



Insights from Northern Trust

Commentary from Katherine Ellis Nixon, Northeast Region Chief Investment Officer

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Although still early to draw a meaningful conclusion, the first earnings reports of the second quarter 2009 season point to a far more stable current economic state, and a far less draconian future outlook. Reports from bellwether companies like JP Morgan in the financial arena and Intel in technology far exceeded most Wall Street analysts' expectations. In fact, the majority of companies that announced earnings last week surprised on the upside, with more than 70% of the reports topping estimated results. Scratching a bit below the surface revealed a striking consistency around the genesis of these beats. Across industries, the bottom line reflected a continued and intense focus on cost-cutting and inventory management in an environment where top line, or revenue growth, remains scarce. Admittedly, the earnings bar was set low, with most analysts hoping for the best but publishing estimates based on a much more dire outlook. With unemployment at 9.5% and many economic indicators pointing to a fragile stability, who could blame them?

The market reaction to both the earnings announcements as well as to the somewhat upbeat management comments that accompanied the reports was swift and powerful. The Dow 30 Industrials and the Standard & Poor's 500 advanced more than 7.3% and 7%, respectively for the week ended July 17, 2009. This achieved two important goals: the market has erased the losses not only of the last month but also for the year as a whole. We are back to the January levels in these broad averages, and are at an admittedly key level here, having tested but been unable to close at higher levels. Smaller stocks fared even better, with the Russell 2000 advancing a whopping 8%. With many more earnings releases scheduled for this week, the continued lack of stability on the revenue front remains worrisome, as does the relatively low trading volume that has characterized this latest market move. We have been, however, particularly impressed by the ability of corporations to effectively manage through this difficult environment.

This sense of optimism is expected to be confirmed this week as Federal Reserve Chairman Ben Bernanke takes the floor during his semi annual testimony on monetary policy. A more optimistic Federal Reserve will set the stage for detailed discussions around how the various stimulus tools may be removed from the system. Recent economic data support some earlier Fed commentary that deflation is less of a concern, and the recent housing reports provided additional evidence that the policies have been effective in stabilizing this important area. A well-articulated exit strategy will be welcomed by the market; however, we do not expect any dramatic action on that front until the recovery is more consistent and we begin to see stability in the unemployment rate.



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Last, with only about 10% of the \$787 billion fiscal stimulus spent thus far, there is still some dry powder that could fortify the economy in the potential absence of more monetary stimulus in 2010. We will continue to keep a watchful eye on the pace and components of this spending, with particular focus on areas that may benefit most from aid. With the spotlight shining brighter on municipal budgetary woes such as those in Philadelphia and California, it is clear that a broader recovery will not be sustainable until the more state- and city-specific issues are resolved.

Investment policy continues to reflect cautious optimism on the economic recovery. However, we remain at a tactical risk posture lower than our strategic norm, based on continued concerns around the endurance of the various signs of improvement in the face of some potential strong headwinds.

Katherine Ellis Nixon holds designations as a Chartered Financial Analyst and Certified Investment Management Analyst.

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