VANTAGE CONSULTING GROUP
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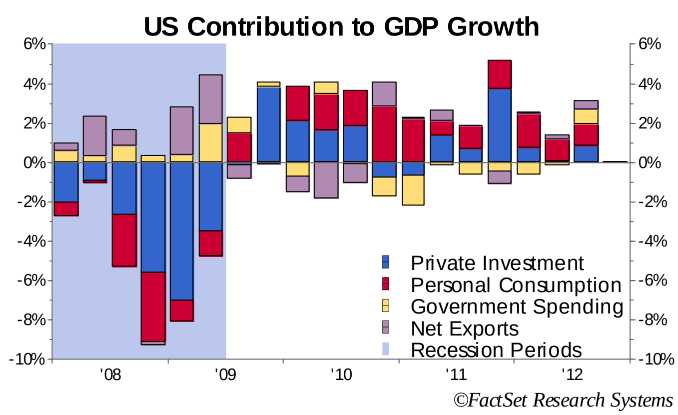
Market Review

December 2012

Economic Review

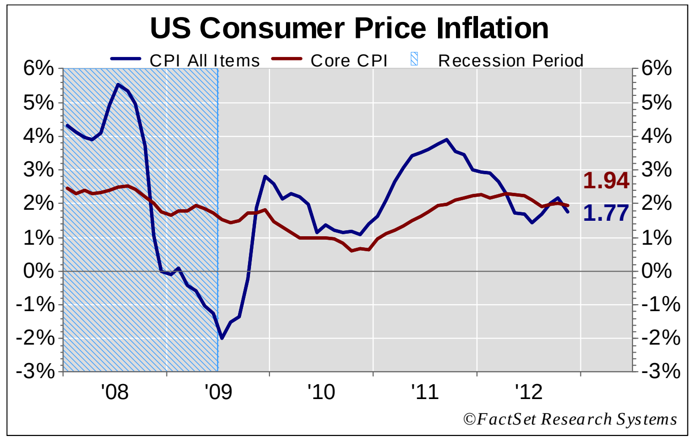
U.S. third quarter real GDP grew at an annual rate of 3.1% according to the BEA's third and final revision. The revision was a surprise, up from earlier estimates of 2.7% and 2%. The main drivers of third quarter growth were accelerating inventory buildup and government spending, which are likely not sustainable. The National Association for Business Economics released a prediction for 2013 GDP growth of 2.1%, based on the consensus view of the organization's members in an annual year-end survey.



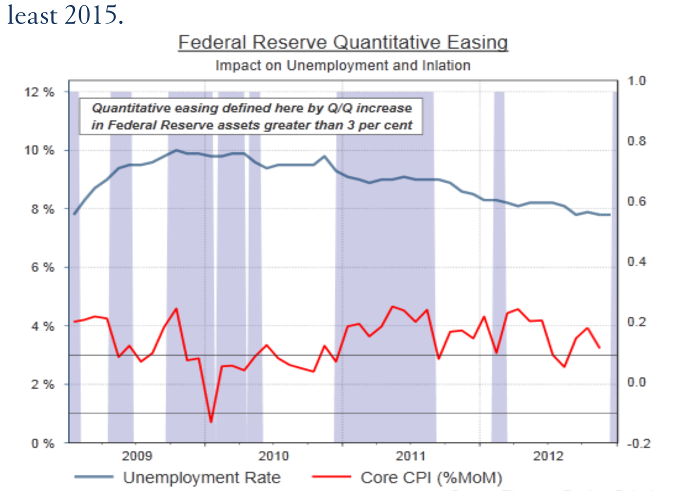
The Non-Manufacturing ISM increased from 54.7 in November to 56.1 in December, signaling that the economy is continuing to expand. The December reading, the highest since February, was led by a significant boost in the employment sub-component, up to 56.3 from 50.3 in November. Imports and backlog, however, crossed into contraction territory, with readings below 50. The Manufacturing ISM rose to 50.7 from a three-year low of 49.5 in November, led by 4% gains in the exports and employment subcomponents.

The U.S. November unemployment rate fell to 7.7% from 7.9%, the lowest rate since December 2008. Payroll data surprised to the upside, as the economy added 146,000 jobs, significantly higher than the 87,000 Bloomberg estimate. Also contributing to the lower rate was lower labor force participation, as 350,000 people left the labor force in November. Keeping with the recent trend of revising previous months downward, the Labor Department adjusted September and October payroll data down by a total of 49,000.

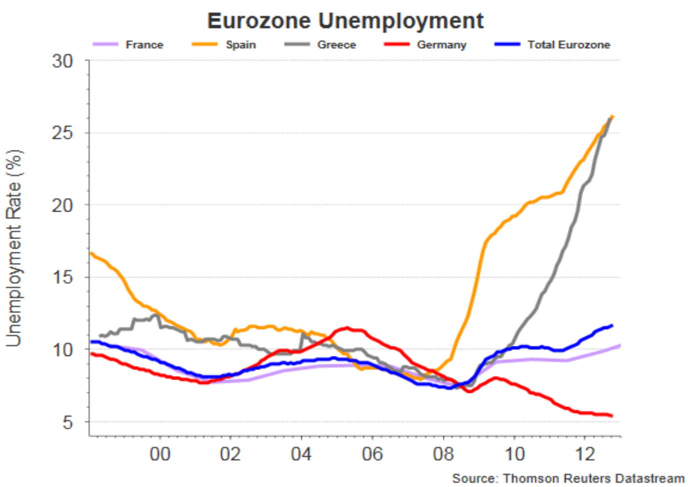
The headline CPI ticked down 0.2% in November on a seasonally adjusted basis, and month over month showed contraction of 0.3%. Both the annualized and monthly figures missed economist expectations by 0.1%. The drop in CPI, the first contraction in prices in six months, was caused mostly by a sharp drop in gas prices, which offset modest gains in other areas. The drop in energy and gas prices of 4.1% and 7.4% respectively were largely expected, and their biggest drop since December 2008. Food costs rose a modest 0.2%, mostly due to a surge in dairy prices. Core CPI, which excludes food and energy costs, rose 1.9% annualized and 0.1% month over month.



The U.S. Federal Reserve's minutes from the November meeting showed an interesting development in the committee's policy direction. As the Fed does not see significant inflation as a danger in the short-to-medium term, the committee stated it will focus exclusively on the other half of the dual mandate: employment. More specifically, the Fed will continue to keep rates near zero until unemployment reaches 6.5% and will buy mortgage-bonds until the job market improves. Though this policy stance leaves the Fed vulnerable to a surprise rise in inflation, the committee does not see that as a threat until at least 2015.

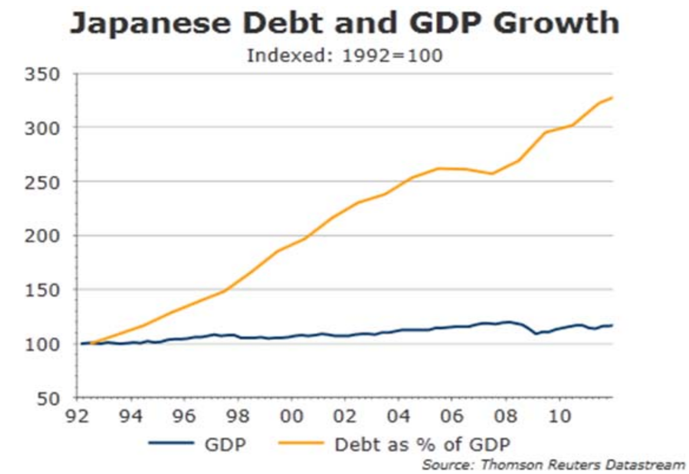


Mario Draghi, head of the European Central Bank, reaffirmed the conditions for countries applying for aid under the Outright Monetary Transaction (OMT) program. Under the program, which could include unlimited bond buying of the sovereign's debt by the ECB, the applicant will have to first apply for aid from the European bailout fund and undergo substantive reforms, including hard budget targets. These comments by Draghi are seen by some market commentators as attempts to quell the dissention from German policymakers, who still remain skeptical of the OMT program.



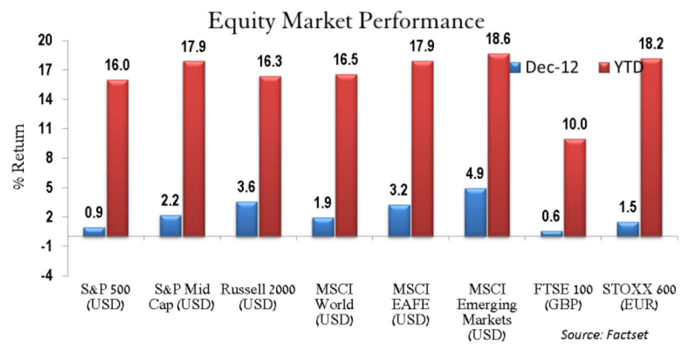
The United Kingdom revised third quarter GDP by 0.1% to 0.9% on a quarter over quarter basis. Although lower, the latest revision affirms the end of three straight quarters of economic contraction, led by significant gains in business investment and consumer spending. The French economy barely escaped recession, clinging to positive GDP growth of 0.1%, though unemployment continued to rise for the nineteenth consecutive month. Spain continues to struggle with over 25% unemployment and recently announced a projected €270 billion deficit for 2013.

Chinese government officials released expectations for 2013 GDP of 8% and accelerated growth in the country's inflation. Despite this optimistic view from Chinese officials, the economic data continued to be mixed. The countries PMI fell to 51.7 in December from 52.1 in November. The Bank of Japan announced additional stimulus, bringing the central bank's asset purchases to ¥76 trillion, approximately 9% of GDP. The Bank also gave signals that its committee will raise the inflation target from 1% to 2%.



Equity Markets

The concerns over the so called fiscal cliff (tax increases and spending cuts in the U.S.) dominated the headlines and overshadowed Fed action and positive economic news last month. Prospects of a possible compromise caused the equity markets to surge on the final day, pushing S&P 500 into positive territory for December. Global equity markets rebounded from 2011 and saw the biggest annual rally in three years, buoyed by unprecedented stimulus from global central banks amid slowest economic growth since 2009. MSCI Emerging Markets enjoyed a strong a 18.6% return in 2012, after climbing 4.9% in December.



Equity markets rallied during the first half of the month on positive economic reports, Fed actions and on hopes of a fiscal deal. Early gains in equity markets, following signs of progress in negotiations, gave way to pessimism during the latter half of the month as Congress and the White House struggled to find common ground. Equity markets declined during the period, but made a comeback on New Year's Eve as the likelyhood of a compromise increased.

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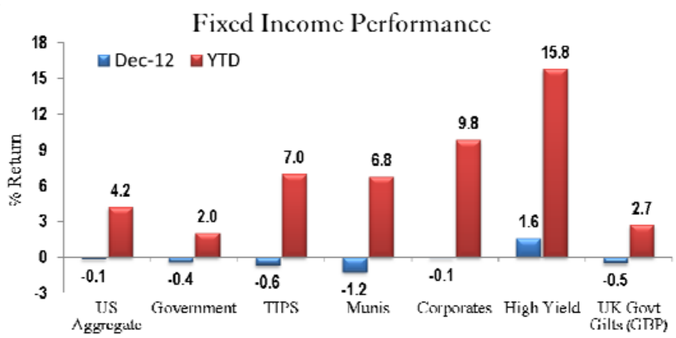
Bond Markets

Barclays U.S. Aggregate Index was little changed in December, after posting positive returns for previous eight months. The Index is up 4.2% for the year. Corporate and High Yield Bonds posted an impressive 9.8% and 15.8% gains in 2012, as global quantitative easing supported risk assets and compressed the corporate and high yield credit spreads. The Barclays Credit Index (A) Option Adjusted Spread narrowed 5 bps in December, the ninth month of spread tightening during 2012.



Source: Factset

During December, both the 10- and 30- year Treasury rates climbed 14 bps to 1.76% and 2.95% respectively, while the 2 year Treasury rate remained flat. The 2/10 yield curve steepened 14 bps. The UK 10-year GILT increased 4 bps in December, but declined 16 bps for the year to close at 1.81%. The Germany 10-year Bund yields declined 53 bps in during 2012 to close at 1.31%.

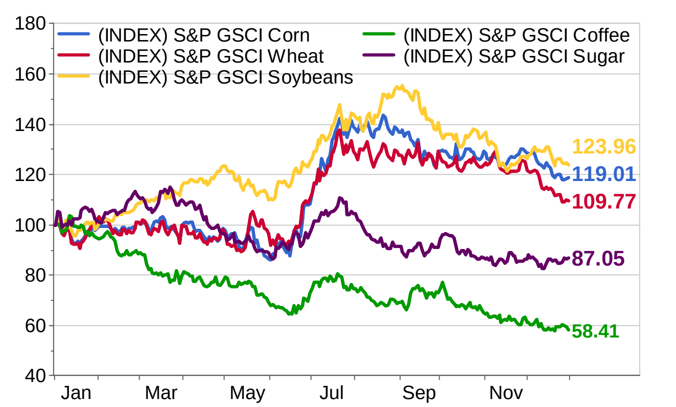
Currency

The US Dollar Index, which tracks the currency against those of six major U.S. trading partners, lost 0.5% in December and is down the same amount for the year. The Euro rallied 1.6% against the USD during 2012 and surged over 7% since Draghi made his "whatever it takes" comment in late July. The South African Rand lead all major currencies in December, by appreciating 4.75 against the US Dollar. The Japanese Yen slumped 4.6% as the new Liberal Democratic Party-led government seemed determined to step up measures to weaken the currency. The British Pound appreciated 1.4% against the US Dollar and closed at 1.6255. The Euro appreciated 1.4% against the greenback to close at 1.3184 in December.

Commodities

The S&P GSCI Total Return Index declined 0.7% in December, paring its gains for the year. The Dow Jones UBS Commodity Index dropped 2.6% last month and ended down 1.08% for the year.

Except for Livestock, all non-energy GSCI sub-indices declined in December. Cocoa, Wheat and Corn were among the worst performers, causing the agricultural sub-index to decline the most. Grain prices declined on expectations of increased production in 2013. Though grain prices have been declining during the last four to five months, the agricultural sub-index managed to be the top performer during 2012. Soybeans, Corn and Wheat gained 24%, 19% and 9.8% respectively for the year. Prices of grains rose sharply during summer, driven by heightened demand and dry weather in Europe and Australia and severe drought in the U.S. Corn and Soybeans set record high prices earlier amid the drought. Coffee and Sugar, also agricultural commodities, were among the biggest decliners last year. Coffee fell 41.6% on record harvest, while Sugar dropped 13% due to excess supply.



Similar to agricultural sub-index, the precious metals sub-index declined in December, but was the second best performing sub-index for the year. Gold lost 2.2% last month, but advanced for the twelfth consecutive year, gaining 6.1%. Silver slumped 9.2% but posted a healthy 7.1% gain for the year. Industrial Metals sub-index gained 1.4% last year, with Lead surging 12.3%. The S&P GSCI Energy Index decreased 1.34% for the year. Brent Crude advanced 8.7%, as tensions in the Middle East offset the weak demand due to recession in Europe and a slowdown in Chinese growth.