



The stock market continues to rise, up nearly 60% from the lows reached in March. As the market rises, the humming of naysayers on the business news channels is droning ever louder. The bears are focused on the lack of corporate revenue growth and the continuing rise of joblessness. They are ignoring the stellar corporate earnings reports, continuing low level of interest rates, productivity improvements, and export growth.

It has been stated that bull markets don't just end, rather they are killed. That is, the flow of money into equities is directly related to the nation's monetary policy. On November 4<sup>th</sup>, Ben Bernanke, as Chairman of the Fed, announced that the emergency rate of ZERO percent put in place last December will remain for an extended time. The Fed is going all-out to re-inflate our economy by having the cost of funds at practically zero. Banks live on a yield curve that rises with longer dated maturities; borrow short, lend long. The steeper the yield curve, the higher the profits. The Fed is trying to aid troubled financial institutions by keeping rates low for as long as possible. Of course, the danger in this policy is that it can induce inflation. The Fed sees inflation as non-existent at this time and is willing to gamble with the extraordinary policy in place.

As the Fed is not willing to raise interest rates at any point in the foreseeable future, it is unlikely that the stock market will halt its upward bias. Traditionally, bull markets do not end until the Fed has increased rates three times. The economic recovery is only just in its infancy stage and the Fed is willing to allow much greater growth in order to stem the rising unemployment. With this backdrop, investors will put capital to work in riskier assets.

The bears are rightfully concerned that corporate profit growth is coming only through cost reductions, i.e. layoffs, and not from increased sales. However, this is how all economic recoveries begin. Companies will not begin to rehire until they are certain that sales will support higher staff for an extended time. Inventory levels are at historical lows as a percent of sales, which is exactly what is needed to see revenues rise. We should expect the next several quarters to show corporate sales increase and earnings increase with higher productivity. Employment will most likely begin to rise in the spring when companies become more confident that the economic recovery will last.

To be sure, there are severe structural issues with our economy. Most notable, both public and private debt are too high. It is likely that consumer spending will be muted for several years and taxes will need to rise to pay for our burgeoning debt at all levels of government. This is precisely why we believe that this bull market, along with the economic cycle, will be shorter in duration than has been typical over the past 30 years.

Cyclical bull markets typically last between 12 and 24 months. We are currently in the 8<sup>th</sup> month of this bull market and it is likely that the Fed will not begin to raise rates until the second half of 2010. Since markets tend to rise until the Fed begins a monetary

tightening phase, it is probable that this bull market still has almost a year left. Of course, this economic recovery is still tenuous as even the official arbiters of recessions have not deemed the recession over as of yet.

Our premise is that the recession ended over the summer, an economic recovery is underway and is beginning to accelerate. Risk assets will do well until rates begin to rise; the stock market sits on top of the risk pyramid and should continue to rise for the better part of the next year.

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