

The Economic and Market Environment

In Sum: We recognize that there are significant risks that could undermine the economic recovery in the U.S. and abroad. Yet, when the dust settles, we believe the U.S. consumer is learning to adapt to the “new normal,” where one must be more financially prudent, borrowing less and living within one’s means. Corporations are also adapting to this change, downsizing to fit demand and finding ways to thrive despite sluggish sales and stiff competition. This bodes well for future corporate profitability, which in turn should prove constructive for the equity market.

Geo-political: The G20, a collection of Finance Ministers and Central Bank Governors from 20 industrialized and developing economies, recently held a summit in Toronto to address the sovereign debt crisis in Greece and strategize on how to prevent the spread of the crisis throughout the Euro zone. Going against the U.S. recommendation that governments should increase their spending to promote job growth and increase economic activity, members of the Euro zone have decided to reign in entitlements and government subsidies and balance their budgets. It remains to be seen whether these austerity measures will succeed without meaningfully reducing economic growth. As the European Union is an important trading partner with the U.S., we have a vested interest in seeing a possible resolution to this current crisis.

Economic: The U.S. economy is showing signs of life following the steep recession although there is some concern that this recovery has largely been supported by government stimulus programs, many of which

have ended or are coming to an end. We believe that the consumer will continue to spend albeit at a very slow pace. Importantly, the private sector must continue to increase its hiring as sales improve, a trend which bears watching. While current economic indicators are mixed, we are not forecasting a double dip recession at this time.

Monetary: The Federal Open Market Committee (FOMC) is continuing its policy of targeting the federal funds rate at 0% to ¼% and appears comfortable maintaining this exceptionally low level due to current economic conditions. As the economy shows signs of a sustained recovery, we look for a change in this policy where rates will be increased and the monetary supply reduced. This may not happen until year-end or sometime in 2011. The next formal meeting to discuss monetary policy is August 10.

Fiscal Policy: The U.S. is pursuing an expansionary fiscal policy in an effort to stimulate the economy, maintain a number of social welfare and entitlement programs and support the war effort. Of course, this means that we are spending more than we are collecting in tax revenues, a trend that cannot continue indefinitely. We are very concerned about our growing deficit and hope that with the upcoming elections this fall, there will be a greater sensitivity by our elected officials to curb the deficit and get our own spending under control so we do not find ourselves in a situation similar to Greece and other Euro zone countries.

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Equity Markets: The stock market is seeking direction at the moment, with investors trying to discern whether the glass is half full or half empty. Clearly, there are significant risks that may undermine the economy and threaten our recovery. On the other hand, many countries are thriving around the globe and corporate profits appear strong and going higher. We will be paying close attention to the release of second quarter results, cautiously optimistic that earnings growth remains positive for the remainder of

the year and into 2011. If corporate earnings growth remains positive, this bodes well for the stock market, all else being equal.

Fixed Income Markets: Short term interest rates remain near record lows, reflective of our current monetary policy. We look for rates to trend higher as the economy improves but we do not expect significantly higher rates over the remainder of this year.

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