

Something for Everyone

Altogether, it was not a bad quarter. After meandering during the first half of the year, the Standard and Poor's 500 index staged a powerful advance in the third quarter, rising just about 11%. All 10 S&P industry sectors gained, led by telecomm services (+19%), materials (+17%), and consumer discretionary (+15%). Financials (+4%) and health care (+8%) were laggards in a market that traded steadily higher, albeit on lower volume than the bulls would like.

Bonds continued to shine despite yields at multi-year lows. Investors searching for alternatives to near 0% money market rates pushed bond prices higher and yields steadily lower during the quarter. The 2 and 10 year US Treasury notes now yield just over 0.4% and 2.5% respectively. As noted above, telecom stocks benefited as investors sought out this historically higher yielding sector. There appears to be no relief in sight for yield-seeking investors, at least not in the bond market, given that recent comments from the Federal Reserve show their concern about the tepid pace of the economic recovery. With interest rates now near zero, the fed may be on the verge of implementing a strategy known as quantitative easing, an operation designed to boost the money supply and revive bank lending, in turn leading to a stronger economy. Rising interest rates, while good for those wishing to increase income, would only serve to further dampen economic activity, and does not appear to be in the cards for the foreseeable future. No matter the course taken by the fed, the hunt for yield is sure to continue.

When it comes to wealth building, all roads seem to lead to the stock market, and there is plenty to talk about. Any worthwhile discussion has two sides (at least), so here goes. The bulls and the bears, as well as the fence sitters, have an overload of data to digest. Be it economic or corporate, global or domestic, past or projected, sufficient data exists to support just about any thesis an investor may have. Here at Abbot, we routinely mine the various data fields looking for direction to the market, and would like to share with you our top three concerns on both the positive and negative sides. We will even venture a conclusion at the end.

We'll start with the bad news. First, the unemployment rate (currently over 9%) in the US is totally unacceptable, and shows no real signs of improving. New job creation is non-existent, and the number of underemployed (those working less than a full week, not by choice) brings the total to approximately 17%, or about 1 in every 6 workers. Second, the residential housing market is still floundering; new builds are down, inventories are high, and foreclosures are rising. Bank owned properties may hit the market, further keeping prices depressed. Third, consumer sentiment, a measure of expectations, indicates a low level of confidence that conditions will improve anytime soon. With that lack of confidence, it is hard to see consumer spending carrying the economy.

If you're feeling a little down after the last paragraph, read on to the positives. First, the global economy continues to roll on. We have talked about the BRIC's (Brazil, Russia, India and China) in the past. Domestic companies exposed to these markets are somewhat insulated from a slow growth US economy. Second, productivity gains have led to margin expansions that produce earnings gains despite top line stagnation. The argument can be made that these gains have come at the expense of the work force, that is, you get greater production from existing employees negating the need for new hires. Third, there are high levels of cash in the hands of both individuals and corporations. As discussed in the opening paragraphs, there is little opportunity in the fixed income markets with rates so low. In fact, the enormous inflow to bond funds over the past year represents a huge potential source of funds that might be directed into stock funds in the future.

Hopefully the foregoing offers something for everyone, and gives you some insight as to some of the factors currently affecting the markets, both positively and negatively, and there certainly are many others not mentioned. You may have your own favorites, so a little cut and paste will be ok with us.

And now to venture a conclusion. That we are long-term investors is the world's worst kept secret, and there has been no change in policy. Despite near-term headwinds, 2011 could produce some stellar corporate earnings reports, which are the ultimate driver of stock prices. While current conditions may not justify an "all-in" investment position, we will be looking at all the data for clues, and will fine tune portfolios as needed.

Those of you who have been clients over the years realize that in these very difficult times progress seems painfully slow. Losses have been a way of life for many, just look at the below average results of most mutual funds over the past 5 and 10 years. At Abbot, we have done our best to preserve capital; and that will remain our focus. If you have any friends or acquaintances that are in need of investment management services, we would enjoy the opportunity to review their goals.



Bill Novelline
bnovelline@abbotfm.co

Third Quarter Scoreboard

S&P 500: +2.3%
Dow Jones: +3.5%
NASDAQ: +4.4%



Bob McLemore
rmclmore@abbotfm.com



Andrew Novelline
anovelline@abbotfm.co