the
SUSTAINABILITY
GROUP

It is hard for me to begin anywhere but with the death of the "liberal lion" Senator Edward M. Kennedy, Democrat from Massachusetts.

I was fortunate to be able to attend his funeral at the church, which was certainly a pageant, but what really fascinated me was the desperation which clearly led him to be such a voice for the voiceless. According to the priest, Kennedy was fascinated that the only portion of the Bible that offered a route to redemption was the passage from Matthew, "For I was hungry and you fed me … what you did for the least of these, you did for me." With his passing, we have lost a passionate fighter for the poor.

And so I turn to Washington, for the economy is growing stronger and stocks are not overvalued, as I argue below. Washington, however, is not giving us a feel-good experience, and psychology matters.

The press has played the health care debate foolishly. They cover the "town hall" meetings as if they are rallies. They repeat Senator Jim De Mint (R of SC)'s statement, "If we're able to stop Obama on this, it will be his Waterloo. It will break him." It is just a lot of loose talk. A majority of Americans want health care for all and believe that insurance companies are not the solution. I'm predicting a public option and a happy public this fall.

Then there is the establishment of checks and balances to the financial institutions that ruined the economy. There is talk of a super regulator. In an editorial in the New York Times, Sheila Bair, chair of the Federal Deposit Insurance Agency, effectively argues that this is a terrible idea. She builds the case that it would probably crush community banks and help the big ones. This superagency isn't what America wants and my bet is it won't come into being.

The Consumer Protection Agency is something most Americans desire; they are sick of credit card gouging. But again, corporate interests are lining up against it and the battle to get anything meaningful will be hard.

Probably the worst news from a human and financial cost is the news that we cannot win the war in Afghanistan without significantly more troops committed. Gen. Stanley McChrystal, the top commander in Afghanistan, is soon expected to argue that the Taliban's tactical prowess has grown much stronger. Meanwhile, there is dwindling popular support inside of Afghanistan for a foreign-led war effort that has only a stated goal of propping up a corruption-riddled government.

Currently, the only action out of Washington that I see as meaningful and helpful is the Securities Exchange Commission's start at addressing trading practices that aided speculation in markets. We are now in a comment period for a proposal to create much stronger rules on short selling.

So I'm not seeing exciting steps that build confidence coming out of Washington for a while.

Meanwhile, people are reeling from a stunning market rally over the last few months and wondering what positive news lies ahead. Well, the economy is a positive. The Institute of Supply Management's Manufacturing Index, which tracks the amount of manufacturing activity that occurred in the previous month, came in at 52.9 for August, the eighth month in a row that the number has increased. Annualized, this implies a 3.7 percent increase in real GDP. This just five months after the market dipped to its nadir.

And housing may be on the comeback. One housing company, Toll Brothers, reported that orders to buy homes increased 3 percent year over year, the first year over year increase in 4 years. One reason for the increase was that cancellation rates improved to 8.5 percent. This is a huge. Last quarter the cancellation rate was 22 percent, and the quarter before that it was 37 percent.

Jobless rates came in at 9.45%, better than expected because "only" 247,000 jobs were lost during the prior month. Consumer saving has leveled off at about the 4.5 percent rate for the last few months. This indicates that consumers have found the level of savings at which they feel comfortable.

With Washington a negative and the economy showing signs of life, we need stock valuations to push us one way or the other. From its closing low of 677 on March 9, the Standard & Poor's 500 stock index has risen 52 percent through August 31. That's a hard act to follow. Last quarter's earnings numbers sent the market higher, but this was due largely to cost-cutting which helped the bottom line.

Where will we go from here? Most gurus are taking a wait and see attitude. The market is waiting for signs of growth, and since earnings aren't due out again until mid-October, that could mean the market goes sideways or even slightly down for a couple of months. Because valuations are no longer at the extreme lows they were earlier this year, we are beyond just being able to "buy the market." We need to buy the right stocks. Now is the time to be certain that quality is high and that we stay focused on our investment themes to choose those companies that will be assisted by a trend larger than themselves.

Sincerely yours,

Amy Domini

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