



Market Commentary First Quarter, 2010

OAK ASSOCIATES, *ltd.*



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FIRST QUARTER MARKET COMMENTARY

In the first quarter of 2010, the US stock market continued to declare that a global economic recovery is alive and well. Following a spectacular year in 2009, market pundits understandably question the stock market's ability to continue higher without the support of further economic improvements. This skepticism reverberated more loudly after a difficult January and February, but proved premature by the end of March. The market's resilience should not be overlooked since both the stock and bond markets tend to be reliable forward indicators of the economy. This, combined with strong operating results from corporations, has continued to push prices higher despite pockets of concern.

Sentiment towards US stocks was pressured in the first quarter due to several macroeconomic and geopolitical concerns. These events, while important to the long-term progress of economic recovery, failed to thwart the stock market gains for the quarter. In January, concern that China may act to slow its domestic economy rattled global equities. As the engine for global growth, a slowdown in China would sound an alarm for the interdependent global economies. Indeed, China's stock market remains one of the weakest performers year-to-date relative to other developing economies. But the performance of other global markets suggests China's qualms of overheating are contained. Specifically, when looking at the performance of international markets, the best performing major emerging markets were commodity producing countries: Australia +6.2%, South Africa +6.4%, Russia +9.4%, Canada +6%. Strength in these markets indicates that demand for raw materials and industrial commodities remains strong and that the global economic growth engine continues to hum along.

Troubles in Europe have also rattled markets worldwide, but are probably not as dire as originally feared and may even help accelerate a flight back into the US dollar. Strength in the dollar has supported sentiment towards an economic recovery domestically. And while the situation in Greece is a concern to European bond investors, the problems are unlikely to be catastrophic for the US stock market and should be contained by the IMF and Euro Zone countries. Indeed, economic problems in Europe's periphery (Iceland, Greece, Italy, Portugal, Ireland, and Spain) have persisted for some time.

The passage of major healthcare legislation dominated the media for much of March, but had little effect on the stock market, which has been resigned to the passage of some sort of healthcare overhaul bill for some time. With much of the legislation not taking effect for several years, the long-term impact on the industry remains to be seen. To generalize the legislation, health insurance will cost employers and individuals more and all the problems of the old system are likely persist. In any case, the final exam for the legislation's success is years off.

Job growth remains a mixed bag of economic possibilities. There have been some signs of improvements in the labor markets recently, with a rise in the labor force over the last three months. This is an improvement considering the economy shed 1.9 million jobs in the second half of 2009. The national unemployment rate of 9.7% remains high, but should also improve in the coming months. Growth in employment has been hampered by the uncertainty of employee healthcare expenses under the pending healthcare bill and the extended unemployment benefits that continue to compensate those out of work. Hourly wages also remain weak and posted a decline in the latest jobs report. If not for strong productivity, this would be more of a concern.

Within the S&P 500, sector performance also confirms the economic recovery is on course. For the first quarter, the best performing sector within the benchmark index was Industrials, followed by Financials and Consumer Discretionary. These are not groups that would be leading the S&P 500 higher if the recession was returning. Consumer stocks have been among the best performers over the last year. The group outperformed in 2009 on the premise that things were probably not as bad as perceived. It has continued to perform well in anticipation of a recovery in consumer spending. Meanwhile, sectors typically considered defensive posted the worst performance in the quarter, with telecom and utilities both dropping more than 4.5%.

The underlying performance of the S&P sectors and the individual companies owned by Oak Associates suggests that street expectations for annualized 2.5% GDP growth in Q1 2010 may be conservative. Companies balance sheets are extremely strong and revamped operating models should support continued high levels of profitability in 2010. Most companies acted decisively in 2008 and 2009 to downsize and streamline operations. These actions are being rewarded today with high productivity, record margins, and strong operating leverage. Earnings are a crucial component in stock price valuations and thus a solid underlying reason that equities can move higher.

We remain very optimistic that 2010 will be another good year for US stocks, though not as robust as 2009. Throughout the rest of the year, economic data will need to both confirm the gains already achieved and indicate that the economic expansion is sustainable. A renewed appetite for risk could also continue to push stocks higher throughout 2010. Flow funds data has shown investors' continued preference for cash-equivalents and bonds. With the S&P 500 up over 75% since its March 2009 closing low and considering the strength in equities and strong financial performance of companies, it is only a matter of time before investors reevaluate their preference for low-yielding, inflation-prone assets.

Best regards,



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