Market Review and Outlook—September 14, 2009

It's slowing down, but stocks keep recovering. Six straight months of red-hot stock returns are normally something to celebrate. In this case, we are merely clawing our way back to recovering some of what was lost in the prior six months. The S&P 500 is 33% lower than its peak from almost two years ago.

What's New? The 'green shoots' are the story of the day—periodically we find small signs of a recovering US economy. Sometimes this is merely the bad getting less bad, perhaps the number of newly unemployed is lower one month than the prior month. Overall, there has been more positive surprises than negative. Most importantly, economist see economic growth rather than contraction.

No Smooth Sailing This doesn't mean that the path forward is clear and rosy. Unemployment, while its pace is slowing, continues to climb, and is expected to grow further and remain high for several quarters. The Fed has put the stimulus pedal to the metal, and it faces a very difficult task of withdrawing the gas fast enough to head off an inflationary spiral, but slow enough to avoid choking off the current, fledgling economic recovery. Political tempers are running hot, as the Republicans and Democrats have very different views on how best to address fiscal policy (such as tax policy, and how much stimulus is enough), energy policy, financial industry regulation, and health care reform. This produces a high level of uncertainty (on the future profitability of energy companies, financial companies, and health care companies, for instance), which makes it very difficult to know how to proceed.

How to Proceed The easy money has already been made, over the past six months. As is my custom, I currently favor maintaining target levels. Keeping stocks low (due to their recent strong rebound of over 50% in six months) risks missing the opportunity of higher-than-normal future returns that appear likely due to the 1) stock levels still being 33% lower than their peak 2007 levels, and 2) a low level of likely returns from cash and bonds. While I am keeping my personal allocation to stocks higher than normal (and have since last October), I cut this back last month, and expect to cut it back fully to normal levels when stock prices recover further. This summer I have adjusted our strategy to direct 40% of stocks to overseas stocks (from the prior 33% level). Thus a portfolio with 60% target for stocks will now have 24% overseas (with 36% in US stocks), rather than the prior level of 20% foreign, 40% US.

Steady As She Goes Three months ago I suggested that if you have a gap in your allocation (if your stocks were 10% lower than your long-term targets), it is worth considering closing the gap by 2% quarterly for a year or so. I continue to feel that this is a good 'middle road' path.

The following data, reflecting results through 8/31/2009,
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	+0.03%	+0.76%	+2.92%	+2.85%	+2.79%
Intermediate Term Bond	+5.65%	+6.43%	+4.15%	+3.52%	+5.31%
Intermediate Muni Bond	+2.07%	+4.32%	+3.41%	+3.11%	+4.37%
Large-Cap Blend Stock	+11.15%	-17.65%	-5.68%	+0.74%	-0.02%
Mid-Cap Blend	+13.13%	-19.01%	-5.15%	+2.21%	+4.58%
Small-Cap Blend	+13.50%	-20.06%	-6.72%	+1.80%	+6.05%
International Stock	+11.51%	-16.48%	-5.45%	+5.28%	+2.09%
Real Estate	+21.01%	-32.04%	-14.75%	-0.88%	+7.78%
Natural Resources	+2.10%	-32.10%	-4.14%	+9.11%	+10.09%
Technology	+13.67%	-10.94%	-0.78%	+4.48%	-3.53%
Multi-Cap Growth	NA	-19.56%	-4.39%	+2.05%	NA
Multi-Cap Value	NA	-17.84%	-7.78%	+0.31%	NA
Conservative Allocation	+7.26%	-3.33%	+0.29%	+2.75%	+3.09%