

Capital Market Review

First Quarter, 2010

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Summary

Stocks and corporate bonds rallied during the first quarter, extending their winning streak to four consecutive quarters. The Federal Reserve held core interest rates steady at close to 0% and indicated it would continue to do so for an extended period.

While there is a lot of handwringing about the economic recovery, most of the evidence suggests a rapidly improving U.S. economy. Consumer spending has been increasing, manufacturing activity is robust, and leading indicators suggest continued expansion. The labor market is the one major holdout but the March jobs report showed the highest level of job growth in three years.

U.S. stocks returned 5.9% during the first quarter, leading developed international and emerging market stock returns. Mid- and small-cap stocks outperformed large stocks while the value approach outperformed the core and growth approaches. Industrials, Finance, and Consumer Discretionary were the strongest performing sectors while Telecommunications and Utilities were the weakest performing sectors and the only two with a negative first-quarter return.

The U.S. bond market returned 1.8% during the quarter

with all three major bond sectors exhibiting positive returns (led by the corporate sector). High yield bonds returned 4.6% and municipal bonds returned 1.3%.

Global commodities declined on a strengthening US dollar and concerns that emerging market governments would take more active steps to slow their economic growth. Agricultural commodities led the decline. Metals had a positive first-quarter return and oil ended the quarter near an 18-month high.

The MSCI Reit index returned 10.1% during the quarter and is up over 110% for the year. On a variety of measures, home affordability is currently high. The real test for the real estate market will come during the spring selling season and when the first time homebuyer credit expires in June. One area of concern for real estate investors is that current reit yields, relative to history, imply a level of overvaluation.

Economic Conditions

The economy expanded at a 5.6% rate during the fourth quarter, exceeding most forecasts. Consumer spending, which comprises about 70% of the economy, unexpectedly showed positive growth. Manufacturing reports showed stronger-than-expected durable goods orders and industrial production. Leading economic indicators suggest continued economic growth. Monetary policy remains accommodative with no immediate signs of a policy change.

Despite many positive indicators, headwinds to short-term economic expansion exist. Labor markets remain constrained with unemployment near 10% and initial unemployment claims remain stubbornly high. Credit remains tight. The market expects to see continued improvement in these indicators as 2010 unfolds.

Our bigger concern is about longer-term economic growth. Interest rates can only go up. The only question is when and by how much. The inability of governments (here in the U.S. but also worldwide) to exhibit fiscal discipline will lead to higher taxes. These factors, along with increased government regulation and mandates will hinder future economic growth.

Stock Market Returns

The stock market rally continues, albeit at a slower pace, due to above-consensus economic and corporate profit news as well as positive investor sentiment. Forward looking guidance remains relatively positive and upbeat.

However, as we approach the halfway mark of 2010,

the market is changing its focus to 2011 economic conditions. In other words, 2010's improving economic conditions are generally reflected in today's prices. Large-cap stocks appear under-valued while mid- and small company stocks are fairly valued.

During the quarter, U.S. stocks returned 5.9%, outperforming developed international and emerging market stock returns of 0.9% and 2.1%, respectively. Small and mid-cap stocks returned just under 9%, outperforming large-cap stocks with a return of 5.7%. The value approach returned 7.1%, outperforming the core and growth approach returns of 5.9% and 4.9%, respectively.

Eight of the ten economic sectors produced positive returns during the quarter. Only Telecommunications (-4.3%) and Utilities (-3.5%) had negative returns. Sector standouts included Industrials (13.1%), Finance (11.2%), and Consumer Discretionary (10.4%).

Bond Market Returns

Credit concerns of several governments dominated first-quarter news. A bailout package was designed for Greece and Portugal debt was downgraded to AA- (and remains on negative watch). While the United Kingdom escaped a downgrade they were warned by a rating agency that their current financial condition is not consistent with a AAA rating. The U.S. may not be too far behind in receiving such a warning.

Finance professionals have always thought of the U.S. bond as the "risk free" security. One must now question that assertion. In fact, during the quarter, a two-year bond issued by Berkshire Hathaway (a U.S. corporation), traded at yields lower than the same maturity U.S. Treasury. In other words, at that point in time, the market had more confidence in Berkshire Hathaway's ability to pay its debt than it did the U.S. Government.

During the quarter, U.S. bonds returned 1.8%, ahead of the developed international bond return of -2.1%, but below the emerging market bond return of 4.3%. A rising U.S. dollar as well as fiscal concerns of Euro-zone nations negatively impacted developed international bonds. Within the U.S., the corporate sector led with a return of 2.3% followed by the mortgage and government bond returns of 1.5% and 1.1%, respectively. High yield bonds returned 4.6% during the first quarter.

In the Treasury market, yields on short-term maturities slightly declined compared to last quarter. The two, five and ten-year maturities currently have yields of 1.0%, 2.56%, and 3.83%.

Stock Returns For Periods Ending March 31, 2010

	<u>Qtr</u>	<u>Ytd</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>	<u>Developed Country</u>	<u>Qtr</u>	<u>1 Year</u>
Nationality						U.S.	5.9%	52.4%
U.S. Market	5.9%	5.9%	52.4%	-4.0%	2.4%	Canada	5.5	68.4
Developed Intl	0.9	0.9	54.4	-7.0	3.8			
Emerging Market	2.1	2.1	77.3	2.8	13.0			
Size						Europe	-2.4	51.1
Large	5.7	5.7	51.6	-4.0	2.3	France	-3.9	46.1
Mid	8.7	8.7	67.7	-3.3	4.2	Germany	-2.8	47.0
Small	8.9	8.9	62.8	-4.0	3.4	Italy	-7.3	43.2
Micro	11.8	11.8	82.3	-6.2	1.4	United Kingdom	-1.6	53.3
Approach						Pacific	5.4	47.8
Value	7.1	7.1	54.5	-7.2	1.2	Australia	2.9	79.7
Core	5.9	5.9	52.4	-4.0	2.4	Hong Kong	2.1	59.9
Growth	4.9	4.9	50.5	-0.9	3.5	Japan	7.3	35.6
Sector						Emerging Market		
Cons Discretionary	10.4	10.4	69.8	-3.2	1.2	China	-1.6	54.3
Cons Staples	5.8	5.8	35.9	4.7	6.7	India	4.8	113.6
Energy	0.6	0.6	29.5	-0.6	6.8	Korea	2.8	76.7
Finance	11.2	11.2	83.1	-21.3	-8.5	Czech Republic	-0.2	41.5
Healthcare	3.4	3.4	34.5	0.4	3.4	Hungary	12.6	175.1
Industrials	13.1	13.1	72.8	-3.1	1.6	Poland	4.2	108.7
Materials	2.9	2.9	56.1	-2.3	4.4	Russia	6.7	102.9
Technology	1.9	1.9	58.0	3.2	5.2	Brazil	-0.5	96.7
Telecomm	-4.3	-4.3	12.2	-8.9	2.6	Chile	0.1	60.3
Utilities	-3.5	-3.5	21.0	-5.7	4.2	Mexico	7.7	91.8

Stock Fundamentals As Of March 31, 2010

	<u>United States</u>		<u>Developed</u>		<u>Emerging</u>	
	<u>Current</u>	<u>1 Year Ago</u>	<u>Current</u>	<u>1 Year Ago</u>	<u>Current</u>	<u>1 Year Ago</u>
Price/Earnings Current	17.3	12.6	15.2	9.7	n/a	6.2
Price/Forecast Earnings	13.4	9.9	11.8	8.3	6.1	5.7
Price/Book	2.7	1.7	1.6	1.0	1.4	0.9
Price/Cash Flow	0.7	5.3	6.9	6.3	2.0	2.5
Price/Sales	0.1	0.7	0.8	0.5	1.4	0.5
Return On Equity	7.4	4.0	5.3	10.2	10.5	21.4
	<u>2011</u>		<u>P/E Using</u>		<u>Estimated Return</u>	
	<u>EPS Estimates</u>		<u>2011 Estimates</u>		<u>15x</u>	<u>18x</u>
Large	\$94.54		12.8		17.5%	41.0%
Mid	51.00		16.2		-7.7	10.8
Small	22.86		16.8		-1.5	7.4

Bond Returns And Characteristics For Periods Ending March 31, 2010

	<u>Returns</u>					<u>U.S. Bond Yields</u>	<u>Last</u>	<u>1 Year</u>	
	<u>Qtr</u>	<u>Ytd</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>		<u>Qtr</u>	<u>Qtr</u>	<u>Ago</u>
<u>Nationality</u>									
U.S. Market	1.8	1.8	7.7	6.1	5.4	Fed Funds	0.16	0.12	0.18
Developed Intl	-2.1	-2.1	8.4	7.5	4.7	Prime Rate	0.75	0.50	0.50
Emerging Market	4.3	4.3	30.4	7.3	9.1	3 Month Treasury	0.13	0.10	0.18
						1 Year Treasury	0.40	0.37	0.64
						2 Year Treasury	1.02	1.14	1.12
						5 Year Treasury	2.56	2.69	2.56
<u>Maturity</u>						10 Year Treasury	3.83	3.84	3.52
Cash	0.0	0.0	0.1	1.7	2.8	30 Year Treasury	4.65	4.60	4.30
Short-Term	0.9	0.9	4.2	5.0	4.6	Aaa Corporate	5.27	5.26	5.50
Intermediate-Term	1.5	1.5	6.9	5.9	5.2	Baa Corporate	6.27	6.37	8.42
Long-Term	1.6	1.6	10.3	5.8	5.3				
						Barclays Aggregate	3.47	3.68	4.06
<u>Sector</u>						Barclays Credit	4.28	4.51	7.03
Corporate	2.3	2.3	20.8	6.0	5.4	Barclays Govt.	2.31	2.40	1.91
Government	1.1	1.1	-0.1	6.0	5.2	Barclays Mortgage.	4.01	4.15	3.71
Mortgage	1.5	1.5	5.2	7.0	6.1	Barclays Municipal	3.59	3.62	4.12
						Barclays High Yield	8.47	9.06	18.12
<u>Other</u>						Barclays Global	2.90	3.07	3.44
High Yield	4.6	4.6	56.2	6.7	7.8	Barclays Emerging	6.06	6.59	10.05
Inflation Protected	0.6	0.6	6.2	6.0	4.8				
Municipal	1.3	1.3	9.7	4.6	4.6				

10-Year Sovereign Bond Yields

Spreads Versus 10-Year Treasury

<u>Developed Mkts</u>	<u>Last</u>			<u>Last</u>		
	<u>Qtr</u>	<u>Qtr</u>		<u>Qtr</u>	<u>Qtr</u>	<u>1 Year Ago</u>
United States	3.82	3.80	Aaa	1.44	1.42	1.98
Canada	3.66	3.75	Baa	2.44	2.53	4.90
France	3.40	3.61				
Germany	3.07	3.38	Barclays Aggregate	-0.36	-0.16	1.37
Italy	3.91	4.05	Barclays Credit	0.45	0.67	4.34
United Kingdom	4.00	4.14	Barclays Govt.	-1.52	-1.44	-0.78
Euro Zone	3.07	3.38	Barclays Mortgage	0.18	0.31	1.02
Australia	5.69	5.74	Barclays Municipal	-0.24	-0.22	1.43
Hong Kong	2.49	2.55	Barclays High Yield	4.64	5.22	15.43
Japan	1.31	1.33	Barclays Global	-0.93	-0.77	0.75
			Barclays Emerging	2.23	2.75	7.36
<u>Emerging</u>						
Brazil	6.16	6.16	Maturity (10yr-2yr)	2.81	2.70	2.40
China	3.29	3.71				
India	8.19	7.72				
Russia	6.29	8.01				