Stock Market Drivers - Commentaries and Review

Description: We have had a great start to 2006, with the quarter up 5.7%, led by smaller companies, primarily small growth companies. As a result, the NASDAQ index reached a five year high of 2,340 at the end of March. However, to put this into proper perspective, 2,340 is less than half the peak achieved by the NASDAQ index in 2000, so there's still plenty of potential for claw back. In our January commentary, we discussed the "January effect," which is the tendency for small companies to perform well in January. Most of the first quarter return was earned in January. The January market was up 4%, led by small companies, which returned 8%. We noted in the January commentary that years with a January effect tend to be good years, partly due of course to the first twelfth of the year being good.

The S&P 500 lagged the broad market in the quarter with a 4.2% return (not shown) due to its large company orientation. Of particular interest in this quarter is the fact that large core, the "stuff in the middle" between large value and large growth, has underperformed. This is unusual and generally occurs at inflection points in investor preferences which we believe is occurring as interest shifts from value to growth. This phenomenon usually causes distortions in the popular indexes, as it has this quarter. On the sector front, production-oriented industries, such as materials, industrials and energy, fared best, while consumer stocks and health care lagged. The global economy is being pressed into service by the demands of emerging economies like China and India.

Outside the U.S., the EAFE index continues to underperform the broad foreign market, as it has for most of this century, because it is void of countries that have been performing well, and it is larger company-oriented at a time when smaller companies have performed best. EAFE earned 9.5% in the quarter, more than doubling the S&P, and the broad foreign market earned 10.5%. Like the U.S., production-oriented industries and smaller companies took the lead, although unlike the U.S. value fared best due in part to stocks in better-performing regions, like Emerging Markets and Latin America, being predominantly classified as value.

To see details of these observations, including examples of attribution analyses applied to popular indexes, sign up to our award-winning monthly commentaries. These commentaries will improve your market intelligence and lead to better decision making going forward. Each month we identify the segments of the stock market that have behaved well and poorly with several objectives in mind:

- Identify trends in investor preferences
- Establish a framework for evaluating investment manager performance
- Put investment performance into perspective

We examine style, economic sector, and country effects so the reader has a good sense of what is working and what is not, and we explain these effects with graphics that are very easy to read and understand. As one reader recently put it "This is absolutely fabulous. In 5 pages you've defined everything I've been doing as a money manager for the last 9 months, but it's taken me 100 times the amount of explanation that this took. Thanks for the concise and clear story."

Each month we examine U.S. market behavior, and in the last month of each quarter we also examine non-U.S. markets, as well as year-to-market behavior. Included in each issue:

- Factors that have been driving the stock markets and why
- Analysis of popular index results
- Opinions on future market behavior

Also, once a year in January we write an extensive review of the long-run capital markets, going back to 1926, discussing the risk-reward characteristics of these markets and how the recent past stacks up against this history. Some highlights include:

- Risk and return statistics for stocks, bonds, Treasury bills and inflation.
- Probabilities of earning various rates of return, and of avoiding losses
- Histograms of stock and bond returns. These are very popular graphs.
- Best and worst stock and bond markets for various time horizons
The January 2004 commentary received the prestigious Kessler award for meritorious contribution to the investment consulting profession from the Investment Management Consultants Association. The January commentary of each year is a keeper and a guide for setting investor expectations throughout the year.

This comprehensive package will provide readers with 12 reports in total throughout the year:
- January Commentary: an extensive review of the long-run capital markets covering the past 80 years as well as the recent past.
- 3 end of quarter commentaries which provide information on US but also covers other markets.
- 7 other commentaries throughout the year which are specific to the US market only.

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