Market Review and Outlook—December 10, 2010

It Was a Good Quarter for Stocks. The past three months, taken as a whole, brought strong gains from smaller US stocks and natural resource stocks, solid gains from large US stocks and foreign stocks, and flat to small losses from bonds. August began with stocks declining, and November ended with declines, however the middle brought solid upward progress for stocks. Stocks rose due to a continuing thaw in consumer confidence, continued evidence of (very slow) growth in jobs, and mostly due to the lack of headline-grabbing crises.

The Same Can't Be Said for Bonds. In early November the Fed announced QEII, the second wave of 'quantitative easing' in which the Fed purchases government and other bonds from the market. They essentially print money to do so, but when the bonds mature, the money is paid back to the Fed and presumably the Fed then burns the dollars. The Fed is proceeding with QEII in order to lower the risk of the US entering a recession, by trying to boost inflation up to a level of 2% or so. By keeping short-term interest rates low, households are able to refinance their mortgages at the current, historically low, levels and therefore put more money in their wallets. Low rates also better enable companies to hire and expand. The bond market moved sideways during the quarter, but has fallen sharply so far this month. This month bond investors appear concerned that the risk of worrisome inflation in the future is growing, even if currently inflation is absent.

Bond Bubble. Yes, bond yields are low and will rise, and yes, bond prices are high and will fall. However a bond bubble is far less dangerous than a stock bubble. A bad year for bonds brings a 5% loss. A bad year for stocks brings a 30% loss. A popped bond bubble means that you don't make money, and may lose a little. That is better than abandoning bonds, ramping up your stocks to nose-bleed levels, and setting yourself up for a painful loss when stocks next take a dive.

Rebalance. Stocks have been strong, so they may be a bit above your long-term targets. If so, cut them back. While bonds have challenges facing them, chosen appropriately, they are a good location for setting aside stock gains. I am comfortable maintaining stocks near normal levels, both in the US and abroad. Larger US stocks and foreign stocks appear to be a bit 'better priced' than smaller US stocks at this time. For bonds, I am adjusting clients' holdings, moving a little from short-term to intermediate-term bonds, due to my expectation that the Fed will be able to keep rates low for many quarters (as long as unemployment remains very elevated).

The 2010 year is shaping up to be another solid recovery year for investors. Let's cross our fingers for 2011.

Category	3 Months	Past Year	3-Year Avg	5 Year Avg	10-Yr Avg
Taxable Money Market	+0.01%	+0.04%	+1.10%	+2.42%	+2.17%
Intermediate Term Bond	+0.39%	+7.69%	+5.84%	+5.49%	+5.67%
Intermediate Muni Bond	-2.13%	+4.01%	+4.21%	+3.92%	+4.39%
Large-Cap Core Stock	+13.19%	+9.69%	-5.40%	+0.81%	+1.31%
Mid-Cap Core	+17.27%	+20.53%	-1.68%	+2.58%	+5.49%
Small-Cap Core	+20.09%	+25.23%	-0.70%	+2.34%	+7.45%
International Stock	+9.98%	+3.95%	-9.57%	+2.26%	+2.76%
Real Estate	+6.92%	+29.71%	-3.26%	+1.10%	+9.74%
Natural Resources	+18.70%	+11.42%	-4.01%	+7.61%	+14.64%
Technology	+20.45%	+21.57%	+0.21%	+4.78%	-2.24%
Moderate Allocation	+8.06%	+9.02%	-1.35%	+2.76%	+3.24%

The data in this table comes from Morningstar, and is as of November 30, 2010.
Information herein should not be construed by any consumer and/or prospective client as a solicitation to effect, or attempt to effect transactions in securities, or the rendering of personalized investment advice for compensation.