

U.S. Stocks Leap 11% During The Third Quarter

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Dear Clients & Friends:

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Alex Thompson

U.S. stocks resumed their remarkable comeback from recession lows by leaping over 11% during the third quarter – including nearly 9% in September alone. The S&P 500 index has risen 74% in 20 months. September, historically a poor month for the stock market, had its best effort since 1939. The rally was global, bringing all the major indices back into the black for the year.

Lance Hollingsworth

John Laughlin

Sarah Haizlip

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	<u>3Q</u>	<u>YTD</u>
Dow Jones Industrial Average	11.1%	5.5%
S&P 500 Index	11.2%	3.8%
MSCI EAFE Foreign Equity	16.4%	1.0%
MSCI World Index	14.3%	3.6%
Barclay's Aggregate Bond Index	2.5%	7.9%

The world is gloomy. How could this happen?

There has been a fascinating disparity between consumer sentiment and market behavior. During the quarter, most people were focusing on the very real problems facing the U.S. and the world. Fears of disaster were priced into the markets, setting equities up for a rebound if disaster didn't occur.

- Markets spent most of the 3rd quarter experiencing a serious correction based on worries that proved to be overdone. Anything less than disaster, and the markets had to recover.
- Many people were genuinely shaken by fear of a repeat of 2008. Even professionals fled the market and plunged into bonds or cash, worried about the potential for a double dip recession in the U.S. and a European sovereign debt crisis that could trigger another global financial meltdown.
- Mid-term U.S. elections, the expiration of Bush tax cuts and new financial industry regulations all were looming ahead, heightening uncertainty.

While economic problems and uncertainties remain, many of these macro issues ceased to be so scary by the end of the quarter. Europe faced up to its sovereign debt problems, curtailing the crisis. There is growing confidence that the Fed is prepared to address any additional slowing of the economy with “quantitative easing,” an action supported by many respected bond market experts.

Fear that troubles in the developed countries would doom China and other fast growing economies has faded. They withstood the uncertainty and have bounced back very nicely.

As fear subsided, attention returned to continued robust corporate profits and attractive valuations in the stock markets. A decline in the value of the dollar also

made foreign investments more attractive. Once the world settled down, recognition of the potential of equity investments was noted and stock buyers waded back into the water.

Outlook

Almost certainly, interest rates are expected to stay low for a while. That keeps the environment challenging for those who rely solely on fixed income investments. However, that has not stopped enthusiasm for bonds. During the quarter, billions of dollars continued to flow from stocks into bonds.

We are concerned that between quantitative easing and excess demand, bond prices may be overvalued. Bonds are bought for both income and stability. However, we believe bond yields are so low that they make stocks attractive by comparison. This makes us glad to be asset allocators who don't put all your eggs in one basket.

Warren Buffett addressed the compelling value of stocks in a recent interview, *"It's quite clear that stocks are cheaper than bonds. I can't imagine anyone having bonds in their portfolio when they can own equities."* While for good reasons, most of our clients need bonds in their portfolios, we share Buffett's attraction to stocks.

Our outlook for the next couple of quarters is much as it has been all year. We believe that the current momentum can continue. Ned Davis Research released a study in January predicting stock market volatility that closely resembles what we've experienced so far in 2010. This study, based on market behavior coming out of recessions, also predicts a strong fourth quarter rally. Additionally, we are entering a period when the markets are both seasonally strong and responding to mid-term elections – historically some of the best times to be invested.

Managing Portfolios and Taxes

Our recent trading should help adjust client investments to capitalize on the opportunities we see. We are taking profits in small- and mid-cap value equity funds and adding to international investments, particularly emerging markets. There is no clarity yet on future income tax rates. We will continue to work with our CPA colleagues to manage your tax situation the best we can as year-end approaches.

Please Welcome New Summit Client Service Representative – Leslie Hill

We hope you will soon meet the newest member of the Summit team, Leslie Hill. Leslie is a Memphian who graduated from the University of Mississippi with a degree in Business Administration. She worked for Morgan Keegan in Atlanta and Memphis, as well as the local accounting firm, The Marston Group LLC.

Thank you for your faith in us and as always, please contact us if you have any questions.

Summit Asset Management LLC