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# Weekly Investment Commentary

## Investors Await Additional Clarity Around Europe

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## Last Week: Stocks Jump on Receding Fears

For the second consecutive week, stock prices moved sharply higher as investors welcomed the news of progress in addressing the European debt crisis and also took some solace in improved US economic data. For the week, the Dow Jones Industrial Average climbed 4.9% to 11,644, the S&P 500 Index advanced 6.0% to 1,224 and the Nasdaq Composite jumped 7.6% to 2,668. Other risk assets, including commodities, also experienced gains last week, while safe-haven assets such as US Treasuries struggled.

## Europe: Progress Being Made, but Uncertainty Persists

As last week's market gains attest, the direction of the financial markets remains highly dependent on the degree to which politicians and policymakers can create a solution to the European debt crisis. Currently, markets are putting a great deal of faith in the possibility that such a solution will come to pass even though the efforts have fallen short before.

At present, policymakers are attempting to engineer a "ring fence" around banks and troubled sovereign nations in an attempt to limit the contagion from a potential restructuring of Greek debt. Any such plan that is created will be subject to the competing interests of a number of parties and as a result, plans and policies will likely not be as bold as many investors would like. In any case, however, the policies that are put into place should help reduce the risks associated with the crisis.

It is impossible to accurately determine whether the worst of the crisis has passed or whether we have only begun to see the negative impact of the region's debt problems. It does seem, however, that the crisis may have passed an important turning point since policymakers appear more aware of the need for a broad-based bank recapitalization than they were several weeks ago. Details will remain elusive as the policies are being created, but we should see some additional clarity in the coming weeks. We are hopeful that the funding measures and improved liquidity will help stabilize the European debt crisis.

## US: Improvements Becoming More Solid

Within the United States, we have been seeing some modest but real improvements in the economic data. On the heels of a better-than-expected September labor market report, initial jobless claims fell slightly last week, reflecting some additional (albeit small) improvement in the employment picture. Retail sales figures, which were quite anemic for much of the summer, also showed some better results in the most recent readings. On balance, it appears that the economy has been less weak than feared and considerably better than surveys and sentiment have indicated.

One wildcard affecting the economy is the political backdrop. We have been suggesting for some time that the economy would benefit from some more supportive fiscal policies, but action on that front has remained elusive. The jobs program that President Obama

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has been proposing has not seen much progress, but at a minimum, we do think that some sort of extension of current unemployment benefits is likely. The broader issues of the large federal budget deficit and longer-term changes to taxation and spending policies remain a drag on sentiment, and we are not expecting to see significant clarity on this front any time soon.

On the earnings front, it appears that corporate America is headed for yet another strong quarter. It is possible, in fact, that the third quarter could be the best on record in terms of earnings per share. In addition to closely watching reported earnings and profits, investors are heavily focused on the commentary and forward guidance that is part of the earnings releases. We are not expecting corporate managements to be overly optimistic about the future, but we are looking for signs that they believe the worst of the economic slowdown has passed.

*For the time being, we expect that markets will remain in their trading range as the downside macro risks compete with attractive valuations and strong fundamentals.*

## Markets: The Trading Range Persists, For Now

Equity market sentiment swings have been ferocious over the last several weeks. Two weeks ago, it looked like stocks were poised to significantly break below the bottom of their current trading range (between 1,100 and 1,250 for the S&P 500) and we are now nearing the upper end of that range.

For the time being, we expect that markets will remain in their trading range as the downside macro risks compete with attractive valuations and strong fundamentals. Should we continue to see progress and improved clarity around the European debt crisis, however, stocks could be poised for improved longer-term performance.

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