Economic & Market Outlook

- The Commerce Department recently reported U.S. GDP declined at an annualized rate of 1% in the second quarter of 2009. The rate of decline slowed from last quarter by more than economists had expected. Looking ahead, we expect the global economy to continue to contract, with U.S. recovery coming in late 2009 or possibly early 2010.
- The U.S unemployment rate jumped to 9.7% in August, the highest since 1983. The pace of job cuts has continued to slow even as unemployment is projected to exceed 10% by early next year. However, the number of discouraged workers no longer looking for jobs is rising quickly, and the number of jobless for 27 weeks or more is also increasing to 1 in 3 unemployed.
- The residential real estate market has started to show signs of stabilization. Sales of new and existing homes have been rising as prices have come down and the tax credit for new home buyers have started to come in effect. Despite the positive signs, the real estate market still faces challenges of high inventories and rising foreclosures.
- We expect consumer spending will remain subdued over the coming year as consumers continue to save. Longer-term, we believe we are in the early stages of a secular trend of reduced consumption, private sector debt reduction and increasing personal savings.
- Inflation remains a lesser concern because of lack of pricing power, declining labor costs, and tremendous slack in the economy. The year-over-year change in the Consumer Price Index (CPI) was -2.1%, and the shorter-term trend remains near zero. The Labor Department reported unit labor costs fell at a -5.9% annual rate in the second quarter, the biggest drop in nine years. Capacity utilization remains near the 42-year low reported in June.
- The Federal Reserve Open Market Committee maintained its 0-0.25% range on overnight rates at its Aug. 12 meeting. As mentioned in our quarterly newsletter, we encourage clients to consider the opportunity cost of owning money market securities yielding close to 0% compared to high-grade bonds or other investments.
- For taxable bond investors, we favor intermediate taxable municipals with A or better underlying credit ratings, industrial and utility corporate bonds with stable or improving credit profiles, and agency-guaranteed MBS with above-average prepayment protection. While financial bond prices have risen, reflecting reduced investor fear, we remain wary that a deteriorating commercial real estate market, as well as upcoming accounting, regulatory and political changes, will impair financials' credit quality.

Products offered through Bremer Trust are not FDIC insured, are not a deposit or other obligation of, or guaranteed by, the depositing institution, and are subject to investment risk including possible loss of principle amount invested. This report has been compiled using data and other statements of fact derived from sources which we believe to be accurate and reliable. However, such data and other statements of fact have not been verified by us, and we do not make any representations as to their accuracy or completeness. Any opinion expressed herein reflects our judgment at this date and is subject to change.

Economic & Market Outlook

- For tax-exempt municipal investors, the trend we have highlighted in previous months continues: strong investor demand coupled with reduced supply due to the Build America Bonds (BABs) program, which lets municipalities issue taxable debt and receive a federal subsidy on the interest payments. Obama's proposed tax increases should increase the value of the municipal tax shield. The decline in market interest rates means almost the entire tax-exempt market is trading at prices above par. Bremer's quantitative tools compare par, discount and premium bonds to find the best value for clients. 0-4 year munis are now expensive to historical averages, while there remains good value in 11-20-year munis with several years of call protection.
- U.S. stocks (measured by the S&P 500) have risen for 6 consecutive months, with the total return for this recent six month period at 40.5%. International stocks are up even more with the emerging market stocks being the best performers so far in 2009.
- We believe the equity markets may pause near term to digest the recent spike in equity prices, especially as we come into the historically weaker return months of September and October. It appears that most of the recent positive news on the economy has been factored into stock prices. However, the rally may continue if we see further positive economic news.
- Within the equity markets, we remain fully diversified but continue to prefer large cap over small cap stocks and growth over value on a relative basis. Developing markets stocks have outperformed developed markets, but they may underperform if the market corrects slightly.
- We believe stocks of high quality companies with less exposure to problems in the credit markets should do relatively well in a slowing/weak economy. Companies with significant international sales should benefit if the dollar weakens. We remain conservative and defensive in our outlook. Cyclical and lower quality companies have outperformed defensive names in this six month rally but we remain wary of their continued strength and believe the market will revert to more consistent, stable revenue and earnings generators.
- We encourage investors to stay focused on their long-term goals in the midst of this current market volatility. It is especially important to stay diversified and to reaffirm that our clients' current asset allocation is consistent with their long-term goals. We advise clients with time horizons less than 3 years to remain cautious toward risky assets. We have continued to increase our exposure to alternative assets that have less correlation to the equity and fixed markets as a better way to improve the risk-reward relationship given our current views on those two traditional asset classes.

Products offered through Bremer Trust are not FDIC insured, are not a deposit or other obligation of, or guaranteed by, the depositing institution, and are subject to investment risk including possible loss of principle amount invested. This report has been compiled using data and other statements of fact derived from sources which we believe to be accurate and reliable. However, such data and other statements of fact have not been verified by us, and we do not make any representations as to their accuracy or completeness. Any opinion expressed herein reflects our judgment at this date and is subject to change.