"A Time To Plant"
Market Commentary – October 2011

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The third estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 1.3% in the second quarter of 2011. This is higher than the first quarter's reading of 0.4%. While economic growth is weak, the sensational news media is fueling fears of something much worse. The depth of the "Great Recession" was in 2008 Q4 and 2009 Q1, when real GDP contracted by -8.9% and -6.7% respectively. During these two quarters, consumer spending contributed to -3.5 and -1.0 percentage points of the contraction in real GDP; business investment accounted for -5.6 and -7.8 percentage points. In 2011 Q2, components of the 1.3% growth in real GDP included +0.5 percentage point for consumer spending and +0.8 percentage point for business investment (net exports and government spending essentially cancelled each other out). As of now, consumer spending and business investment are nowhere near the dismal levels seen in 2008-2009. According to *The Economist*, U.S. GDP growth is forecast at 1.6% in 2011 and 2.0% in 2012 (down from last month's forecasts of 2.3% in 2011 and 2.9% in 2012).

In a maneuver dubbed "Operation Twist", the Federal Reserve is attempting to lower long-term interest rates and thus boost business investment and the housing sector. In a statement released on September 21, the Federal Open Market Committee (FOMC) noted "there are significant downside risks to the economic outlook, including strains in global financial markets". With the Fed Funds rate already at "exceptionally low levels…at least through mid-2013" and the Fed's balance sheet bloated with a $2.65 trillion securities portfolio due to QE1 and QE2, the FOMC decided to utilize a new tool. The Fed "intends to purchase, by the end of June 2012, $400 billion of Treasury securities with remaining maturities of 6 years to 30 years and to sell an equal amount of Treasury securities with remaining maturities of 3 years or less". The hope for Operation Twist is that lower long-term interest rates will coax investors to buy riskier assets, including corporate bonds and stocks. The next FOMC decision on monetary policy will be announced on November 2.

Technical factors of the market are mildly bullish (more demand than supply), while fundamentals are attractively priced – therefore, we are mildly bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) over the next 12 months is $104.16, which implies a price-to-earnings (P/E) ratio of 10.9 with the S&P 500 at 1131. The earnings yield (E/P) is currently 9.21%, which represents attractive value relative to the 10-year U.S. Treasury note yield of 1.92%. Earnings estimates have started to come down a bit, dropping from $106.23 two months ago. Of course, there is never a guarantee that what is cheap cannot get cheaper, but Banyan Asset Management maintains the view that an investor must be very afraid to sell stocks with valuations at such low levels.

Support on the S&P 500 has been holding in the 1120 area…so far. Stocks spent the month of September bouncing in a trading range between 1120 and 1220 on the S&P 500. Should support at 1120 fail, the next level of support is around 1050. Resistance above should be encountered near the 50 day moving average at 1196, the 1220 area, and also around 1260 from the March and June 2011 lows.

Human nature is creating opportunities for investors who can remove emotion from the investment decision-making process. Without a doubt, there are many problems in the world today. A Greek default on sovereign debt could cascade throughout the financial system in a contagion. The great deleveraging of personal and government balance sheets will likely create headwinds for the economy for years to come. Unemployment is high. Economic growth is low. The list goes on. People are falling victim to the 24-7 news cycle and allowing emotion to cloud their judgment. It is too easy to imagine that the world is ending. Investing is similar to farming; there is a time to plant and a time to harvest. Now is a time to plant. It is in the midst of turmoil that investors find the best deals. Therefore, we continue to incrementally buy, while maintaining some cash liquidity for an even rainier day.