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April 30, 2010

Adviser Eye on the Markets

Caterpillar opened the week with stronger earnings and prospects for more as the year advances. CAT is something of a global bellwether since it sells its heavy machinery around the world and, of course, when sales grow, that means customers have more projects at hand—a good measure of expansion. Another bellwether is UPS, where profits jumped 33% amid higher volumes, particularly overseas, mimicking the report of a week or so ago from FedEx.

The week's news cycle has been spilling ink and shading pixels at a feverish pace. In D.C., Goldman Sachs took the stand in testimony that lasted more than 10 hours and resolved nothing other than the fact that whether the Senator is Democrat or Republican, they are most interested in TV time. Thursday we learned that the SEC has referred the case to the Justice Department for possible criminal prosecution—this story is far from over, but what lasting impact it will have depends greatly on the regulators. The bigger discussion has to happen in the Senate, where the Republicans gave up blocking debate on financial reform and we can now get down to brass tacks including, hopefully, increased transparency and some kind of public market for the structured and synthetic securities that helped get Wall Street, and Main Street, into the mess that got us into the recession.

Overseas, Greece went to the IMF with its hand out as S&P cut its bonds to junk status (short rates shot to 14%) and Portugal seemed next in line. Spain, downgraded by S&P as well, is also on the hot-seat. The Greek bailout could run between 100 and 120 billion euros. "Moral hazard" is with us again, both at home and abroad.

Tech companies from Amazon, which saw a 46% increase in first quarter revenue, to Microsoft, which saw strong demand for *Windows 7*, continue to help the markets climb higher. AutoNation's 60% first-quarter profit jump is another indicator that the auto industry is getting up off the mat. IBM hiked its dividend 18% and is doing another buyback of stock. All in all it's been a pretty good earnings reporting season, and while there's more to come we think the markets are now looking ahead to the current quarter and the second

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half of the year, discounting prices to what they think will be even better sales and profits in the coming months.

Of course it wouldn't be Wall Street without something more to worry about. Add to the list of uncertainties that plague the markets this new one: When and how will the Fed begin selling its mortgage bonds. Also, the Treasury has begun selling its stock in Citigroup. The first tranche: A measured sale of 1.5 billion of the 7.7 billion shares it holds should bring a tidy profit to the government. And it doesn't even count the preferred shares or warrants the Treasury holds. But how will this impact Citi and the financial sector as a whole? So far financials have, along with consumer discretionary companies, been leading the markets higher.

As expected, the regularly scheduled Fed meeting that concluded on Wednesday didn't raise rates, but did talk down the likelihood of a near-term hike, suggesting that the low rate environment will continue for an "extended" period of time. Still, Fed Fund Futures predicted a near 100% chance of a rate hike of 0.25% by December. We think that's to be expected; the Fed is likely to test the market's resilience to a rate hike with one. In fact, we think we may see a few rate hikes before we even see inflation.

This morning, we got our first estimate of first quarter GDP growth, which came in at 3.2%, slightly less than the forecasted 3.4%. This is the third straight quarterly gain, and is a good gauge of the economy's slow, but steady strengthening. ISM numbers next week will give us a better sense of how manufacturing and service companies are faring and whether this V-shaped recovery is holding. If the more localized Chicago ISM numbers are any indication, manufacturing remained in expansion as the second quarter opened.

Talk that the bull market has peaked ignores the fact that markets act as discounting mechanisms and the indexes' increases to date have been met by higher profits and, in some case higher revenues. If companies indeed are poised for further gains through this year, we expect stock markets to rise in advance of such news. Cognizant of the potential unforeseen risks, we remain cautiously optimistic about the remainder of 2010 and into 2011.

Fidelity Bolsters Bond Department

In a move that may come too late to capitalize on the bond bull market, Fidelity created a new position for Karthik Ramanathan, who will serve as senior vice president and director of bonds starting this June.

Ramanathan's primary responsibilities with Fidelity will center around tailoring the firm's bond strategies to fit client needs, expanding the firm's institutional fixed income business through subsidiary Pyramis Global Advisors, and he will also serve as the bond division's public mouthpiece.

Ramanathan, who will be reporting directly to Fidelity's bond group president, Christopher Sullivan, has been with the U.S. Treasury Department since 2005, where he held two high-profile positions

during his tenure, with involvement in everything from issuing over \$8 trillion in Treasury securities to overseeing public debt management to regulation of financial markets. Prior to joining the Treasury, he spent 10 years with Goldman Sachs.

This hire should certainly increase Fidelity's bond group's profile, and Ramanathan's past experience makes him a well-qualified addition to the firm.

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