TW Advisors

Newsletter
May 2010

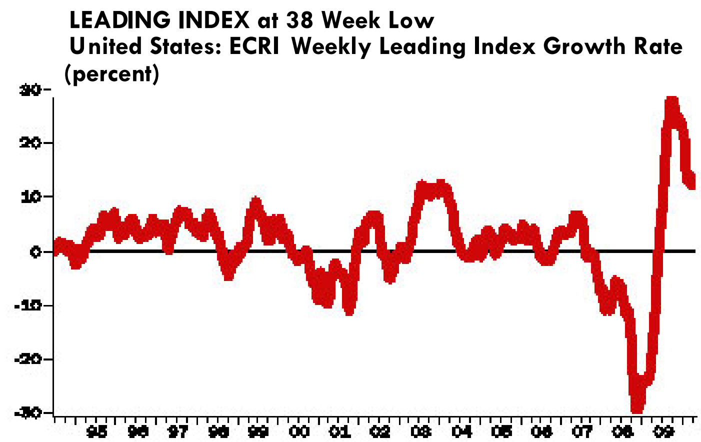
Does Good News Mean Good News for You?

Remember last year (2009)? The news was ugly, economic reports were worsening, and the stock market had plumbed the depths. From a sentiment perspective, investors were dour and generally in no mood to be bullish. Yet, from an analytical perspective, all emotions aside, stocks were very inexpensive and in many cases financially healthy. As it turned out, amidst a disheartened frame of mind for investors, stocks bounced off a bottom and continued to rally. Recently the mood has changed somewhat, valuations have changed quite a bit and the economy has, in most cases, moved in a positive direction. **Since history shows that stocks prices and economic results do not correlate in timing, should one be bullish today?**

From the perspective of the economy, the recovery is underway. The economy and corporate earnings are in some cases “less bad” and in others growing positively. Late recovery items such as unemployment are still ugly, but budding indicators such as new temporary jobs are on the rise. Globally we have been blessed with active and growing emerging market economies. Some would argue that the impact of these new marketplaces and the emergence of the new consumer have provided growth in the world economy that may have otherwise been stick in the mud. China, like other countries, introduced significant stimulus into their economy through construction and outright purchases of goods and materials. Large global companies, many of which we have targeted in our portfolios have been beneficiaries of this stimulus, giving them a boost in their earnings in a weak dollar environment. The ISM Manufacturing index (chart below) has benefited from this stimulus and continues to rise due to the added growth of manufacturing through the export market.

While the strength of the stock market signals an exit from the economic malaise of 2008 and 2009, the underlying structure of our economy has been drastically altered by the methods chosen to save the economy. The $8,000 housing tax credit pushed home sales significantly in April but it is likely the month of May will show buyer exhaustion. Debt used to solve the Debt Crisis has added stimulus to housing and autos but as of now those programs have ended and the EXTRA Debt remains.

The economy is pretty much on its own now. Banks still get money for free, but you and I, the consumers, do not! Leading indicators (chart below) that have recovered powerfully from the low of 2008 recently peaked and have turned down again. As labeled, these indicators lead the economy and the markets, rising before the true recovery and dropping in advance of a downturn. Historically the stock market has acted similarly relative to the economy. The economic challenges for nations around the world will be to balance government budgets in the face of rising debt/interest levels until grow accelerates again. Recent financial tremors in the Euro area have added to the volatility in the marketplace.



Volatility is Back

For many months during the recovery there was very low volatility in stocks as a whole. Two shallow corrections in June of 09 and January of 2010 were followed by solid rallies. In recent weeks we have seen a return to higher volatility and regular episodes of 1% up and down days. Volatility tends to cluster and when it occurs after extended market rallies it is likely to lead to a market downturn.

Before the recent return to market instability we had maintained equity allocations in response to the ongoing market strength but chose to reduce our exposure to risky stocks rather than exiting stocks altogether. Stocks whose earnings are less cyclical in nature, with solid balance sheets, attractive valuations, and better cashflow and dividends are preferred in this environment. If the market shifts from favoring risky stocks, we would expect our selections to outperform.

Since it appears the market may be entering a corrective phase we have selectively trimmed and sold certain positions. We would like nothing more than the opportunity to employ some of our sideline cash into other high-quality companies.

Thanks for listening and as always we enjoy your response and comments.

Steve Wenstrup, Jim Tillar, CFA