Economic Update

Broadleaf Partners, LLC

Burgers, Parades & Baseball Games

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The stock market continues to vacillate between the double dip and recovery crowds, but has also managed to hold the February lows now on two separate occasions. We believe that the domestic recovery remains intact and that European concerns and BP's oil spill are exacerbating the typical shifting of gears that occurs at this stage of the economic cycle. To be clear, our notion of shifting momentum isn't meant to imply a bearish stance on the markets, but rather the sense that what will work for investors and at what rate may likely be different than that experienced over the last year and a half.

Last year, the stock market acted very well, anticipating an eventual turn in the face of what was at the time very poor economic news. For 2010, we continue to expect somewhat the opposite as the stock market experiences more measured gains even as the economy demonstrates solid growth. A near term range of 1050 on the downside - the February lows - and 1150 on the upside may likely persist until we get some sense of closure on both Europe and offshore drilling. If we can get past these issues, a year end target of 1250 would still seem plausible, roughly the level where the markets traded when Lehman went down a year and a half ago. The good news is that this year end target now represents a fourteen percent gain from current levels as opposed to only five percent one month ago.

We believe that three top down factors have a major influence on investment value and stock market return characteristics. These include the economic cycle, the rate of innovation, and the availability and sources of credit. The economic cycle, we believe, is the most important of the three since it tends to have a major influence on sector returns. The rate of innovation, or the innovation cycle as we call it, is almost always an investable concept as serial innovators like Apple tend to create entirely new markets or better ways of doing the same old thing, often in spite of the economic climate. The only caveat is that greater rates of innovation typically engender faster rates of growth, meaning that valuations tend to be higher and the penalties for missteps magnified for this type of company.

The credit cycle, may be most useful in determining the sources and magnitude of investable funds and in offering potential warning signs about the presence of new asset bubbles. We have used the term "fund flows gone wild" in the past to describe the nature of the credit cycle, or the sources of money chasing newly favored asset classes. In the early 2000's, venture capitalists and everyday stock market investors funded the bubble in technology stocks, during the mid 2000's, banks financed the housing bubble, and more recently, the rush to private equity fueled a huge run up in commodities like oil and mergers and acquisition activity.

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So far, we'd be hard pressed to identify any major sources of "fund flows going wild" in the current environment, but government spending might be one place to monitor for the future. Taken to the extreme, excessive government spending in an economy can engender an entitlement society, and the eventual popping of sovereign asset bubbles now being witnessed in places like Greece. Ironically, a potential bubble in gold may also be a result of too much government spending, as investors trade their fears of deflating and inflating currencies for the hoped for "stability" of a "precious" metal.

At this point in time, we are relatively sector neutral, or at least more so than we have been in the recent past. This may reflect a budding sense that the economic cycle may have no more or less influence over sector dynamics than the credit or innovation cycles at this stage of the game. At the same time, given the 10-15% decline in many stock indices over the past month, it is likelier that strong earnings reports in the third quarter will have a more positive impact on stock prices than they had this quarter when they were near their highs.

Recently, I finished watching the HBO DVD series on President John Adams. Based on the biography of the same title, it provided great insight into the minds of our country's earliest leaders who sought independence from the British monarchy at the cost of their own lives and for the benefit of generations to come. As soon as the war was won, Hamilton, Jefferson and Adams, among others, embarked on their own personal quests for power, each in his own inevitable way, mini-monarchs in search of their own kingdoms. In a bit of irony, the world at large may now be hurtling down the same path, hoping that a king or queen of our own or new laws and regulations might somehow save us from ourselves. With Greece as Exhibit A, I remain unconvinced.

Over Memorial Day weekend, between the burgers, parades, and baseball games, I hope to find some time to remember those who died to remove the very shackles we now seem so eager to try.

Kindest Regards,

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