkable recovery has pushed equities to levels that leave little room for an economic misstep, before an overpriced stock market endures a subsequent selloff. In fact, the recent fast and furious equity market comeback has clearly increased the risk of a profit-taking sell off and points up the need for vigilance in the weeks ahead.

During the third quarter of 2009, the Dow Jones Industrial Average added 15.82%; the NASDAQ Composite grew 15.91%;the S & P 500 Index gained 15.61%; the MSCI EAFE International Index increased 19.47%; and the Barclays Capital U.S. Aggregate Bond Index improved 3.74%.