



Summary

The U.S. economy expanded at a 3.2 percent annual rate in the first quarter. Combined with the 5.6 percent growth in the fourth quarter, this marks the best performance for the economy since the second half of 2003. Inventories contributed to gross domestic product, but did not have as much of a positive impact on growth as they did in the fourth quarter of 2009. Consumer spending, which accounts for nearly 70 percent of the economy, was the largest contributor to GDP during the first quarter. In fact, consumer spending took its most significant leap since the first quarter of 2007 – an improved job market has likely raised consumer confidence to the point where they are spending money with greater ease. The housing market remained strong through April as buyers took advantage of the federal tax credit before it expired. The question now is whether the housing market can maintain its momentum without the tax credit. Also of concern to the economy is the situation in Europe with regard to Greece and several other countries. While the problems these countries are having may not directly impact the U.S. economy, there is the danger of ancillary impacts, particularly with major U.S. trading partners in Europe. Inventories were a less-significant contributor to growth in the first quarter, a trend that is likely to continue going forward. As a result, further expansion of GDP will most likely be dependent on the consumer. Although the consumer feels more optimistic about the economy, there are issues on the horizon that may prove to be a negative influence, such as higher taxes, a reduction in stimulus programs and a continued high unemployment rate. We continue to believe that the economy will face headwinds in the second half of the year, but we do not anticipate anything worse than slowed growth.

POSITIVES

- ❑ Index of leading economic indicators rose sharply in March
- ❑ Positive trends in Conference Board's consumer confidence index
- ❑ Manufacturing expanded in April at the fastest pace since June 2004

NEGATIVES

- ❑ Spending by state and local governments continues to decline as tax revenues are constrained
- ❑ Stronger dollar is negative for exports
- ❑ Slower retail sales during April

UNKNOWNNS

- ❑ The economic impact of the reduction in stimulus programs and the expiration of housing tax credits



EQUITY OUTLOOK

Summary

April was full of positive and negative surprises, capped by a 1.58 percent increase in the S&P 500 by month's end. As of April 30, the index is up 7.05 percent year to date. The first surprise of the month came with earnings reports: expectations for earnings per share were already high, but the majority of companies exceeded these expectations and revenue growth was stronger than anticipated. So far, these reports indicate that the earnings recovery is broad-based and can be expected to continue. Contributing directly to the bottom line are a recent pickup in sales and cost-cutting measures implemented by many companies in 2009. The earnings recovery seems to have moved beyond cost cutting and may now be driven by an increase in demand.

Two negative surprises influencing April's equity markets were allegations of wrongdoing at Goldman Sachs and the oil rig explosion in the Gulf of Mexico. Regardless of the outcome of the Goldman Sachs investigations, U.S. government regulatory reform of the financial industry seems imminent. The impact of the oil spill in the Gulf of Mexico is as yet unknown but may be a significant negative. Both events have worrisome implications for the U.S. economy, particularly at a moment of overall economic improvement. Concerns over sovereign debt issues in Western Europe also continue to trouble American investors. These concerns appear to be the driving force behind May's early pullback in the equity markets, rather than fundamental issues regarding earnings and economic reports.

Despite the wall of worry facing equity investors, our longer-term view of the equity markets remains intact. An improving economy, low interest rates and stronger corporate balance sheets should be positives for stocks as we go forward.

POSITIVES

- ❑ Interest rates are still relatively low
- ❑ Economy is improving
- ❑ Earnings are improving

NEGATIVES

- ❑ High unemployment could last longer than anticipated
- ❑ Expectations of higher tax rates
- ❑ Global slowdown
- ❑ Impact of sovereign debt issues in Western Europe

UNKNOWNNS

- ❑ Impact of eventual reduction of massive government monetary and fiscal stimulus



Summary

The Barclays Capital Aggregate Bond Index returned 1.04 percent in April, bringing the rolling 12-month return to 8.30 percent. Corporate bonds once again led performance for the month, with returns generally higher for longer maturity, lower quality issues. The month was characterized by several positive economic announcements, including increased home sales, solid first-quarter corporate earnings, an increase in non-farm payrolls, and better-than-expected retail sales. All helped drive U.S. corporate bond returns. These statistics would usually lead to a gradual rise in market rates, but just as the 10-year Treasury note touched 4 percent, the Federal Open Market Committee reiterated their stance on keeping the federal funds rate low for an extended period of time. The Fed's position, combined with low inflation figures, helped increase demand for fixed income securities, thus pushing rates lower. However, the FOMC and low inflation were not the greatest influences on the markets during April and early May.

European deficit problems became the dominant catalyst for markets, wreaking havoc on equities and driving market rates lower. The potential bailout of Greece by other members of the European Union and the International Monetary Fund was called into question, and fears of contagion rapidly spread. Riskier asset classes were sold off indiscriminately, and investors sought shelter in safer securities such as U.S. dollar-denominated fixed-income instruments. By the first week of May, the 10-year Treasury note had fallen more than 0.5 percent from the recent high. We believe market rates will remain low in the near term, but with a broad trading range based on fears of contagion from the sovereign debt problems in Europe. We continue to favor high-quality corporate bonds with an intermediate maturity.

POSITIVES

- ❑ Solid first-quarter corporate earnings, positive retail sales, increase in home sales
- ❑ FOMC maintaining zero to 0.25 percent federal funds rate; low inflation

NEGATIVES

- ❑ Internal pressure at the FOMC to raise the federal funds rate
- ❑ Accelerating U.S. deficit; a similar path for countries around the world

UNKNOWNNS

- ❑ Resolution to the deficit problems within the E.U.
- ❑ Impending financial market regulation; higher taxes