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# First Quarter 2013

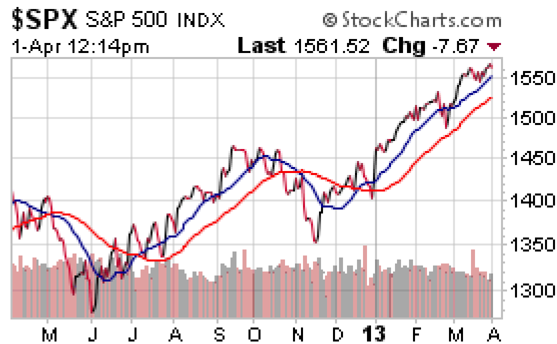


Fig. 1 – S&P 500

Fig. 2 – 10 Year U.S. Treasury Yield

US stocks posted strong gains in the first quarter as economic growth showed signs of reacceleration, with both the Dow Jones Industrial Average and the S&P 500 hitting all-time highs. The large cap S&P 500 rose 10.6% (**Figure 1**) while the Russell 2000 Small Cap index finished 12.4% higher. International markets were considerably weaker. The MSCI Europe, Australia and Far East Index rose 5.2%, and MSCI's Emerging Markets Index fell 1.8%.

According to Factset, 71% of S&P 500 companies exceeded fourth quarter earnings expectations and 65% beat revenue estimates. In a positive sign for the U.S. economy, earnings growth accelerated, rising 4.2% over last year after a decline of 0.9% in the third quarter. Utilities and financials logged the strongest growth, while industrials and telecoms lagged.

In contrast with the prior quarter, 2013 began with greater investor confidence in the economy. The U.S. government passed a compromise bill that resolved fiscal cliff uncertainties. This left businesses, consumers, and investors to focus on improving economic fundamentals, as it became less likely that the U.S. was about to enter recession. Purchasing manager surveys, a key indicator of economic growth, generally posted stronger readings. Private sector employment exceeded expectations in January and February, and housing starts, home sales and prices all showed solid improvement over last year. The increased payroll tax appeared to hurt consumer sentiment early in the quarter, but retail sales held up well, helping consumer staples and discretionary stocks begin the year with solid gains. In a very positive local development, the bond rating firm Fitch upgraded the state of Michigan's bonds to AA.

U.S. markets showed resilience in shrugging off potential shocks during the quarter. Automatic spending cuts of more than $80 billion went into effect when Congress was unable to reach a compromise to avoid the "sequestration". While these cuts may hamper economic growth, as of this writing, private spending and investment appear robust enough to maintain modest growth.

In addition, in mid-March banking system problems erupted in Cyprus, one of the Eurozone's smallest members. These debt-related issues raised concerns that if Cyprus was forced to abandon the Euro, one of the larger member

***Index returns taken from iShares.com by BlackRock***.

economies such as Spain or Italy might follow suit. European stock exchanges initially fell hard as Cypriot lawmakers and international banking organizations worked on a solution. However, U.S. indices only suffered minor losses, as investors continued to show confidence in the U.S. economy.

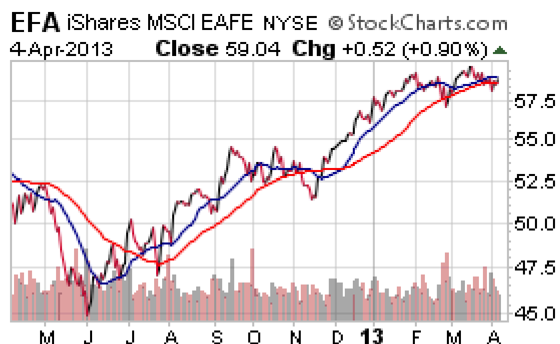


Fig. 3 – iShares MSCI Europe, Far East & Australia

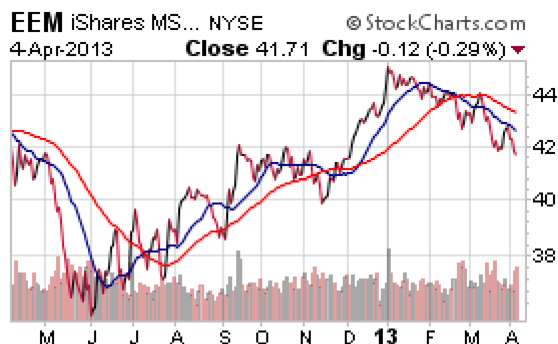


Fig. 4 – iShares MSCI Emerging Markets

After posting solid returns in 2012, international markets lagged the U.S. by a considerable margin. Many European countries are in or close to recession (**Figure 3**), still weighed down to some extent by uncertainty over the future of the Euro currency. Some of the largest emerging market economies (**Figure 4**) are also facing significant challenges. India, for example, is wrestling with both slowing growth and rising commodity costs. China is attempting to maintain economic expansion while cooling off its overheated real estate market.

These adverse global conditions have left U.S. stocks, and to some extent U.S. bonds (**Figure 2)**, as the most attractive current investments. We note that domestic indices have already risen considerably this year, and that U.S. equities are not immune, by any means, to negative developments in the rest of the world. We will be watchful for changes in the economic climate that might impact client portfolios. At the same time, we remain cognizant that market pullbacks often create buying opportunities for alert investors.

As always, we encourage you to contact us for any reason.

Sincerely,

Kenneth M. Bernard, CFA