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## **ECONOMIC AND INVESTMENT FORECAST May 2010**

The U.S. Gross Domestic Product (GDP) grew at a 3.22% annualized rate for the 1<sup>st</sup> quarter of 2010, and most economists expect a continued strengthening of the economy. Corporate spending on capital equipment and business software rebounded strongly during the 1<sup>st</sup> quarter, indicating a growing business confidence. The Federal Reserve recently reaffirmed its commitment to exceptionally low short-term interest rates (currently at 0 - 0.25%) for an “extended period” and government stimulus programs will continue through at least the 1<sup>st</sup> quarter of next year. Housing prices rose in nearly 60% of U. S. cities in the 1<sup>st</sup> quarter of this year as the housing market began to stabilize in response to the billions of dollars in federal spending. However, price recovery remains elusive in some regions. Retail sales were a little weak in April due to an early Easter, which produced strong sales in March. Temporary employment, generally a precursor to full-time work, has increased, and jobless claims declined modestly during the 1<sup>st</sup> quarter. However, the overall unemployment rate is expected to remain high while discouraged workers, who had stopped looking for work and had not been counted, return to the job market, and corporations remain cautious on new hires. Labor productivity increased at a strong annual rate of 6.3% last year, which was an important factor in the 1<sup>st</sup> quarter’s strong corporate profits. These earnings were anticipated by the stock markets, which have rallied over 70% from their lows in March 2009. We expect this upward trend to continue, although at a slower rate with increased volatility. Inflation in the U.S. remains muted. However, the increasing budget deficit, now the highest percentage of GDP since World War II, as well as continuing government stimulus spending and higher energy and other costs will likely lead to higher inflation.

The leading economic indicators for the developed world expanded in the 1<sup>st</sup> quarter at the highest rate in more than three decades. This should provide a positive environment for U.S. exports. Asian markets are projected to grow at a 7% annualized rate during 2010 and 2011 according to the IMF. The largest emerging markets, the BRIC countries (Brazil, Russia, India and China), may grow even faster. China recently raised mortgage rates and down payment ratios to reduce real estate speculation and lower inflation, as growth has approached double digits. The sovereign debt crisis in Greece and its possible contagion to other southern European countries has resulted in diminished confidence in the EU, and is likely to result in higher interest rates in Europe as some developed countries attempt to fundamentally restructure their societies. The dollar, which had significantly depreciated against the euro, is now recovering against the euro and is expected to strengthen over the next year, which will make our exports more expensive in that region.

For the past three decades, bond investors have benefited by a long-term decline in interest rates (as yields decline, bond values rise). In contrast, over the last 10 years, equities failed to generate real returns (returns over the rate of inflation). Many economists refer to this time as the “lost decade.” We expect U.S. bond yields to rise and values to decline as inflationary pressures force interest rates higher next year. Therefore, we will maintain short U.S. bond maturities and continue to look to closed-end funds, energy stocks and MLPs, and REITs for higher yields. Fundamentally strong U. S. large-cap companies with solid dividends will also be attractive as alternative income investments. In addition, emerging markets will continue to offer opportunities for positive equity appreciation. We anticipate that small and mid cap U.S. equities will outperform.