Although markets got a boost early last week as some decent economic news and a pervading "risk on" sentiment pushed prices higher, momentum faded later in the week as renewed concerns about the European debt crisis emerged.

One of the main factors underlying improved economic conditions has been a continued trend of better-than-expected jobs market data. Unemployment claims have fallen steadily since the Fall, and monthly jobs growth and unemployment data has been surprisingly strong of late. The housing market remains weak, but that sector of the economy does appear to be in a long-term bottoming process. While we are not expecting to see any significant near-term upside in housing, housing-related headwinds in gross domestic product do appear to be fading.

Overall, we retain our generally positive view toward the US economy, but we do not expect the recent almost-uninterrupted trend of positive data to continue. There is little prospect for economic acceleration beyond what we have seen lately, which suggests that economic risks are skewed to the downside compared to where we are today. Over the course of the year, we expect the US economy to remain firmly in "muddle through" mode.

Regarding corporate earnings, we are now well past the halfway mark for fourth-quarter reporting season. While results have been generally good, the degree of positive surprises is down from that of previous quarters. By the time reporting season draws to a close, overall results should be somewhat ahead of expectations.

The week ended with a relatively sour note on the European debt crisis when the European Union (led by Germany) rejected the proposed austerity plan for Greece, stating that they believe it does not do enough to reduce Greek debt levels and leaves deficits too high. As such, it appears that Greece will have to propose further spending cuts and/or tax increases in order to move the process forward.

In spite of last week’s modest setback, risk assets have enjoyed a strong run over the past couple of months as reduced fears from the European Union financial problems and a better economic climate in the United States have driven investors back into stocks and other risk asset classes.

Our view is that the “risk on” trade is the right one in the long term given that the world’s major economies are healing and that debt problems are slowly improving. It is important to remember that these processes will not occur in a straight line and we will see setbacks along the way. As a result, at some point we will almost certainly see at least a pause in the upward move as markets experience some sort of consolidation or corrective action.

February 13, 2012