

### September Song

The opening lyrics to the American Pop Standard, “September Song”, written by Kurt Weill and Maxwell Anderson are “Oh, it’s a long, long while from May to December”. Those words have never been truer than over the past five months.

In May, Greeks were rioting in the streets over austerity measures imposed by their government and investors feared a European debt contagion would spread across the globe. The Deepwater Horizon well was spewing millions of gallons of oil into the Gulf of Mexico each day with no end in sight. A “Flash Crash” drove the Dow Jones Industrial Average down almost 1,000 points on the afternoon of May 6<sup>th</sup>, and the S&P 500 Index dropped 11.8 % during the second quarter as investors worried about the possibility of a double-dip recession. Stocks are said to “climb a wall of worry”, but in May it appeared climbing boots might not be sufficient to scale the mountain of issues facing investors. That said, the S&P stands 6.37% above its close on May 31<sup>st</sup>.

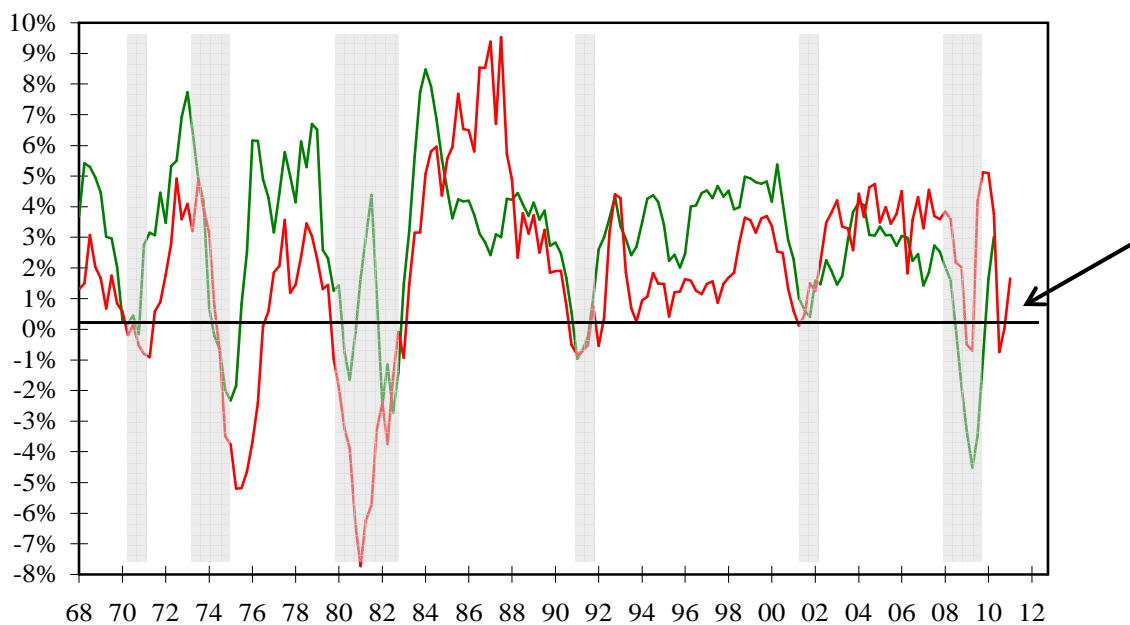
In our July commentary, we highlighted the contraction in Real Total Debt Growth and the risk that posed to the continued economic expansion. Our analysis pointed out that a severe contraction in debt or available credit is a key component of every recession. We also noted that double-dip recessions are extraordinarily rare economic events.

[\(Click here to view our July Commentary\)](#)

According to The Federal Reserve in July, for only the second time in the past 21 months, U.S. commercial bank total credit (loans and securities) increased.

### Real GDP vs. Real Gross Total Debt\* Growth

12 Month Rate of Change, Debt leads 9 months



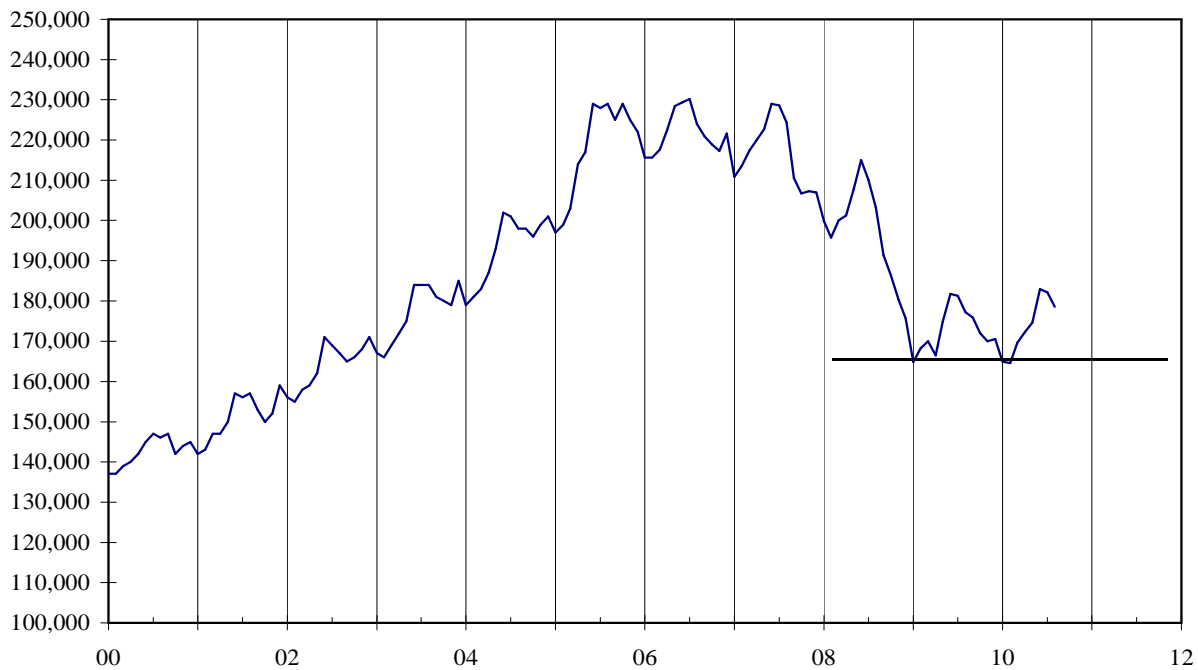
Source: Stephens Capital Management

■ Real GDP ■ Real Debt

While we cannot determine whether this is the beginning of an upward trend in bank credit, there is other evidence that would suggest that the July increase in bank credit was more than just a one-off event. The recently-released Federal Reserve Senior Loan Officer Lending Practices Survey indicated some actual easing in commercial bank lending terms to small businesses in July and easing in lending terms to consumers for the second survey in a row. If lending terms continue to ease, this will be a very positive sign for bank credit growth going forward and for aggregate demand growth in 2011. Real Total Debt is expanding again which gives us increased confidence that the U. S. economy will not re-enter a recession in the coming months.

U.S. Housing prices appear to have reached a sustainable bottom in the spring of 2009. We have experienced the normal seasonal increase in prices during the spring of 2010 and now must wait to see if the bottom in housing prices holds throughout the remainder of the year. Our guess is that it will.

### Median Existing Home Prices



Source: Stephens Capital Management

As summer progressed, the European Finance Ministers approved a comprehensive rescue package worth almost a trillion dollars which essentially guaranteed the debt of the weaker EU countries like Greece, Italy and Spain. The Deepwater Horizon well was capped on July 15<sup>th</sup> and the federal government declared the well “effectively dead” when a relief well was completed on September 19<sup>th</sup>.

The Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) began their investigation into the causes of the Flash Crash, and the economic recovery sluggishly marched onward. As we entered September, historically one of the worst performance months of the year for the stock market, many of the issues plaguing investors in May appeared less worrisome and a change in investor sentiment was beginning. The market proceeded to confound investors with the Dow Jones Industrial index posting the best September returns since 1939 rising 7.7% for the month. The Standard & Poor's 500 index rose 8.8 % for the month and 10.7 % for the quarter.

On September 20<sup>th</sup>, the National Bureau of Economic Research reported that the longest economic downturn since the Great Depression officially ended in June 2009. The current economic expansion is a mere 15 months old, and unemployment remains unusually high at this point in a recovery cycle. Estimates of GDP growth for the fourth quarter and 2011 continue to be revised lower, but with the earnings yield of the S&P 500 at 8% based on projected 2011 earnings and the yield on the 10-yr. T-Bond at 2.40%, well below its average of 6.63% over the past 50 years, stock investors are being well rewarded for keeping their climbing boots on.

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Capital Management

## Third Quarter Investment Review

By Brian Bush

October 12 2010

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