



Daniel P. Crawford, CFA
SVP & Managing Director, Chief Investment Officer
NexTier Wealth Management



Economic & Investment Outlook *4th Qtr 2010*

Better to Light a Candle than Curse the Darkness

The fourth quarter of 2010 promises to be an interesting period for investors. The major drivers of the financial markets for the remainder of 2010 and into 2011 will be the:

- Strength of our economic and employment data.
- Health of the housing market.
- Mid-term election.

The Economy

The recession officially ended in June of 2009. Hooray! However, before we get too excited, please note:

- The recession lasted 18 months - the longest recession since the Great Depression.
- The recession slashed GDP by 4% - twice as much as the 1980-81 recession.
- The latest revision for Q2 2010 GDP growth is an anemic 1.7%. Not enough for meaningful job creation.
- The unemployment rate is currently 9.6% - hovering at a 26-year high. It will remain at these elevated and exhaustive levels through 2011 and dampen consumer spending.

The housing market shows no signs of strength. Sales of existing homes in August were the second lowest on record. Currently, an 11-month supply of existing homes is on the market versus the normal average of six months. According to Moody's Analytics, home prices have dropped 28% since 2006 and are projected to fall for another three years. Foreclosures continue to create insurmountable headwinds for the housing market. RealtyTrac projects that foreclosures will add an additional 3 ½ years of supply of homes for sale on the market, all at distressed prices.

Interest Rates & Fixed Income

Interest rates remain at historical lows. The yield on the two-year Treasury note recently fell below 0.4%, the lowest yield on record. The Federal Reserve's mandate is price stability and full employment. However, with regard to price stability, the Federal Reserve continues to confront the inflation vs. deflation debate. The Consumer Price Index (CPI) stands at 1.2% over the past 12 months while Core CPI, excluding food and energy, is at 1.0%. This is hardly inflationary. The Fed has historically targeted an inflation rate of 2% to ensure price stability. Our suspicion is that the Fed would rather see higher inflation and eliminate the potential emergence of a damaging deflationary environment.

The Fed's challenge will be to keep interest rates low in an effort to stimulate the economy through job creation and a stronger housing market. We believe the Federal Reserve will choose to perpetuate the low interest rate environment through quantitative easing (QEII), to be rolled out after the mid-term elections. Fire up the printing presses and prepare for a weaker U.S. dollar.

In the fixed income arena, we continue to favor:

- International bonds – provide diversification and benefit from a weaker U.S. dollar.
- High yield bonds – continue to perform well in a low interest rate environment as spreads tighten and the U.S. economy chugs along.
- Short-term investment grade bonds.

In anticipation of higher interest rates, we continue to avoid long-term U.S. Treasuries.

Equities

The mid-term election is historically of great importance to the near term performance of the financial markets. All 435 House seats and more than one-third of the Senate seats are up for election. Since 1942, there have been 17 mid-term elections. Never in the 200 days following the election has the stock market experienced a negative return. The average gain over this time period has exceeded 18%.

In addition, the stock market has returned an average of 16.6% during the third year of a President's term over this same time period. Investors should cheer for a change of control in both Democratic Houses. Why? The equity market has historically returned 15.3% annually when Republicans control both the House and the Senate while a Democrat occupies the Oval Office (1940 – 2008).

Thus, there are three potential positive drivers for the U.S. equity markets as we head toward 2011:

- Mid-term elections.
- The third year of the Presidential cycle.
- Chance that Republicans gain control of both the House and Senate.

Our Strategy

Our investment theme continues to focus on asset classes that benefit from a weakening U.S. dollar and strong emerging market growth. We continue to recommend increased exposure to commodities (precious metals, agriculture, and energy) and emerging markets.

We are cautious longer-term but believe financial assets in aggregate will deliver positive returns over the next several months. NexTier Wealth Management's client portfolios remain fully invested, according to each of their respective investment objectives.

While global economies and financial markets face numerous and serious challenges ahead, investment opportunities will always exist. The goal is to identify those opportunities and position portfolios accordingly. Better to Light a Candle than Curse the Darkness.