AMBS
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VIEW FROM THE GRAND...

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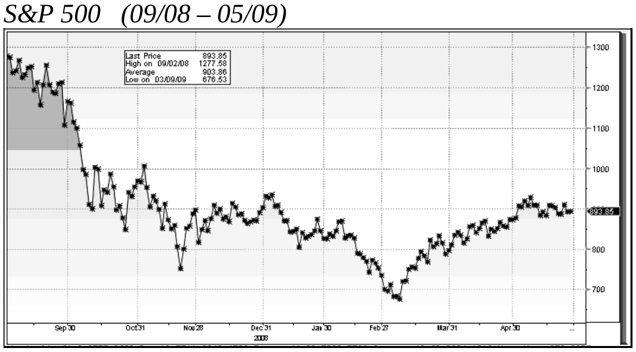
Back to reality…

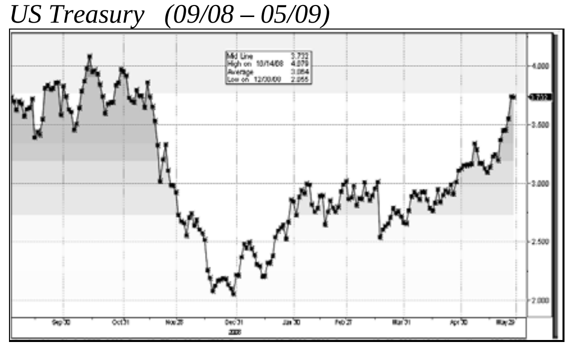
The financial markets finally feel like they are moving out of panic mode and into a period of critically assessing each piece of economic news that becomes available to determine where we are in the recovery process. This is creating a much healthier environment for investors to make rational, less emotional decisions. But it is also causing a great deal of volatility on a day-by-day basis. The news during the past few months has been mixed. In summary, the news is "less bad" but not yet good. The "green shoots" that the Fed is watching for are becoming more abundant, but there are still some huge issues, both old and still emerging, to deal with.

The graphs below show the price of the S&P 500 and the yield on ten-year US Treasury Notes since September 1, 2008 (just before Wall Street came unglued). As you can see, stocks bottomed in early March and have experienced an impressive rally of roughly 30% from that bottom. Looking more closely, the month of May was a period of consolidation, with stocks exhibiting some daily volatility but little absolute change in values. Looking at Treasury yields, you will see that rates declined dramatically from 4% to 2% during the last two months of 2008 as investors poured money into this safe haven in a classic flight to quality. Interest rates rebounded back to 3% during the first quarter as some of this money was redeployed into other areas of the market. But look more closely at the period from mid-March to the end of May. We are now seeing interest rates returning to levels that prevailed for most of 2008.

S&P 500   (09/08 – 05/09)



US Treasury   (09/08 – 05/09)



Clearly the markets are reacting to a wide variety of news events. On the "good news" side of the equation, we are seeing an upturn in consumer confidence despite unemployment numbers that continue to rise. The housing market has given us some tentative signs of improvement as sales are improving in many parts of the country. At this point, much of this activity is the sale of foreclosed homes. Contacts in Western Michigan are telling us that roughly 70% of sales activity for the past two months has been foreclosed homes and prices are still declining. However, we clearly need to work through this inventory overhang before the market improves, so all of this is good news.

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The huge amount of cash being injected in the financial markets around the world is finally having a positive impact. Many early recipients of government TARP funds are ready to repay this money. The bank stress tests revealed a healthier picture of bank balance sheets than had been feared (despite some potential flaws in the testing methodology). As a result, the rhetoric coming from Washington has been less anti-business than what was being portrayed earlier in the year. All of this news has helped Wall Street to feel less stressed; although it would be an exaggeration to say that anyone has yet heaved a sigh of relief.

There are also many data points that show signs of renewed activity around the world. As a result, many commodity prices, including oil, have rebounded from their lows. A barrel of oil peaked at over $140 last July before declining to under $40 near the end of the year. At just over $60 today, it is not back to levels seen in 2008, but one could build the case that oil and other commodities had become overpriced and will not rebound to old highs any time soon.

On the “less good” news side of the equation, we are seeing many companies that are struggling with huge declines in revenue and an incredibly challenging business environment. The problems on Wall Street have worked their way through to Main Street and the buying patterns of consumers and businesses have become decidedly cautious. The well publicized problems with the auto companies and the headaches of bankruptcy have a wide reaching impact. Although the problems are not new and the risks are already built in to the values of auto company stocks and bonds, some of the real impact on the lives of employees, dealers and suppliers are yet to be felt. This will prolong a real recovery for American workers.

And finally, the huge amount of money being spent by the US government is beginning to have an impact on interest rates. There has been a fear all along that the massive amount of spending will be inflationary. That, in our opinion, remains to be seen. But what we are seeing currently is a bond market that is having a difficult time digesting the amount of Treasury securities being issued to finance the spending. Currently roughly $160 billion of new Treasuries are being brought to market; the largest one week issuance ever. As expected, based on simple rules of supply and demand, investors are seeking a higher return on this investment and interest rates are rising as can be seen on the graph referenced above. In isolation, this is not really a big deal. However, many mortgages are priced on a spread over the ten-year US Treasury yield. If government intervention cannot begin to work those interest rates lower again, we face the risk of choking off the housing market that is in its infant steps of recovery. This bears close watching.

So the news is mixed and is highly likely to continue to be so for many months to come. As a result, we are always looking for security specific opportunities to add value to our clients’ portfolios, but are not changing our generally cautious strategy quite yet. There are still many significant economic challenges to be resolved and solutions are unlikely to come quickly or in a straight line. We will let you know when we are ready to change strategy and become more aggressive. But as always, we encourage you to let us know if you have any comments, concerns or topics that you would like to discuss. We will keep watching for those “green shoots”.