

# What's in store for 2011?

Advantus Research Director Erica Bergsland's insights on the markets, the Fed, housing and bonds

Erica Bergsland, CFA  
Director, Research and Trading

## How do you see the fixed income and equity markets in 2011?

Low interest rates, a favorable Federal Reserve policy, and modest growth could have a favorable impact on the equity and fixed income markets. I think certain dividend-paying stocks and Real Estate Investment Trusts (REITs) potentially may be favorably positioned.

I expect inflation to remain subdued and the Fed's easy money policies to continue. American corporations are well positioned, so certain bonds may potentially be a good alternative in the near term.

## Will the Federal Reserve succeed in stimulating economic growth?

The Fed's current policy of buying intermediate financial assets (so-called quantitative easing) may support some incremental growth by driving up financial asset prices. This could create a wealth effect as investors migrate to higher return, riskier assets, such as the stock market.

Over the longer run, I see limited upside to this strategy and think it incurs significant risks. It will likely be difficult for policy makers to withdraw easy money on a timely basis. In addition, the Fed's actions distort relative value and will create imbalances if left in place too long.

The Fed turned to quantitative easing because its traditional monetary tools did not stimulate hiring and investment. Despite rock bottom short-term rates, growth remains muted. Consumers will be reluctant to borrow until housing prices improve and job prospects brighten. U.S. corporations are unlikely to expand until

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- Certain dividend-paying stocks and REITs may provide quality investment opportunities in this investment environment.
- The Fed may find it difficult to manage a timely withdrawal of its easy money policies. The longer those policies are in place, the more likely they are to distort value and create imbalances.
- Bond values are not out of sync with the low-inflation, low-growth, volatile environment.

health care and tax policies have been resolved and the economy is on a clear growth trajectory.

## How will European debt problems affect the U.S.?

In the near term, investors may migrate to U.S. assets as they try and avoid the uncertain European environment. This would support U.S. markets. I think the dollar is likely to continue to show strength vs. the Euro. That would create something of a headwind, especially for exporters.

I think it's likely that one or more of the European Union members will have to restructure its sovereign debt, causing losses for bondholders. This may raise concerns about municipal debt in the U.S. if this risk sharing becomes the norm.

## When will home prices turn around?

I expect the recovery in housing to take longer than most investors expect. That's unfortunate, because the housing sector has helped lift the country out of previous recessions. The substantial backlog of

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foreclosed properties, subdued sales appetite, and now, legal issues, will slow the purging of properties.

The adjustment will continue to be painful, and I see continued weakness in housing prices next year, particularly in overbuilt markets. Prices are sensitive to local economics and housing will likely recover first in areas of the country with a below average unemployment rate and some jobs growth.

### **Is there a bond bubble?**

Higher bond prices have been driven by real demand. Demographics – retiring baby boomers increasing their fixed income holdings – turmoil elsewhere in the world, and risk avoidance have driven that demand.

So far, the run up appears orderly, but the Fed's easy money policy is a concern. The Fed will have to sell assets at some point. This could mimic the race to the exit that popped previous bubbles. Additional Fed asset purchases will raise our concern that stock and bond prices will be driven above fundamental values. In the near term, risks appear manageable given our outlook for subdued inflation, modest economic growth and continued global volatility.

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