ECONOMIC AND INVESTMENT FORECAST
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Consumer confidence in the U.S. continues to remain weak as the lingering effects of the recession restrain bank lending, corporate hiring, and consumer spending. The U.S. economy has been slowing as government stimulus programs wind down and consumers continue reducing their debt. GDP growth is projected to be only 1-2% for the next few quarters. Private sector job creation remains below levels necessary for a sustainable recovery, while unemployment hovers at 9.5%. The Federal Reserve, which most Americans look to for the outlook and direction of the economy, has been inconsistent with its forecasts and policies, which is contributing to weak consumer confidence. Although inflation is currently benign, it will likely be a significant problem as the recovery progresses. Former Fed Chairman Alan Greenspan recently called for an end to the Bush tax cuts because of the rapidly rising inflationary budget deficit. However, some economists are becoming more concerned about a double dip recession and deflation, and think that these tax cuts should be extended indefinitely for everyone. Although the short-term data is mixed, we believe that the most likely outcome is a continued slow growth environment in the U.S.

In contrast, growth in emerging economies has been robust. China’s GDP grew 10.3%, Indonesia’s 6.2%, Russia’s 5.3%, and Singapore’s grew 18.8% year over year during the second quarter. Many of the developing export countries are beginning to focus growth domestically, creating infrastructure, and importing goods and services from developed nations. The growing middle class in Asia, India, and Latin America has helped boost European GDP, which grew by 1.7 % year over year during the second quarter. All Euro zone countries, with the exception of Greece, are out of recession and appear to have weathered the sovereign debt crisis, with Germany and France showing the highest growth rates. The Euro zone GDP numbers were the strongest in the last 3 1/2 years and showed Euro zone growth outpacing that of the United States in the March-June period. While both Chinese and Euro zone exports continue to soar, U.S. exports actually contracted in June, due in part to U.S./China trade disputes.

U.S. corporate profits have continued to exceed analysts’ expectations, mostly as a result of productivity gains and growth from international markets. Over 40% of the S&P 500’s earnings come from overseas. Corporate profits have likely peaked for now, although individual companies may still post record profits. We expect more mergers and acquisitions activity as U.S. businesses utilize their hoards of cash. Dividends have increased dramatically during the past year, which may represent a fundamental change in corporate policy. During the 1950s and 1960s, over half the return from stocks came from dividends. Bond yields are expected to remain at their current low levels until mid 2011. High dividend equities, REITs, MLPs, short-term lower grade corporate bonds, and income-producing mutual funds will fulfill the income role until longer term investment grade bond yields become significantly higher. Companies in emerging markets will continue to be attractive for appreciation with their rapidly growing sales growth, cleaner balance sheets, and cheaper valuations.