



Investment Overview

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Economic and Markets Summary

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Fourth Quarter 2009

Most economists believe the economy has turned the corner, ending the serious recession that began during the fourth quarter of 2007. The economy bottomed out in the third quarter of 2009 which registered a gain of 2.2%. Growth for the quarter just ended should be a bit higher. The first estimate of Gross Domestic Product for the fourth quarter will be released January 29.

The recovery is perhaps somewhat less solid than thought in early November when preliminary third quarter GDP was released showing a growth rate of 3.5%. The downward revision and the less-than-robust finish to 2009 is due in part to very aggressive policy efforts applied in the summer and autumn which may have worked against year-end strength. The cash-for-clunkers program and the \$8,000 subsidy for first-time home buyers may have benefitted the third quarter at the expense of the fourth quarter.

However, those that were hoping for a stronger recovery in 2010 were heartened when the December employment report was released. The report for unemployment and new job creation released on December 4 was much stronger than expected with unemployment dropping from 10.2% the previous month to 10.0%. Job losses amounted to only -11,000 compared to -111,000 the previous month. The forecast for the December report was -125,000 jobs lost. Job losses for the previous two months were also revised downward.

It did not take long for the newfound optimism to be toned down. Chairman of the Federal Reserve, Ben Bernanke, continued to retain his downbeat assessment of the economic recovery going forward.

In a speech given Monday, December 7 after the Friday unemployment report was released, he reiterated his optimism but made cautionary comments similar to the speech he made November 16 at a gathering of economists and Wall Street veterans at the Economic Club of New York.

He stated, "it's still too soon to declare that the budding recovery will last. We have some way to go before we can be assured that the recovery will be self sustaining." He repeated the notion that "the economy was encountering some formidable headwinds including a weak job market, cautious consumers, tight credit and constrained bank lending, and that would prevent the expansion from being as robust as we would hope."

Some private forecasters continue to be concerned that the recovery could fizzle late in 2010 as government stimulus fades. The fears of a double dip, or a W-shaped recovery, will continue to surface, particularly coincident with the release of weak economic indicators.

Under a recent Fed forecast the jobless rate would remain high in 2010, ranging from 9.3% to 9.7%, even if the recovery and expansion is well grounded. The Fed warned that it could take five or six years for employment to return to normal. The Central bank has the dual mandate of maintaining stable prices and to keep the economy at full employment, which means an unemployment rate in the range of 5%-6%. In his December 7 speech he again reiterated the belief of the Fed that interest rates will remain at exceptionally low levels for an extended period of time due to the low threat of rising inflation.

The notion that the economy is on the mend was confirmed by the release of the Fed's "beige book" report in early December. This roundup of anecdotal reports from the 12

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regional Fed banks featured its most upbeat assessment since the economy tumbled into recession two years ago. Eight of the 12 regions surveyed reported some pickup of activity or improved conditions. The other four regions – Philadelphia, Cleveland, Richmond and Atlanta – described conditions as little changed or mixed.

Comments from the Kansas City Fed bank included the view that “activity expanded modestly. Retail sales have increased, supported by heavy discounting of merchandise. Sales of mid-priced appliances were brisk. Auto dealers said sales were stable and were optimistic about prospects going forward. Manufacturing grew modestly while capital spending in high-tech services and transportation sectors grew. The housing market continued to recover, helped by the government’s homebuyer credit. Sales were strongest in the low end of the market, while sales of luxury homes were anemic. Commercial real estate remained weak.” Regarding agriculture the Kansas City Fed reported that some grain prices, cattle and hog prices have edged up but are still below break-even because of rising feed prices.

Interest Rates

A moderate or weak recovery should not be considered negative for the economy in 2010. As long as real GDP growth remains in the slow or moderate range, Federal Reserve monetary policy can remain accommodative and maintain the low interest rate environment. The most favorable strategy of the Federal Reserve is to hold interest rates as low as possible for as long as possible in order to create favorable conditions for economic growth going forward.

The low interest rate policy does have its risks, however. The dollar on world markets has again resumed its downward course after showing significant strength in 2008 and early 2009 when it was considered a safe haven for capital as a result of the credit crisis and turmoil in the world economy and financial markets. As a result of the weaker dollar, investment flows of funds have gone into oil, gold and other commodities and also into stocks worldwide. Some are concerned that this might contribute to speculative bubbles such as the ones in technology in 2000 and housing more recently. Dr. Bernanke has said the Fed was wary of raising interest rates to combat future bubbles, but did not rule it out.

Credit conditions have improved dramatically during the course of 2009, and this has also contributed to healthier conditions for the stock and bond markets. The 3-month London Interbank Offered Rate (LIBOR), the rate that measures the level of confidence that applies to interbank lending, stood at .30% in mid-December, down from 1.43% in January 2009 and down from its 2008 peak of over 5%. The TED spread between 3-month treasury bills and LIBOR has declined to 0.22%, down from 1.34% last January. At current levels both LIBOR and the TED spread can be considered normal as a measure of interbank lending confidence.

The Federal Open Market Committee of the Federal Reserve had two meetings on their schedule during the fourth quarter of 2009. The first meeting concluded November 4 with Fed Funds remaining at a range of 0 - 0.25%. The post-meeting comments remained very similar to previous meetings, with officials repeating the line from the previous 5 statements signaling no increase for an “extended period” in the “exceptionally low” Fed Funds rate.

The second meeting concluded on December 16. Again Fed Funds were held at the same range of 0 - 0.25%. Post-meeting comments deviated little. The FOMC again emphasized that the economy warranted exceptionally low levels for the Fed Funds rate for an extended period. The FOMC noted “the pick up in economic activity and financial market conditions have become more supportive of economic growth. The Committee expects that inflation will remain subdued for some time.”

The consensus appears to be that Fed Funds will stay at present levels until at least mid-2010. Then it will be a matter of strength and durability of the economic recovery. The Fed will probably begin to tighten slowly in the second half of 2010. Intermediate and long rates should resume their upward climb, perhaps somewhat earlier, and be expected to rise moderately over the course of the succeeding three to five years. Hopefully inflation remains low so that the move to higher interest rates is gradual. Already we are seeing the beginning of divergence between short and long rates.

The movement of interest rates and the change in the yield curve can be seen in the table below, which shows various rates at the beginning of 2009 and the beginning and end of the fourth quarter.

	Treasury Bill		Treasury Notes & Bonds			FED Funds
	3 mo.	1 yr.	5 yr.	10 yr.	30 yr.	
12/31/08	0.11	0.34	1.56	2.25	2.68	0 - .25
9/30/09	0.11	0.39	2.31	3.30	4.04	0 - .25
12/31/09	0.05	0.41	2.63	3.80	4.62	0 - .25

The movement in interest rates created positive returns for various bond fund categories during the year. Below are some examples of different bond fund returns for 2009 according to the *Wall Street Journal*.

Year-to-Date Percentage Returns			
Corp. Bonds (Barclays Agg)	+6.00	Investment Grade Corp. (Short)	+10.40
U.S. Gov't	+3.31	High Yield Taxable	+43.75
GNMA	+8.55	Municipal Bond Index (7-12yr.)	+8.60

Commodity prices showed a great deal of variability as specific commodities traded independently. Much of the lack of uniformity had to do with the speculative interest shown for specific commodities due to the weak dollar on world markets rather than actual supply and demand characteristics.

Oil and gold both climbed throughout 2009. The price of oil, which began trading at \$44.60 per barrel at the beginning of 2009, stood at \$70.61 at the end of the third quarter and finished the year near \$80.00. The price of gold began 2009 at \$884 per ounce. On September 30 gold traded at \$1,008, and after reaching an all-time high of \$1,225 on December 3, closed near \$1,100 per ounce on December 31, 2009.

The Stock Market

The stock market leads or forecasts the economy six months ahead, so the old Wall Street saying goes. This was very much the case in 2009. This relationship between the stock market and economy held true with the stock market bottoming out in early March and the economy going from negative to positive growth approximately six months later.

After the stock market bottom was made on March 9, stocks began a furious climb that showed little hesitation for the balance of the year. As a result of the long and steep bear market, the worst in the post-World War II era, stocks were undervalued and became the asset of choice for available cash. The stock market bargains, combined with low and near zero expected returns for bonds and cash, created huge buying interest for both domestic and foreign stocks. The fact that many stocks paid dividends yielding 3% - 6% provided additional confidence that stocks were not only appreciation providers but also income generators.

The stock market bulls are anticipating that favorable conditions will extend throughout most of 2010. The substantial bond rally occurring after the first quarter of 2009, resulting in lower interest rates and narrower spreads, leaves bonds little room to provide good returns going forward. Returns on cash equivalents should remain low in accordance with Fed policy, which again suggests that stocks should remain the favored asset class in 2010.

Granted, after the 60-plus percent advance from March lows, stocks cannot be considered bargains and are closer to fair value as we enter the new year. Corporate profits are expected to show solid but unspectacular growth going forward. Earnings projections for the Standard and Poors 500 Index range from \$77.00 to \$80.00 per share in 2010 and \$83.00 to \$91.00 in 2011. This gives a forward price/earnings ratio of 14 to 16, suggesting the stock market is reasonably valued. Also there is room for price/earnings ratios to move higher in a low interest rate environment.

The respected Bank Credit Analyst publication believes that stock market strength exhibited in 2009 leaves less room for above-average returns this year. Percentage gains are likely to be in single figures for stocks during 2010, but that will still beat returns for bonds and cash. With successful sector and stock selection, it will be possible to achieve double-digit returns. Therefore it will yield benefits to find reasonably priced stocks showing

superior sales growth, market share gains, and pricing power. In the less exciting environment that is expected in 2010, extra attention should be given to those stocks that can consistently raise dividends each year. Also, those stocks with high current dividend yields of 3% - 6% may continue to be in demand from investors seeking income as well as price appreciation.

The table shows percentage returns for 2009, for various equity sectors and investment styles as computed by Lipper Inc., and featured in the *Wall Street Journal* on a daily basis.



Stock Fund Indices

As of 12/31/09

Large-Cap Growth	+39.15%
Large-Cap Core	+29.24%
Large-Cap Value	+26.07%
Multi-Cap Growth	+40.44%
Multi-Cap Core	+36.46%
Multi-Cap Value	+27.77%
Mid-Cap Growth	+44.22%
Mid-Cap Core	+40.90%
Mid-Cap Value	+41.48%
Small-Cap Growth	+39.72%
Small-Cap Core	+35.99%
Small-Cap Value	+34.64%
Equity Income Fund	+24.93%
Science & Tech Fund	+58.39%
International Fund	+36.09%
Balanced Fund	+24.01%

Regarding the domestic stock market, below is a chart of industry sectors ranked by percentage change by Bloomberg Research at year end.



Percentage Gain by Stock Sector

	4th Qtr.	2009
1. Technology	+11.42	+61.33
2. Basic Industry	+7.78	+46.42
3. Consumer Discretionary	+9.67	+40.15
4. Industrials	+6.21	+18.88
5. Health Care	+9.68	+18.81
6. Financials	- 3.70	+14.78
7. Consumer Staples	+5.55	+12.62
8. Energy	+5.79	+12.07
9. Utilities	+7.76	+8.49
10. Telecommunications	+7.17	+3.89

Fund Results as of December 31, 2009

Equity Funds

	Quarter Return	12-Month Return
Allianz NFJ Large Cap Value	+6.45%	+16.18%
Allianz RCM Mid Cap	+5.44%	+48.47%
Fidelity Adv Eqy Income	+3.70%	+24.88%
Goldman Sachs Mid Cap Value	+5.83%	+33.19%
Janus Adv Intl Growth	+4.09%	+70.85%
JP Morgan Mkt Exp Idx Select	+5.29%	+34.45%
Lazard Emerging Markets	+5.82%	+69.82%
Stratus Growth Portfolio	+5.93%	+23.61%
Templeton Inst Foreign Equity	+1.40%	+33.63%
Thornburg Int'l Value	+3.89%	+31.98%
Vanguard 500 Index	+6.03%	+26.49%
Vanguard Morgan Growth	+7.46%	+36.31%
Vanguard Small Cap Index	+4.07%	+36.12%
Vanguard Strategic Equity	+6.67%	+32.28%
Idx: S & P 500	+6.04%	+26.47%
Idx: Russell 2000	+3.87%	+27.17%
Idx: EAFE	+2.26%	+32.18%
Idx: NASDAQ Composite	+7.20%	+45.36%

Fixed Income Funds

PIMCO Total Return Fund (Inst.)	+0.99%	+13.83%
Stratus Gov't Secs	+0.00%	+3.56%
Templeton Global Bond	+2.75%	+19.21%
Vanguard GNMA	+0.41%	+5.29%
Vanguard Infl-Prot Secs	+1.91%	+10.80%
Vanguard Total Bond Idx	+0.07%	+5.93%
Idx: M.L. Int Term Bond	-0.12%	+0.06%

Past performance is no guarantee of future results.



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