Leigh Baldwin & Co.

Investment Brokerage

The first quarter is officially over and 2011 has taken off where 2010 ended as a full throttle bull market. Even with a healthy sell-off in late February and early March that actually took the major averages into negative territory briefly, the first three months of this year enjoyed the best quarterly returns since 1998. The Dow finished up 6.4% as the index is up 7 of the last 8 quarters. With all this fanfare, what is an investor to do next?

The gains for the first quarter came over about a two week period so in a bull market, it definitely pays to be invested through both the good and the bad times as market timers surely know. Looking back at 2010, the same is true, as the market went from negative territory in late August to finish the year up over 15% for the Dow. Missing out on the best days and weeks of full market cycles can dramatically lower investment returns. As long as the bull remains intact, as we think the markets in 2011 will be, investors need to maintain exposure to high quality stocks and mutual funds.

The interest rate environment has changed little this year as the Fed continues to embrace an "easy money" policy of virtually zero percent interest rates. With the lone voice at the Fed clamoring for higher interest rates, Kansas City Fed President Tom Hoenig, recently announcing his retirement in October, the prospect of higher rates remains murky. Investors should keep an eye on the potential contagion of European financial markets (or possibly the Middle East) as a barometer of a dramatic increase in US rates. Unfortunately, if and when rates go up, the rise could be swift and significant and difficult for those issues with longer term maturities and weaker credit. We recommend keeping fixed income shorter in duration and spread out over the entire yield curve.

Speaking of interest rates, by keeping rates low, the Fed may deliver to us long-run hyper inflation and lost jobs. With regards to inflation, in the short term it is certainly the wind behind the sails of many stocks (like the oils, equipment firms, food, aluminum, steel, etc) but we may pay the future price for years to come. As we mentioned in our previous letter, if and when the price of gasoline hits $4 or more, if past history can be our guide, the economy comes screeching to a halt. That may be a time to lighten stock positions.

The ability of this market to shake off negative headlines like nuclear meltdown, new wars in the Middle East, 10% unemployment, governmental financial crisis, etc. is a testament to the strength of this market, as strong corporate earnings and money flowing in from bonds push it higher. Seasonally, the money flows should also be positive through the good part of next quarter. The market negatives include the threat of inflation, the weakness of the world's financial markets, and the possibility of higher interest rates.

112 Albany Street
Cazenovia, New York 13035
315-655-2964, 315-655-9138 fax
leigh@leighbaldwin.com