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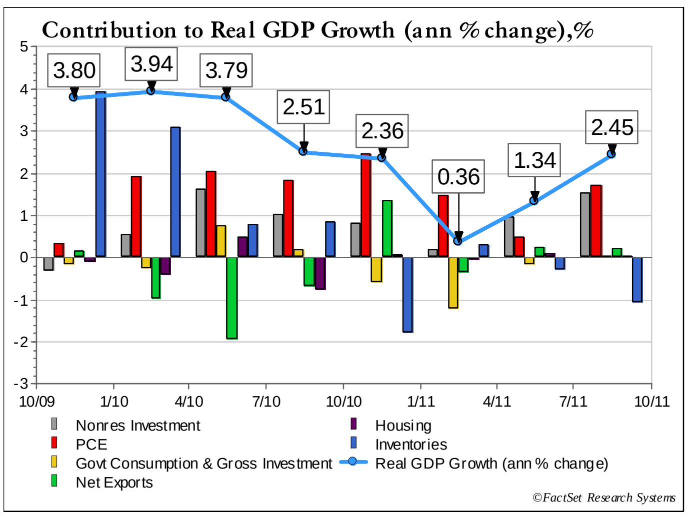
Market Review

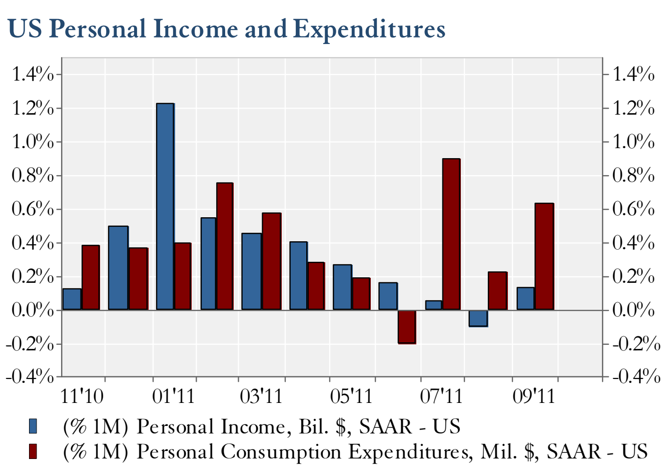
October 2011

Economic Review

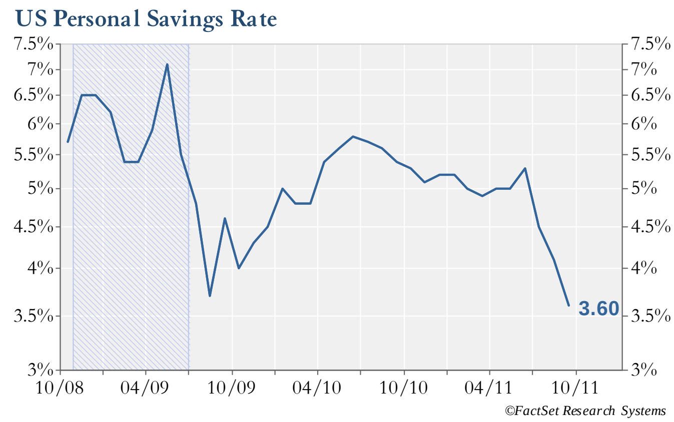
Led by personal consumption, the U.S. economy picked up pace during the third quarter, growing at 2.5%, above the consensus estimate of 2.4%, according to the advance estimates released by the Bureau of Economic Analysis. With this rise, real GDP is now just above the previous high set in 2007. Personal consumption expenditure (PCE) (red bar in the chart below) contributed 1.72 percentage points to the third quarter GDP, up from a 0.5 percentage point contribution during second quarter. Non-residential investment (grey bar) and net exports (green bar) also contributed positively to the GDP while inventories contracted. Real final sales – GDP less changes in private inventories – increased 3.6%.



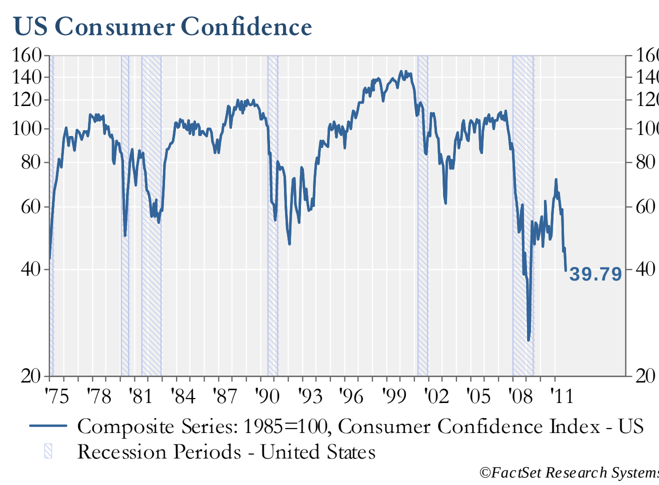
Consumer spending surged during the third quarter but income growth remained sluggish as can be seen in the graph below. The consumer had to draw from savings rather than rely on higher wages to support the spending. This is unsustainable in the long term.



Personal savings, as a percentage of disposable personal income, fell from 5.3% in June to 3.6% in September, the lowest level since June 2008.



Job growth is the key to long term consumer spending. The U.S. unemployment rate was little changed at 9 percent in October. The Conference Board Consumer Confidence Index dropped to 39.8 during the same period, the lowest number during a non-recession period and significantly below the consensus estimate of 46. The October ISM manufacturing came in at 50.8, below the estimate of 52 and indicating an expansion for the 27th consecutive month. The weaker number was primarily driven by a decline in prices and inventories and increase in new orders. The ISM non-manufacturing was at 52.9%, down slightly from 53% in September. A number above 50 indicates an expansion.



The September Federal Reserve minutes revealed that the Fed remains dovish. In separate speeches during October, Fed officials Janet Yellen and Daniel Tarullo each called for more balance sheet expansion, likely hinting at more easing in near future. On Nov 2nd, the Fed lowered the forecasts for U.S. growth and raised their forecasts for unemployment for the next two years.

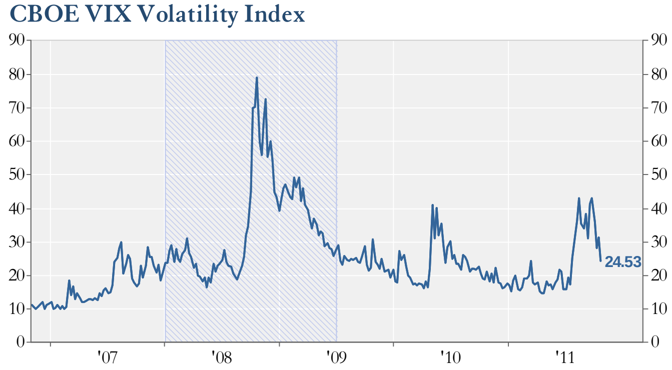
The EU leaders struck an agreement at the 14th Euro Summit on October 26th aimed at addressing the Eurozone sovereign debt problems. The deal, which lacked details, included a "voluntary" 50% haircut on Greek debt held by the private sector, an increase in European banks' tier 1 capital ratios to 9% by June 2012 and introduced the concept of levering the EFSF four or five times in order to provide up to one trillion Euros, an amount the politicians felt was sufficient to ring-fence Greece and prevent further contagion. The equity markets rallied immediately after the announcement, but the European credit markets did not seem convinced as Italian debt spread over German bunds continued to widen.

Equity Markets

Expectations of a comprehensive solution to solve the European debt crisis, better than expected economic data and strong corporate earnings increased investor risk appetite, contributing to a rebound in global equity markets after five months of losses. The S&P 500 Total Return Index surged 10.93% in October, the best monthly gain in nearly two decades and is now up 1.30% for the year.

The downgrade of Italian and Spanish sovereign ratings by Moody's and Fitch and lack of clarity on further financial assistance to Greece added to investor's concerns at the start of the month. The S&P 500 continued to slide through Oct 3rd, closing at 1099.23 – nearly a 20% decline since the April peak as CBOE VIX Index climbed above 45. Then, the market made a dramatic 4% reversal near the closing hour of October 4th, with banking stocks leading the rebound, on rumors of a broad recapitalization plan for European Banks. The S&P 500 continued to rally almost uninterrupted during the following three weeks. On October 27th, the index surged 3.43% on the announcement of a deal in Europe and a decent GDP number.

CBOE VIX Volatility Index



Small cap stocks outperformed large and mid-cap stocks after lagging for five consecutive months. The Russell 2000 Index grew 15.14%, but is still down 4.46% for the year. The S&P Midcap Index was up 13.75%, trimming the year's loss to -1.06%.

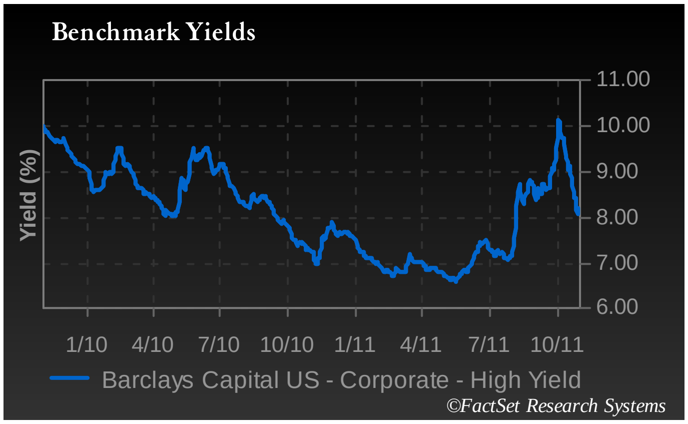
Measured in US Dollars, the MSCI World Index rose 10.37% last month and is now down 2.68% for the year. The MSCI EAFE Index rallied 9.65% in October. The MSCI Emerging Markets surged 13.26% and is down 11.27% for the year. Measured in their local currencies, the FTSE 100 and STOXX 600 indices gained 8.20% and 7.72% respectively. In 2011, the FTSE 100 has declined 3.25%, while the STOXX 600 has fallen 9.32%.

Bond Markets

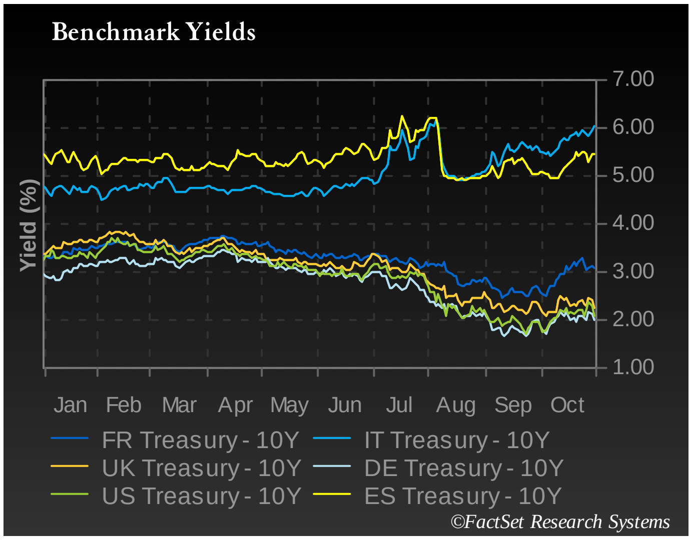
Corporate bond spreads narrowed in October as U.S. Corporate bonds outperformed Treasuries. The U.S. bond market, as measured by the Barclays Capital U.S. Aggregate Index, edged up 0.11% in October and is up 6.76% for the year.

U.S. Government bond yields fell sharply with the 10 year Treasury bonds losing 15 basis points on the first day of the month, as no decisive action was coming from the policymakers in Eurozone. The Federal Reserve also purchased long dated bonds which likely gave an extra boost. During the next three weeks, Treasuries retreated, while the corporate credit market (especially high yield bonds) rallied. Treasury yields peaked on October 27th with the 10 year Treasury bonds closing at 2.4, in reaction to the agreement reached between Eurozone members. Treasury yields snapped back during the final two days with the 10 year Treasury bond yields dropping 29 bps.

For the month, 10-year Treasury yields increased 20 basis points to close at 2.11%, while 30-year Treasury yields increased 21 bps to close at 3.13%. The Barclays Capital U.S. Aggregate Government Treasury Index declined 0.82% in October and is up 7.96% for the year. Corporate debt spreads narrowed, with Barclay Capital U.S. High-Yield Index rising 5.99%, the biggest gains since July 2009.



The UK 10 Year GILT yield stayed nearly flat for the month, closing at 2.28%. The yield on the German 10 Year Bunds increased 12 bps during October, to close at 2.02%. Sovereign bond markets did not support the equity rally as Eurozone sovereign bond spreads (vs. German debt) continued to widen throughout the month.



Currency

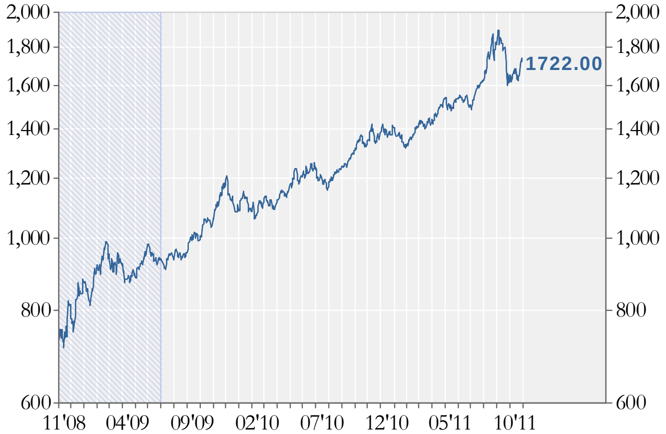
The US Dollar Index, used to track the US Dollar against a basket of six currencies, fell 3.04% in October after rallying for two consecutive months. The Index is now down 3.62% in 2011. The Euro climbed 3.1% against the Dollar closing at 1.3851 USD/EUR while the Pound climbed 3.48% to close at 1.6064 USD/GBP in October.

Commodity Markets

Commodities rallied along with other risk assets in October after U.S. economic data improved. Led by Energy and Metals, the S&P GSCI Commodity Index delivered 9.8%, the best return since May 2009. The index is down 0.5% for the year. The Dow Jones UBS Commodity Index climbed 6.62% in October and is down 7.9% for the year.

Crude oil led all commodities, advancing 17%. This is the biggest monthly gain since May 2009. Silver and Copper also made strong gains, rising 14% each while Gold rallied 6.3%.

Gold (US$/Troy Oz)



Live cattle, Natural gas and Coffee were among the worst performing commodities in October losing 3.3%, 0.9% and 0.8% respectively.