An economic update as of March 31, 2011

QUOTE OF THE QUARTER

"Never look down on anybody unless you're helping him up."

– *Rev. Jesse Jackson*

QUARTERLY TIP

Many Americans don't have wills. If you haven't created a will, do so – if you pass away without one, someone else will decide the destiny of your estate.

Feel free to share this update with colleagues.

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THE QUARTER IN BRIEF

All quarter, investors watched political revolution in North Africa and the Middle East - and then in March, they tried to assess the impact of the unprecedented series of tragedies in Japan. Wall Street came through all this tumult remarkably well: the S&P 500 rose 5.42% in the 1Q. Ultimately, U.S. investors responded to better-than-expected corporate profits and improved domestic economic indicators such as consumer spending and unemployment. During March, CNBC.com columnist John Carney joked of a "Teflon market", and while Wall Street wasn't that invincible, its 1Q performance was impressive. Certain commodities soared; home sales and prices retreated. At the end of the quarter, the bulls were still clearly in charge.

DOMESTIC ECONOMIC HEALTH

The first quarter ended with some superb news: the Labor Department noted that our economy had added 216,000 jobs, with more than a third of the new hires coming within the important category of business and professional services. Unemployment was at 9.0% in January, 8.9% in February and 8.8% in March – contrast that with the 9.8% jobless rate in November.

Consumer spending increased by 0.3% in January and 0.7% in February, but inflation was rising too, driven by jumps in energy and food prices. (Food prices rose 3.9% in March alone, and that was the biggest monthly increase since 1974.) The federal government's Consumer Price Index increased by 0.4% in January and 0.5% in February, putting annualized inflation at 2.1% (it had been just 1.1% in November). The Labor Department told us that producer prices soared by 1.6% in February after rising 0.8% in January; this put annualized wholesale inflation at 5.6%.

What were consumers buying? Well, they seemed to be buying fewer hard goods. Core durable goods orders (i.e., with transportation orders factored out) fell by 3.0% in January and 0.6% for February. However, the Census Bureau did note a 0.3% rise in retail sales in January followed by a 1.0% gain in February.

The key U.S. purchasing manager surveys brought good news. At the end of the quarter, the Institute for Supply Management's monthly report on the service sector had hovered close to 60 in January (59.4) and February (59.7). ISM's manufacturing report reached a peak of 61.4 in February before making a slight descent to 61.2 in March – still, the sector had grown for 20 straight months.

GLOBAL ECONOMIC HEALTH

In Asia, the inflation preoccupations of January and February gave way to March concerns over the damaged economy and infrastructure of Japan. Even with those concerns (and the yen dropping 2.4% in the 1Q against the dollar), there were signals of expansion. China's official purchasing managers index went to 53.4 in March from 52.2 in February, the first increase in four months; elsewhere in March, the benchmark PMIs in India (57.9), Taiwan (55.6) and South Korea (52.8) were all showing expansion. (Australia was the odd nation out – its manufacturing PMI has been below 50 for four of the past five months.) South Korea's inflation rate hit 4.7% last month and its exports were up 30.3% year-over-year in March. Indonesia's inflation rate was 6.7% in March, down from 6.8% in February. China, of course, has been tightening for months in response to its inflationary pressures.

The European Union found another debt crisis on its hands in Portugal. A third national bailout by the EU and the International Monetary Fund seemed probable as the 1Q drew to a close. On the positive side, France's statistics agency said that it had reduced its deficit from 7.7% of GDP in 2009 to 7.0% of GDP in 2010; Germany's deficit is at 3.3% of its GDP. Germany's jobless rate declined to 7.1% last month from 7.3% in February. According to the EU, annualized Eurozone inflation increased by .2% in March to 2.6%.

WORLD MARKETS

Eyeing global markets in U.S. dollar terms, we see that some of the biggest 1Q gains came in Europe. In fact, the world's best performing stock index in the 1Q was Bulgaria's SOFIX, which rose 35.1%. (The quarter's worst performer? Egypt's EGX 30. It dropped 23.0%.) The 1Q gains among notable indices were as follows: Russia's RTSI, +14.8%; Spain's IBEX, +13.5%; France's CAC 40, 10.6%; Germany's DAX, +7.4%; Canada's TSX Composite, +7.0%; South Korea's KOSPI, +6.3%; China's Shanghai Composite, +4.7%; Indonesia's Jakarta Composite, +4.4%; Australia's All Ordinaries, +2.9%; England's FTSE 100, +2.8%; Brazil's Bovespa, +2.0%. The MSCI World Index went +4.3% while the MSCI Emerging Markets Index went +1.7% for the quarter.

In the 1Q loss column, we find these notable stock exchanges: Hong Kong's Hang Seng, -0.9%; the Philippines PSE Composite, -2.3%; Taiwan's TAIEX, -4.2%; Japan's Nikkei 225, -5.3%; India's Sensex, -6.9%.

REAL ESTATE

The quarter ended with a succession of sour notes for the housing market. The latest S&P/Case-Shiller 20-city home price index (January data) showed existing home prices down 3.1% from a year before and just 1.1% above the low from April 2009. S&P index committee chairman David M. Blitzer may have merely been the messenger, but he saw "no real hope in sight for the near future." The dreaded "double dip" seemed a real possibility.

As for existing home sales, the National Association of Realtors said they slipped 9.6% for February after a (revised) 3.4% improvement in January. New home sales? Even with the potential for serious readjustment of these statistics at the Census Bureau, the numbers were quite bad: down 19.1% for February (and 28.0% year-over-year) after slipping by 12.6% in January.

On March 31, Freddie Mac's Primary Mortgage Market Survey put the average interest rate for the 30-year FRM exactly where it had been at the end of 2010: at 4.86%. Average rates on 1-year ARMs were precisely where they had been in the December 30 PMMS (3.26%). Average rates for 15-year FRMs went down to 4.09% from 4.20%; average interest rates on 5-year ARMs descended from 3.77% to 3.70%.

LOOKING BACK...LOOKING FORWARD

In a quarter notable for the severity of its disasters and the boldness of its political unrest, the U.S. stock indexes registered sizable gains. The quarter represented the third chapter of a striking ascent for stocks. Across the last three quarters, the Dow has advanced 26.05%, the S&P 500 28.63% and the NASDAQ 31.85%.

Wall Street stood up to the challenges of the first quarter, but what might be ahead? Optimism remains: CNNMoney surveyed 15 noted investment strategists and found that nine expect the S&P 500 to finish the year at 1,400 or higher. If the S&P does wrap up 2011 near the 1,400 level, that would mean a price return of around 11%.

% CHANGE	Y-T-D	1Q CHG	1-YR CHG	10-YR AVG
DJIA	+6.41	+6.41	+13.48	+2.47
NASDAQ	+4.83	+4.83	+15.98	+5.11
S&P 500	+5.42	+5.42	+13.37	+1.43
REAL YIELD	3/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.99%	1.60%	2.35%	3.52%

Source: online.wsj.com, bigcharts.com, ustreas.gov, bls.gov - 3/31/11
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

The worries about a correction brought on by the events of March have subsided (for now) and we have some strong, positive indicators at home – a descending unemployment rate and manufacturing and service sectors that are clearly growing. At the moment, oil and gasoline prices seem to be the biggest hazard for the consumer (and by extension the broad economy). Another earnings season begins next week; let's hope that soaring oil and commodity costs haven't dented corporate profits too much.

According to data compiled by Standard and Poor's and Yale University's Robert Shiller, the S&P 500's earnings are poised to surpass the 2007 peak of $90 a share in 3Q 2011. In 1Q 2009, earnings were just $7 a share. This would represent the biggest profit gain for the S&P 500 in the last 110 years. S&P and Shiller think that by the 3Q, the difference between S&P companies' projected 12-month profits and average earnings over the last 10 years will be wider than at any time since 1951. That kind of talk might compel even the most bearish to stick with stocks.