Market Review and Outlook—September 6, 2011

While the Sky Hasn't Yet Fallen—It Doesn't Seem Too Stable. We have had a balance of hopes and fears this year. Reflecting this, stock prices, after peaking in late April, drifted a little downward until late July, when the fears overtook the hopes. US stock prices dropped sharply by early August, amidst extremely high volatility, and have been bouncing wildly up and down ever since.

Bond prices have incredibly continued to rise and bond yields to fall. Ten year treasury bonds yield less than 2%, while both the Dow Jones and the S&P 500 indices yield more, 2.7% and 2.2%, respectively. US government and corporate bond prices are trading at 52-week highs. Municipal bond prices, however, are a bit under half of the 52-week range, due to continued concerns over state and municipality financial strength.

What's Looking Bad—How much time do you have? The question appears to be not whether a European government will default on their debt, but how many such countries will. Not that we can cast stones—a month ago many US Representatives were arguing for a US default. Congress finally boosted the debt ceiling, but only with a budget compromise that is heavy on promises and light on details. Economic growth in the US is anemic two years after the official end of the recession, and unemployment refuses to fall below 9%. As was the case last summer, this summer we have been hearing predictions of a 'double dip recession.' Last year those predictions came to naught—it is too early to judge the current predictions. I remain skeptical.

What's Looking Good—Consumers and corporations, which together make up 80% of the US economy, are all revved up, but have nowhere to go. Consumer savings rates have risen to over 5% from a pre-crisis level of 2%. Corporations have a historically high level of cash in the bank. Consumers are holding up on spending until they are more certain of their jobs and future, and corporations are holding up on spending until more consumers boost their spending. It is a classic Catch-22.

Stock prices appear to be incredibly cheap, and bond prices incredibly expensive. This situation could certainly continue for some time, and even worsen. However today's stock investors should receive more than 2% in annual dividend income plus eventually higher stock prices, while today's bond investors (or at least government bond investors) should expect to receive no more than 2% in annual interest income and eventually lower bond prices. What makes more sense to you?

So Now What?—Investors' fear appears to hold the upper hand at this time. Giving in to fear invariably leads to taking financially disastrous steps. The 3- and 5-Year figures in the table below make clear that stocks are a bargain now, and that bonds are expensive. What do you want to sell now and what do you want to buy?

Category	3 Months	Past Year	3-Year Avg	5 Year Avg	10-Yr Avg
Fidelity Cash Reserves	+0.00%	+0.03%	+0.49%	+2.04%	+2.06%
Intermediate Term Bond	+1.16%	+4.27%	+7.49%	+5.83%	+5.15%
Intermediate Muni Bond	+2.28%	+2.04%	+4.97%	+4.18%	+4.05%
Large-Cap Blend Stock	-10.13%	+16.58%	-0.30%	+0.29%	+2.45%
Mid-Cap Blend	-13.14%	+19.07%	+1.21%	+2.04%	+5.89%
Small-Cap Blend	-13.49%	+21.59%	+1.54%	+1.50%	+6.15%
Foreign Large Blend Stock	-11.82%	+10.32%	-2.40%	-1.22%	+4.55%
Real Estate	-7.74%	+16.68%	+1.77%	-0.64%	+8.95%
Natural Resources	-10.91%	+21.75%	-2.34%	+4.77%	+13.76%
Technology	-3.53%	+15.97%	+0.60%	+3.43%	+5.26%
Moderate Allocation	-6.41%	+11.77%	+2.72%	+2.47%	+3.90%

The data in this table comes from Morningstar, and is as of August 31, 2011

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