After faltering for the previous couple of weeks, stocks returned to their winning ways last week thanks to some continued good economic news and some continuing signs of progress on the European debt crisis.

The general economic trend in the United States over the past couple of months has been that positive surprises have outweighed negative ones and the overall tone of the data shows that economic improvements are continuing. The labor market in particular has been accelerating, with jobless claims on a noticeable downward trend. Even the housing market, which has long been a source of weakness, has begun to show some signs of life. The banking and credit sectors are also continuing to heal, which is important as they can help perpetuate the type of positive feedback loops in the economy that we are starting to see. At this point, we would expect first quarter gross domestic product growth to be decent, but we would be surprised if it exceeded 3%, meaning that it should be about the same as the fourth quarter of last year.

In Europe, the European Central Bank is growing more aggressive in terms of supporting the banking system and appears committed to lowering interest rates. These moves should help reduce the risk of a massive run on the European banking system. In any case, however, while the next round of financing appears likely to come to fruition for Greece, the long-term outlook for Greece remains uncertain. The prospects of a chaotic debt default have been reduced and we do not believe that Europe is positioned for Greece to exit the European Union, but it does appear to us that the interest in keeping Greece in the EU for the long term is fading somewhat.

Turning back to the United States, we did see some political headlines last week that could have some economic and market implications. President Obama released his budget plan and is calling for deficit reduction on the order of $2 trillion. His plan call for $20 worth of tax increases for every $1 in spending cuts, with the biggest surprise perhaps being his decision to tax dividends at ordinary income levels. His plan would effectively raise dividend taxes from their current level of 15% to a maximum of 39.6%. In addition, a new tax of 3.8% on investment income would come into effect in 2013. Should these plans come to pass, it would result in nearly tripling the dividend tax rate from 15% to 43.4%. Of course, Congress still needs to weigh in on the budget debate and as we have seen in recent years, budget conversations can become quite contentious.

Additionally - last week, Congress agreed to an extension of the payroll tax cut for the remainder of 2012. In a turnaround from the trends of the last year, it was the Republicans who appeared to give in on their demands as their goal to fund these tax cuts with spending cuts were not met.

Looking ahead, we believe the backdrop for risk assets remains a solid one. The global economy is hardly experiencing boom conditions and remains subject to the hangover effects of the massive financial crisis, but improvements have been real and sustainable. Interest rates around the world are low, with little chance of moving higher any time soon. This backdrop, combined with at-least reasonable valuations, should help equities to continue to outperform.

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