



Teton Wealth Management, Inc.

Registered Investment Advisor

## Market Recap – 4th Quarter 2010

December 31, 2010

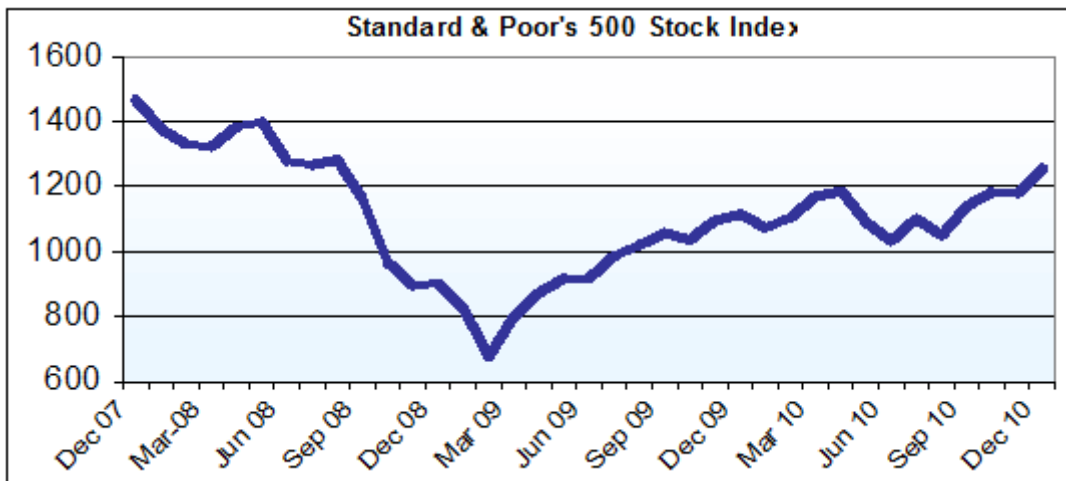
Having grappled with doubt for much of the year, U.S. investors finally put their fears aside in the fourth quarter to focus on the prospect of a more sustained recovery. With the Federal Reserve once again proving its willingness to support financial markets and economic data showing marked improvement, the bull market that began in early 2009 found plenty of fuel to drive through to the end of 2010 and possibly beyond.

### US Equity Markets

Although many investors retreated to the sidelines in November to digest the results of U.S. mid-term elections, the quarter was largely positive for stocks. With fears of a “double dip” recession having almost evaporated by December, equity prices rallied through the end of the year.

The Dow Jones Industrial Average, reflecting the performance of the stock of 30 top U.S. corporations, gained 7.31% during the quarter; counting dividend payments, the blue chip index was up 8.04%. The large-cap Standard & Poor's 500 stock index surged 10.16% (10.76% after dividends), while the Nasdaq Composite soared 12.33%.

The quarter's gains helped all three indices extend an unusually bullish 12-month performance. The Dow appreciated 14.06% in 2010, the S&P 500 was up 15.07%, and the technology-rich Nasdaq gained 16.91%. As the bull market that began in March 2009 approached its third year, the Dow industrials have advanced 76% off their credit crunch lows, the S&P 500 86%, and the Nasdaq a spectacular 109%.



The equity market advanced on a broad front, with only utilities—considered defensive in times of uncertainty, but generally ignored in rising markets—declining mildly. Among the other nine industry groups Standard & Poor's tracks, energy and materials producer stocks led the way with jumps of 20.8% and 17.5%, respectively, during the quarter.

Growth in corporate earnings remained extremely robust, although with the recession receding into memory, year-over-year comparisons became less extraordinary. Third-quarter profits, which companies reported during the fourth quarter, averaged a 36% gain from 2009 levels for members of the S&P 500, and Wall Street analysts expect fourth-quarter growth of 27%. Banks and other financial companies continued to repair their businesses, tripling their profits on a year-over-year basis, but a wide range of other companies—from retailers to health care providers—expanded their bottom lines by just a few percentage points. Even then, profitability increased faster than stock prices, leaving equities slightly less expensive on a price-to-earnings (P/E) basis. By December 31, the average P/E for S&P 500 companies was just above 15.

## Global Equity Markets

In previous phases of the worldwide recovery, overseas stocks—largely in emerging markets—led the way while conditions in the United States were slow to improve. By the fourth quarter of 2010, this imbalance seemed to reverse, with an improving U.S. outlook contrasting with sovereign debt problems in Europe and inflation worries in Asia.

Credit quality and the prospect of additional European bailouts for eurozone countries added risk to international markets. In November, Ireland and its heavily indebted banks had to accept a humiliating rescue that could cost member nations as much as 100 billion euros. Meanwhile, in the booming economies of Asia's developing nations, inflation became a serious issue for governments from Delhi to Beijing. Central banks countered with interest rate hikes that could slow the pace of economic growth.

Against this backdrop, the MSCI EAFE Index, a leading gauge of blue chip stocks in the developed markets of Europe, Australasia, and the Far East, lagged its U.S. counterpart by a considerable margin for the quarter and the year. During the year's final three months, the EAFE edged up only 5.66% in local currency terms, reversing previous losses to deliver a full-year gain of 5.26%. Yet a strengthening dollar boosted the value of those profits for U.S. investors, giving the EAFE an October-to-December gain of 6.65% in U.S. dollar terms and a full-year advance of 8.21%.

Single-country equity markets reported widely mixed results, with debt-laden Greece and Spain falling 10% for the quarter while stronger European economies including Germany gaining as much as 10%. Japan also fared well, surging 12% in the quarter as exporters found eager buyers overseas.

Strong commodity prices resulted in another exceptionally bullish quarter for emerging market countries that produce oil, gold, or other metals, while sapping the strength of nations that import those same materials and their rising prices. The MSCI Emerging Markets Index ended the quarter up 7.36% and gained 19.20% for the year.

## The Bond Market

As the global risk environment gyrated through the fourth quarter of 2010, money initially crowded into the safety of U.S. Treasury debt, pushing short-term yields to their lowest levels of all time. However, in early November, a fresh demonstration of the Federal Reserve's resolve to do whatever it takes to stimulate the U.S. economy gave many investors the courage to move again into stocks—a shift that then triggered a significant retreat in the Treasury market.

December 17 marked the second anniversary of the Federal Open Market Committee's decision in the wake of Lehman Brothers' collapse to reduce its overnight interest rate target to a previously unimaginable range of zero to a quarter of a percentage point (0.25%). As 2010 progressed, the economy's slow progress and lack of inflationary pressure led to expectations that Fed Chair Ben Bernanke and his fellow central bankers would keep rates low for the foreseeable future, and in fact they voted twice during the fourth quarter—on November 3 and again on December 14—to keep the target at its effective level of zero.

That left Bernanke and company with few traditional tools for nourishing the still-fragile recovery, forcing the Fed to announce a second round of quantitative easing at its November meeting. This widely anticipated QE II, a sequel to a \$1.75 trillion bond-buying campaign in late 2008 and 2009, was meant to keep long-term interest rates low and ward off deflation. The Fed elected to authorize up to \$600 billion in new bond purchases through the third quarter of 2011. The rationale was that with the Fed in the market buying bonds, Treasury prices would rise beyond their natural levels, depressing the associated yields and keeping lending rates for mortgages and other consumer loans in check. (Bond yields and prices move in opposite directions.) That should then unlock liquidity for borrowers looking to shield businesses from economic shocks, reinvest in operations, or simply purchase more goods and services.

Despite the Federal Reserve's stated goal of buying \$75 billion in long-term Treasury debt every month, the added support didn't immediately reduce bond yields. If anything, the Fed's commitment to improve the economy encouraged many traders to cut their allocations to bonds in order to chase the prospect of higher returns in the stock market. That left bond prices falling and yields on the rise.

As a result, while the quarter began with short-term Treasury yields sinking to previously unimagined lows, by December, yields were back at levels last seen in May. This reversal hurt total returns for bond investors, who saw long-term bonds decline 8.1% during October, November, and December. Still, for the full year, Treasury debt returned 5.3%, the best performance since 2008, when the massive flight to Treasuries delivered a full-year gain of 27.1% for long-term bond portfolios.

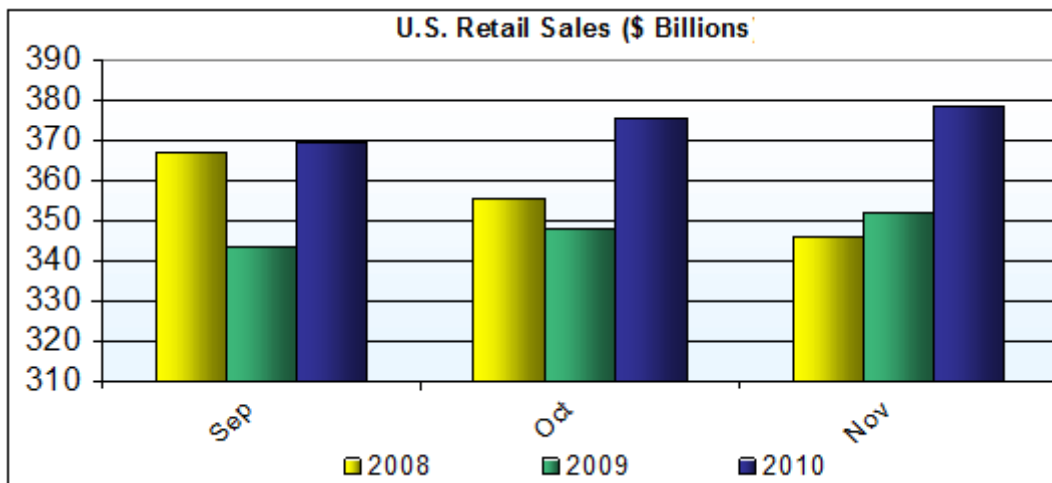
## The Economy

Fed by QE II and nourished by the lowest interest rates in U.S. history, the credit markets—and the larger economy—continued to heal. But the wounds of the deepest recession in a generation remained fresh, and housing and job markets showed scant improvement. Minutes from the Fed's November meeting reveal that Ben Bernanke and his colleagues found the recovery "disappointingly slow." Although extraordinarily low interest rates normally feed inflationary pressures, prices remained flat throughout the fourth quarter, fueling fears of outright deflation that QE II is intended to counter.

Still, relatively robust data during the fourth quarter eventually gave investors confidence that the economy was again picking up speed. The final reading on third-quarter gross domestic product, the widest gauge of U.S. economic strength, revealed that the economy was growing at a 2.6% rate, an improvement on the second quarter's 1.7% growth. Although economists suspect that GDP expanded at a much more robust 3.1% rate during the final months of 2010, they will need to wait until 2011 for confirmation.

## Retail Sales

The retail engine of the economy shifted into higher gear as U.S. households quietly returned to pre-recession spending habits. By November, aggregate retail sales activity reached \$379 billion—the highest level since the credit crunch and within a whisper of the \$381 billion peak touched in December 2007. With consumer spending up a fairly spectacular 9.5% over last year, some retailers rejoiced that the boom was back. However, much of the shopping represented families' need to replace aging vehicles and keep them full of fuel: by November, Americans were spending twice as much on their cars as on food.

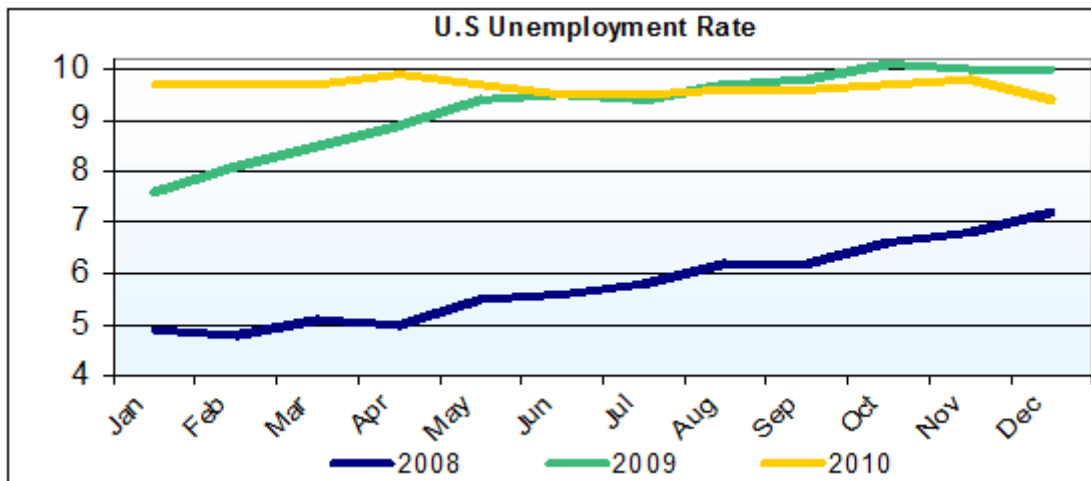


## Consumer Confidence

As far as the public was concerned, the economy closed 2010 in only marginally better shape than it began the year. Consumer confidence, as tracked by the Conference Board, drifted around the neutral 50 level throughout the fourth quarter. Opinions on the job market, the health of the overall economy, and the future all worsened slightly, with a full 46.8% of those surveyed indicating in December that jobs were "hard to get."

## Unemployment

The job market showed enough signs of strength to convince Wall Street that a broader recovery may be coming, but hiring remained too low to overcome years of massive layoffs. Even though U.S. companies created a net 384,000 jobs during the fourth quarter, the unemployment rate still edged back upward, returning to a seven-month high of 9.8% by November before receding again. With 7.2 million fewer paid positions in the economy by year's end than there were in December 2007—and with many would-be retirees coming back to the job market to replenish recession-depleted nest eggs—economists wondered what it would take for the country to return to something like full employment.



## Inflation

Despite an October spike in energy prices, consumer price increases were virtually nonexistent through the fourth quarter, as inflation slowed to an annualized rate of 1.1% by November. Factoring out food and energy costs (largely tied to volatile commodity markets rather than to consumer demand), prices approached the end of the year up a mere 0.8%. The price of clothing continued its long deflation, joined by slight declines in utility and vehicle costs.

## Summary/Outlook

Although the world's financial markets ended 2010 with the United States seemingly back on the rise, the only certainty in investing is that nothing lasts forever. Inflation remains so weak—at least in North America—that the Federal Reserve is more concerned about fighting deflation than keeping prices from climbing, and in that environment, the Fed feels justified in keeping interest rates low and printing literally trillions of dollars. Nonetheless, inflation—driven by rising commodity prices—has already become a problem overseas, and it could eventually spread to U.S. shores. But in the meantime, U.S. companies are making money, some are hiring, and by year's end, even housing prices were showing tentative signs of a recovery.

Richard Bloom, CFP – January 14, 2011

## Performance Indices

Asset Class	Index	4Q10	1-year 2010	3-year annualized	5-year annualized
Large Cap US Equities	S&P 500	10.76%	15.07%	-2.85%	2.29%
Small Cap US Equities	Russell 2000	16.25%	26.86%	2.22%	4.47%
International Equities	MSCI EAFE	6.65%	8.21%	-6.55%	2.94%
Emerging Markets	MSCI EM	7.36%	19.20%	-0.03%	13.11%
Fixed Income - Taxable	BC Aggregate Bond	-0.75%	6.14%	5.73%	5.76%
Municipal Bonds	BC Municipal Bond	-5.27%	1.85%	3.90%	3.98%
Multi-Strategy	60% S&P 40% BC Bond	5.79%	12.07%	1.12%	4.07%