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04/02/12: Hear the Markets Roar!

Who could possibly have guessed? After all the discussion in the press about the long economic slowdown, last year's downgrade of American sovereign debt, talk of double-dip recessions and looming crises in Europe and China, the U.S. investment markets turned around and, in the first three months of this year, posted the best first-quarter returns in 14 years. Global markets followed suit, albeit more modestly, and investors received double-digit returns from real estate and high single-digit returns from commodities investments as well.

The S&P 500 index, which is the most widely followed barometer of the U.S. stock market, was up 12.6% for the first three months of the year. Large cap and midcap stocks in the U.S. provided almost identical positive returns in the first quarter, with the Wilshire large cap index up 12.66% and the Wilshire U.S. midcap index was up 12.35%. Small cap stocks posted the kind of positive returns that you seldom see over the course of a really good year. The Wilshire U.S. small-cap rose 18.75%, while the tech-heavy NASDAQ Composite Index gained 18.67% for the quarter.

Interestingly, the two economic segments that were responsible for last decade's major market busts, information technology and financial companies, led the markets this past quarter, posting aggregate returns of 21.14% and 21.46% respectively. But the uptrend could be seen across nearly all sectors. Materials, industrials, energy, consumer discretionary and staples, healthcare and telecom sectors all posted gains; the only losing sector were the ultra-conservative utilities, down 2.68% for the quarter. But utilities was one of the best performing sectors last year, so the others were due to catch up.

Looking at international equity markets, the MSCI-EAFE (which stands for Europe, Australasia, and the Far East and is pronounced "eefah" or "eefeeh") Index, which therefore tracks global stock markets in the economically developed nations, rose 9.97% for the first quarter of 2012. European stocks were up 9.89%, while the Far East index posted an 11.03% gain, led by a 19% upswing in Japan's Nikkei index--its strongest first quarter rise in 24 years. MSCI's emerging markets (MSCI-EM) index, which covers market returns in the lesser-developed (or economically emerging) nations (such as Brazil, India and Malaysia) rose 13.65% for the quarter. Remember, by and large, EM countries have accumulated FAR less debt than either the U.S. or other developed nations over the past decade or so, so they are in a much better financial position going forward.

Real estate and commodities participated in the upswing, but more modestly than stocks. The Wilshire REIT index, which follows real estate investment trusts that invest in commercial, residential and industrial properties around the country, was up 10.79% for the quarter. The S&P GSCI commodity index rose 5.88% in a quarter when crude oil prices rose 15% to hit $128 a barrel, just $20 below the all-time peak in 2008.

As for the bond market, there is little change in the interest rate scene over the past quarter; investors are still getting record-low yields from Treasuries. The yield on 1-year Treasury bonds is 0.17%, rising to 0.33% for two year maturities, and 0.5% for 3-year issues. (Ouch! Sounds pretty darn close to zero to me!) At the 10-year maturity level, rates started the quarter at 1.87% and rose to 2.21% by the end of March. Investors have been willing to buy U.S. government debt as a safer alternative to Euro-zone bonds; however, a recent article published by Reuters notes that the recent resolution of the Greek debt crisis might send investors back across the Atlantic. If that does happen, the result is likely to be higher Treasury bond rates, and losses for existing holders of Treasury securities. (Remember how bond rates move in the opposite direction of bond values.)

Corporate bonds performed well during the first quarter; the iShares iBoxx US Dollar Investment Grade Corporate Bond ETF rose 2.34%. However the spread between 10-year corporates (currently at 3.44% in aggregate) and government 10-year bonds (2.21%) is low by historical standards.

It goes without saying that the strong stock returns were a pleasant surprise, and might be an indication that investors believe the economy is turning the corner at last. Since early March 2009, the S&P 500 index has more than doubled in value, from 683 to over 1400 (1408 at market close at the end of the quarter), making all the peaks and valleys and twists and turns seem like background noise. Since the swoon last summer, the index is up nearly 30 percent.

The important lesson for investors is that returns can't be predicted in advance, and that has proven especially true of these lengthy--albeit choppy--market updrafts that have restored much of the wealth that was lost in the Great Recession. Of course, after a roaring first quarter, the lesson should also be viewed in reverse. We don't know what the markets will give us for the rest of the year, and there will almost certainly be some more downswings as the roller coaster moves from here to December. But those downswings will mean that stocks are (at least temporarily) being sold at a discount to current prices. Even that can be good news to investors who are putting money into the markets to meet their financial goals.

Wilshire index data: http://www.wilshire.com/Indexes/calculator/

Russell index data: http://www.russell.com/indexes/data/daily_total_returns_us.asp

S&P index data: http://www.standardandpoors.com/indices/sp-500/en/us/?indexId=spusa-500-usduf--p-us-l--

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Nasdaq index data: http://quicktake.morningstar.com/Index/IndexCharts.aspx?Symbol=COMP

International indices: http://www.mscibarra.com/products/indices/international_equity_indices/performance.html

Commodities index data: http://www.standardandpoors.com/indices/sp-gsci/en/us/?indexId=spgscirg--usd----sp------

Treasury market rates: http://www.bloomberg.com/markets/rates-bonds/government-bonds/us/

Broader bond analysis for the quarter: http://bonds.about.com/od/Issues-in-the-News/a/2012-First-Quarter-Bond-Market-Returns-The-Quarter-In-Review.htm

Home price data: http://www.standardandpoors.com/indices/sp-case-shiller-home-price-indices/en/us/?indexId=spusa-cashpidff--p-us----

Reuters analysis: http://www.reuters.com/article/2012/03/31/us-markets-global-outlook-idUSBRE82U02120120331

http://www.reuters.com/article/2012/03/31/us-usa-stocks-weekahead-idUSBRE82U01O20120331

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