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summaries

SIGMA INVESTMENT COUNSELORS

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# The Economic and Market Environment

**In Sum:** At the time of this writing, virtually all major equity markets had recovered from the losses suffered from the world wide sell off of February 27, 2007. Part of this may be due to a sense that global economic growth appears sustainable, while most geo-political crises are manageable. Monetary policy looks to be benign, if not outright accommodative, and fiscal policy in the major industrialized economies appear absent any major imbalances.

**Geo-political:** Making money or making headlines? A host of geo-political ills have been chronicled on these pages the past several months. While each of these ills teases a seriously negative outcome, the reality is they have been relatively well contained considering the current state of affairs and the prospective worst-case scenario. While the ebbs and flows of difficulties in Iraq, Iran, North Korea, Lebanon and Venezuela make headlines, the reality is global economic prosperity continues.

**Economic:** At the risk of sounding redundant in each monthly commentary, for the past several quarters global economies have sustained their progress. Inflation, the major concern for central bankers, has shown signs of moderating from modestly higher than desired levels earlier in the year and last year. The March 2007 US consumer price index rose at a modest 2.5% annual rate. Most developed economies are experiencing similar inflation rates. US new home construction and information technology capital spending appear to be the primary areas of weakness.

**Monetary:** The Federal Reserve Board is on hold, monitoring economic growth statistics and inflation signals. After raising interest rates for most of 2006, there is evidence that these increases have had their desired effect on slowing the rate of economic growth. With a US presidential election looming, it would appear unlikely that the Fed would engineer material rate changes in the next several months. Central bankers in the rest of the globe have a bit more latitude and will probably err on the side of restraint.

**Fiscal Policy:** The US federal budget deficit should continue to improve during the 2007 fiscal year. Government finances in the rest of the developed economies of the world are in similarly sound condition. A new reticence to promote unfunded social programs by the US congress bodes well for the near term. Elections in Great Britain and France bear watching to determine if fiscal policy will be changing in those two strategic regions.

**Equity markets**: Virtually all of the losses registered from the substantial global market sell off in late February have been reversed. Equity prices have climbed the proverbial "wall of worry" and have confounded most who had expected the decline to usher in a prolonged corrective phase. Still, equity prices rarely advance for more than three or four years uninterrupted, so investors should remain vigilant over the near term.

**Fixed income markets:** The yield curve remains inverted, implying that short-term interest rates remain higher than longer-term rates. Investors have earned a higher yield in money market funds, CD's and short-term bonds than their longer-term counterparts. We believe this inversion will eventually correct to a more normal yield curve, but it is impossible to predict when. We would not be surprised to see short-term rates trend downward and longer rates stabilize or inch higher in the not too distant future. A balanced approach in diversifying across the maturity spectrum still makes sense in the construction of a fixed income portfolio. However, in anticipation of a correction in the yield curve resulting in higher long-term yields, an emphasis may be placed on purchases of shorter-term investments.

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