



Insights from Northern Trust

Commentary from John Leo, Chief Investment Officer – Illinois

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Although a short month, February certainly carried its weight in terms of action and drama, providing investors with plenty to digest as well as think about in terms of implications for future market movement. If one were to create a tally sheet of positives and negatives for the investment tableau, neither side would fall short. On the encouraging side, corporations reported a set of profit results that beat expectations and included a decent resumption of sales growth – a key factor that had been notably absent over recent quarters. In response, the Standard & Poor's 500 posted its best February return in 12 years, restoring some balance to a market that was firmly in correction mode as we entered the month. On the negative side, sovereign debt concerns in Europe, early steps toward monetary policy tightening around the globe and further concerns around the health of the consumer and the housing market all acted to keep investor enthusiasm in check.

On this last point, revisiting the health of the consumer bears some consideration as we assess the investment landscape ahead. Consider for a moment the three basic building blocks of economic activity. Government spending has been working overtime since late 2008 and will for some time yet. Capital expenditures by the corporate world are showing some signs of a positive turn. But the consumer, whose relative contribution is twice the size of the other two constituents combined, continues to face stiff headwinds. This was borne out by a sharp decline last week in the February reading of the Conference Board's Consumer Confidence Index, which fell from 56.5 in January to 46.0 last month – its lowest point since July of last year.

The principal contributor to the confidence swoon is certainly the tough employment situation. Initial jobless claims jumped again last week, representing another step in the wrong direction after many months of improvement in the second half of 2009. This week's report of the February employment particulars will be closely scrutinized as it always is, although there is justifiable concern that the big snowstorms that pounded the Eastern seaboard may have an impact that will cloud the results. The housing market, another key factor influencing consumer sentiment, remains weak as evidenced by last week's report in which January sales of existing homes fell 7.2% on the heels of a 16.2% decline in December. We did find one source of encouragement regarding the housing market from Warren Buffett who, in his annual letter to Berkshire Hathaway's shareholders, stated that "residential housing problems should largely be behind us" within a year as supply falls into line with demand, though "prices will remain far below bubble levels."

While the concerns around the U.S. consumer bear close scrutiny, regular readers of our commentaries know that we maintain a generally constructive outlook for global economic activity in 2010 and into succeeding years. The most conspicuous challenge to this view of late centers on the fiscal challenges within the European Union. Progress toward a Greek rescue package seems to be in

the offering this week as it appears that both German and French authorities have signaled their willingness to participate as buyers and/or guarantors in a significant debt offering. If this comes to fruition, in return for this support, Greek authorities will agree to a sizable slate of austerity measures designed to reassure investors that progress is being made. Whether these measures prove sufficient to stem the tide of negative sentiment against the euro will be worth watching. Statistics out of the Chicago Mercantile Exchange last week confirmed that investor bets against the euro already sit at historically high levels and have contributed meaningfully to the resurgent move in the dollar over recent weeks.

Finally, the coming week should also contain a full complement of Washington news, with progress on jobs legislation likely and further details surrounding the financial regulatory reform package reaching the public airwaves. President Obama is likely to press for additional bipartisan work on health care, emphasizing that the legislative tactic known as “reconciliation” remains a potentially viable – albeit controversial – option. That so much focus remains centered on Washington serves as a reminder to investors that the economic recovery has been given a big assist by the fiscal programs enacted in 2008 and 2009. A successful transition from government-assisted growth to organic economic expansion is what investors will want to see over the months and quarters ahead. It is our belief that this will occur, even if the ultimate organic growth trajectory winds up being less exciting than we have experienced in prior economic expansions. So long as this transition is successfully completed, we believe investors will be appropriately rewarded for taking risk in the capital markets.

John Leo holds designations as a Chartered Financial Analyst and Certified Private Wealth Advisor.

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