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Market Review

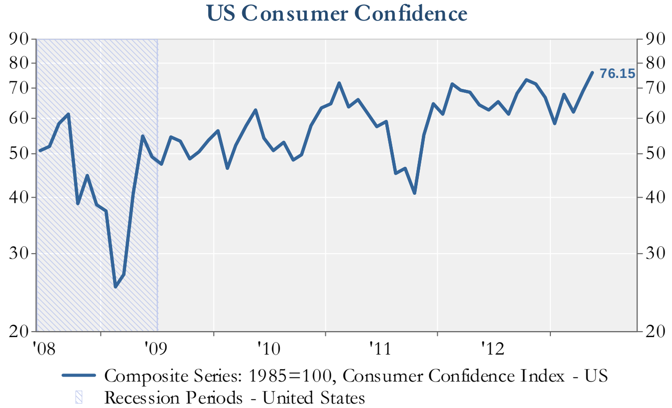
May 2013

Economic Review

Economic reports were mixed in May. Consumer confidence, home sales and labor markets posted better than expected data while industrial production, auto sales, personal spending and construction spending reports lagged expectations. The U.S. economy grew 2.4% during the first quarter of 2013, slightly lower than the initial estimate of 2.5%, but higher than prior quarter's 0.4%. Business inventories and exports grew slightly less than previously reported. Wall Street estimates for second quarter GDP are in the 1.0% to 2.0% range.

The Conference Board's Index of Consumer Confidence increased to 76.2 in May, up from a revised 69.0 in April and well above the consensus estimate of 71.2. University of Michigan's Consumer Sentiment Index surged to 84.5, its highest level in six years. The unemployment rate continued to inch downward in April and reached its lowest level since December 2008. According to the Bureau of Labor Statistics, the unemployment rate dipped to 7.5%, as Non-farm payrolls increased by 165,000 in April, slightly above the consensus estimate of 161,000.

US Consumer Confidence

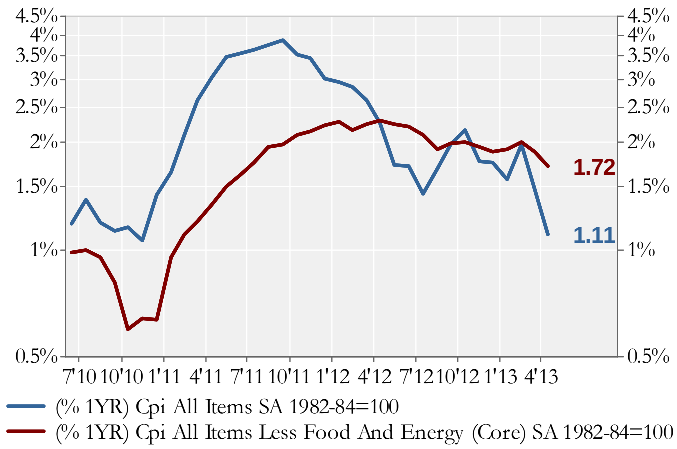


Data on the housing market continued to show improvement. March home prices, as measured by the S&P Case-Shiller 20 City Index were up 10.9% year over year, the strongest growth in seven years. New home sales rose 2.3% while sales of existing homes increased 0.6% for the month of April. Housing starts fell 16.5% in April 2013, but were 13% higher compared to last April.

Manufacturing data was mixed in May. Durable goods orders gained 3.3% after a sharp decline in the previous month. Chicago Purchasing Manager survey climbed to 58.7 in May from 49 in April, the largest increase in thirty years, and beating analysts' estimate of 50. However, other regional manufacturing reports (Federal Reserve's Empire State and Philly Fed manufacturing surveys) showed general business conditions declining during the month. Retail sales rose a seasonally adjusted 0.1% in April. Consumption declined 0.2% in April, with personal income flat and outlays for energy and goods and services falling.

The monthly Consumer Price Index (CPI) declined for the second straight month on falling energy prices. The CPI declined 0.4%, the most since December 2008 while the year over year increase was a mere 1.1%. The monthly Core CPI (CPI ex food and energy) increased 0.1%, while the year over year CPI increased 1.7%. The 5 Year/5 Year Forward Breakeven inflation rate declined nearly 30 basis points to 2.5%.

US Consumer Price Inflation



The Federal Reserve announced that it would hold the short-term rates at record lows and continue its bond purchases. However, according to a statement issued at the end of the meeting, the Fed is "prepared to increase or reduce the pace (of asset purchases) as the outlook for the labor market or inflation changes". Federal Reserve Chairman Ben Bernanke's congressional testimony substantiated market expectations that the Committee could reduce the pace of purchases on evidence of sustained economic improvement.

The final fourth quarter 2012 GDP estimate for the Eurozone showed contraction of 0.2% with 9 of the 17 member-countries currently in a recession. This is the longest ever recession for the European Union and the six consecutive quarters of contraction in the EU surpasses the length of the financial crisis in 2008-2009. Unemployment across these 17 countries ticked up again, setting a record-high for the third month in a row. Eurozone unemployment now stands at 12.2%, up from 12.1% in March. Recent data does not signal any relief in the near future; the Eurozone Purchasing Managers' Index (PMI) for the manufacturing sector registered 47.7 in May, signaling further contraction.

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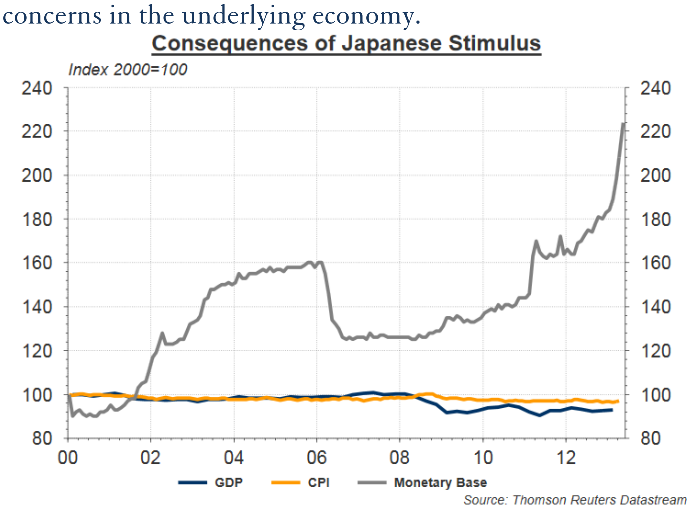
The HSBC PMI for China fell to a 7-month low of 49.6, indicating the first contraction in Chinese manufacturing since October 2012. Chinese factories remain saddled with excess capacity as the country faces weak export demand from the softening economies in the U.S. and Europe. The Organization for Economic Cooperation and Development (OECD) cut its 2013 growth forecast for China from 8.5% to 7.8%, indicating that the government may need to provide additional stimulus to meet its internal growth targets. The government, however, seems reluctant to do so, as there are growing fears of accelerated credit expansion and a property bubble forming in Chinese real estate.

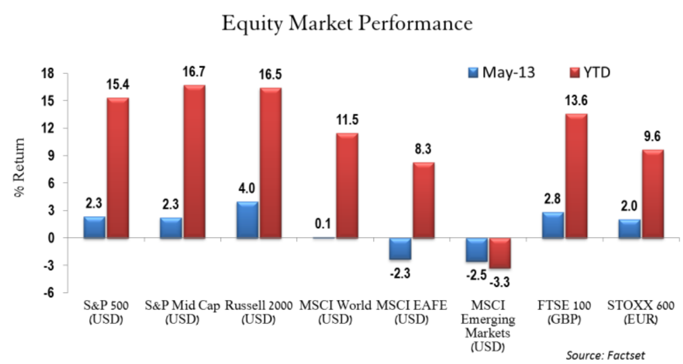
The Japanese economy is seeing some signs of increased growth as a result of aggressive stimulus policies from the Bank of Japan and Prime Minister Shinzo Abe. Japan's GDP grew at an annualized rate of 3.5% in the first quarter of 2013, led higher by increased exports on the back of a weaker Yen. Though this points to a potential uptick in the Japanese economy, taming deflation has proven more elusive. Inflation readings last month showed a year-over-year deflation of 1.2%, though some economists expect price declines to ease gradually as the weakening of the Yen drives prices for domestic goods higher. Capital expenditures by companies in Japan have fallen for five consecutive quarters, showing continued fundamental concerns in the underlying economy.



Equity Markets

May continued the winning streak for domestic equities, as the market added to the impressive returns thus far in 2013. The S&P 500 finished May up 2.3%, though intra-month gains climbed as high as 5.6%, and the index is up 15.4% year-to-date. U.S. Small Cap stocks posted an even better month in May, reversing April's losses and finishing with a gain of 4%. Emerging Markets continued to struggle, as the MSCI Emerging Markets Index lost 2.5% in May and has lost 3.3% this year. The FTSE 100, the main benchmark for British stocks, posted a strong 2.8% gain in May, extending YTD gains to 13.6%. Eurozone stocks, measured by the Stoxx 600 Index, advanced 2.0% in May, though European stocks continue to lag other developed market equity indices in 2013.

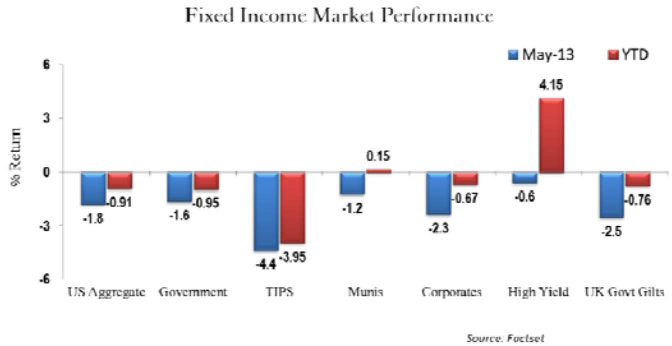
Stock markets fell into a noteworthy paradigm in May, as investors continued to weigh the possible ramifications of a gradual reduction in bond buying by the Federal Reserve. As additional easing has been positive for stocks, the belief persisting in the market is that a tapering of stimulus programs by the Fed could have a painful impact on stock and bond markets. More recently, this led to a market dynamic that would react unfavorably to good news, as positive economic data spurred worries about a reduction in the Fed's market participation. Conversely, the market received negative economic data in a more favorable light due to expectations of further stimulus.



Bond Markets

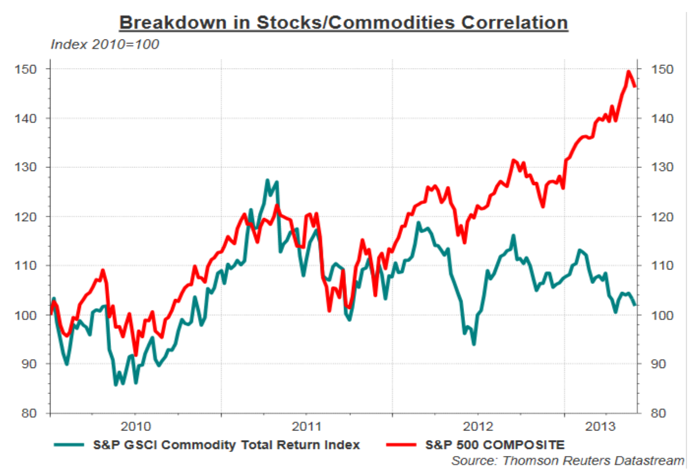
U.S. Treasury yields increased sharply in May on: rumors of potential tapering of asset purchases by the Federal Reserve, some better than expected U.S. economic reports, and aggressive monetary and fiscal policies in Japan. The 30-year Treasury bond yield saw the largest monthly increase since December 2009. Real interest rates rose, while the break-even inflation rate fell. Ten-year treasury yields spiked 48 bps. Credit spreads were unchanged in May, but investment grade fixed income posted a negative 2.3% return due to higher general interest rates. High yield bonds lost 0.7% in May, the first negative month since May 2012.

Yields of the 10 year and 30 year U.S. Treasury bonds increased 48 bps and 41 bps to close at 2.16% and 3.3% respectively. The 30/2 yield curve steepened 31 bps. The German 10-year benchmark bond yield climbed 28.8 bps to close May at 1.50%. The yield on UK 10-year benchmark bonds increased 31.5 bps to close at 2.00 %.



Commodities

The S&P GSCI Total Return Index, a gauge of 24 leading raw materials, lost 1.5% in May as falling energy prices and a continued bear market in precious metals dragged the Index lower. The loss in May extended YTD losses for the headline index, as the GSCI has lost 5.66% thus far in 2013. The Industrial Metals sub-index was the only positive GSCI sub-index in May, adding 2.62% on the month to reduce year-to-date losses to 9.57%.

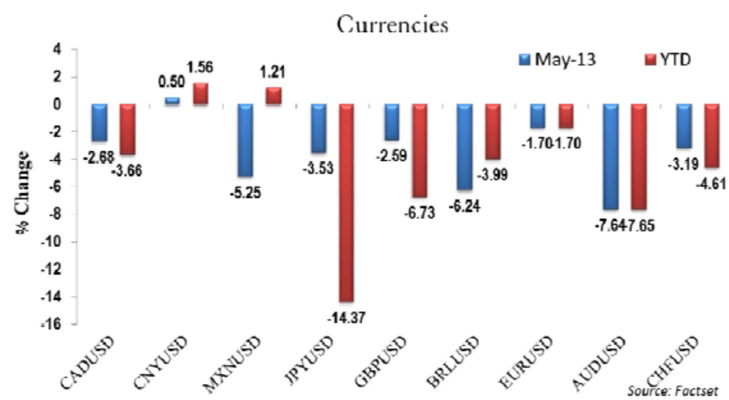


Natural Gas posted the largest loss for any individual commodity, down 9.42% for the month, as increased supply pushed prices lower. Silver and Gold added to their bear market losses, down 8.03% and 5.47%, respectively. Dampened global inflation expectations coupled with the prospect of reductions in stimulus by the Federal Reserve have increased price pressure on Precious Metals. Coffee and Sugar continued to decline, as global oversupply concerns have pushed prices lower in 2013 by 14.97% and 15.19% respectively.

Industrial Metals, such as Lead, Zinc, and Aluminum, all posted gains in May, amid calls for increased infrastructure spending in China and signs that the U.S. housing market is rebounding. Soybeans added 7.93% in May, as lengthening planting delays and excessive rain are driving concerns about the next harvest's output. Lean Hogs prices rallied into the end of the month after an announced acquisition of Smithfield Foods (SFD), the largest U.S. hog producer, by a Chinese conglomerate and an increase in feed prices increased the costs.

Currency

The US Dollar Index increased about 2% in May, the best monthly performance since February, to close at 83.375. The Japanese Yen posted its eighth straight month of losses against the USD, declining 3.5% in May and is now down 14.4% for the year. The Euro weakened against the Yen and the US Dollar, hurt by record euro-zone unemployment and low inflation. The Euro depreciated 1.7% against the US Dollar to close at 1.3184 Euros/USD, the same level it opened the year. The British Pound depreciated 2.6% against the Dollar, the most in three months, to close at 1.5161 GBP/USD. The New Zealand and Australian Dollars fell 7% and 7.6% against the USD respectively as Reserve Bank of New Zealand took steps to curb its currency strength and the Reserve Bank of Australia cut interest rates.



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