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## Economic Update 4Q 2009

The quarter in brief. The effects of low interest rates and government assistance finally pushed GDP in positive territory, up 2.2 percent for the third quarter. World economies were gaining strength as well. Stocks continued to rally, with the S&P 500 up nearly 5.5 percent for the quarter and commodities across the board moved higher. Health care reform remained the political topic of the day with varying versions working their way through Congress. Opposition to the bill gained momentum throughout the quarter leaving many to question whether a bill will even find its way to the President's desk.



Mark Stevens, CFA  
Senior Vice President

Major indexes. The market remained on an upward trajectory in Q4 as signs of economic recovery took hold and companies handily beat corporate profit estimates for the third quarter. The S&P 500 was up 5.49 percent on a price basis and international stocks (MSCI EAFE) were up 1.8 percent. Emerging markets had another great quarter up 8.25 percent.

Looking back, the market bottomed on March 9 with the S&P 500 hitting 12-year lows. As we neared the end of the first quarter, a growing confidence emerged that the worst was behind us and the markets began a spectacular

Domestic economic health. GDP finally turned positive in Q3 ending a

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streak of four consecutive negative quarters. It appeared that the longest recession since the Great Depression had come to an end. Other data points showed signs of improvement as personal income increased for the fifth straight month and personal spending moved higher for the fourth time in the last five months. Key manufacturing statistics began to show signs of strength as well. The ISM Manufacturing Index rose to 55.6 in December, the highest level since April 2006. However, the labor market remained weak and unemployment stood at 10 percent at year's end. Since December 2007 the unemployment rate has doubled with the number of unemployed workers rising by over 8 million.

The Federal Reserve kept rates at record lows with little indication of a shift in policy. Inflation moved higher in November 2009, increasing 1.8 percent from the same time last year. This marks the first year-over-year gain since February 2009.

Unemployment remains above 10 percent and the broad unemployment rate (includes part-time workers seeking full-time jobs, and those who are unemployed and have stopped looking) is near 17 percent. Though employment typically lags a recovery, some improvement in employment will be necessary for consumption trends to improve.

and ended the year up 23.45 percent on a price basis. Investors regained confidence worldwide and markets across the globe made similar advances. The MSCI EAFE Index was strong throughout the year up 27.75 percent. Emerging markets remained red hot as evidenced by the MSCI Emerging Markets Index, up over 74.50 percent. As we ended the year, the recovery was firmly in place and participation was worldwide. The dramatic move off of the March 9 low will go down as one of the strongest reversals on record.

Major Indexes	4Q 2009	3Q 2009	All 2009
DJIA	+7.37	+14.98	+18.82
NASDAQ	+6.91	+15.66	+43.89
S&P 500	+5.49	+14.98	+23.45
MSCI World	+1.80	+18.79	+27.75
MSCI Emerg Mkts	+8.25	+20.06	+74.50

*Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.*

Commodities markets. The U.S. Dollar Index reversed trend gaining 1.7 percent in Q4. However, this didn't keep commodities from moving higher with most commodities gaining 10 to 20 percent for the quarter. In fact, only two widely traded commodities went negative during the fourth quarter: coal (-4.64 percent) and cattle (-0.39 percent).

For the year, the weak dollar provided a tremendous backdrop for hard assets. Copper (137.34 percent), palladium (116.67 percent), gold (23.96 percent), silver (49.14 percent) and platinum (56.24 percent) were all up big for the year. Agricultural commodities had a great year and oil moved higher by 77.94 percent. The two major commodities that struggled in 2009 were natural gas (-.89 percent) and coal (-24.36 percent).

**Housing & interest rates.** New home sales were down 11.3 percent for November after rising 1.8 percent for October. Existing home sales rose 9.9 percent for October and 7.4 percent for November. Pending home sales, which had risen for nine straight months, raised eyebrows by slipping 16 percent in December. Housing starts reversed, diving 10.1 percent for October but rising 8.9 percent a month later.

Mortgage rates for 30-year fixed-rate mortgages (FRMs) touched record lows but eventually climbed above 5 percent again. From the last 3Q Freddie Mac survey to the last 4Q Freddie Mac survey, the average interest rate on a 30-year FRM went from 5.04 to 5.14 percent.

Though the housing data has been mixed, the new home-buyer tax credit helped boost real estate across the board. Demand has decreased the inventory on the market. The supply of existing homes relative to sales had gone from 11 months in April of 2008 to 6.5 months by year end. This helped stabilize prices and home prices rose 5 percent in October, the first increase since 2006.

**2010 outlook.** For the first time in a long time the mood is upbeat. Many analysts think we are just two or three quarters into a U-shaped recovery that will play itself out over the next few years. However, the sustainability of the recovery remains unclear. Massive stimulus efforts, rock-bottom interest rates, and the introduction of over 30 government programs helped turn this economy to a positive trajectory. The unwinding of these programs and the effective withdrawal of the massive liquidity injected into the system will be the keys to sustainability. It is unlikely that the Fed will make any rash moves until there are clear signs that the recovery is on sound footing.

As we see signs of improvement in housing, personal consumption, and manufacturing, the one major obstacle to prosperity is jobs. High levels of unemployment will be a drag on our recovery and remains the key statistic to watch in 2010. The Fed has always been reluctant to shift monetary policy when unemployment is high and their ability to unwind the stimulus will require impeccable timing.

As we enter 2010 the market is becoming more and more optimistic about investing in riskier asset classes. The market has been on a meteoric rise since the March 9 low with down days almost entirely absent. Most credit instruments have regained their pre-crisis values and financial markets are operating as close to "normal" as can be expected. The carnage in stocks left valuations cheap and the market pounced on these opportunities. A snapback of this magnitude is unprecedented, but so was the fall. The historic gains since March 9 have far more to do with "normalizing" valuations than economic improvement. Now that these valuation gaps are gone, investment returns will be more dependent on the fundamental outlook of economic growth and improvement in corporate profits.

The market can't stay this hot forever and it is likely that there will be some type of pullback in 2010. Corporate profits have been improving following aggressive cost cutting. Earnings expectations for 2010 are expected to be at least 25 percent greater year over year. But at some point revenue must accelerate. The ability for the Fed to maintain a growth path while taking back the stimulus remains the key theme for 2010. If the Fed gets it right, we could have another good year. Sam Stovall, chief investment strategist at Standard & Poor's, points out that since 1949 stocks have never fallen in year two of a bull market, with the average annual gain for year two being about 15 percent. Investor optimism to date would indicate that many feel history is on our side and the markets will stay on solid ground.