Quarterly Market Update

March 31, 2013

With both the S&P 500 and the Dow Jones Industrial Average ending the quarter at new highs, the obvious question is, "Where will markets go from here?" The Dow Jones Average was up almost 12%, its best first quarter in 15 years, while the S&P 500 was up almost exactly 10% and NASDAQ was up a little more than 8%. A year ago, the equity markets were also up nicely, but with NASDAQ up the most, followed by the S&P 500 and then the Dow Jones Average. In other words, precisely the reverse order from today.

Meanwhile, fixed income investors have seen yields on 10 year U.S. Treasury Notes remain at almost precisely the same level as one year ago, 1.87% to be exact. That means fixed income investors have earned just under 2% over the past twelve months. With inflation roughly 1.8% for the past year, fixed income investors have earned an inflation adjusted return of 0.2%. No wonder there is a collective judgment on the part of investors to move assets out of fixed income mutual funds and towards equity mutual funds.

This prospective shift by individual investors, reducing fixed income and increasing equity investments, is a large part of the argument that equity markets can go higher on a sustained basis. On the other hand, the pattern of the past several calendar years has been for the market to start out well during the first quarter and then decline for several months before turning up near year end.

The markets have been unfazed by the "fiscal cliff," the "sequester" and the "continuing resolution." An improving housing market and an increase in private sector hiring seem to have had a much greater impact on investors' views about our economic future than the negative rhetoric emanating from Washington, D.C.

It has been four years since the equity markets hit bottom. While the economy is certainly improving, it is not possible to describe current conditions as "early" in an ongoing bull market. Equity valuations still remain below historic averages and we continue to believe there are several years yet to go in this recovery cycle.

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