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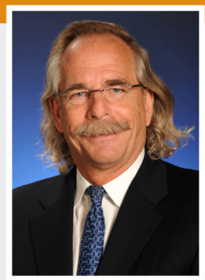
Investments



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How to Play the Republican Senate Victory

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The stunning victory by Republican Scott Brown over Martha Coakley to fill Ted Kennedy's Senate seat has sent a strong message to the Obama administration that the mid-term elections may be very difficult for incumbent Democrats. Mr. Brown's victory also pushes back potential legislation to regulate the financial industry and, of course, it derails the current health care bill.

The market's immediate response was to drive health care related stocks higher and for good reason. The targeted tax increase for health care related companies may very well be scuttled. Yesterday, the health care sector rose 2.00% while the S&P 500 gained 1.25%. In today's early morning trading hours, the health care sector added an incremental 0.50% to its gains while the overall market was down 0.86%.

Health insurance companies and medical device companies are expected to be the big winners if the health care bill fails to be enacted. The financial sector might be another winner, benefiting from less stringent regulation. An easier tone from the Senate Finance Committee should be expected, as outgoing Senate Finance Chairman Chris Dodd will now need to woo Republican committee members in order to push through tougher regulations.

Financial stocks are also showing strong performance, as many investors are now beginning to believe that the worst may be over for the beleaguered banking sector. Case in point was Citigroup's price action in the wake of weaker than expected fourth quarter earnings. Initially, Citi's stock dropped from $3.44 to $3.30 and then rallied back to $3.54 at the close of the day.

The combination of the steeply sloping yield curve, an expected increase in merger and acquisition activity, and expectations of new corporate debt issuance provides a strong fundamental backdrop within the financial sector for the year ahead.

While the timing of exit strategies from excess liquidity programs creates some headwind, we are still far from maintaining a "restrictive monetary policy regime". Central banks are only now beginning to take action to "normalize rates".

Eventually, central banks will have to reign in excess liquidity. If they do not, they may be forced into more aggressive action in order to combat inflation expectations, should they arise. Moving back to pre-crisis monetary and fiscal policies should be applauded by all investors because it indicates that the economy has moved to a sustainable level of growth. Understandably, investors have been hesitant to add to equity positions over the past year; however, that reluctance has been accompanied by a hefty opportunity cost from not being invested. Thus, pent-up demand should be sufficient to propel the equity market higher over the months ahead, despite certain headwinds.

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