

Winter 2011

“The American stock market enters 2011 in a jolly mood. In the past four months it has leapt by 20%, to heights last enjoyed when Lehman Brothers was a going concern. Investors are likely to cheer a second consecutive year of double-digit returns.” *The Economist* (Jan. 1, 2011)

As 2011 opens, many investors are feeling better about the future and are turning more positive on stocks and more cautious on bonds. This is a significant change from the past couple of years when risk-averse investors put more funds into bonds rather than stocks.

The final three months of the year included several events that hurt the bond market, but helped the stock market. First, bond prices declined because the economic news indicated the U.S. economy was strengthening again, after cooling off last summer during the European debt crisis. Second, the bond market weakened after the Fed announced another round of monetary stimulus, raising inflation expectations. Finally, bond prices decreased, after the President and Republican leaders agreed to extend the Bush era tax rates for two years and cut social security payroll taxes for one year, increasing concerns about the debt and the deficit.

What was bad news for bonds during the fourth quarter was good news for stocks, with the S&P 500 rising to its highest level since 2007. In fact, recent data indicate that many investors may be shifting to a less defensive strategy by reducing funds going into bonds and increasing funds going into stocks. Another sign of increased investor confidence was the better performance in recent months of small-cap U.S. equities compared to large-cap equities.

Looking overseas, the U.S. stock market has recently done better than several European markets where sovereign debt concerns continue to spread. However, many of the emerging stock markets continued to do well, benefiting from strong economic growth in Asia. Commodity prices have also increased as investor sentiment toward the economy turned more favorable.

Finally, stock market volatility has subsided as the health of the economy improves. Of course, the economic recovery is still fragile and volatility could increase again if there are any unexpected shocks.

This year’s tax filing date has been extended to April 18. 1099s will be delivered by February 15.

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