THOMAS FINANCIAL

First Quarter 2010

Quarterly Economic News

"Politically-charged" is a good way to sum up the first quarter of 2010. Although it may seem like everything else took the back seat to the healthcare debate, a number of other programs designed to put people back to work, alleviate pressure on the housing market, and stimulate small-business lending made it through Congress. Markets responded to the flurry of activity, and many sectors of the economy reacted strongly to decisions made on Capitol Hill.

Market Mayhem

John F. Kennedy once said: "The one unchangeable certainty is that nothing is certain or unchangeable". In times where this month's truth is next month's fallacy, this quote hits home. Early in the quarter, the major indices were on the decline as caution returned amidst renewed concerns about the U.S. economic recovery.

A slump in January performance can be a troubling sign for the year ahead and February returns seemed to confirm this trend with the Dow Jones Industrial Avergae (DJIA) dipping below the 10,000 mark on February 8. There was a light at the end of the tunnel for this first quarter: March performance dispelled the myth with returns reaching highs not seen since October 2008. On March 16, the Federal Open Market Committee (FOMC) voted to maintain interest rates at their record low levels. The FOMC also said in a policy statement that economic conditions are "likely to warrant exceptionally low levels of the federal funds rate for an extended period". The stock market responded positively in the days that followed the announcement. The following table shows returns for various indices:

Index	1st Qrt	1 Year	5 Year	10 Year
S&P 500	5.39%	49.77%	1.92%	-0.66%
Russell 2000	8.85%	62.77%	3.36%	3.68%
MSCI EAFE (Net)	0.87%	54.44%	3.75%	1.27%
Barclays Agg. Bond	1.63%	4.15%	5.47%	6.13%

The S&P 500 is a commonly used measure of common stock total return performance.

The Russell 2000 is a commonly used measure of small capitalization stocks.

The MSCI EAFE is a commonly used measure of common stock total return performance of international markets.

The Barclay's Aggregate Bond Index (formerly Lehman Brothers' Aggregate Bond Index) is a commonly used measure of the bond market.

All referenced indices are unmanaged and not available for direct investment.

Past performance is not a guarantee of future results.

Insult to Injury

The Securities Investor Protection Corporation (SIPC) recently exposed a scam targeting victims of financial fraud. A fictitious organization, operating as the "International Security Investor Protection Corporation" (ISIPC), falsely claimed to have collaborated with Interpol to recover $1.3 billion in stolen money from a hideout in Malaysia. In an attempt to achieve an appearance of legitimacy, the ISIPC website mimicked the design and content of the SIPC site, and urged victims to submit confidential financial information to verify that they were on the refund list (the website was taken down after a press release from the SIPC on March 9). The SIPC warned that this is a common ploy to further fleece financial fraud victims. SIPC President Stephen Harbeck said he did not know of any investor that had been taken in.

"Investors who lose money in widely publicized schemes are often targeted by con artists looking to cash in on the victim's desire to recover losses," said Lori Schock, Director of the SEC's Office of Investor Education and Advocacy. "Victims of fraudulent schemes should be aware that such refund schemes commonly exist, and can be perpetrated through copycat Web sites that appear similar to those of actual regulators or other organizations."

Big Revenues, Bigger Bonuses

Wall Street's high-rolling antics have not entirely vanished despite a recession that sobered the nation and landed excessive practices under the microscope. In early January, most major U.S. banks and securities firms were on pace to achieve record compensation awards for 2009, upward of $145 billion (as projected by the Wall Street Journal). To quell some of the public outrage, a number of financial institutions announced that they would curb their "win big, lose little" compensation practices by paying employee bonuses in stock that cannot be sold immediately, more closely linking employee income to firm performance. To further curb excessive compensation practices, President Obama proposed a 10-year $90 billion bank tax – a "Financial Crisis Responsibility Fee" – which would apply to the largest and most highly leveraged firms and require a repayment of taxpayer-funded bailout dollars. At quarter close, this proposal was still pending approval by Congress.

"Banks Set for Record Pay", Stephen Grocer, The Wall Street Journal, January 15, 2010.

It's All Greek to Me

Greece, home of the Olympics, vacation destination, and now lynchpin in the global economic recovery. Out of control debt levels, an extremely high deficit and failure to implement financial reforms left Greece in an abysmal situation when the global economic downturn struck. Over the last few months, major rating services (Standard & Poor's, Moody's Investor Service and Fitch Ratings) have downgraded their credit ratings for Greece over concerns that the country will struggle to finance its deficit.

In an effort to regain control of public finances, austerity measures have been imposed, including public sector paycuts and tax increases on fuel, tobacco and alcohol. In response, thousands of people took to the streets in protest, and a number of civil servant strikes cripled Athens' government-run institutions.

In late March, leaders of the euro zone, in coordination with the International Monetary Fund, agreed to intervene in the event Greece's debt troubles intensify. The agreement stipulates emergency funds will be triggered only if Greece runs out of other fundraising options.

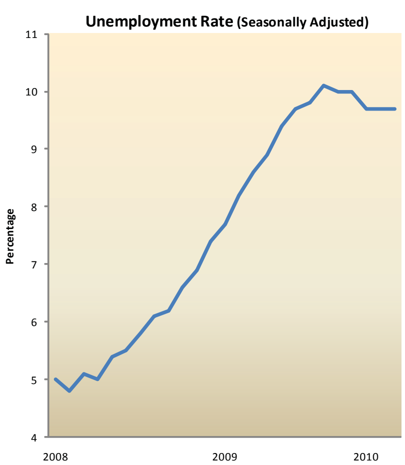
Banks Limit Lending

In 2009, U.S. banks posted the largest decline in lending since 1942. The issue of troubled commercial real estate loans is a major factor impacting banks' ability to lend, and willingness to lend has declined, in particular for lower-tier banks struggling to stay afloat while the economy recovers. An initiative proposed by the Obama administration to increase small business loans – the Small Business Lending Fund – would transfer $30 billion from the Troubled Asset Relief Program (TARP) to a new program outside of TARP aimed at supporting small business lending. According to a White House press release issued in February, this Small Business Lending Fund will target community and smaller banks, and offer incentives to increase small business lending.

This new program is positioning banks in a difficult situation as it relies on them making loans amidst pressure from regulators to be more prudent and add to reserves. As expected, with loans receding, reserve ratios – the measure of reserves to loans – are on the rise. This could boost the bottom line for many banks as their profits are no longer redirected into those "rainy-day" accounts.

Jobs, Jobs, Jobs

The unemployment rate remained unchanged for the entire first quarter, closing at 9.7%.



Source: Bureau of Labor Statistics

The Bureau of Labor Statistics published a special note in their February Employment Situation News Release stating that severe winter weather in parts of the country may have affected payroll employment and hours. Overall, there has been some job creation in the first quarter, but sustained gains in employment may still take some time to achieve. In March, the Senate approved a $17.6 billion jobs bill that is expected to spur job creation by extending payroll tax cuts to companies that hire unemployed workers. The White House indicated that this is the first of a series of job-creation bills that will put people back to work; however, it is still too early to tell what kind of impact this bill will have on employment.

Conclusion

There is growing confidence that, despite weak spots, the U.S. economy is on the mend. This should bode well for U.S. stocks as trends that helped stage a recovery in share prices in 2009 are expected to continue.

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