VANTAGE CONSULTING GROUP
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Market Review

October 2013

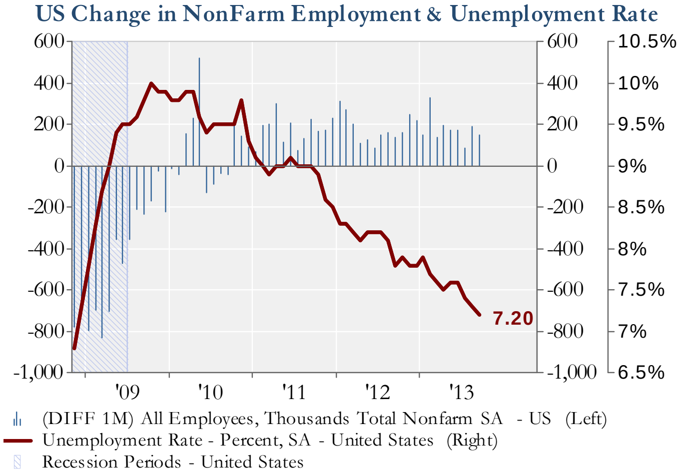
Economic Review

October headlines were dominated by political brinkmanship in Washington which led to a partial government shutdown and near technical default on U.S. government debt. The shutdown left roughly 800,000 federal workers on furlough during the first half of October. President Obama signed a measure on October 17th that funds the Federal government through mid-January 2014 and lifts the debt ceiling through the first week of February 2014. This allowed the government to reopen after a sixteen-day shutdown. Several key economic reports were delayed due of the shutdown.

U.S. third quarter real GDP grew at an annual rate of 2.8%, according to the advance estimate from the Commerce Department, above the consensus forecast of 2.3%. This is the quickest pace in a year after expanding at 2.5% in the second quarter; however, inventory accumulation added a hefty 0.8% to the third quarter growth while consumer spending, which accounts for roughly 70% of US economic activity, expanded at only 1.5%, the slowest since second quarter of 2011. This may mean that some of the inventory accumulation by corporations was due to weaker demand in the current period. Economists at Goldman Sachs lowered their fourth quarter GDP estimate to 1.5% from their prior estimate of 2% on the faster pace of inventory accumulation in third quarter.

The U.S. unemployment rate continued to move downward, reaching 7.2% in September, the lowest since November 2008. However, nonfarm payrolls increased at a much slower pace than anticipated. A total of 148,000 jobs were added during September, well short of the expected number of 180,000.

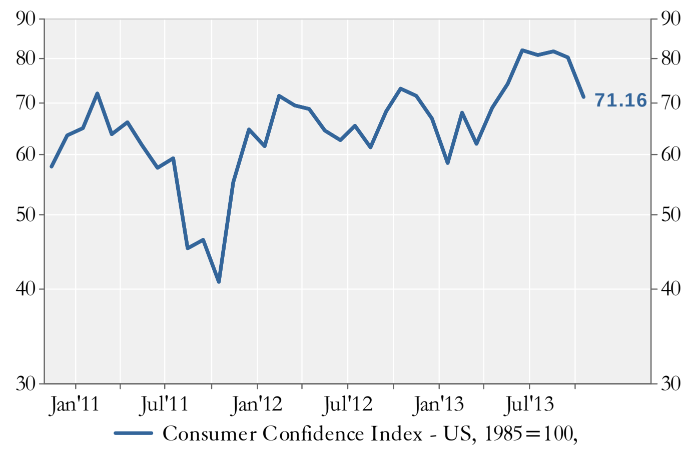
US Change in NonFarm Employment & Unemployment Rate



ISM manufacturing data continued to show strength in domestic manufacturing. The index rose to 56.2, the highest level since April 2011 and topping the consensus expectation of 55. The previous month's reading was 55.7. The ISM non-manufacturing index fell to 54.4 from 58.6 the month prior and below the consensus estimate of 57 as service industries grew at a slower pace. A pace above 50 indicates expansion.

Consumer confidence fell to a six-month low in October. Led by an increase in aircraft orders, durable goods orders rose 3.7%, more than the 3.0% expected in September. Industrial production and capacity utilization were both higher than expected. Retail sales meanwhile, fell 0.1% in September as auto sales declined 2.2%. Retail sales (ex-auto sales) increased 0.4%.

US Consumer Confidence



The Consumer Price Index rose 0.2% in September, primarily due to increases in energy and housing prices. The year over year (YOY) CPI rose 1.2%, its lowest level in almost 3 years. The core CPI rose 0.1% in September, less than 0.2% expected, while the YOY CPI rose 1.7%, less than the 1.8% expected. The 5 year/5 year forward breakeven inflation rate was approximately 5 basis points lower at 2.41%.

The S&P/Shiller 20-City Composite Index rose 13% year over year in August, the fastest pace since early 2006. Existing Homes sales declined 1.9% in September to a seasonally adjusted annual rate (SAAR) of 5.29 million as sales of both single family and multi-family units declined, after August Existing Home sales saw the highest annualized sales figures in three years. Data on New Home sales iss delayed to early December due to the government shutdown.

The Federal Open Market Committee (FOMC) left the monetary policy unchanged, citing recent slowing of the housing recovery. Market participants were expecting the FOMC to insert language that addressed the impact of the government shutdown and ongoing fiscal crisis on the economy. The FOMC included the following in its statement: *"taking into account the extent of federal fiscal retrenchment over the past year, the Committee sees the improvement in economic activity and labor market conditions since it began its asset purchase program as consistent with growing underlying strength in the broader economy. However, the Committee decided to await more evidence that progress will be sustained before adjusting the pace of its purchases".* The market interpreted this statement as hawkish and believed it left room for a possible taper announcement in the December or January meetings. President Obama nominated Federal Reserve Vice-chair Janet Yellen to replace Ben Bernanke when the Chairman's term concludes on January 31st.

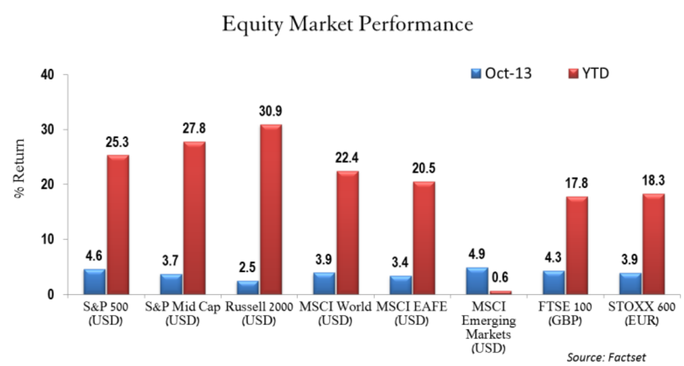
The Bank of Japan raised its forecast for 2014 GDP growth to 1.5% and kept core consumer inflation expectations unchanged at 1.3%. The Japanese economy is showing signs of improvement in recent months, as manufacturing activity and factory output grew at the fastest pace in several years. Many economists, however, see these projections as optimistic given the Japanese government's plan to enact a 5% hike in the country's sales tax. In addition, Japan is significantly behind the stated goal of wage inflation, as wages have risen only 0.1% over the last 12 months. In China, the official government GDP estimate for the 3rd quarter showed 7.8% growth, driven by stronger foreign demand and domestic retail sales. An Economic Information Daily report, however, has asserted that the government's figures overstate the size of the economy by as much as 8.5%.

Second quarter GDP growth in the European Union was revised down to 0.3%. Growth in the second quarter was driven by improved household consumption and better than expected private investments. On a more concerning note, a report was issued in October that showed Eurozone public debt had crossed 90% of GDP in 2012, with Greece, Italy, Ireland, and Portugal all recording public debt above 100% of GDP. In addition, the jobless rate across the Eurozone hit an all-time high of 12.5%, with official youth-unemployment in Greece and Spain hitting more than 50%. Inflation also fell to 0.7%, the lowest rate in four years.

Equity Markets

Equity markets continued to rally in October as the government shutdown ended and the debt ceiling was raised. The S&P 500 reached an all-time high in late October and ended the month up 4.6%, the most since July. All ten sectors were in positive territory led by Telecom, Consumer Staples, and Industrials. European indices fared better than Asia with the FTSE 100 & STOXX 600 returning 4.3% and 3.9% respectively. The MSCI World index climbed 3.9% during October and is now up 22.4% for the year.

Stock markets were volatile during the initial days of October with investor sentiment driven by political developments. The S&P 500 was down 1.5% for the month through October 9th when President Obama nominated Yellen as the new Fed chair. Then the S&P 500 rallied 6.1% as investors welcomed the choice of new Fed Chair and lawmakers reached an agreement to reopen the government. Anticipation of further delays in Fed tapering due to a weak payroll report as well with generally positive reception of third quarter earnings reports, helped push equity markets in the latter half of the month.



Bond Markets

U.S. Bond markets, as measured by Barclays U.S. Aggregate, were up 0.8% in October. The bond market reacted positively to the end of the partial federal government shutdown and the extension of the U.S. debt ceiling. The shutdown and debt ceiling negotiations had a significant impact on the treasury yield curve; the yield on 30-day T-bills rose from 1 bps to peak at 34 bps, which was higher than the yield for a 1-year note. After lawmakers reached a debt ceiling agreement, the 30-day yield fell back to 1 bps. Bond markets stabilized after the Federal Reserve stated the desire to see more evidence of a recovery before announcing a reduction in bond purchases.

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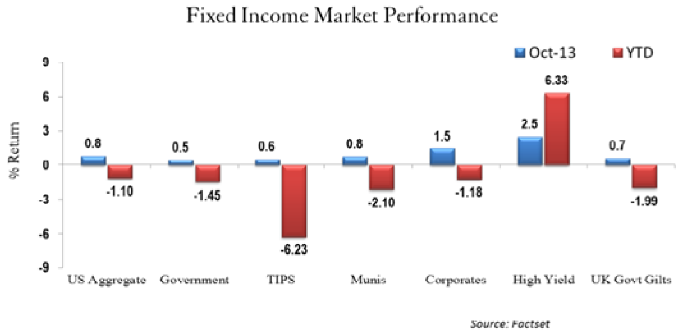
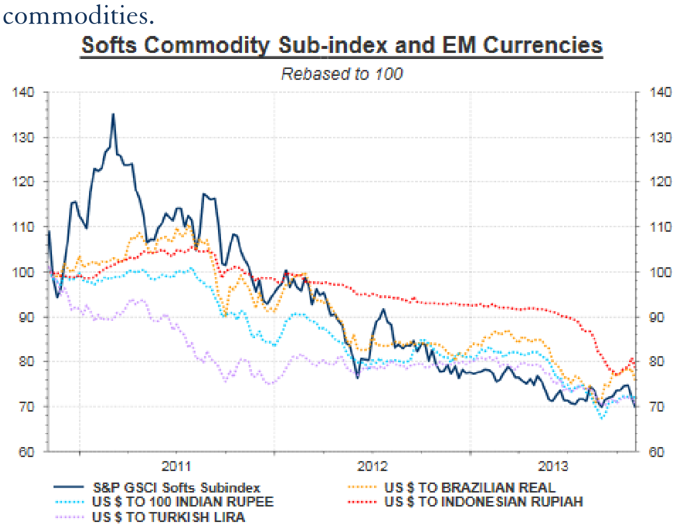


Yields on the 10-year and 30-year U.S. Treasury bonds declined 5.2 bps and 4.5 bps, respectively. The 10-year bond closed at 2.56% and the 30-year bond closed at 3.64%. The yield on German 10-year benchmark bonds declined 11 bps to close October at 1.67%. The yield on UK 10-year benchmark bonds declined 9 bps to close at 2.45%. High-yield credit spreads, measured by the Bank of America Merrill Lynch US High Yield Master II Option-Adjusted Spread, tightened 47 bps in October to close at 4.36%.

Commodities

The S&P GSCI Total Return Index, a gauge of 24 leading raw materials, lost 1.14% in October. Nearly every sub-index finished the month with a loss. Only the Livestock and Industrial Metals sub-indices posted monthly gains. The indices representing Agricultural and Softs, which tracks crops such as coffee, sugar, and grains, had the largest losses in October, down 2.47% and 4.29% respectively. These commodities are more sensitive to both inflation and emerging market demand. Global inflation has remained tame, and emerging markets, specifically China, continue to soften, dampening the outlook for Agricultural and Soft commodities.



The Industrial Metals were among the strongest individual commodities in October; Nickel advanced 4.58%, Lead gained 2.96%, and Zinc added 1.27%. Industrial Metals, as well as other growth oriented asset classes, have rebounded on optimism for global growth. Cotton was the worst performing individual commodity in October, losing 11.5% to erase nearly the entirety of year-to-date gains. Coffee lost 7.3%, continuing a steep slide in 2013 during which the commodity has lost over 31%. Crude Oil lost 5.69% after a report indicating that supply has been increasing for six straight weeks.

Currency

The US Dollar Index, a measure of the Dollar against six trading partners, was down modestly in October after touching its lowest level since first week of February. The US Dollar rallied immediately after the FOMC meeting as its statement was interpreted to be more hawkish than markets were expecting. The Dollar Index closed at 80.2 and is up 0.5% for the year. The US Dollar had gained strength and reached a 3-year high on July 9th and has since weakened over 5%.

The Malaysian Rand rallied 3.3% against the US Dollar, the biggest gainer amongst sixteen trading partners. The Canadian Dollar depreciated 1.43% against the US Dollar. The Euro climbed 0.43% against the US Dollar to close at 1.3595 USD/Euro and the British Pound declined 0.8% against the US Dollar to close at 1.6066 USD/GBP.