Market Review and Outlook—December 9, 2009

What a year it has been! Three months of downward moves have been followed by nine very strong months for stocks. The one-year returns are from +30 to +40%! The bond funds have gained from 12 to 19%, which is even more astonishing. In a vacuum, these would be results worth celebrating. Coming on the heels of a terrible market crash, it has merely provided a partial recovery.

Why the rise? There are many reasons that stocks (and bonds) have been rising this year. The overall reason is that the world did not end, economically. We have seen a steady decrease, since January, in the number of new unemployment applications. We have seen some signs of life in the decimated residential real estate market. The US government stimulus programs for car and home purchases have unsurprisingly yielded positive results. This is not to say that we are on easy street—rather we are no longer precipitously hanging over a cliff.

Where are we going? I am certainly not smart enough to know this answer. I do, however, offer some observations. 70% of the federal government stimulus spending has not yet occurred. This means that almost $550 billion remains to reach the US economy. That will provide quite a tailwind in the coming quarters. Our economy has already begun to post concrete growth. There are of course significant headwinds. One major one is the high unemployment rate, and the low (if any) equity in consumer's homes. These factors will likely restrict consumer spending, at least on more discretionary items. The second major headwind is the gigantic government deficit, this year, next, and for years to come. Left unchecked, this should lead to rising interest rates (and losses for bond investors) and possibly to rising inflation. Few expect Congress and the President to take the painful steps necessary to significantly lower the future deficits. I am hopeful that the headwinds will slow future economic growth, but not halt it.

What is an investor to do? I consider bonds to be riskier than normal at this time, and I consider stocks to be 'normally risky.' Stocks appear less risky than two or more years ago, but far riskier than last winter when their prices reached bargain-basement levels. There are two types of investors at this time—those who sold stocks during the downturn, and those who held on throughout. Which are you?

If you are sitting on cash, consider identifying a long-term allocation target (between stocks, bonds, and cash), and laying out a plan to build up to that level gradually. Perhaps this will be over a year, or over five. You set the term.

If you held on over the past year or so, then it is time for a normal rebalance. I favor shorter-term bonds, and economically sensitive bonds (high yield and floating rate). I favor maintaining stocks at or near long-term target levels. I continue to favor a 60/40 split between US and foreign stocks. I prefer a value-tilt to stocks at this time. I view commodities as fairly priced, and real estate as cheaply priced, but still with too much risk to go overboard.

Category	3 Months	Past Year	3-Yr Avg	5-Yr Avg	10-Yr Avg
Money Market, Taxable	+0.02%	+0.46%	+2.66%	+2.83%	+2.71%
Intermediate Term Bond	+3.76%	+18.84%	+4.58%	+4.20%	+5.58%
Intermediate Muni Bond	+2.23%	+12.15%	+3.59%	+3.57%	+4.58%
Large-Cap Blend Stock	+7.01%	+28.01%	-5.87%	+0.64%	+0.30%
Mid-Cap Blend	+5.45%	+36.41%	-6.04%	+0.99%	+4.45%
Small-Cap Blend	+3.09%	+29.36%	-8.14%	-0.30%	+6.04%
International Stock	+6.09%	+38.30%	-5.68%	+4.12%	+1.62%
Real Estate	+8.82%	+42.04%	-15.72%	-1.07%	+9.41%
Natural Resources	+11.92%	+46.07%	+0.20%	+10.75%	+13.11%
Technology	+7.87%	+57.69%	-1.61%	+2.56%	-5.39%
Multi-Cap Growth	NA	+35.92%	-4.50%	+1.41%	NA
Multi-Cap Value	NA	+29.30%	-8.31%	-0.31%	NA
Conservative Allocation	+5.74%	+26.14%	-2.18%	+2.20%	+2.58%