

# CAPITAL INVESTMENT MANAGEMENT

*Registered Investment Advisor*

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## March 2010 Economic Update

### The Economy

- Many factors are in play right now as the markets try to find their footing.
- In early February, the following issues provided investors with an incentive to take profits: China's regulatory efforts to control its growth, weakness in European economic growth and high unemployment in both Europe and the U.S.
- Following this recent (and overdue) pullback, sentiment corrected quickly and is now positioned for a possible market uptick:
  - Manufacturing, which tends to lead the economy, has seen steady improvement. The Institute for Supply Management manufacturing index came in at its highest reading since August of 2004.
  - Despite high uncertainty regarding the impact of severe weather on the February non-farm payrolls report, fewer jobs were lost than expected.
  - Stocks in Europe also advanced on the news that Greece's bond deal saw demand outpacing the size of the offering by nearly three times, quelling fears for the ability of the nation to raise funds to address its budget and debt issues.
- However, weakness in the U.S. housing market remains a concern:
  - Some of the weakness can be attributed to the original expiration of the government tax credit and its subsequent extension. We remain concerned about prospects of a new dip in housing.
  - Billions of dollars of so-called 'option ARM's' come due this year, which could put renewed pressure on foreclosures.
  - The Fed is still set to end its support of the mortgage-backed securities market at quarter end, which could push mortgage rates higher.
- The core consumer price index (CPI) – a measure of retail inflation – actually declined early in the first quarter, for the first time since 1982. The jobless rate remains elevated indicating continued slack in the labor market and restrained wage inflation. While longer-term inflation concerns may be valid, these indicators show us that near-term inflation is not much of a worry.
- How the federal deficit is reduced will be of great importance going forward. There are three main options: raising taxes, cutting spending and growing the economy. It is the balance, or combination of these options that will be critical to the economic recovery.

### Summary

- The better than expected labor report, along with China reaffirming its growth forecast and waning fears about Greece's deficit problems are helping boost optimism that the global economy appears to be on the mend. The picture is brightening as data continues to improve.
- Housing, inflation, and the deficit will be factors we continue to watch. Will the concern over these policy areas be sufficient to derail the market recovery? We are optimistic that they are not, but they do serve as a reminder of the risks inherent in the current market.

- Our portfolios were hedged or moved to cash for much of February, and we have since stepped back into the market as our signals responded to improvements in economic data. We will continue to monitor and reassess as additional data comes in, but we are cautiously optimistic on the market direction at this time.