



March 1, 2010

Investors spent last week trying to decide which of the two ongoing stories was more compelling: The Greek government’s campaign to convince its European partners that it could be fiscally responsible or the Federal Reserve’s efforts to persuade its American audience that it was not yet ready to raise its short-term rate. In the end, the drachma drama edged out the rate reassurances and the Dow fell 0.26%. For all of February, however, the Dow had its best month since November, up 2.6%, with the S&P 500 and the NASDAQ following suit, rising 2.9% and 4.2% respectively.

Over the past few weeks, the Fed has taken a number of steps to begin a return to normalcy, including raising its emergency loan interest rate the week before last, an unexpected – if largely symbolic – move that led some analysts to conclude it was going to raise its overnight interest rate sooner than expected. This week, Fed chairman Benjamin Bernanke spent two days delivering his semiannual report to Congress, and he made it clear that while the Fed has ended, or was set to end, some of its special and emergency spending and lending programs, the short-term rate would remain where it was for “an extended period” because of the still “nascent” recovery. Mr. Bernanke also used his time on the Hill to defend the Fed’s oversight of the nation’s banks and holding companies at a moment when Congress is considering several versions of a bill that would overhaul the nation’s financial regulatory system. He said that taking that responsibility from the Fed would be a “grave mistake,” adding that the

	Key Market Data		
	Week ending		
	2/26/10	2/19/10	Change
Dow Jones Industrial Average Index	10,325.26	10,402.35	-0.74%
S&P 500 Index	1,104.49	1,109.17	-0.42%
NASDAQ Composite Index	2,238.26	2,243.87	-0.25%
10-Year Treasury Note Rate	3.595%	3.782%	-0.187 pct. pts.
NYMEX Crude Future (Barrel)	\$79.66	\$79.81	-0.50%
Euro/U.S. Dollar	\$1.3617	\$1.3595	+\$0.0022

Fed was going to make “fundamental changes” in the way it oversees banks.

On Monday, five Republican senators, including the recently arrived Scott Brown of Massachusetts, crossed party lines to move a \$15 billion job toward a vote, something of a surprise given the partisan jockeying that’s been going on as the midterm elections loom. The bill was then approved 70-28 with 13 Republicans voting for it. The bill was spun out of a larger, \$85 billion proposal and, assuming it is passed by the House, it will include tax incentives and credits to businesses that hire and retain new employees as well as public works projects. President Obama said, “The American people want to see Washington put aside partisan differences and make progress on jobs, and today the Senate took one important step in doing that.”

Also last week, the Commerce Department announced that, despite a recent increase in the size of the trade gap, fourth quarter gross domestic product (GDP) growth was even better than originally reported: 5.9% rather

than 5.7%, the best clip since the second quarter of 2003. Still, during this stop-and-start recovery, no good news seems to go unqualified, and this revision was no exception with analysts noting that the bulk of the improvement came from the fact that businesses reduced inventories by only \$16.9 billion, revised from \$33.5 billion, adding 3.8 percentage points to the growth rate as compared to the original 3.39 percentage points. Meanwhile, consumer spending, which accounts for nearly 70% of GDP growth, was revised downwards from 2.0% to 1.7%. For 2009, GDP growth fell 2.4%, the worst showing since 1946.

There was a lot of news about housing last week, most of it bad despite low prices, mortgages that are still very low by historical standards, and government incentives for buyers. First American Corelogic reported that another 600,000 households went “underwater” in the fourth quarter, meaning their homes were worth less than their mortgages, bringing the total number of houses with negative equity to 11.3% million, 24% of all residential properties with mortgages. The Commerce Department followed up by reporting that in January new home sales fell 11.2%, the third straight decline and the lowest level since the department began keeping track in 1963. And Mortgage Bankers Association said that applications for mortgages fell 7.3% last week to their lowest point in 13 years. Lastly, the National Association of Realtors reported that existing home sales fell 7.2% in January to a seasonally adjusted rate of 5.05 million, whereas an increase had been forecast. On a rare positive note, the Standard and Poor’s/Case-Shiller index of home prices in 20 major metropolitan areas rose 0.3% in December on a seasonally adjusted basis, the seventh month in a row that the index has been up. Further, analysts are expecting an uptick in the next two months as buyers who have been holding off move to take advantage of the extended home buyer’s tax credit program, due to expire at the end of April.

The bleak housing story, coupled with ongoing unemployment, was seen as being behind the sharp drop in the Conference Board’s consumer confidence index, which fell to 46 from a revised 56.5 in January (the forecast had been 55). The gauge measuring current conditions dropped to 19.4 from 25.2, its lowest point since 1983.

The Federal Insurance Deposit Corporation (FDIC) added to the gloom with its annual recap, reporting that U.S. banks showed their sharpest decline in lending since 1942, while the number of banks at risk of failing was 702, a 16-year high (140 banks collapsed in 2009). Smaller banks have been slower to rebound than their large, bailed-out brethren and are thus less likely to lend the money to consumers and small businesses that could speed the recovery.

The Labor Department said that first time unemployment claims rose 22,000 to 496,000 for the week ended February 20, the highest level in three months and not a good sign with the jobless rate for February due to be announced this coming Friday.

Lastly, orders for durable goods were up 3% in January to \$175.7 billion, the Commerce Department reported, mainly because of commercial aircraft goods. Excluding the volatile transportation orders and military goods, orders fell 2.9%.

### **The broader view**

In another eventful week for Greece, it was visited by European finance ministers who wanted to see its books, endured a general strike, and postponed an expected bond offering of €3-5 billion for fear that it would fall short, especially after four of Greece’s biggest banks had their rating downgraded by Fitch Ratings. Furthermore, Moody’s and Standard & Poor’s both said they were considering downgrading Greek debt, which would make it harder – and more expensive – for Greece to sell its bonds, and EU authorities concluded that the current plan

for Greece to lower its debt as a percentage of GDP by four percentage points in 2010 (to 8.7% from 12.7% in 2009) was not going to work. And in the United States, Mr. Bernanke acknowledged that both the Fed and the Securities Exchange Commission (SEC) are both looking into some of the financial transaction engineered by Goldman Sachs, among other firms, that used derivatives to help Greece shield its debts from EU member countries. What happens in Greece is not important because of the size of its economy – by that yardstick, it is one of the EU’s least significant members – but as a case study in how the union will handle an errant member to make sure a crisis in investor confidence does not affect the euro all 16 member nations use as their currency. The question now is who will blink first. Greece wants its EU partners to come out and say that they’ll bail it out so it can sell its bonds and pay its debts. But those partners, primarily Germany and France, don’t want to act until Greece overhauls its public spending and taxes. If Greece defaults in the meantime, the contagion will likely spread. Greece is expected to announce new austerity



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All index references and performance calculations are based on information provided through Bloomberg. Bloomberg is a provider of real-time and archived financial and market data, pricing, trading, analytics, and news.

measures this week – it has been given a deadline of March 16<sup>th</sup> by its EU partners to do so – with Prime Minister George Papandreou saying, “Tomorrow it will be too late and the consequences will be much more dire.” After that, Greece is expected to issue its bond – unless the sale is again delayed, which would hardly be a confidence-builder.

### **A look ahead**

This week, there will be updates on construction spending, car sales, and consumer confidence while, from the manufacturing front, reports will be released on nonfarm productivity and factory orders. In addition, the Fed will release its Beige Book, a snapshot of economic activity in 12 of its districts. All of that will serve as a mere prelude to Friday’s Labor Department release of the unemployment rate for February, which unexpectedly fell to 9.7% in January and which seems to be the best barometer of the rising, or falling, consumer sentiment that is so crucial to Mr. Bernanke’s “nascent” recovery.

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Standard and Poor's 500 Index<sup>®</sup> (S&P 500<sup>®</sup>) is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Standard & Poor's offers sector indices on the S&P 500 based upon the Global Industry Classification Standard (GICS<sup>®</sup>). This standard is jointly maintained by Standard & Poor's and MSCI. Each stock is classified into one of 10 sectors, 24 industry groups, 67 industries and 147 sub-industries according to their largest source of revenue. Standard & Poor's and MSCI jointly determine all classifications. The 10 sectors are Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunication Services, and Utilities.

The NASDAQ Composite Index<sup>®</sup>. Stocks traded on the NASDAQ stock market are usually the smaller, more volatile corporations and include many start up companies.

NASDAQ - National Association of Security Dealers Automated Quotations. The NASDAQ is a computer operated system owned by FINRA that provides dealers with price quotations for over the counter stocks.

Bear market calculations and interpretations are derived from data supplied by Ned Davis Research, Inc.

The S&P/Case-Shiller Home Price Indices are designed to be a reliable and consistent benchmark of housing prices in the United States. Their purpose is to measure the average change in home prices in a particular geographic market. They are calculated monthly and cover 20 major metropolitan areas (Metropolitan Statistical Areas or MSAs), which are also aggregated to form two composites – one comprising 10 of the metro areas, the other comprising all 20.