

# Investment Policy Committee Notes

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## Economic and Stock/Fixed Income Market Outlooks

### Economic Outlook

#### Recent Reports

- Companies added fewer workers (83k) to payrolls in June than forecast (110k), reinforcing concerns the recovery will weaken as Americans curtail spending. Including government, nonfarm payrolls (-125k) fell for the first time this year because of a drop in census workers (-225k). The jobless rate dropped to 9.5% from 9.7% as the labor force shrank.
- Sales at U.S. retailers fell in June for a second month, indicating that the pace of economic recovery has moderated. Purchases decreased a more-than-projected 0.5% following a 1.1% May drop. Excluding auto dealers, demand fell 0.1%, matching the median forecast.

#### Upcoming Reports

- (7/15) Producer Price Index (-0.1% vs. -0.3%, 3.1% vs. 5.3% YOY) & (7/16) Consumer Price Index (-0.1% vs. -0.2%, 1.2% vs. 2.0% YOY).
- (7/15) Industrial Production (-0.1% vs. 1.3%) & Capacity Utilization (74.1% vs. 74.1%).
- (7/20) Housing Starts (575k vs. 593k, -3.0% MOM) & Building Permits (568k vs. 574k, -1.1% MOM).

#### Longer-Term Outlook

- Financial markets remain in a tug of war between cyclically improving economic and company fundamentals on the one side, and structural concerns about debt-related stress points and the longer-term strength of the economic recovery on the other.
- The tension between these opposing forces has left investors uncertain and the stock market stuck in a trading range. We think that unusually high uncertainty could be with us for years to come because the economic challenges we face are serious and will not be resolved quickly.
- In a low growth world with zero interest rates and fiscal policies that are hamstrung by large deficits and debt levels we expect volatility to remain at high levels. With low rates and high debt policy makers and governments will have less ability to "smooth-out" the business cycle, leading to higher volatility.

### Market Outlook

#### Equity Outlook

- We are 10 years into a flat stock market period and we think it will be many years until the stock market reaches new highs. The bright-side is we can still see decent returns (mid to high single digits) over those years because the decline in '07-'08 was so steep.
- Growth in the developed world is likely to remain challenged for several years, leading investors to seek out markets and investments with higher growth potential. Investors are likely to pay a premium for this better growth, which may benefit the emerging markets and stocks that can consistently grow in this environment.
- Near term, we are beginning the quarterly earnings season (Alcoa reported late 7/12) and have noted that it could prove to be a positive catalyst.

#### Fixed Income Outlook

- Through-out the 80's and 90's there was mostly a negative correlation between bond yields and the stock market, in other words, as the yield on bonds came down, the stock market went higher. In our current deflationary (or very low inflation) world, bond yields have tended to converge with real economic growth. Therefore higher bond yields have tended to be consistent with higher economic growth, which then leads to higher stocks prices (vice versa).
- Treasury yields are likely to stay constrained, because the level of debt is so high there is a natural "choke-point" for the economy if yields rise too high. From here, risks for yields are to the upside and we do anticipate bonds entering a low-grade bear over the next couple of years.

## S&P 500 GICS Sector Performance and Recommended Sector Weightings

S&P 500 Sector	% Total Return			Forward P/E Ratio	Actual Sector % Weightings	Forward Looking
	MTD	YTD	2008			CB&T Sector Emphasis
Consumer Discretionary	6.5	4.8	41.3	14.6	10.1	Marketweight
Consumer Staples	5.3	2.3	14.9	14.1	11.4	Marketweight
Energy	6.4	-6.6	13.9	11.7	10.8	Overweight
Financials	7.1	3.2	17.2	14.4	16.4	Underweight
Health Care	3.6	-5.5	19.7	11.2	11.8	Marketweight
Industrials	5.9	5.0	20.9	15.2	10.3	Marketweight
Information Technology	8.1	-3.3	61.7	13.5	19.1	Overweight
Materials	8.3	-5.6	48.6	15.1	3.5	Marketweight
Telecommunication	4.8	-4.0	8.9	14.0	2.9	Marketweight
Utilities	6.3	-1.3	11.9	12.2	3.7	Underweight
S&P Composite 1500	6.2	-0.2	27.3	13.8		
S&P 500	6.3	-0.7	26.5	13.4		
S&P MidCap 400	5.8	4.3	37.4	16.9		
S&P SmallCap 600	5.0	4.1	25.6	19.3		

Sector recommendations are market-cap weighted, influenced by economic, fundamental, and technical consideration.

The above information is provided by outside data vendors; CB&T cannot guarantee the accuracy of the data provided.

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