

Headlines

- GDP grows 5.6% in fourth quarter 2009
- Equity markets begin the year nicely
- It was a good quarter for bonds as well
- Unemployment rate was flat but job growth in March

	YTD 2010 Return	2009 Return
Dow Jones Industrial Avg	+4.9%	+18.8%
S&P 500	+4.8%	+23.4%
Nasdaq Composite	+5.6%	+43.9%
	Qtr End 2010 Yield	Year End 2009 Yield
10 Year Treasury Yield	3.84%	3.83%
3 Month T Bill Yield	0.15%	0.06%

GDP grows 5.6% in fourth quarter of 2009

The growth in the fourth quarter was driven by private inventory investment, exports, personal consumption, and nonresidential fixed investment. Imports, which negatively affect GDP, increased in the quarter. There was some modest good news in the residential investment area (housing), but it was not as meaningful as the others areas.

The acceleration in real GDP in the fourth quarter versus the third quarter primarily reflected increases in private inventory investment, an upturn in nonresidential fixed investment, an acceleration in exports, and a deceleration in imports that were partly offset by decelerations in PCE and in federal government spending.

Motor vehicle output added 0.45 percentage point to the fourth-quarter change in GDP after adding 1.45 percentage points to the third-quarter change. Final sales of computers added 0.01 percentage point to the fourth-quarter change in GDP after subtracting 0.08 percentage point from the third-quarter change.

Equity markets begin the year nicely

The S&P 500 ended the quarter up 4.8%. Most of this performance came in March (up 5.8%). The performance of other indices was mixed. U.S. small cap stocks were up 8.3% (up 7.7% for March), international developed markets were up 1%, and emerging markets were up 1.5%. A reading of the

tea leaves regarding this performance would say that small cap stocks outpacing large cap stocks suggest a recovering U.S. economy. The economic statistics back this up.

It was a good quarter for bonds as well

Interest rates were flat to down slightly during the first quarter of 2010. The Federal Reserve continued to be accommodative in monetary policy; short term rates were kept near zero and the Fed continued purchasing mortgage securities. The liquidity was also felt in the corporate bond market as risk premiums continued to shrink. Companies issued large amounts of investment and high yield debt to take advantage of the robust demand. All in all, it was another good quarter for fixed income.

Unemployment rate flat but job growth in March

The headline unemployment rate for March 2010 was 9.7%, essentially unchanged for the entire quarter. Average hours worked per employee has begun to rise and stands at 33.3 hours per week. The March jobs report showed that 162,000 jobs were created that month. Hiring of temporary and part-time workers continues to grow.

Census workers accounted for about 40,000 of the reported jobs in the month, a trend which will continue through the summer. There was some strength in other segments of the economy, including manufacturing and services.

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Outlook

Economy

The economy continued to grow in the fourth quarter, but analysts continue to remark on the tepid nature of that growth. Over 75% of the growth in the fourth quarter was attributable to inventory rebuilding. Final sales (to consumers) were modest. The bulk of the stimulus funds appropriated by Congress in early 2009 will be spent by mid 2010. Analysts are now watching for the consumer, traditionally 70% of GDP, to step back up to the plate and start spending.

As far as recoveries go, this one is below par. On average, the second quarter of a recovery shows GDP growth of about 8%. The second quarter of this recovery, which was the fourth quarter of 2009, only showed 5.6% growth. The performance of the consumer is the difference.

Inflation is muted but it is measurable. There continues to be ever so slight increases in the year-over-year change in the Consumer Price Index but the monthly reading for February of 2.1% Year-over-Year change in prices is still well below the long-term average.

Equities

Corporations will begin reporting first quarter financial results in the coming weeks. The stock market has been responding favorably to recent results. The comparables were very favorable in the fourth quarter of 2009, when the estimate of \$16.75 of earnings was compared to the fourth quarter of 2008's reported loss of \$0.09 per share. First quarter 2010 earnings estimates also compare quite favorably to the prior quarter, an estimate of \$17.16 versus comparable quarter of \$10.11.

We are firmly in the camp of economic recovery with bumps along the way. We are also intrigued with the idea that the consensus

Key Economic Indicators	2008 Actual	2009 Act/Est	2010 Est
Real GDP	1.1%	-2.0%	2.0%
S&P 500 Earnings (Operating)	-20%	-15%	+30%
Consumer Price Index	0.1%	+1.2%	+1.5%
Housing Starts (million)	0.90	0.55	0.65
Auto & Light Truck Sales (mil)	13.2	10.3	10.8
Unemployment Rate	6.9%	10.1%	9.9%
10 Year Treasury Bond	2.21%	3.83%	3.80%
3 Month Treasury Bill	0.08%	0.06%	0.25%

thinking is still calling for a near-term correction and that the recovery will be a slow slog. Therefore, we believe the "surprise" could come in the form of a sharper recovery leading to a higher stock market.

Valuation still looks reasonable with the S&P 500 trading around 14 to 15 times our 2010 earnings estimate. The consensus earnings estimates have been slowly moving towards our more normalized view of \$75 plus over the last few quarters and is now at \$78 for 2010. We think that "high quality" growth stocks are looking better to us in terms of relative price, and therefore lower risk.

Fixed Income

The bond market enters the second quarter with lots of momentum from the rally that began in March 2009. There are several storm clouds on the horizon however. Looming large is the ending of the quantitative easing program that injected over \$1 trillion dollars into the financial system. How will the bond market react without its largest buyer? Time will tell if the recovery in the bond market can sustain itself.

Treasury bond issuance continues at a torrid pace. Interest rates started rising in March. Is this the start of a worrisome trend that could push interest rates higher? We look for interest rates to moderate around 4% for ten year notes. The economy is still too fragile for the Fed to raise interest rates meaningfully. Risk premiums have little room to narrow and are vulnerable to widening.