



# Market Perspectives

CITY NATIONAL ASSET MANAGEMENT

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## Is an Economic “Aftershock” on the Way?

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Even the nasty weather couldn't suppress evidence of the economic recovery. Retail sales climbed despite the blizzards last month, and payroll stats showed relatively well, indicating the unemployment rate will soon show signs of strength.

Stocks and other risky assets rose on the favorable economic news, while bond prices mostly retreated.

All three domestic equity indices gained 1-2% last week. The international equity markets increased by 2-3% and REITs shot up by over 5% on average. Still, gold prices slipped 3% and most bonds showed fractional losses.

Year-to-date, all three domestic equity indices are now in the black: the S&P is up 4%, the Dow is up 3% and the NASDAQ has gained almost 5%. Small cap value stocks – which CNAM injected into client portfolios – in particular are doing very well. The Russell 2000 Small Cap Value index is up over 9% so far this year.

Interest rates moved up marginally last week with the three-month T-bill yield now at 0.14% and the 10-year Treasury Bond yield at 3.7%, while the Dollar gained a fraction against the Yen, but lost ground against the Euro and Pound.

All eyes will be on the Federal Reserve next week as the FOMC meets again. It is widely expected that the Fed Funds target rate will remain where it is, but most investors will be scrutinizing the text of the Fed's announcement for any signs of monetary

policy tightening. The Fed Funds futures market will reflect any and all such changes immediately and we will report on that next week. For now, however, all signs point to the Fed waiting until next Fall or Winter before doing anything on that front.

Economic reports continue to evidence a nascent global recovery.

However, one of the more troubling disconnects is our own recent survey data indicates personal spending will likely be held at or below current levels for the next several months. If true, this begs the question of where the anticipated growth in corporate sales is going to come from cutting back on consumption.

Another concern is inflation. Borrowing from the physical sciences for a moment – every action has an equal and opposite reaction. Think of a rubber band stretched out to almost its breaking point – that's what has happened to our financial system. Now, as monetary policy begins to revert back to normal, the rubber band is very likely to snap back violently in the other direction, something known as “overshooting” in the field of investment theory. For investors, it means higher interest rates and inflation. Essentially the economic version of an aftershock – something many Californians are already familiar with.

One final note to think about from an economic and investment perspective: The midpoint of the baby-boomer generation will turn 65 in 2020. The implications for social security, health care, and other social programs are important and will, no doubt, be a concern for the next several years.

**Thank you all and have a good week.**

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