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## ***VIEW FROM THE GRAND...***

***March 2010***

Way to go, Ben!

People like transparency. Retail investors like it when selecting investments. Analysts like it when researching company financials. Institutional portfolio managers like it when managing money. But, financial market participants really like it when the Federal Reserve signals potential changes in monetary policy. The funny thing is that many investors may have missed Fed Chairman Ben Bernanke's "heads-up" because they were too busy shoveling snow! On February 10<sup>th</sup>, Mr. Bernanke was scheduled to testify before Congress on current monetary policy, but because Washington D.C. was snowed in, his prepared testimony was instead posted on the Fed website where he stated:

"...The Federal Reserve is in the process of normalizing the terms of regular discount window loans...**before long, we expect to consider a modest increase in the spread between the discount rate and the target federal funds rate.** These changes, like the closure of a number of lending facilities earlier this month, should be viewed as further normalization of the Federal Reserve's lending facilities..."

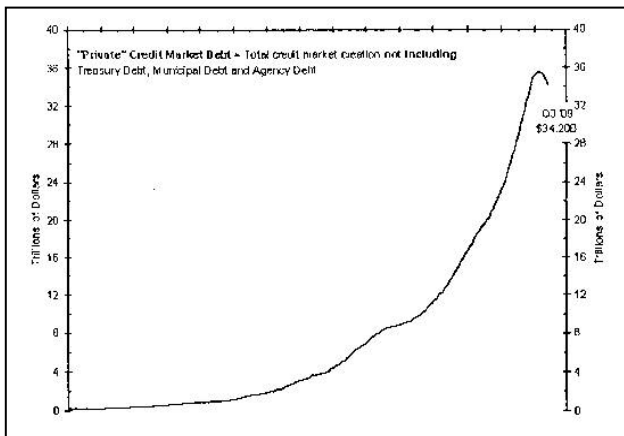
There you have it. The Chairman telegraphed a discount rate hike to the markets. On February 18<sup>th</sup>, he followed through with action and the discount rate was raised from 0.50% to 0.75% – its first increase since June 2006. While some may argue that banks weren't borrowing at the discount window anyway because of the negative stigma associated with it, others say it is an important first step in a tightening sequence that the Fed has long planned. The sequence that he has outlined to the market to date includes: a rise in the discount rate, increased use of reverse repos and term deposits to be followed eventually by rate hikes. By rate hikes he means either the federal funds rate or the interest rate paid on reserves in combination with reserve quantities. In addition, as the economic recovery becomes more visible and sustainable, the Fed plans to reduce the size of its ballooned balance sheet through asset sales. We believe this will most likely be a ways off as the Fed will be closely watching how the market reacts to the late-March expiration of its \$1.25 trillion mortgage purchase program before committing to any future sales. The key take-away from the proposed policy action is that Mr. Bernanke and his team still have many levers to pull. In the coming months, we should expect many more public statements from FOMC members as well as many of the above mentioned incremental policy actions. The good news is that the market, near recent highs, seems to be responding well to Bernanke's well-choreographed style.

Equities have also been buoyed by a rebound in demand and strong corporate earnings. Inventories have been rebuilt as consumer and business confidence have increased. The extent of the restocking is evident in the most recent gross domestic product data. Specifically, fourth quarter GDP advanced +5.7% year-over-year but only +2.3% ex-inventory growth. This led to much stronger than expected revenue growth during the fourth quarter. Through the third week in

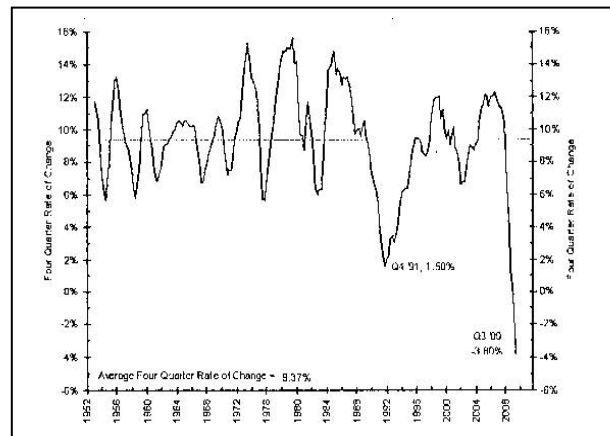
February, over 85% of the companies in the Standard & Poor's 500 Index had reported earnings. On average, revenues were up 6% over last year's fourth quarter. Going into earnings season, expectations were for only a low single digit revenue increase. The top-line growth, combined with a much lower cost base, has flowed right to the bottom-line as profit margins have recovered. EBIT profit margins currently stand around 15% – almost triple the trough levels of just a year ago! The improved earnings outlook has provided much needed confirmation and support to the equity markets.

Although market fundamentals and gross domestic product data have improved, we don't think now is the time to get out our rose colored glasses just yet. First of all, management teams on several corporate earnings conference calls have expressed caution about the sustainability of inventory led GDP growth and have warned analysts not to get too aggressive with expectations. In addition, we remain very much concerned about the fiscal state of the average U.S. consumer. Unemployment has marginally improved to under 10%. However, the broader U-6 data, which includes discouraged and part-time workers (those who have either temporarily given up looking for work or have part-time jobs but want full-time work), is substantially higher at over 17%. Housing still remains troublesome. Mortgage delinquencies may have recently improved, but the number of people in trouble with their mortgages (behind in payments or in foreclosure) is up from 11% last year to 15% today (about 7.8 million households). These discouraging trends remain a headwind to consumer confidence and a drag on future economic growth. As a result, consumers continue to build savings and reduce their debt obligations (as shown in the charts below). Total private credit market debt has fallen from a recent +12% four-quarter growth rate to a -3.8% rate in just over a year. This is the most significant deleveraging ever experienced. More can and should be expected.

Total "Private" Credit Market Debt



Private Credit Rate of Change



Private sector deleveraging provides a dramatic offset to the significant releveraging of the government sector. The key question remains: Will the U.S. economy be able to stand on its own two feet when Fed Chairman Bernanke removes all this government-juiced growth? The answer is not clear. But, so far, so good. As you know, things can change and we will have to be ready for all potential outcomes.

Speaking of change, AMBS is pleased to report that as of March 1<sup>st</sup> we will be settled in our new office location just two miles east of our current offices. Our new address is 625 Kenmoor SE, Suite 307, Grand Rapids, MI 49546. Our telephone number, fax and email addresses remain the same. We invite you to stop by for a personalized office tour.