Market Review and Outlook—June 10, 2008

Are we in a recession or not? Technically perhaps not, but in the trenches, almost certainly. By economic definition, a recession occurs when US GDP falls for two successive calendar quarters. As the US economy grew slightly in the past quarter, the earliest a recession could have begun is April 1st. That said, many Americans feel that we have been mired in a recession for months. The double-whammy of slumping house prices (and home equity) plus surging energy prices have put consumers 'on the ropes.' While we may avoid a textbook recession, the US economy will have a hard time recovering until consumer confidence rises. I expect that the economy will begin to strengthen by year-end, and that stock markets therefore will rebound meaningfully later this year.

What's happened with the markets? US stock markets continued to fall in March, but rose nicely in both April and May, ending the three months up 6 to 8%. Foreign stocks recovered most of their January losses during a strong April and a fine May, and ended the three months up over 6%. Year-to-date, most stocks are down about 3%. The best year-to-date results come from Latin American (energy heavy) funds rising 18% and natural resource (energy) funds earning over 13%, while inflation bonds, real estate, and precious metals funds rose from 3 to 6%.

Is Oil in a Bubble? I fear that we are in an anti-Goldilocks environment, where nothing is 'just right,' and where fear, rather than greed, dominates. Americans expect gas prices to exceed $5 a gallon soon. I am doubtful. Americans are cutting their gas consumption. India and Malaysia are cutting their gas subsidies, subjecting their citizens to higher gas prices, which will lead to reduced consumption. China's growth is slowing. Short-term supply hiccups in the North Sea and Russia are being corrected. Saudi Arabia is bringing additional oil supply online next year. Americans expect the economy to be in the doldrums for many, many months. I am doubtful. The weak US dollar is resulting in a strong level of exports. A survey released today reports that a growing number (and now a majority) of private economists doubt that the US will enter a recession this year. My worry about an oil bubble could be wrong, or it could be early. Yet I consider it riskier to speculate on rising oil prices than on stable or falling prices.

Therefore … At this time, I recommend that clients build up their **US stocks** to target levels, and keep **foreign stocks** near targets. I would like to continue to build up **real estate** investments, with a long-term target of about 5% of most portfolios. **Energy/natural resource** funds should be cut back, sealing in profits in the process of limiting energy exposure in most portfolios to no more than target levels (13% or so of stocks).

I continue to feel that **the best returns for the next year or two should come from stocks.**

The following data, reflecting results through 5/31/2008,
comes from the Wall Street Journal and Morningstar's Advisor Workstation product.

Category	3 Months	Past Year	3-Yr Avg	5-Yr Avg	10-Yr Avg
Money Market—Taxable	NA	NA	NA	NA	NA
Intermediate Term Bond	-1.30%	+3.44%	+2.97%	+2.98%	+4.89%
Intermediate Muni Bond	+3.31%	+3.55%	+2.72%	+2.58%	+5.50%
Large-Cap Blend Stock	+5.71%	-6.11%	+7.70%	+9.67%	+4.39%
Mid-Cap Blend	+8.33%	-7.30%	+9.18%	+12.93%	+8.04%
Small-Cap Blend	+8.46%	-11.38%	+7.70%	+12.87%	+7.78%
International Stock	+6.27%	-0.62%	+17.25%	+18.37%	+6.11%
Real Estate	+8.62%	-15.09%	+9.66%	+16.57%	+11.50%
Natural Resources	+13.86%	+33.63%	+30.43%	+30.18%	+16.71%
Technology	+13.06%	+1.47%	+9.56%	+10.56%	+4.74%
Multi-Cap Growth	NA	-0.10%	NA	+9.87%	+11.26%
Multi-Cap Value	NA	-2.27%	NA	+6.46%	+10.59%
Conservative Allocation	+1.97%	-0.06%	+4.96%	+5.49%	+4.33%