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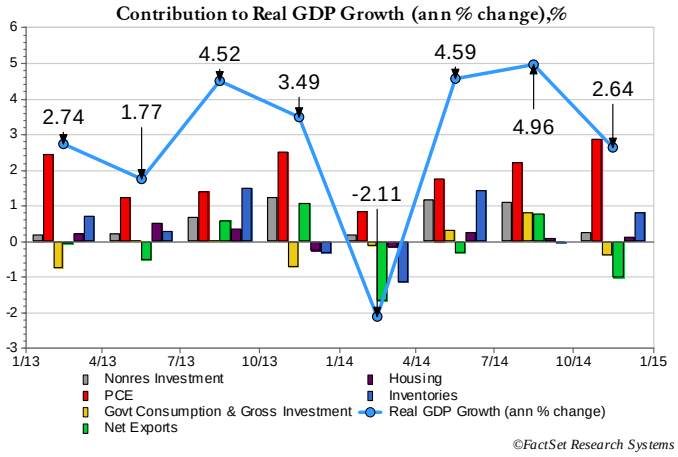
# Market Review

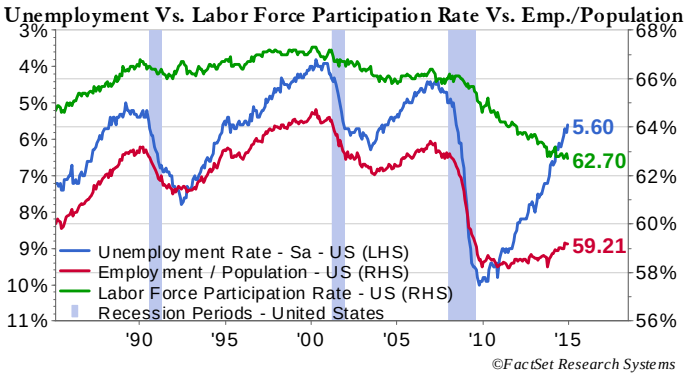
January 2015

## *Economic Review*

Fourth quarter GDP growth disappointed with a 2.6% advance estimate compared to economists' estimates of 3.2%. Personal consumption expenditure, which accounts for about 70% of demand in the U.S. economy, rose 4.3%. Inventories surprised to the upside adding 0.82% to GDP. Exports grew by 2.8%, a slowdown from the previous two quarters, as a rising US Dollar posed a challenge to U.S. exporters. Imports surged making trade a drag on GDP. Government spending was also lower, subtracting 0.4% from growth. Year-over-year (YoY), fourth quarter GDP grew by 2.5%, consistent with the below average post-recession performance.

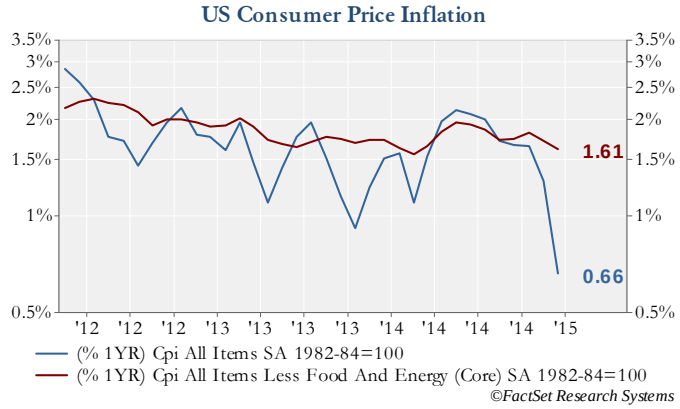



The unemployment rate declined 0.2% to 5.6% in December and fell 1.1% during 2014. Also in December, the civilian labor force participation rate edged down 0.2% to 62.7%, the lowest level since 1977, while the employment-to-population ratio was 59.2% for the third consecutive month. Total nonfarm payrolls increased by 252,000, exceeding most analysts' expectations. Job growth averaged 246,000 per month during 2014 compared to an average monthly gain of 194,000 in 2013.




Housing data was mostly positive in January. The S&P/Case-Shiller Home Price Index rose 0.74% month-over-month (MoM) on a seasonally adjusted basis during November and is up +4.3% YoY; the slowest increase since 2012. Existing home sales rose 2.4% MoM to an annualized rate (a.r.) of 5.04 million unites. Existing single-family homes accounted for the increase as multi-family units contracted. Existing housing inventory is the lowest in nearly two years and represents 4.4 months of supply at current sales levels. Housing starts increased 4.4% MoM during December to a.r. of 1.09 million. Building permits declined 1.9% during December.

The headline CPI declined 0.4% MoM in December and increased 0.8% YoY. The core CPI, which excludes food and energy costs, was unchanged in December and up 1.6% YoY. The inflation readings continue to reflect a benign inflation environment led by a stronger US Dollar and lower energy prices. Breakeven inflation also continued to decline. The 5 year/5 year forward breakeven inflation rate declined 7 bps, to 1.84%.




In a statement released after the January meeting, the Federal Reserve announced that it plans to keep short-term interest rates near zero until at least mid-year. The Fed supported their decision by noting 'solid' economic growth with 'strong job gains,' while acknowledging a recent fall in inflation and inflation expectations.

Eurostat's estimate of December inflation in the Eurozone was -0.2% year-over-year, marking the first time that consumer prices have fallen on an annual basis since October 2009. Weak headline inflation was driven largely by a sharp fall in energy prices, which have declined 6.3% over 12 months, while all other goods and services rose by 0.6%. A flash estimate of January prices showed acceleration in deflation; prices fell -0.6% in January year-over-year matching the record drop in July 2009, though core inflation (excluding food and energy) was slightly steadier

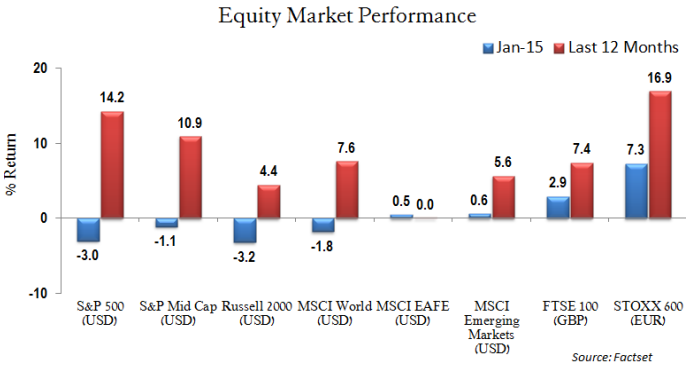
at +0.6%. In response, the European Central Bank (ECB) announced a stimulus program in which the bank would purchase €60 billion in bonds monthly through September 2016. The program is broken down into €10 per month of asset-backed bond purchases, with the balance of purchases in government and institutional bonds.

In the UK, the Office for National Statistics (ONS) released a flash estimate for the country's fourth quarter GDP growth at 0.5% quarter-over-quarter. This growth rate is lower than the previous quarter's 0.7% rate, and lower still than the second quarter's 0.9% rate. In annual terms, the UK economy grew 2.6% in 2014, driven by the services sector and consumer spending, with manufacturing and construction pulling down growth. The ONS also estimated the unemployment rate at 5.8%, as the number of jobless (1.91 million) stands at a six-year low. In addition, UK workers are enjoying real-wage growth, as wage growth (1.8%) is outpacing inflation (0.8%). The benign inflation and moderate growth environment has eased pressure on the Bank of England to raise rates, and the Monetary Policy Committee voted unanimously to hold rates steady at its latest meeting.

In Asia, the Chinese economy grew at its slowest pace in 24 years, growing 7.3% in the fourth quarter year-over-year, which was lower than the 7.4% expectation. China's economy has struggled to keep growth at historical levels, as property prices have cooled off and local governments deal with heavy debt loads and slowing investment. The World Bank and International Monetary Fund have predicted that China's growth will slow to 6.3% by 2016. January also saw significant central bank activity in Asia, as the Reserve Bank of India cut its benchmark interest rate to 7.75% from 8%, and the Reserve Bank of Australia (RBA) signaled that a rate cut was under consideration. (The RBA ultimately cut its benchmark rate in early February, and the People's Bank of China (PBOC) cut bank reserve requirements to spur growth).

## *Equity Markets*

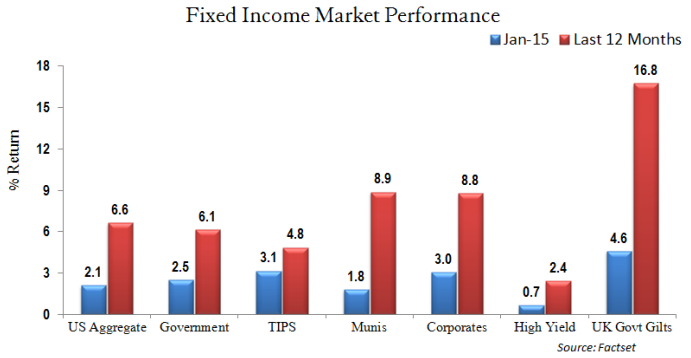
Global equities ended January mixed, as the MSCI World lost -1.8% for the month, though the index is up 7.6% over the last 12 months. Domestic large cap stocks, as measured by the S&P 500, lost -3.0% in January, as concerns about Europe, a tepid earnings season, and declining oil prices pushed stocks lower. Domestic mid-cap stocks, as measured by the S&P 400 returned -1.1%, while the Russell 2000 small-cap index finished the month down 3.2%. The headline indices for Europe (STOXX 600) and the UK (FTSE 100) gained 7.3% and 2.9%, respectively. The MSCI Emerging Markets index gained 0.6% in January, and is up 5.6% over the last 12 months.




The S&P 500 traded choppily in January, as the impact of falling oil and European deflation concerns weighed heavily on the market. After falling 3.2% over the first two weeks of the month, the index rallied back to flat by January 22, before losing 3% in the last 4 days of the month. Market volatility, as measured by the CBOE Market Volatility Index (VIX), finished the month higher, closing at 20.97, up from 19.20 at the end of December. The 20.97 monthly close is slightly above the long-run average of 20. Volatility of European stocks, measured by the Euro Stoxx 50 VIX Index closed January at 24.73, slightly lower than the 26.19 close in December.

## *Bond Markets*

January saw a continuation of last year's strong Treasury Bond Rally on global disinflationary concerns. Several central banks lowered official interest rates while the ECB announced alternative forms of accommodation. Long-term Treasury rates fell to historically low levels and credit spreads widened on weaker earnings, Greek election results and geopolitical risks. The Credit Index Option Adjusted Spread widened 7 bps in January, the sixth consecutive month of spread widening, to close December at +132 basis points.



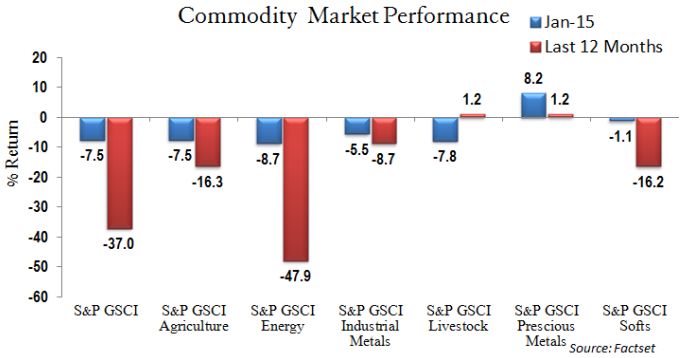

As in 2014, the 30-year U.S. Treasury bond yields continued to decline in January, falling 49 bps to close at 2.26%. The

10-year U.S. Treasury bond yields also fell 49 bps to close at 1.68% last month. The 30-year and 10-year Treasury yields declined 119 bps and 84 bps respectively during 2014. The UK 10-year benchmark gilt yields declined 42 bps to close at 1.33%. The yield on German 10-year benchmark bonds fell 27 bps to close at 0.27% in January.

## *Commodities*

The S&P GSCI Total Return Index, a headline index of 24 commodities, continued to slide in January, losing -7.5% in the month; the index has lost -37.0% over the last 12 months. Of the six major sub-indices, only the Precious Metals sub-index finished the month in positive territory, as global deflation and an accelerating energy price decline pushed commodity prices lower. The Precious Metals sub-index gained 8.2% in January, led by a 10.3% gain in Silver and an 8.0% advance in Gold. After bottoming at $1,140/oz in early November 2014, Gold has rallied $140 to close January at $1,283/oz.

The Energy sub-index added to recent losses, returning -8.7% in January, the sub-index has lost -47.9% over the last 12 months. West-Texas Crude Oil opened the month at $53.71/bbl and traded down most of the month, closing January at $47.85/bbl. The precipitous drop in Crude Oil prices has been driven by a stronger US Dollar and oversupply concerns; U.S. oil inventories stand at 406.7 million barrels, the highest level since 1924. The price decline in Crude has also called into question the staying power of the U.S. shale oil boom. Research by IHS Energy concludes that the breakeven price on Crude Oil for over half of U.S. shale producers is over $60/bbl and nearly 30% have a breakeven above $80/bbl. In addition, Bloomberg New Energy Finance estimated that the breakeven price is above $50/bbl in 37 of the 38 U.S. shale oilfields.

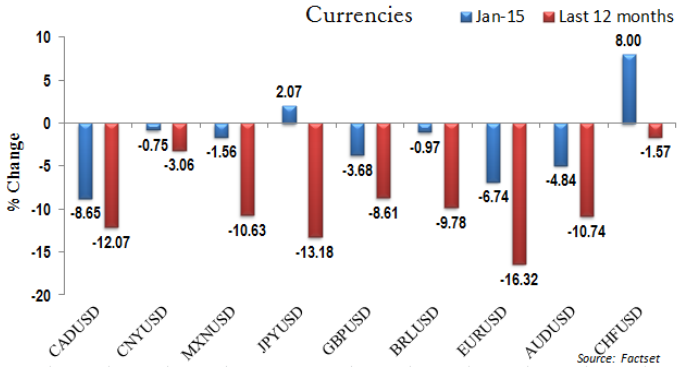



U.S. refining margins expanded in January, as Refined Products lost less than Crude Oil on average. Gasoline [-2.2%], Heating Oil [-5.4%], and Gasoil [-9.0%] all lost in January, but Crude Oil [-10.5%] and Brent Crude [-9.6%] declined more. The average price of gasoline in the United States dropped to $2.0691/gal, $1.2422 lower than the same period in 2014. 28 states now report average gasoline prices less than $2/gal.

## *Currency*

The US Dollar rallied for the seventh straight month against a basket of peers in January, boosted by global central bank actions, falling oil prices and expectations of higher domestic interest rates. The US Dollar Index appreciated 5.1% in January. USD appreciated 12.8% during 2014.

In a surprise move, the Swiss National Bank (SNB) stunned the markets in mid-January when it scrapped its three-year-old peg of 1.2 Swiss francs per Euro. In a statement, the bank stated that the Euro depreciated considerably against the US Dollar and this caused the Swiss Franc to weaken against the U.S. Dollar. In these circumstances, the SNB concluded that enforcing and maintaining the minimum exchange rate for the Swiss Franc against the Euro is no longer justified. The Swiss Franc rallied around 30% against the Euro and 25% against the US Dollar immediately after the announcement. The peg was introduced in September 2011 as a response to investors building big positions in Swiss Franc as a safer foreign exchange alternative to the Euro or the Dollar.




The Euro declined for the seventh month against the US Dollar on further monetary easing by ECB. The Euro declined -6.7% against the US Dollar to close at 1.128 USD/EUR. The British Pound depreciated -3.68% against the US Dollar in January to close at 1.50.