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summaries

SIGMA INVESTMENT COUNSELORS

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March Madness

As we pen this missive, we mark the one-year anniversary of the equity market lows of March 9th, 2009. From these lows, the rise in the equity markets has been nothing short of remarkable. Back in late February of 2009, we acknowledged in our investment committee discussions that just to get back to even from the end of 2008 would require a 25% rise in the market. At that time, we believed the markets were oversold and we were expecting a reversal, as noted in our March 2009 Sigma Summary. However, we did not anticipate the strength and depth of the global rally as investors took cash off the sidelines and began to reinvest in riskier assets. Even fixed income securities posted equity-like returns in 2009. While we believe the 2008 systemic collapse of the markets may have represented a "once in a lifetime experience," we suspect (regrettably) that the market returns of 2009 may also represent a similar experience. (A sample of 2009 returns is below).

Total return for 12 months ending 3/9/10
(1 year from the market lows of 3/9/09)

Domestic Market Indexes:	
Dow Jones Industrial Average	+ 66.2%
S&P 500	+ 72.3%
Russell 2000 (Small cap stocks)	+ 97.9%
International Markets*:	
Developed Markets	+ 78.3%
Emerging Markets	+ 111.5%
Bond Market*:	
High Grade Corporate Bonds	+ 6.25%
High Yield Bonds	+ 58.3%

*The iShares' EFA and Vanguard's VWO ETFs are used as the proxies for returns in the International Developed and Emerging markets respectively as the indices do not include dividends; The Barclays Intermediate/Corporate Bonds is used for High grade corporate bonds; iShares' HYG ETF is used as the proxy for high yield bonds.

In our July 2007 Sigma Summary, with the market showing impressive strength, we shared our concerns regarding "investors' lack of sensitivity to incremental risk" and we were worried that the pendulum was swinging too far in that direction. Little did we know how prescient we were at the time. Similarly, in March of 2009, we spoke about the pendulum swinging too far the other way, believing that the market was oversold. Again, little did we know how close we were to the actual bottom.

At the present time, we believe that the pendulum is in a much smaller expanse around the center. As we look to the remainder of this year, we do not have a dire outlook for the equity markets but we also believe that the market may have limited upside potential. Unlike 2009, when a rising tide (market) lifts all boats (stocks), one may have to be much more selective and opportunistic to achieve above average returns.

Our read on the equity markets is based on several conflicting factors. On an encouraging note, companies are posting positive earnings, improving fundamentals and it appears as if we are coming out of the recession. Much of this good news, we believe, is what is supporting the current market.

On the other hand, the rate of change in many of the statistics that we monitor is beginning to slow. (This is often referred to in the press as the rate of change of the rate of change, otherwise known as the second derivative effect.) Despite being in an economic upswing, we are still in a fragile economic environment. Capacity remains underutilized across the spectrum; the real estate markets remain depressed; consumers are slow to spend and unemployment is still high. As if that were not enough, the uncertainties in the US political arena including healthcare reform, the threat of higher taxes, increasing financial market regulation and our growing budget deficit, may undermine the recent rally.

All that being said, we are cautiously optimistic. Why? We believe that the current momentum in the economy provides support, albeit fragile, for continued economic improvement. US companies have pared their costs to the bone. Those firms that have survived are stronger and going forward, they are poised for growth and should be able to better support their cost structures. Many are flush with cash and have little debt. Thus, they will be seeking opportunities to deploy their capital, either through increasing their dividends, buying back their stocks or acquiring other companies. Any of these three actions would be viewed positively by the market.

The financial system has also gone through a deleveraging/recapitalization process. It has not been pretty and we do not condone all the steps taken to get to this point nor do we expect that all the issues in the banking system have surfaced. However, it is likely that, at least for some time, issues that surface will be institution-specific as opposed to systemic.

Households and consumers are deleveraging as well. Among other things, this has lead to an increase in the US household savings rate. Merger and acquisition activity continues to pick up, indicating a continued thaw in the credit markets. And while consumer spending has been weak, it has certainly not disappeared. In sum, for the balance of 2010, we believe that our concerns are well reflected in aggregate valuations of the equity indices while skepticism is creating selected opportunities not being properly accessed.

The fixed income markets will almost certainly prove to be much more challenging versus the past year. In 2009, bond investors had the wind at their backs. They had the benefit of investors stepping back into riskier assets and reaching for yield, driving bond prices up dramatically. We are now beginning to see some firming of yields in the bond market and it is likely that we will see rates begin to drift upwards as we move through the latter part of 2010 and well into 2011. As the yield curve goes up, bond prices are likely to trend down.

On a longer term basis, we are well aware of the issues that face the US economy and most developed nations. The US will be anchored down by a large deficit and seemingly out of control spending. Unlike our prior debt experiences, the US (like all developed countries) is now a more mature economy, which is code for slower growth. If our economy grows at a slower rate than what we have been accustomed to as we exit the recession, it will be difficult to self fund all of our priorities and pay down our debt on a timely basis.

We take the deficit issues and other concerns that face the economy seriously and continue to discuss ways to position portfolios for not only the near term, but for a longer term time horizon as well. Our goal is to have a thoughtful and comprehensive process so that portfolios are well positioned to avoid the pitfalls we see and still be positioned to capitalize on opportunities as they present themselves in the months and years ahead. Ultimately, our goal is to understand our clients' financial goals and seek solutions to achieve them.

As always we welcome your input and encourage you to discuss these issues with us during future meetings.

Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives.

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