

# insights

July 2010

## Stock Market Correction or Bear Market?

by *Kevin Norris, President & CIO*



The stock market rally from the March 2009 lows took a breather in the second quarter of 2010 as investors grew increasingly concerned over the sustainability of the U.S. economic recovery, stubbornly high unemployment levels, massive government debt, slowing economic growth in China, and the uncertain seriousness of the European debt crisis. While it was not unexpected that volatility would return, it was just another contributing factor. The stock values of the 500 companies that comprise the S&P 500 index are now down -6.65% this year, with most of the losses coming in the past two months.

As the third quarter of 2010 begins, the most pressing question facing investors is whether we are merely experiencing a typical stock market **correction** or are we entering another **bear** market. A "correction" is a short period of time where stock prices decline before resuming their upward trend. On the other hand, a bear market is typically a longer period of time where stock prices decline more dramatically. While we certainly acknowledge that the risks have risen for a more pronounced decline in stock prices, we view the current situation more analogous to a correction. It is very common for the stock market to hit a soft spot 12-15 months following the end of a recession.

The consensus of economists is that the U.S. economic recovery will continue in 2010 and 2011. Growth may be below what typically occurs in a recovery, and problems in housing and other sectors may persist. But even if growth is 2%, that should allow companies' earnings to grow, buffeting stock prices.

The recent stock market sell-off had nothing to do with stocks being overvalued or reflecting "bubble" conditions. In fact, stock values are extremely attractive for long-term investors willing to brave the volatility and uncertainty. Consider for instance, that stock prices of the companies in the S&P 500 index have historically traded at a multiple of 16 times their estimated earnings per share. Earnings per share this year are "conservatively" expected to be around \$80. With the S&P 500 index currently at 1,048.08, that translates into a multiple of 13 times. If earnings come in on target at \$80, and you apply the historical multiple of 16 times earnings, that would put the S&P 500 index at 1,280 at year-end, or 22% higher than today.

As was mentioned earlier, the risk of a significant decline in stock prices has risen and adjustments to client portfolios, where necessary, have already been implemented. Further adjustments may be necessary as incoming data dictates. Several of our defensive holdings in portfolios performed very well, limiting the stock market's damage on portfolio values.

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## Changes are coming!

by *Christine Baluk*

Over the past few months, our team has been hard at work converting our in-house portfolio management software to a more modern and efficient system. One new exciting feature is the **Client Portal**, which will allow us to provide additional services to you. More of our clients are requesting online access to view their accounts, and with the Client Portal, you can safely and securely view your accounts 24 hours a day. You will also have access to a document safe (where you and your portfolio manager can exchange files), financial calculators, market news, and research tools.



We also realize that most of you opt for electronic statements from TD Ameritrade. Whether it's to be "green" or simply because you are overloaded with mail, you will be able to choose electronic Girard Partners statements as well. Starting next quarter, we encourage you to choose this paperless option.

If you are interested in being set up with a Client Portal and would like paperless Girard Partners statements, please contact me at [cbaluk@girardpartners.com](mailto:cbaluk@girardpartners.com) and I'll set you up!

### Listen in on our Conference Calls

On April 20th, we held a conference call with clients to recap the first quarter and to provide an update on our expectations for the remainder of the year. If you were unable to listen in on the call, you can go to our website at [www.girardpartners.com](http://www.girardpartners.com) and listen at your convenience.

**Our next conference call is scheduled for Thursday, July 22 at 4:00 p.m.**, where we will review the first half of 2010 and update you on how we see the remainder of the year unfolding. You should receive a notice either via e-mail or regular mail in the coming days with the specifics of the call.

[www.girardpartners.com](http://www.girardpartners.com)  
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## The Hussman Strategic Growth Fund: Adding Protection to Your Portfolio

by Kathleen Kelly-Fay,  
Portfolio Manager & Financial Analyst



For the past few years, we have invested in the Hussman Strategic Growth Fund for client portfolios. The major advantage of having a long-short fund in your portfolio is that this type of fund tends to behave differently than the stock market as a whole. The Hussman Fund is different from most equity funds because it is a long-short fund, meaning that it can both own equities long and sell them short. "Shorting" is a strategy whereby a manager profits from the downward movement of equities. This means that long-short funds like the Hussman Fund can benefit from both market rallies on the long side and also market retreats on the short side.

John Hussman, Ph.D., taught economics and finance at the prestigious University of Michigan for approximately 10 years before he started the fund in July 2000. Dr. Hussman makes economic forecasts for the fund in addition to selecting specific stocks. This rare approach may bring cohesion to the execution of his strategy.

The Hussman Fund has historically had a strong negative correlation to the stock market and tends to profit in market downturns. Dr. Hussman believes the U.S. economy is at risk of a double-dip recession. His bearish outlook is being carried through in a conservative strategy that might limit upside returns while providing protection to investors if the economy does experience a second decline during the recovery.

Although this fund will probably not produce exceptional returns in an up market, it is expected to strongly outperform in a down market. For example, through June 30th of this year, the fund has risen +5.24%, while the S&P 500 has been down -6.65%. It appears that Dr. Hussman's bearish stance and conservative hedging is producing consistently solid returns in the face of uncertainty. In the last several years, the returns have been in the mid-single digits, with only one negative return year (2008 -9%; S&P was down -37%). Since the fund's overall performance has been better than its benchmarks and the market as a whole in many recent quarters, this fund is a valuable component of client portfolios.

### Annual Policy Disclosure

*In addition to your quarterly statement and newsletter, enclosed are Girard Partners' Privacy Policy, Business Continuity Plan, and Anti-Money Laundering Statement. For regulatory purposes, these are required to be reviewed, updated, and provided to you annually. If you would also like a copy of our Securities & Exchange Commission (SEC) Form ADV, please contact Christine Baluk at 610-337-7640 and she will be glad to assist you.*

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## Stock Market Correction or Bear Market?

We are keenly sensitive to your fears that a stock market decline, comparable to that experienced in 2008 (S&P 500 -37%), could occur once again. While we place the probability of that as low, we clearly recognize its possibility and are maintaining a vigilant watch on portfolio allocations to the stock market, the performance of portfolio holdings and market indicators. We are prepared to increase our communication with you in coming months to help ease your concern. As always, feel free to contact your portfolio manager for information and reassurance.

## Thinking about refinancing your current mortgage?

The one good thing to occur in the 2nd quarter is that mortgage rates fell again to near historic levels. Thirty-year fixed-rate mortgages with no points stood at **4.5%** at the end of the quarter, while 15-year fixed-rate mortgages were at **4.25%**. While current rates are very low, if you think rates are going lower, keep your eye on the 10-year U.S. Treasury yield. Mortgage rates tend to move in the same direction with the yield on the 10-year Treasury, because the average life of a mortgage is about 10 years.



*Nurturing your wealth for life*

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