Market Review and Outlook—September 13, 2010

A Real Mixed Bag. The past three months, taken as a whole, brought nice gains from bonds and from foreign stocks, but some significant losses from US stocks. The three months were anything but smooth—they were closer to bipolar, with strong losses one month (June) followed by strong gains the next. Foreign stocks benefited primarily from the awful results in the prior months—Greece and the rest of the Mediterranean European countries did not go bankrupt and so their stock markets came back from the brink. US stocks fell due to disappointing economic news that increased the risk of a double dip recession. Fortunately, these same fears led investors to boost their bonds, which boosted bond prices and returns.

Volatility—Get Used to It. I am becoming convinced that wild daily and monthly swings in stock prices are here to stay. It is partially due to the antagonistic environment in Washington, DC. News and views are portrayed as black and white, either good or bad, and this leads to an abandonment of the middle-ground and nuance. Hedge funds and exchange-traded funds enable manic investors to drive prices up sharply, and later enable newly-depressed investors to drive them down just as sharply. This has been the case all year.

This isn't necessarily a bad thing. Long-term, patient, contrarian investors (such as Warren Buffett, and perhaps you) can benefit from volatility caused by schizophrenic investors. Start by reminding yourself that events are not as dire (or terrific) as the headlines indicate—grey exists. Therefore, when prices for one type of asset leap, cut back on that, and use the proceeds from the sale to buy assets that are falling in price. **This is normal rebalancing, a seemingly lost art.**

So Now What? Bonds continue to look overpriced, especially long-term, treasury, and inflation-linked bonds. Based on my conviction that the global recovery will continue, albeit unevenly, I feel that stocks, both US and foreign, deserve to be at least at target levels. More timid investors can lean to larger US and foreign stocks. I like stocks of all sizes at current prices.

There are opportunities for bond investors. If the economic recovery does unfold, even slowly, junk bonds should continue to fare well (they rose almost 19% in the year ending 8/31/2010). High quality (with the exception of long-term) corporate bonds should hold up when interest rates eventually rise (next year some time). Bank loan bond funds also hold promise when rates rise. If the US government is unable/unwilling to meaningfully address its budget problems, at least by the time that the recovery is more solid, the US dollar should weaken. This should benefit foreign bond funds. Finally, the possible expiration of the "Bush Tax Cuts" could lead to increased purchases of municipal bonds (despite the weak finances for most states and municipalities), although I would still avoid long-term municipal bonds.

Category	3 Months	Past Year	3-Year Avg	5 Year Avg	10-Yr Avg
Taxable Money Market	+0.01%	+0.05%	+1.48%	+2.55%	+2.31%
Intermediate Term Bond	+4.22%	+11.35%	+6.65%	+5.09%	+5.85%
Intermediate Muni Bond	+3.32%	+8.82%	+5.73%	+4.29%	+4.74%
Large-Cap Core Stock	-3.31%	+3.91%	-8.62%	-1.03%	-1.08%
Mid-Cap Core	-5.40%	+8.43%	-7.06%	-0.23%	+2.31%
Small-Cap Core	-7.94%	+7.50%	-7.54%	-0.92%	+4.24%
International Stock	+4.73%	+0.40%	-10.59%	+0.97%	+0.42%
Real Estate	+2.89%	+32.05%	-6.67%	+0.21%	+9.09%
Natural Resources	-0.96%	+5.02%	-6.50%	+4.68%	+11.26%
Technology	-3.91%	+8.86%	-4.60%	+2.13%	-8.94%
Moderate Allocation	-0.20%	+6.53%	-3.39%	+1.34%	+1.76%