

APRIL 15, 2013

## WEEKLY INVESTMENT COMMENTARY

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### Stocks Look Past Slower Growth

#### Stocks Close in on New Record Highs

Last week's economic data skewed toward the negative (retail sales in particular were disappointing), but despite a broad selloff on Friday, stocks still managed to post strong gains for the week. The Dow Jones Industrial Average jumped 2.1% to end the week at 14,865, and came close to the psychologically important 15,000 level. Likewise, the S&P 500 Index closed in on 1,600 before faltering at the end of the week (the index gained 2.3% to 1,593). For its part, the Nasdaq Composite also saw strong gains, rising 2.8% to 3,294.

In fixed income markets, Treasury yields rose slightly through much of last week (as prices fell), before dropping on Friday. The yield on the 10-year Treasury was little changed on a week-over-week basis, moving from 1.71% to 1.72%.

#### Economic Data Showing Signs of Softening

While the US economy appeared to be surprisingly strong during the first quarter of this year, we have been seeing evidence that the consumer sector is weakening. As alluded to above, the retail sales figures for March that were released last week were quite weak (down 0.4%, the largest drop since last June) and well below expectations. We have discussed in the past that much of the strength in consumer spending that occurred earlier this year came at the expense of a falling savings rate, which is an unsustainable trend.

Since income growth remains anemic and since the savings rate is already quite low, it is not surprising that consumption levels appear to be dropping. From an investment perspective, this is the key reason why we remain skeptical toward consumer-oriented stocks.

#### So What's Holding up Stock Prices?

It seems a bit of a paradox that stock prices would continue to rise as economic data is showing signs of softening. Our analysis of this trend is that stocks are being buoyed by two interrelated forces: still-aggressive central bank policy and continued investor flows into equities. The US Federal Reserve remains committed to its asset-purchase program (i.e., quantitative easing) and we recently saw the Bank of Japan's move toward aggressive easing policies as well. These policies are helping to keep interest rates at extremely low levels, which, in turn, is forcing more and more investors out of low-yielding cash and into higher-risk assets such as stocks and high yield bonds.

While flows into stock funds have slowed a bit compared to where they were earlier in the year, the money is still coming into the markets, and investors who are moving



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*Within the United States, we continue to advocate a focus on mega-caps, which have begun to perform better than their smaller-cap counterparts.*

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back into stocks appear to be focusing on US equities, which has helped that asset class in particular. Looking ahead, we continue to have a favorable view toward equities in general, but believe that some caution is warranted. Within the United States, we continue to advocate a focus on mega-caps, which have begun to perform better than their smaller-cap counterparts.

### Interest Rates Unlikely to Rise Quickly

Not all asset classes have been ignoring the signs of softening growth, however. Oil prices have been dropping amid signs of softening demand, and the International Energy Agency cut its forecast for global oil demand last week, which accelerated the selloff.

US Treasuries have also been reacting to signs of slower growth. One month ago, the yield on the 10-year Treasury was hovering around 2.0%, but has since dropped around 30 basis points. As the economic data has weakened, investors appear to have become less worried about near-term changes in monetary policy. With the recovery appearing to slow, we believe the Federal Reserve will maintain its current pace of quantitative easing, at least through the second quarter. Until then, while we may see modest advances in yields, any increase in interest rates is likely to be muted with the economy still on the mend and with the Fed still aggressively buying.

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