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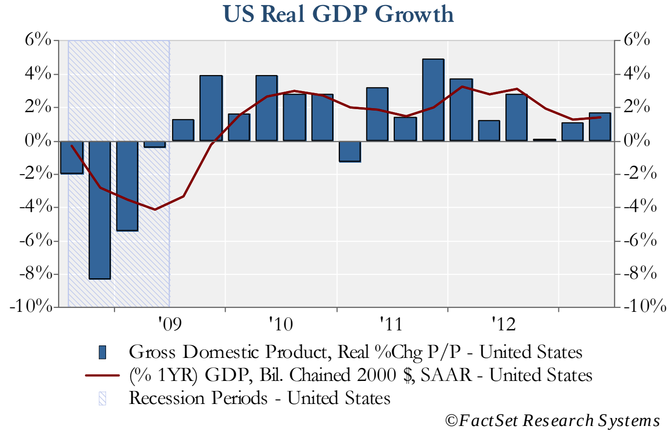
Market Review

July 2013

Economic Review

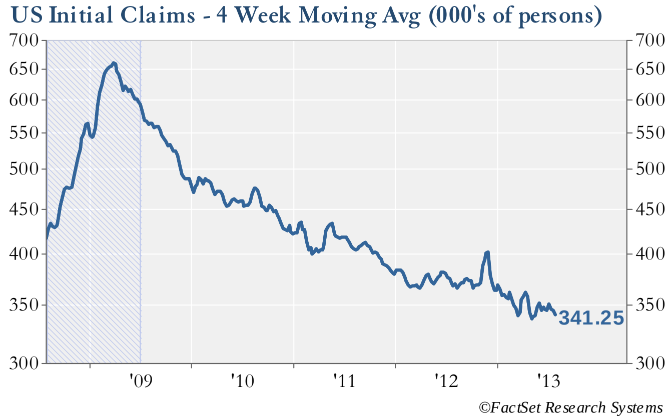
U.S. real GDP grew at an annual rate of 1.7% during the second quarter of 2013 according to the advance estimate. This was higher than the consensus forecast of 1%, but sluggish by historical standards. The increase in real GDP primarily reflected positive contributions from personal consumption expenditures, exports and non-residential fixed investment. Negative contributions came from federal government spending and imports. At the same time, first quarter real GDP growth was revised down to 1.1% from 1.8% (previously revised from 2.4% to 1.8%). Nominal GDP grew at an annual rate of 2.4% during the second quarter. It has been below 3% for four of the previous five quarters.

US Real GDP Growth



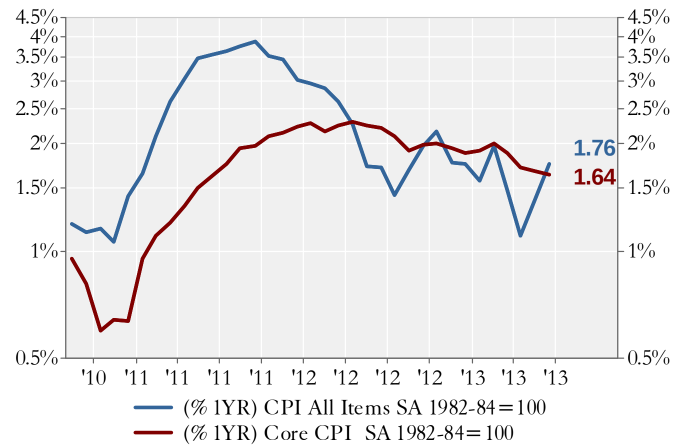
The U.S. labor market showed signs of improvement as number of jobs increased more than expected in June, while jobless claims remained near five-year lows in July. The economy added 195,000 jobs in June while the estimates for April and May were revised upward. The unemployment rate held steady at 7.6%, as increase in employment matched the increase in labor force. Weekly unemployment claims fell to a 66-month low of 326,000 during the last week of July. The less volatile, four-week moving average fell to 341,250.

US Initial Claims - 4 Week Moving Avg (000's of persons)



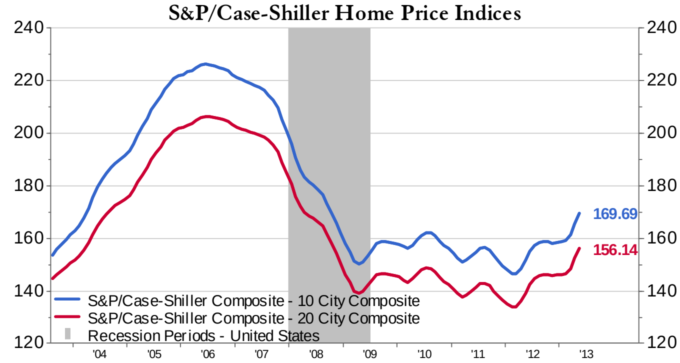
The Consumer Price Index (CPI) rose 0.5% in June, primarily driven by increases in energy prices. The CPI has increased 1.8% for the last twelve months. Core CPI (CPI ex food and energy) increased 0.2% month over month and 1.6% on a yearly basis. Personal Consumption Expenditures (PCE) rose 1.31% y/y in June compared to 1.07% increase in May. Core PCE (PCE ex food and energy), the Fed's preferred indicator for gauging inflation, increased 1.22% y/y. The 5 Year/5 Year forward breakeven inflation rate closed at 2.45% in July, 22 basis points higher than June.

US Consumer Price Inflation



Housing data were mixed in July and it is not yet clear what impact the recent increase in mortgage rates will have on the housing market. Home prices across 20 large U.S. cities grew by 1% in May, slightly below expectations of 1.3%, according to the S&P Case-Shiller Home Price Index. Home prices grew 12.2% year over year, the highest since May 2006. Monthly new homes sales grew 8.3% in June while existing home sales and building permits declined 1.2% and 7.5% respectively.

S&P/Case-Shiller Home Price Indices



The Federal Open Market Committee left monetary policy unchanged in July and noted that economic growth will pick up from its recent pace and the unemployment rate will gradually decline. After roiling the markets in June by stating that the Fed may taper asset purchases soon, Federal Reserve Chairman Bernanke tried to reassure investors during his recent testimony to Congress. Bernanke emphasized that current policy will be around for the foreseeable future and that the pace of asset purchases is not on a preset course and depends on economic and financial developments. He also acknowledged the current low inflation rate, growth-hampering fiscal policy, and high unemployment rate as obstacles to normalizing policy. The next Fed meeting is scheduled for September.

In Europe, the European Central Bank held interest rates unchanged at 0.5%, though ECB President Mario Draghi reiterated a willingness to further reduce rates if economic conditions warrant further stimulus. After shrinking 0.2% in the first quarter, Eurozone leaders are hoping to see a return to economic growth by the end of 2013 or early 2014. Recent economic data are showing a potential strengthening across the Eurozone. Though the overall unemployment rate held steady at 12.1%, the number of unemployed in the EU fell for the first time since April 2011. In addition, July's Manufacturing PMI Output Index rose to 52.3 from 49.8 in June, the largest monthly increase in output since June 2011.

UK inflation accelerated again in June, with the reading for annualized consumer price inflation rising to 2.9% from 2.7% the previous month. The Bank of England targets 2% inflation, and a 3% reading triggers a mandatory open letter from BOE Governor Mark Carney to the UK Treasury explaining the policy failure.

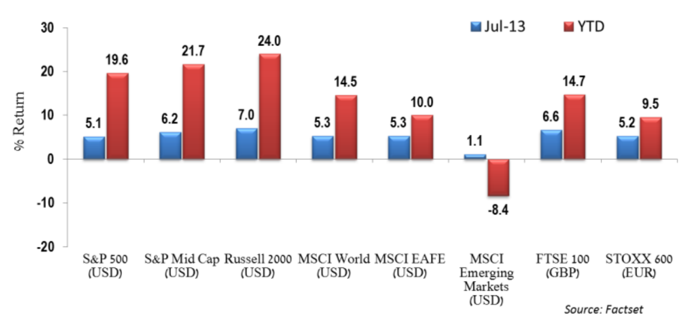
The HSBC China PMI fell to an 11-month low of 47.7 in July from 48.2 in June, and the employment sub-index posted the lowest reading since March 2009. The Chinese government has announced a series of infrastructure spending policies to boost output, as their economy continues to struggle with lack of foreign demand for exports from the U.S. and Europe. In Japan, the Bank of Japan held its accommodative policies in place, citing modest recovery on the horizon for the first time in over two years. Recent economic data show Japanese business and consumer confidence rising and a stabilization of consumer prices. Both are significant positives for advocates of "Abenomics", the aggressive stimulus measures championed by Japanese Prime Minister Shinzo Abe.

Equity Markets

Equity markets posted strong performance in July, as stocks continue to add to year-to-date gains. The S&P 500 finished July up 5.1%, and is up 19.6% thus far in 2013. Mid and Small Cap stocks performed even better, up 6.2% and 7%, respectively. International stocks were strong performers as well, as the MSCI World Index and the EAFE Index each gained 5.3%. Emerging Markets (EM) posted a positive month, though EM stocks continue to lag other indices; as the MSCI Emerging Markets Index is down 8.4% in 2013. The FTSE 100 and STOXX 600 indices, the main benchmarks for British and Eurozone stocks, gained 6.6% and 5.2% in July, respectively.

Stocks continue to be highly reactive to announcements surrounding the Federal Reserve's stimulus programs. After signaling a potential reduction of bond purchases by 2014, which sent markets down in June, Chairman Ben Bernanke sought to calm the markets in July. Equity markets reacted positively to reassurances that accommodative policy was not going away any time soon, and the guage of market volatility (measured by the VIX) fell to the lowest value since March 2013.

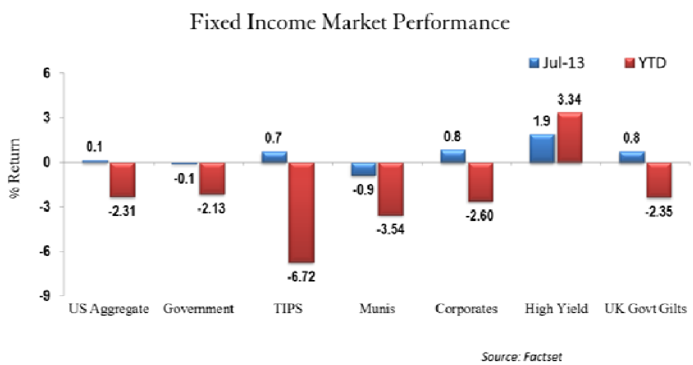
Equity Market Performance



Bond Markets

U.S. Treasury bonds declined for the third consecutive month on speculation that Fed will start scaling back its asset purchases. Unexpectedly strong payroll figures in early July, followed by Bernanke's dovish reassurances later in the month, pushed investment grade credit spreads tighter throughout July. Credit spreads retraced almost all the widening that happened in June and are nearly back to the tightest levels since the beginning of the year. According to Barclays U.S. High Yield Index, High-Yield bonds returned 1.9% in July and are up 3.34% for the year.

The Treasury yield curve steepened in July as two-year note yield fell 4 basis points, while the yields on the 10-year and 30-year U.S. Treasury bonds increased 9 and 13 bps respectively. The 10-year bond closed at 2.58% while the 30-year bond closed at 3.63%. The yield on German 10-year benchmark bonds declined 6 bps to close July at 1.67%. The yield on UK 10-year benchmark bonds declined 8 bps to close at 2.36%.



Commodities

The S&P GSCI Total Return Index, a gauge of 24 leading raw materials, gained 4.91% in July, as a continued rebound in energy prices and a sharp rally in precious metals led the Index higher. The Precious Metals sub-index, which remains down 23.9% in 2013, rallied 6.34% after announcements of further global stimulus. The Petroleum and Energy sub-indices each gained over 7%, as concerns about the impact of Egypt's civil unrest on the Suez Canal and general instability in the Middle East sent oil and refined product prices higher.

Gasoline posted the largest gain for any individual commodity, up 12% in July on instability concerns in the Middle East and an unusual drop in the supply of West-Texas Intermediate (WTI) crude oil. In addition to Gasoline, other refined products such as Heating Oil and Gasoil, posted strong gains in July. Gold rallied 7.11% in July, off 3-year lows to finish the month at $1,322/oz. Gold rallied after Ben Bernanke's latest testimony sent the US Dollar lower and fueled some renewed concern about future inflation. In addition, hedge funds increased net-long gold positions by 26% in July.

Corn posted the largest loss for any commodity, down 8.82% in July, after strong rains in the Midwest increased optimism about yield as the corn crop enters a crucial period in the growing season. Predictions for cooler than normal temperatures sent Natural Gas prices down 3.35%, the only energy-related commodity to post a negative month. Natural Gas power plants are used most frequently during peak electricity demand periods, such as hot summers, and the modest temperature forecasts have fueled speculation that power plant demand for Natural Gas will fall.

Currency

The US Dollar finished the month lower versus almost all major currencies except the Australian Dollar as market participants anticipate the Fed's monetary policy will remain accommodative. The US Dollar Index declined 1.66%, the most since October 2011, to close at 81.452. The Index is up 2.1% YTD. The Euro appreciated 2.15% against the US Dollar to close at 1.32785 USD/Euro. The British Pound was nearly flat against the Dollar for the second straight month, to close at 1.51605 USD/GBP.

The ongoing weakness in the Australian Dollar (down 13.6% YTD against the US Dollar) is primarily due to the slowdown in the country's mining and mineral sectors, reflecting the slowing growth in China. The Reserve Bank of Australia (RBA) cut interest rates to record lows in May to offset weakening business activity. The currency took a further hit towards the end of July on remarks by RBA Governors about weak business confidence and low inflation that signaled more simulative monetary action ahead.