THE CONROY REPORT

Quarterly Outlook
As of April 1, 2010

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Summary

Economic Outlook

The U.S. economy shrank by 2.4% in 2009 while the unemployment rate has risen to a current rate of 10.5%, creating the largest gap in four decades. However, economic growth turned positive in the latter half of 2009 and this momentum may continue in 2010. Despite market signals, we continue to advise caution.

Investment Recommendations

We reiterate our recommendation for cash and money market instruments. Interest rates are back on the rise and we believe they will continue to rise. As such, better investment returns will be found in short term securities.

Economic Forecast

The U.S. economy shrank by 2.4% in 2009 (see **Green** bar in Chart 1), due to contraction early in the year. Yet 2009 ended on a positive note with a 5.9% annualized rate of expansion in the fourth quarter, following on from a 2.2% rate of growth in the third quarter. Will this momentum continue and how does this bode for the investor?

We believe the U.S. economy will expand further in 2010. Government monetary stimulus is strong, inflation is under control thereby aiding consumers, interest rates are low offering cheaper capital for corporate expenditures, and the US Dollar has weakened recently versus foreign currencies supporting exports. Reflecting the weak economy, the current 10.5% unemployment rate is higher now than after the Energy Crisis, inflation and ensuing rate hikes of the early 1980s (see **Black** line in Chart 2). If this statistic can be corrected through job creation, this bodes well for potential economic growth.

Despite recent strong gains, our investment recommendations remain cautious. On July 1, 2008 we recommended that investors sell stock for cash, money market securities and short term corporate bonds. The decision to move to safety preceded tremendous losses in stock markets, coming before the most precipitous drops in valuation. While we were early out, we have resisted the temptation to reinvest. Hence, we have forgone a recovery of little more than half of their total loss since their peak in October 2007. Medium and long term investment-grade bonds have also rebounded along with stocks. Although we recommended these bonds six months ago, when will we advise taking on more investment risk, including a return to the stock market?

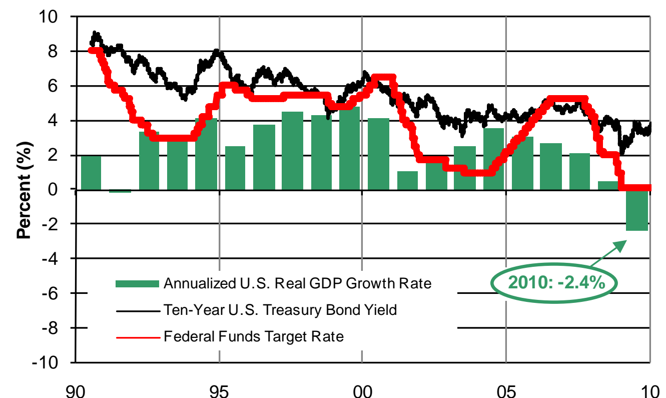
We advise investors to avoid stocks until volatility subsides. While we believe stock and corporate bond markets will continue to post gains for the remainder of 2010, we were reminded of a simple, yet instructive mathematical model in a recent New York Times article[1]:

(Percentage Loss) x (The Same Percentage Gain) = Overall Loss

The model is based on the equation $(1 - X) \times (1 + X) = 1 - X^2$, where X is the percentage change in value, or return. Whenever the return, X, is non-zero, there is always a loss on the initial investment given by the subtraction of the positive value of X^2. Following from this observation is that when market volatility is particularly high, as it has been recently, then so too are the chances for investment losses.

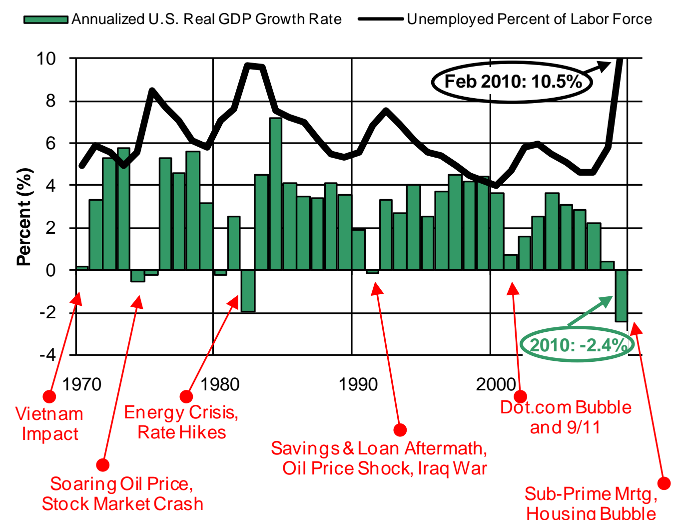
We continue to prefer money market instruments. Interest rates are back on the rise and we believe they will continue to rise along with inflation, government spending and regulatory stimulus. When rates rise, better investment returns will be found in short term securities, particularly for buy and hold investors, so this is where we advocate investors to stay.

Chart 1. The U.S. Economy Shrank by 2.4% in 2010



Sources: Federal Reserve, U.S. Department of Commerce Bureau of Economic Analysis, Yahoo! Finance. U.S. Real GDP Growth Rate in chained 2005 dollars.

Chart 2. High Unemployment Amidst Economic Slump - the Largest Gap in Six Recessions Over Four Decades



Sources: U.S. Department of Commerce Bureau of Economic Analysis, U.S. Department of Labor, Bureau of Labor and Statistics. Seasonal unemployment rate.

[1] *The Joy of X*, by Steven Strogatz, February 28, 2010.

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