

Lighthouse Beacon

A Guide in the 21st Century

Volume 12, Number 2

Quarterly Report

May 2010

Lighthouse Investment Commentary

Resilient Surge in Stocks Defies Skeptics

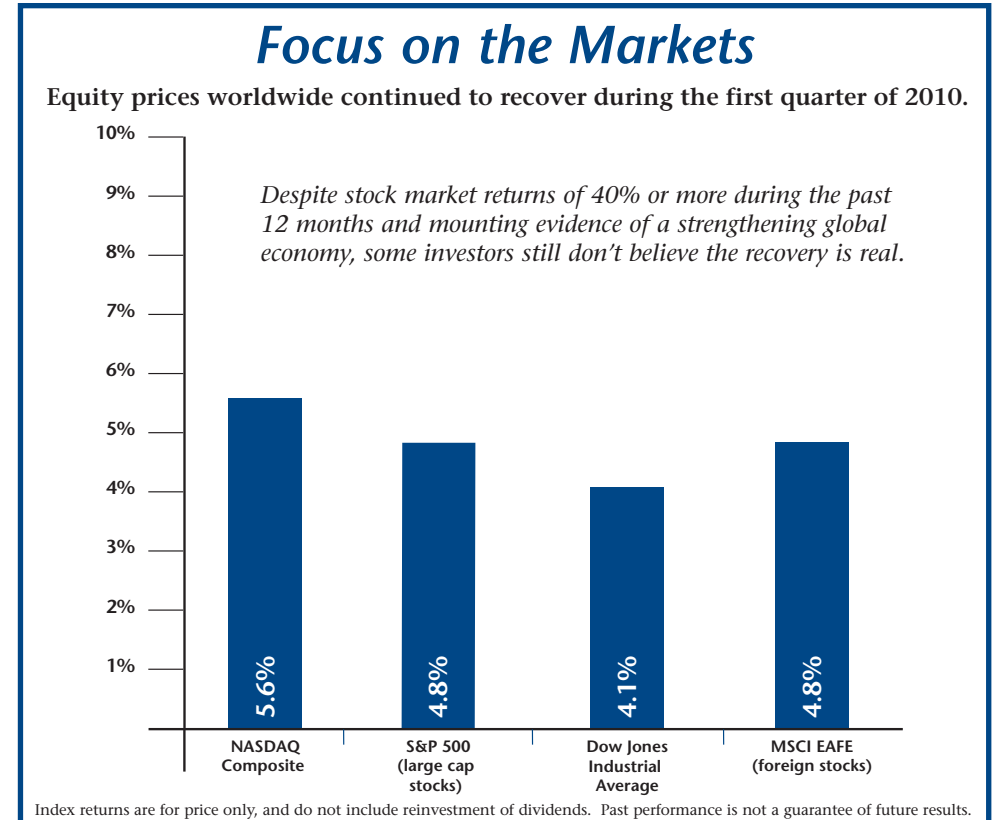
Stock markets throughout the world delivered solid returns during the first quarter of 2010, continuing the rally that began slightly more than a year ago when the markets reversed direction and began moving higher. So why isn't this being celebrated?

While the consensus of most economists is that the economy is pulling itself out from recession, you would hardly believe it from hearing the commentary of many politicians and media pundits.

If you look at the economic data that fueled the upward trajectory of stock prices, it is very difficult to make the case that this rally is a fluke. U.S. gross domestic product (GDP) grew at a brisk 5.6% annual rate in the final quarter of 2009, and the advance estimate for growth in the first quarter of 2010 was a respectable 3.2%. To be sure, unemployment remains a major concern and job growth has only just started, but employment gains usually are one of the final signs of an economic recovery. (See Lighthouse Guides, reverse page.)

Overseas, trends also are encouraging. Japan, the world's second largest economy, grew at a 3.8% rate in the same quarter, the largest increase in exports in 30 years. Meanwhile, the increasingly important Chinese economy grew at an astounding 11.90% pace.

No wonder the stock markets have soared since the rally began in March 2009. Responding to evidence of economic strengthening at home and



abroad, the Standard & Poor's 500 Index returned 46.87% for the 12 months ending on March 31, 2010, while non-U.S. industrial markets (as reflected in the EAFE Index) rose by 55.20%.

We have just passed the one-year anniversary of the beginning of the bull market, but you would never know it from some elements of the media and some politicians. According to them, the sky is falling. This has become the Bull Market nobody enjoys. You would think we are still on the verge of falling into the Second Great Depression. These

reports seem to give no credit to the positive effects of all the monetary and fiscal stimulus programs that have been put into effect throughout the world to head off such a calamity.

The tragedy is that trillions of dollars are sitting on the sidelines, parked in bank and money market funds, earning almost no interest at all. Recently, two-year promissory notes sold by Warren Buffett's Berkshire Hathaway Corp. paid a lower interest rate than two-year notes sold by the U.S. Treasury. Why would anyone buy these at such low

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rates? Sadly, too many investors sold out at the lows of the stock market and never returned. They've missed the dramatic gains experienced during the past year and they are left to complain about less-than-1% returns on their bank accounts or money market funds.

We seem to be in the "Yes, but . . ." market.

Yes, credit quality at banks is improving, but . . .

Yes, economic news is better than expected, but . . .

Yes, we have just seen the biggest gains in jobs in three years, but . . .

Yes, corporate profits are rebounding sharply, but . . .

Yes, pending home sales are exceeding expectations, but . . .

These positive economic developments and countless other trends all point to a sustained economic recovery, rather than the "double-dip" recession the market bears predict. Pessimists try to paint a portrait of deteriorating economic fundamentals from some real, but isolated, problems, such as debt problems in Greece, slowly rising consumer spending, and rising government deficits. All these issues can and will be addressed. But they do not trump the overwhelming evidence of a strengthening economy: increasing corporate profits, improving productivity, low interest rates, continued low inflation, rising inventories, expansion of the service sector, to name a few.

Political ideology appears to be clouding the skeptics' judgment and leading them to ignore the real progress being made in economies and in capital markets throughout the world. There appears to be a vested interest in some quarters to be bearish and ignore all facts that don't fit with negative preconceptions. It is almost as if

they are willfully ignoring what is actually happening in the real world.

To be sure, the evidence of the strengthening economy can be seen almost daily on the business pages of most newspapers and magazines and in the economic news reports of most television, cable and radio reports. But the influence of these reports seems to be at least partially drowned out by ideologically- and politically-driven commentators and office-seekers.

This combination of media madness and political ideology is causing confusion, mistrust and apathy.

What should we do?

We need to read with a critical eye and listen with a skeptical ear, searching for the real news about the economy and corporate profits. If what you are hearing doesn't make sense in terms of the underlying market and economic dynamics, find a new source to rely on, someone who respects facts, has an open mind and understands the economy and the market. Hopefully a trusted investment adviser may fit the bill.

We should stop listening to the voices of those whose only expertise seems to be that they have the largest megaphones and focus on what is really occurring in the marketplace.

Lighthouse Guides

Q: *If the domestic economy is recovering, why is unemployment still at almost 10%?*

A: The phenomenon of lagging employment growth has been true in the early stages of almost every economic recovery. Economic historians have pointed out this trend many times, but many observers still find it hard to believe in an economic rebound when members of their family and friends are struggling to find a job.

The truth, though, is that both large and small corporations are hesitant to add to their payrolls during the early stages of improving profitability. They prefer to try to be more productive with their existing work forces before they start adding to their operating costs by hiring new workers.

We already are seeing the dramatic growth in productivity throughout the economy. The

U.S. Labor Department reports that the productivity of American workers increased at a 6.9% annual rate in the fourth quarter of 2009 and that the total productivity of American workers increased by 5.8% during all of 2009. At the same time, the total average hours of working Americans has edged up.

This is normal. But at some point, corporations will gain enough confidence in their improving revenues that they will begin adding to their payrolls. We may already be seeing evidence of stabilization and even improvement. Total employment actually increased in March 2010 by 162,000 jobs. While the nation's unemployment rate remained at a too-high 9.7% level, the rate was lower than the 10% rate of December 2009.

Just don't expect a quick snap-back in total unemployment. The economy just doesn't work that way.

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