Weekly Commentary
February 16, 2010

The Markets

The Reuters/University of Michigan consumer sentiment preliminary index for February that was reported last week declined slightly from the late January number and it was lower than expected as consumers continued to fret over unemployment. The index is now down 24% from January 2007, according to data from the St. Louis Federal Reserve. Ironically, when consumers are glum, that could be good news for the financial markets.

A 2002 study by Meir Statman and Kenneth Fisher found that, "Low consumer confidence is followed by high stock returns more often than it is followed by low stock returns." That seems a little counterintuitive because you would expect apprehensive consumers to be in no mood to buy financial securities and push their prices higher. On the contrary, though, the authors said, "When people lose confidence as consumers, they should regain it as investors."

So, how does this make sense?

Not surprisingly, declining financial markets tend to drag down consumer confidence. However, at some point, financial markets typically revert to the mean and start heading up again. Often, financial markets start heading up before consumer confidence does. This suggests that consumer sentiment is a contrarian indicator, according to Mark Hulbert at MarketWatch.

Does this mean you should base your entire investment strategy on the level of the consumer sentiment index? No. Sentiment is just one of many indicators that may play a role in the complex interplay of factors that affect asset prices. Oh, and just for the record, the U.S. stock market did rise last week so the consumer sentiment "contrarian" indicator did work--at least for one week!

Data as of 2/12/10	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	0.9%	-3.6%	30.1%	-9.1%	-2.3%	-2.5%
DJ Global ex US (Foreign Stocks)	1.4	-6.3	44.4	-8.5	1.9	0.1
10-year Treasury Note (Yield Only)	3.7	N/A	2.7	4.8	4.1	6.5
Gold (per ounce)	2.3	-2.0	14.7	17.6	20.6	13.4
DJ-UBS Commodity Index	2.7	-6.6	19.2	-7.4	-2.4	2.8
DJ Equity All REIT TR Index	-0.5	-6.1	52.5	-16.5	0.0	10.3

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.
Sources: Yahoo! Finance, Barron’s, djindexes.com, London Bullion Market Association.
Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

THE DRUG OF EASY MONEY will eventually be withdrawn from the worldwide economy since governments cannot indefinitely spend (or create) money that they don't have. The question of when and how that happens is looming large over the financial markets. Just in the U.S. alone,

we invested (spent?) trillions of dollars propping up the economy, according to CNN, and so far, it has helped avert a potentially even larger disaster. Unfortunately, it may have just delayed the next day of reckoning.

So, how do you withdraw the drug of easy money from an economy without tipping it back into a recession? Very carefully! *The Economist* has identified three key issues to address in order to pull off an effective exit strategy.

First, you have to get the timing right. If you pull the stimulus too soon, you might end up with a relapse into recession. If you let the stimulus slosh through the economy too long, it could break the budget, lead to unacceptable inflation, or cause new bubbles to form.

Second, you have to get the tactics right. The two main tactics include cutting the government budget and raising interest rates. However, if you cut the budget too much, you run the risk of--you guessed it--another recession. Ditto for raising interest rates too soon.

Third, you have to get the technique right. The U.S., in particular, was zealous in creating newfangled funding mechanisms, bailout programs, backstop guarantees, and lending facilities to stop the market meltdown in 2008-09. How we unwind these programs may have a big impact on the economy so we have to get this right, too.

Ultimately, there are no easy answers to these three issues, yet they are vitally important to our economic future. And, the best way to monitor how effective the government is in answering these issues is to follow the reaction in the financial markets. Of course, we do that on your behalf so you can spend your time in areas that are most important to you.

Weekly Focus – Think About It

"Nobody can go back and start a new beginning, but anyone can start today and make a new ending."
--Maria Robinson

Best regards,
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Wealth Advisor