MVCM Quarterly Newsletter

First Quarter Ended March 31, 2010

Seize the day…

---because one hath no better thing under the sun, than to eat, to drink and to be merry…
-Ecclesiastes 8.15

Come, let us go while we are in our prime;
And take the harmless folly of the time.
-Robert Herrick "Corinna's Going a-Maying"

An unusually harsh winter in the Mid-Atlantic area has given way to an unseasonably warm start to spring, with temperatures reaching well into the 80s and a higher than usual number of folks descending on the Home Depots and desultory nurseries & gardening centers that dot the suburban landscape. As goes the trend for daffodils and Miracle-Gro in Bethesda or Fairfax, so it apparently goes for retail sales nationwide. Consumers opened their wallets in March to boost retailers' top lines by 1.6% in March, and this after a modestly positive showing in February despite the best efforts of Mother Nature to thwart shopping-minded types from Philadelphia to Baltimore to Newark.

Incomes may not be rising anywhere in plain sight, and unemployment remains stuck just below double digits, but it seems that America's redoubtable consumers are feeling as energetic and giddy as the blushing young maids of Robert Herrick's rural English Maypole idylls. *Carpe diem* goes the Latin incantation – Seize the day! The winter of punishing recession and asset price deflation is over, and hope springs anew. Such is the human spirit, and such it would seem is the resilience and adaptability of the US economy. Not only consumers, but businesses as well are feeling in the pink. Manufacturing activity has been expansionary for a number of consecutive months now, and businesses are adding to inventories in anticipation of increased demand for their goods and services. Inflation is nowhere in sight for the moment. And as anyone with a 401(k) knows, the stock market is more than playing its part in the festive *gavotte du printemps*.

…for tomorrow who knows?

Let us eat and drink, for tomorrow we shall die.
-Isaiah 22.13

Will the good times keep rolling on? Or will our remarkable recovery turn out to be little more than a frivolous spring fling, a brief thaw in a long winter of discontent for investment markets?

Statistical analysis makes the upbeat case. We have just seen the worst ten-year stock market performance for the last 70 years; the S&P 500 returned -0.95% on an annual average basis from January 1, 2000 to December 31, 2009. That's way out of line with the long-term norm. In a recent *Financial Analysts Journal* article Guofu Zhou and Yinzi Zhu note that the average annual return of the Dow Jones Industrial Average from May 1896 to June 2008 (yes, that's right, 112 years) was 7.4%. What the statistics say is that betting against the stock market for the next 3-5 years is not a bet with the odds in its favor.

The problem, of course, is that statistical analysis doesn't predict outliers, those iconic black swans. We still need a convincing story for long-term growth, and the main headwind this story runs into comes down to one word: Debt. Government debt, household debt – that debt is out there and at some point there is likely to be a reckoning.

Amazingly, US households paid down $11.3 billion in household debt in February, even as retail sales were rising and incomes stayed flat. That is not likely sustainable. The story of the last 30 years was falling interest rates that unleashed torrents of debt-fueled growth. As we have said before, that story has run its course and the sequel has yet to emerge.

So we are realistic about the long term. But we also don't think it's time yet to write off the economy's present springtime. Eat and be merry under the sun indeed, but always with an eye on that which may be down the road.

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