

## 2010: THE FINANCIAL YEAR IN REVIEW

### QUOTE OF THE YEAR

“To climb steep hills requires slow pace at first.”

– William Shakespeare

### THE YEAR IN BRIEF

2010 was a very nice year on Wall Street. At the closing bell on December 31, the Dow Jones Industrial Average was sitting just eight points beneath a two-year high recorded two days earlier. The S&P 500 finished up 12.78% for the year and the Dow, NASDAQ and S&P all posted double-digit yearly gains. The Dow finished 2010 at 11,577.51, the NASDAQ at 2652.87 and the S&P at 1257.64.<sup>1</sup>

The economy grew, but instead of a V-shaped recovery we saw a shallow U-shaped one. The Fed didn't touch the benchmark interest rate all year; it did embark on another round of monetary easing. The unemployment rate stayed consistently above 9%. On Capitol Hill, you had the passage of health care reforms and the Dodd-Frank Act, the surprisingly easy extension of the Bush-era tax cuts, and a resolution to the estate tax question. The real estate sector stumbled along; mortgage rates fell remarkably before rising a bit at the end of the year. Consumer spending increased, though not impressively; inflation was barely on the radar. The bull market in commodities continued. Foreign economies struggled with problems much greater than ours.

### DOMESTIC ECONOMIC HEALTH

The American economy comes down to the consumer, and the good news is that consumer spending increased in nine out of the 11 months on record for 2010 (it was flat in April and June). As for inflation, it was almost nil: the Consumer Price Index gained just 1.1% from November 2009 to November 2010, and core CPI rose but 0.8% in that span.<sup>2,3,4,5</sup>

The Conference Board's consumer confidence survey moved from 50.6 (December 2009) to 54.1 (December 2010). The Reuters/University of Michigan survey moved from 72.5 to 74.5 across that span, with a 9.4% improvement in consumer expectations. When it came to unemployment, there was very little improvement: the jobless rate was 10.0% in December 2009 and 9.8% in November 2010.<sup>6,7,8</sup>

Let's look at the growth in the service and manufacturing sectors through the lens of the Institute for Supply Management. Its November manufacturing report indicated the 16th straight month of growth in the sector, with employment trending positive for 12 months and production expanding for the past 18 months. The November service sector report indicated the 11th straight month of expansion and the 15th straight month of growth when it came to new orders. Census Bureau data showed durable goods orders up 14.3% from year-ago levels in October (and without seasonal adjustment, the year-over-year rise was 10.4% from November 2009 to November 2010.)<sup>9,10,11</sup>

In the nation's capital, the Republicans gained control of the House in the mid-term elections and President Obama seemed eminently agreeable to their demands by year's end. In March, landmark health care reforms were passed to fulfill the President's mandate of bringing health insurance coverage to (virtually) every American, though the public option that would have made the federal government a competitor in the health insurance industry was defeated. In July, the Dodd-Frank Act was passed bringing new regulations to the financial industry. Besides trying to prevent a repeat of TARP, it green-lighted the creation of a new watchdog agency to help protect and educate consumers, opened up derivatives trading to the public eye, and set the FDIC insurance limit permanently at \$250,000.<sup>12,13</sup>

The fall brought a new round of bond-buying from the Federal Reserve - QE2, as it

came to be called in the media. The Fed committed to buying \$600 billion worth of Treasuries through June 2011 and announced plans to buy up to \$900 billion in debt by the end of next September. In December, the President struck an accord with Republicans resulting in swift passage of new tax laws: the EGTRRA and JGTRRA cuts were preserved for another two years, employee payroll taxes were cut by 2% for 2011, and the estate tax resumed for 2011 at 35% with a \$5 million exemption.<sup>14,15</sup>

## **GLOBAL ECONOMIC HEALTH**

It was a harsh year for the euro and for the European Union. Central banks and governments faced payback for years of loose lending and nonchalant spending. Greece was the first EU member to crack, getting a €110 billion bailout from the EU and the International Monetary Fund in May. In November, Ireland got a £72 billion EU/IMF bailout, and Portugal and Spain remain on the EU watch list. (At one point last year, the bank bailout guarantees amounted to about 25% of the EU's GDP.) In May, French prime minister Nicolas Sarkozy warned that his country would ditch the euro if Germany's chancellor, Angela Merkel, didn't agree to create an EU bailout fund. She did, and a €440 billion fund is now in place for any future rescues.<sup>16</sup>

In the third quarter of 2010, China became the #2 economy in the world, right behind the United States; Japan fell into third place. China's manufacturers saw their collective profits rise 49.5% across the first 11 months of 2010. The nation's central bank twice raised interest rates during the year. Japan couldn't shake its deflation – in November, its core consumer price index went negative for an astonishing 21st consecutive month – but its industrial output rose in November for the first time in six months. India's remarkable economic engine showed little if any sign of slowing down – the IMF projected India would end 2010 with a +9.7% GDP and forecast 8.4% growth in 2011.<sup>17,18,19,20</sup>

## **WORLD MARKETS**

Looking at the consequential stock markets around the world, we see some great 2010 performances. At the top we find Argentina's Merval, +51.8% for the year. Finishing second, we have Indonesia's Jakarta Composite, +46.2% for the year. Rounding out the top five, we have Thailand's SET (+40.6%), the PSE Composite in the Philippines (+37.6%) and Chile's IPSA (also +37.6%). Several other benchmarks outpaced the S&P 500 last year: Pakistan's KSE 100 (+28.1%), South Korea's KOSPI (+21.9%), Mexico's IPC (+20.0%), India's Sensex (+17.4%), Germany's DAX (+16.1%) and Canada's TSX Composite (+14.4%). Other gains: Singapore's Straits Times Index, +10.1%; Taiwan's TAIEX, +9.6%; Great Britain's FTSE 100, +9.0%; Hong Kong's Hang Seng, +5.3%; Brazil's Bovespa, just 1.0%.<sup>21</sup>

Some benchmarks went negative: Australia's All Ordinaries index (-2.6%), Japan's Nikkei 225 (-3.0%), Ireland's ISEQ (-3.0%), France's CAC-40 (-3.3%), China's Shanghai Composite (-14.4%), and finally two indices you would expect to finish at or near the bottom for 2010: Spain's IBEX (-17.4%) and Greece's ASE (-35.6%). How did the MSCI World Index and Emerging Markets Index fare in 2010? In U.S. dollar terms, the World Index gained 9.55% and the Emerging Markets Index posted a 16.36% return.<sup>21,22</sup>

## **COMMODITIES MARKETS**

The bull market continued. Palladium was the best-performing marquee commodity of 2010, gaining an astonishing 97.3%. Other metals also posted great yearly gains: gold rose 29.8% to close 2010 at \$1421.10 per ounce, silver gained 83.8% to \$30.91 a troy ounce, and copper prices rose 33.4% to \$4.4395 a pound for December. Platinum futures advanced 21.5% last year.<sup>23</sup>

How did energy and crop futures do? Well, oil climbed 15.2% for the year, with prices cresting at \$91.51 on December 6 and finishing the year at \$91.38. Natural gas was the "blown tire" of the commodities sector, with futures dropping 20.9% for 2010. Corn gained 51.8%, wheat 46.7% and soybeans gained 34.1%, spurred by a drought affecting Russia. Coffee futures were up 76.9% for the year, and sugar

futures gained 19.2 across 2010. The Dow Jones-UBS Commodity Index followed its 19.0% 2009 gain with a 16.8% advance for 2010.<sup>23</sup>

The U.S. Dollar Index gained 1.41% for 2010 and the real yield of the 10-year note went from 1.48% on December 31, 2009 to 1.00% a year later (a 32.4% decline).<sup>24,25</sup>

## REAL ESTATE

This is an annual review, so let's talk about the numbers that really matter when it comes to the housing market: the year-over-year change in home sales and home sale prices. The latest available data we have, of course, comes from November 2010 – so let's reference those figures. In November, existing home sales were down 27.9% from a year ago, though the median sale price improved by 0.4% in that time. New home sales were down 21.2% from 12 months ago, with a median sale price of \$213,000 – a year-to-year retreat of 2.0% from \$217,400 in November 2009.<sup>26,27,28</sup>

Has the housing market hit bottom? Will we have to wait until sometime in 2011 ... or 2012 ... to see a bona fide recovery? As the biggest drag on the real estate market is actually unemployment, and as unemployment will continue at high levels for the foreseeable future, the near future of the sector does not look too bright.

Mortgage rates moved downward for most of 2010; new record lows seemed to be set every week during the summer and fall. Rates were on the upswing in December, at least in the short term. When Freddie Mac assessed matters on December 30, they noted the following year-to-year movement: average rates on conventional 30-year FRMs had moved down to 4.86% from 5.14%; rates on 15-year FRMs were averaging 4.20%, down from 4.54%; average rates on the 5-year ARM were at 3.77%, down from 4.44% a year prior; average rates on the 1-year ARM had descended to 3.26% from 4.33%.<sup>29</sup>

## LOOKING BACK ... LOOKING FORWARD

It is hard to forecast the future; just ask the experts. At the start of 2010, some analysts were predicting growth of more than 3% for the U.S. economy (didn't quite happen), an unnerving double dip in housing prices after the end of the homebuyer tax credit (this only happened to a minor degree), and a jobless rate well over 10% (it stayed below 10% from January-November). Some voices worried about deflation; that hasn't happened either. And Harry Dent – the author of *The Roaring 2000s* who famously predicted the Dow would hit 40,000 during the last decade – forecast a severe bear market beginning in 2010 (as you can see below, that hasn't happened at all).<sup>8,30</sup>

% CHANGE	2010	2009	5-YR AVG	10-YR AVG
DJIA	+11.02	+18.82	+1.60	+0.73
NASDAQ	+16.91	+43.89	+4.06	+0.74
S&P 500	+12.78	+23.45	-0.15	-0.47
REAL YIELD	12/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	1.00%	1.48%	2.06%	4.03%

Source: cnbc.com, bigcharts.com, ustreas.gov, bls.gov - 12/31/10<sup>1,35,31,32</sup>  
 Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.  
 These returns do not include dividends.

The fact is, we don't know what 2011 will bring. There seems to be less talk of a double-dip recession in the air; the tax deal forged in Washington certainly eased the minds of the affluent (lenient estate tax, Bush-era cuts preserved) and the middle class (2% payroll tax reduction). Are we going to see a greatly improved real estate market in 2011? How about a big reduction in the jobless rate or a big jump in GDP? It doesn't seem likely. The economy and the stock market have some momentum going; if the geopolitical climate remains relatively placid and indicators continue to pleasantly surprise, 2011 could be a better year for Wall Street and Main Street than

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The IPSEA Index is a Total Return Index and is composed of the 40 stocks with the highest average annual trading volume in the Santiago Stock Exchange (Bolsa de Comercio de Santiago). The Karachi Stock Exchange 100 Index (KSE-100 Index) is a stock index acting as a benchmark to compare prices on the Karachi Stock Exchange (KSE) over a period of time, including companies with the highest market capitalization. The Korea Composite Stock Price Index or KOSPI is the index of all common stocks traded on the Stock Market Division. The Mexican Stock Exchange (BMV: BOLSA) (in Spanish: Bolsa Mexicana de Valores, BMV) is Mexico's only stock exchange. BSE Sensex or Bombay Stock Exchange Sensitivity Index is a value-weighted index composed of 30 stocks that started January 1, 1986. The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The S&P/TSX Composite Index is an index of the stock (equity) prices of the largest companies on the Toronto Stock Exchange (TSX) as measured by market capitalization. The Straits Times Index (STI) is the most globally-recognized benchmark index and market barometer for Singapore. The TWSE, or TAIEX, Index is capitalization-weighted index of all listed common shares traded on the Taiwan Stock Exchange. The FTSE 100 Index is a share index of the 100 most highly capitalized companies listed on the London Stock Exchange. The Hang Seng Index is a free-float-adjusted market capitalization-weighted stock market index in Hong Kong. The BM&FBOVESPA or Bolsa de Valores Mercadorias & Futuros de São Paulo is a stock exchange located at São Paulo, Brazil. The S&P/ASX All Ordinaries Index represents the 500 largest companies in the Australian equities market. Nikkei 225 is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. The Irish Stock Exchange (ISE) is Ireland's only stock exchange and has been in existence since 1793. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. The IBEX 35 is the benchmark stock market index of the Bolsa de Madrid, Spain's principal stock exchange. The Athens Stock Exchange or ASE or ATHEX is a stock exchange located in Athens, Greece. The MSCI World Index is a free-float weighted equity index that includes developed world markets, and does not include emerging markets. The MSCI Emerging Markets Index is a float-adjusted market capitalization index consisting of indices in more than 25 emerging economies. All information is believed to be from reliable sources; however we make no representation as to its completeness or accuracy. All economic and performance data is historical and not indicative of future results. Market indices discussed are unmanaged. Investors cannot invest in unmanaged indices. The publisher is not engaged in rendering legal, accounting or other professional services. If other expert assistance is needed, the reader is advised to engage the services of a competent professional. Please consult your Financial Advisor for further information. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards.

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