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## Economic Improvement Continues

The path of the business cycle follows a regular pattern. However, the timing, extent, and duration of each cycle can vary widely.

On September 15<sup>th</sup>, Federal Reserve Chairman Ben Bernanke said, "From a technical perspective, the **recession is very likely over** at this point." He also added "It's still going to feel like a very weak economy for some time because many people will still find that their job security and their employment status is not what they wish it was."

On September 16<sup>th</sup>, The Federal Reserve reported that **Industrial Production rose a greater than expected 0.8% in August** and revised the July number upward from 0.5% to 1.0%. The rise in the past two months follows eight consecutive monthly declines. Additionally, the increase was not only due to a rebound in the auto sector due to the Cash for Clunkers program, but also included upticks in manufacturing related to most other industries.

With the economy expanding again, low interest rates, and accommodative monetary policy, the **current environment favors stocks over bonds or cash**. However, not all companies will participate equally in the recovery. Therefore you **need to be highly selective of which stocks to own** in this environment. Some industries, such as autos, housing, retailing, and banking, continue to cope with challenges. Oil, commodities, and global companies may benefit from a weaker dollar as well as increased global economic activity.

While we expect a continuation of improving economic results for a number of quarters, we are also on the lookout for what could derail the recovery.

Rising interest rates could cause the recovery to stall. However, historically, the Federal Reserve does not begin to worry about inflation and raise short term rates until unemployment reaches a low level and capacity utilization exceeds 85%. The latest reading on **capacity utilization**

**showed a rate of only 69.6%, and unemployment remains at a high level**. We therefore expect the Federal Reserve to keep short term rates low for an extended period of time in order to help support the economic recovery.

A new shock to the financial system could ruin the recovery. However, almost everyone now agrees that letting Lehman Brothers fail was a mistake. We do not believe that the Federal Reserve, Congress, or the President will want to risk repeating such a mistake by allowing a corporate failure to escalate into another round of financial market distress and broad economic weakness.

Another spike in the prices of oil and commodities could induce another economic downturn. While the price of oil has rebounded from the recession low of \$31 in November, to \$71 currently, it is still quite a bit below the high of \$145 reached in July of 2008. Commodities show a similar pricing pattern.

Raising taxes could also negatively affect the recovery.

Additionally, credit expansion usually precedes economic expansion. However, we have not seen evidence of increased lending in the private sector, mainly due to deleveraging efforts by businesses and consumers. While it is understandable that credit expansion would be subdued until the banks, businesses and consumers strengthen their respective balance sheets, failure for credit to eventually expand could provide a headwind to the recovery.

We will watch for these and other currently unforeseen potential threats to the global economic recovery.

**ASSET MIX:** As the economy transitions from contraction to expansion, we will be reducing the overweight to investment grade bonds in favor of equities.

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