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Annual Market Review 2010

The Markets

Finishing strong: Despite persistent debate over whether the economic recovery was genuine or simply the calm before another storm, U.S. equities extended 2009's remarkable rally, though at a slower pace that involved substantial volatility. From their March 2009 lows, both the Nasdaq and the Russell 2000 have more than doubled, while the broader Standard & Poor's 500 is up 86%. Though it spent much of the year bouncing around within 100 points up or down from 1,100, the S&P ended the year with its strongest December since 1987; the month's 6.5% Santa Claus rally represented almost half the index's appreciation for the entire year.

As they have historically done after previous recessions, small caps led other domestic equities for most of the year. The Russell 2000 almost doubled the gains of the S&P ; the Russell's eye-popping 16% in the last quarter alone almost equaled the entire 2010 gain for the tech-heavy Nasdaq. However, all four U.S. equity indices looked robust compared to the Global Dow. Though a fall rally rescued the global index from the negative returns that dogged it for much of the year, its 2010 gain was still less than half that of the Dow Industrials.

However, the stock market rally doesn't mean individual investors were once again completely comfortable with risk, as they poured money into bond mutual funds for much of the year. Along with the Federal Reserve's determination to keep interest rates low, that helped send bond prices soaring despite massive new issuance by corporations, local governments, and the U.S. Treasury. (By November, some of that money began to flow back out again, especially from muni funds). However, anxiety about U.S. debt levels and the potential for future inflation paled beside European debt concerns, which nearly paralyzed global markets briefly during the second quarter. Investors worried that bailouts, which helped stave off defaults on Greek and Irish sovereign debt, might not be available in the future if larger economies such as Spain needed help. Treasuries benefitted during the summer from those concerns, but by the end of the year, bond yields were beginning to rise once again despite--or perhaps because of--the Fed's new round of quantitative easing.

Gold rose in tandem with anxiety about debt and currency stability. The spot price hit a new record high above $1,400 an ounce. Other commodities also did well; silver nearly doubled, and despite a dip during the summer, oil prices by the end of the year had reached $90 a barrel, a level last seen in the fall of 2008. Consumer inflation that was already tame fell further over the year to an annual rate of less than 1%, which the Fed said was one of the reasons unemployment remained just under 10%.

Market/Index	2009 Close	As of 12/31	Q4 Change	2010 Change
DJIA	10428.05	11577.51	7.32%	11.02%
NASDAQ	2269.15	2652.87	12.00%	16.91%
S&P 500	1115.10	1257.64	10.20%	12.78%
Russell 2000	625.39	783.65	15.90%	25.31%
Global Dow	1984.48	2087.44	7.17%	5.19%
Fed. Funds	.25%	.25%	0 bps	0 bps
10-year Treasuries	3.85%	3.38%	85 bps	-47 bps

The Year In Review

JANUARY: Congress launched hearings on the 2008 financial meltdown. The Federal Reserve, which had bought toxic bonds and Treasuries to help prevent economic collapse, announced record profits, most of which went into the U.S. Treasury. Though unemployment stayed at 10%, nonfarm payrolls showed their first increase since December 2007, while January saw the largest monthly decline in consumer borrowing on record. **FEBRUARY:** Concerns about potential default on European sovereign debt made global markets queasy. The unemployment rate fell to 9.7%., where it hovered much of the year. The Securities and Exchange Commission (SEC) adopted an alternative uptick rule to rein in short selling, while the Fed took a baby step toward tightening credit for banks. **MARCH:** Domestic equities celebrated the one-year anniversary of 2009's March lows by rebounding into positive territory; by month's end, the S&P 500 had risen roughly 47% in 12 months. Health care reform became law, and U.S. manufacturing expanded for the seventh straight month. **APRIL:** Europe erupted as Greek bonds were cut to junk status, underscoring worries about the PIIGS (Portugal, Ireland, Italy, Greece and Spain), while an oil rig erupted in the Gulf of Mexico. Financial reform became the new congressional battleground, and the SEC stunned Wall Street by charging Goldman Sachs with securities fraud. As the home buyer's tax credit deadline neared, home sales shot up and the U.S. economy continued to expand, though more slowly than in Q4 2009. **MAY:** Already unnerved by euroangst, shell-shocked investors watched the Dow plunge almost 1,000 points in a matter of minutes in a so-called "flash crash"; the SEC later proposed new circuit breakers designed to slow trading in times of market chaos. The European Central Bank calmed markets by buying government bonds to bail out Greece. **JUNE:** The Census Bureau said new single-family home sales fell off a cliff once the home buyer's tax credit deadline passed. The weak housing data reinforced the slide in domestic equities that started in May. The unemployment rate fell to 9.5%, its best for the year. **JULY:** As domestic stocks reached their 2010 low and began to recuperate from their second-quarter beating, financial reform was adopted. The new law revised lending practices, increased transparency, limited risky banking practices, and set up a process for monitoring systemic risk and dissolving failed financial institutions. **AUGUST:** As U.S. stocks re-entered positive territory for 2010, the trade deficit widened sharply. GM announced an IPO that would let the Treasury begin unwinding its ownership stake. **SEPTEMBER:** The National Bureau of Economic Research said the longest recession since the end of World War II had ended in June 2009. However, second-quarter 1.7% gross domestic product (GDP) showed the recovery was anemic. Foreclosures nationwide hit a new monthly record. However, U.S. stocks saw the start of an upward movement that would last the rest of the year. **OCTOBER:** Falling Treasury yields hit levels last seen during the financial crisis; 5-year Treasury Inflation-Protected Securities (TIPS) sold at auction with a negative yield for the first time ever, while the benchmark 10-year yield fell below 2.5%. Many major lenders temporarily halted foreclosures because of charges that "robo-signed" paperwork had led to faulty foreclosures, and some large investors pushed banks to buy back mortgages underlying troubled bonds. China raised interest rates for the first time in three years, prompting fears that tighter credit might impede global recovery. October also saw the end of the Troubled Asset Relief Program (TARP). **NOVEMBER:** The Fed took on the task of supporting the fragile economy by buying an additional $600 billion in bonds--so-called QE2--through June 2011. That didn't sit well with bond markets; the yield on 10-year Treasuries moved up from its October low and bond mutual funds began seeing net outflows. Ireland followed Greece in accepting a bailout from its EU colleagues. **DECEMBER:** Domestic equities finished the month at levels not seen in over two years. After procrastinating over tax increases scheduled for Jan. 1, Congress pushed through last-minute legislation that extended tax rates on all income levels, long-term capital gains and qualifying dividends; reinstated the estate tax; and reduced 2011 employee payroll taxes, among other provisions. A presidential commission couldn't muster enough votes to send its deficit reduction proposals to Congress.

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