

# Asset Allocation Views



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- We believe that the U.S. recession has now reached an end, and expect a stronger-than-consensus recovery in the United States and globally. In our view, consensus economic forecasts remain too low, underestimating the impact of the inventory and production cycles, of global policy and of pent-up demand for consumer durables on the likely strength of recovery. Only five of the more than 50 forecasters in last month's Blue Chip Consensus survey see 3.0% or greater U.S. GDP growth in 2010 – even though deep recessions tend to be followed by sharp recoveries. This cautious consensus suggests that markets should continue to be surprised positively by economic news over the next several months. As a result, even after a major move-up from their March lows, we do not believe that stocks fully discount the prospects for economic revival. We have therefore moved to an overweight on equities.
- After a -1.0% decline in in the second quarter, we expect positive growth in U.S. GDP starting this quarter. Growth should initially be led by government spending but supported by exports and by recovery in housing and consumer spending. U.S. personal consumption fell by a cumulative 6% in real terms during this recession, and real spending on durable goods by nearly 12%. Sales of autos and other consumer durables can thus grow robustly for some time before reaching anything like normal levels.
- The manufacturing ISM index provides perhaps the clearest signal of the likely strength of recovery in our view. While the total index remained just below the 50 threshold indicating growth in manufacturing in July, new orders and production rebounded strongly and now signal growth. Equally sharp recoveries can be seen in similar indices from around the world, including both developed and emerging countries.
- With nearly two-thirds of S&P 500 companies reporting, second-quarter earnings have been resilient. About 70% of companies have beaten estimates, compared with a normal "positive surprise ratio" of 55%. While most of the positive surprises came from tight cost controls, this augurs well for even stronger earnings once sales growth revives.
- Despite a 50% recovery in the S&P 500 from its March low, we believe that stocks as a class remain undervalued and that consensus earnings estimates remain too low. We therefore see further potential in stocks from current levels and have moved to an overweight.

## Current Positions — Model Portfolio

	Benchmark (%)	Recommended Allocation (%)	Change from Last Move
<b>Major Asset Classes</b>			
Stocks	65.0	67.0 Overweight	Increased
Bonds	35.0	33.0 Underweight	Decreased
Cash	0.0	0.0 Neutral	Unchanged
<b>Allocation Among Stocks</b>			
<b>Domestic U.S. Stocks</b>			
Large-Cap Core Stocks	18.0	20.0 Overweight	Increased
Large-Cap Growth Stocks	13.5	13.5 Neutral	Unchanged
Large-Cap Value Stocks	13.5	13.5 Neutral	Unchanged
Mid-Cap Stocks	4.0	4.0 Neutral	Unchanged
Small-Cap Stocks	6.0	6.0 Neutral	Unchanged
<b>International Stocks</b>			
EAFE Stocks	10.0	10.0 Neutral	Unchanged

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The ISM (Institute for Supply Management) Index is unmanaged national manufacturing index based on a survey of purchasing executives at roughly 300 industrial companies.

The Standard & Poor's 500 Index is an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The indices do not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot invest directly in an index.**

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