

	March 2009	Year to Date 2009	<u>MARKET RETURNS</u>	March 2009	Year to Date 2009
DJIA	7.7%	-13.3%	MSCI EAFE	5.9%	-14.6%
S&P 500	8.5%	-11.7%	MSCI Emerg Markets	14.2%	0.5%

March Bear market rally or new bull market, let's not obsess and enjoy the moment. It is interesting to note the emerging markets are this year's leader and the first to recover. This reflects their improved fiscal and monetary policy since the 1997 Asian Financial Crisis.

Fixed Income Opportunities Abound Though fixed income markets are driven by the yield curve's level and slope, some bond classes now offer potential returns rivaling those associated with stocks. We find the following areas interesting:

- **Investment Grade Corporate Bonds** These bonds are priced as a percentage yield over a comparable maturity US Treasury bond, referred to as the "spread". The December 2008 spread was 625 basis points (6.25%) and is currently about 575 basis points, compared to normal spreads at 100 to 200 basis points. Investment grade corporate bonds now yield 4.9% to 5.9% and offer excellent total return potential, including interest and possible capital gains, as more normal spreads return. An emphasis on short maturities can further limit risk.
- **Tax Exempt Municipals** Muni yields, including those of the highest quality, are still unusually high compared to taxable Treasury bonds. Tax reform would make munis more valuable for investors in the top tax brackets, but some uncertainty remains. Tax law changes limiting the exemption munis enjoy could undermine their value. Also, a fundamental change in Federal taxes, such as a consumption-based tax structure like Europe's Value Added Tax, could also reduce their appeal. For now, investors are amply compensated for the uncertainty.
- **Treasury Inflation Protected Securities (TIPS)** We discussed TIPS in the March Market Commentary. Suffice it to say at some point the liquidity being pumped into the economy will result in higher inflation expectations, if not actual inflation.
- **High Yield Corporate Bonds**, also know as junk bonds. Credit markets still face a surge in corporate defaults, but high yield bond prices reflect this expectation. High yield bond funds offer around 10% yields. Investors are being paid handsomely to await this sector's recovery when the current recession ends.
- **Strategic Bond Funds** These are invested in a wide range of bond sectors, including Treasury, agency, corporate and foreign bonds. Strategic bond funds have an average credit rating of BBB, the lower end of the investment grade range, yet their yields approach 10%, rivaling those of high yield bonds funds, but with better credit quality.

Stocks Equity markets are driven by greed and fear. In the Fall of 2007, with the Dow at 14,000, greed was not as apparent as in the late 1990's but still apparent. Over the last several months, as the economy slowed, credit markets seized, and the Dow slid near 6,400, fear was palpable. A return over the next few years to the midpoint between 14,000 and 6,400 would represent a 44% gain. We recognize this case rests more on gut feel than our careful, well reasoned economic outlook, but to paraphrase a report from Citi Global Wealth Management, the 22 recessions we've had since the late 1800s all ended. This one will too.

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Norwalk and Sandusky • 888.645.4121 • www.CitizensWM.com
Dublin and Urbana • 800.604.9368 • www.CWealthManagement.com

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