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Market Review

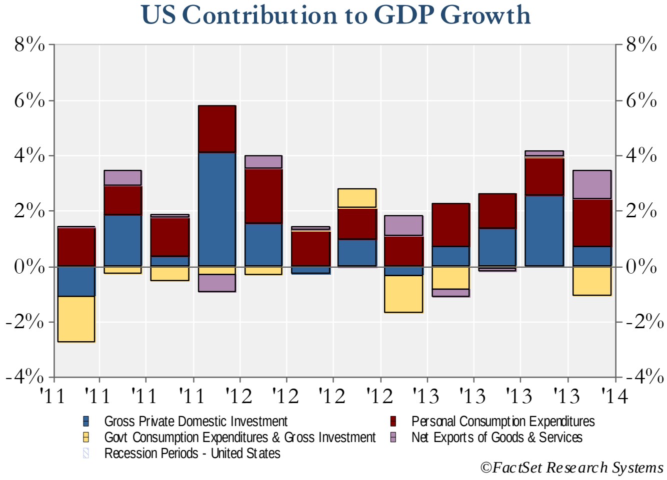
February 2014

Economic Review

Economic reports released in February were generally weaker than expected. Market commentators primarily attributed the weakness to extreme winter weather. Many of these reports also made significant downward revisions to November and December data, indicating a lower positive momentum towards the end of the year.

The Bureau of Economic Analysis (BEA) revised fourth quarter 2013 real GDP lower to 2.4%, from the original estimate of 3.2%. Real GDP growth in the fourth quarter came principally from personal consumption expenditures, exports, nonresidential fixed investment, and private inventory investment. These positive contributors were partly offset by negative contributions from federal government spending, residential fixed investment, and state/local government spending. The economy expanded 1.9% in 2013 compared with an increase of 2.8% in 2012. First quarter 2014 GDP is now expected to be in the 1.0% to 2.0% range.

US Contribution to GDP Growth



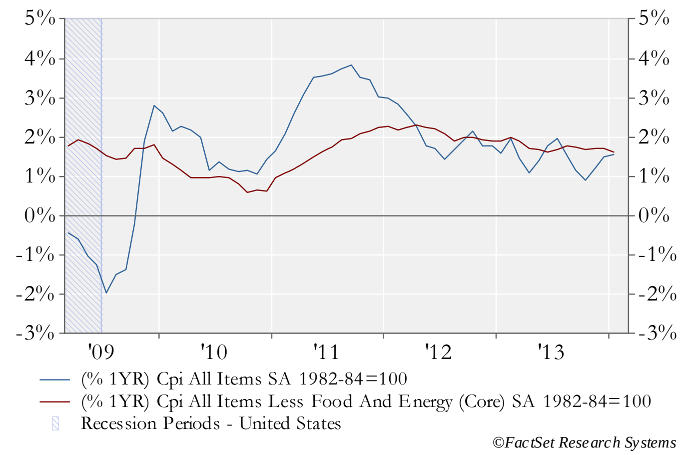
Nonfarm payrolls increased by 113K, more than December's 75K, but well below expectations of 185K. The pace of job growth over the past three months has slowed to 154K. The unemployment rate decreased 0.1% to 6.6%, the lowest level since October 2008. The labor-force participation rate rose to 63% from 62.8%. The U6, a broader measure of unemployment, fell to 12.7%, down from 13.1% in December.

Manufacturing data in U.S. generally showed signs of slowing. ISM's manufacturing index fell more than 5% to 51.3 as new orders declined by 13.2%. Industrial production dropped 0.3% vs. an estimate of 0.2% gain. Capacity utilization dropped to 78.5 from 78.9. Durable goods orders excluding the volatile transportation sector rose 1.1%, the largest increase since May after falling 1.9% in December.

Consumer confidence fell to 78.1 in January from a downwardly revised 79.4%. Retail sales missed expectations as it fell 0.4%, causing some economists to cut their forecasts for first quarter GDP growth.

Inflation continued to remain well within Fed's comfort level. The Consumer Price Index for All Urban Consumers (CPI-U) increased by 0.1% in January. Over the last 12 months, CPI-U increased 1.6%, compared to a 1.5% increase for the 12 months ending in December. Increases in household energy consumption accounted for most of the increase. The index for all items less food and energy also rose 0.1% in January. The index also rose 1.6% over the last 12 months, the smallest increase since June.

US Consumer Price Inflation



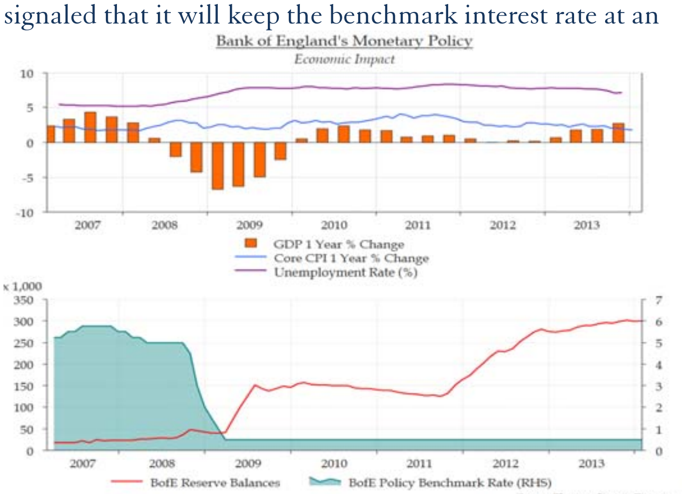
Cold weather throughout the country affected the housing market in the U.S. as existing home sales, housing starts, and building permits saw declines. Existing home sales declined -5.1% in January to 4.62 million, below the consensus of 4.67 million. Housing starts fell -16% to 880K annualized units in January, well below the estimate of 950K. New home sales rose 9.6% m/m to 468K annualized units, above expectations of 400K. The S&P CaseShiller Home Price Index rose 0.8% m/m in December, after a 0.9% rise in November and increased 13.4% y/y.

The U.S. Senate passed legislation that suspended the debt ceiling through March 2015, avoiding renewed conflict over an increase of the debt ceiling. The minutes from the January Federal Open Market Committee (FOMC) meeting revealed that Fed policy makers agreed, that "with the unemployment rate approaching 6.5%, it would soon be appropriate for the committee to change its forward guidance after that threshold was crossed". New Fed Chair Janet Yellen attributed some of the recent weak data to unusually cold weather and reiterated that it would take a "significant change" in the economic outlook for the Fed to adjust its tapering plans.

In Europe, recent reports indicate a continuation of very mild growth and inflation. The estimated 4th Quarter Eurozone GDP growth came in at 1.2% annualized, which was slightly stronger than expected. Eurostat's advanced estimate of February inflation was 0.8%, which is unchanged from January's report and is well below the European Central Bank's (ECB) target of 2%. The ECB kept the benchmark interest rate unchanged at 0.25% for the third straight month.

Eurozone unemployment was unchanged at 12% in January, though the number of jobless rose by 17,000 after falling during the three previous months. Peripheral countries and international bailout recipients continue to post unemployment rates above the regional average: Spain posted a 25.8% rate; Portugal reported 15.3% unemployment; and the most recent report from Greece showed a 28% unemployment rate in November 2013. By contrast, Austria and Germany have unemployment of 5%. Youth unemployment remains high, with over 23% of Eurozone youth jobless.

The Bank of England's Monetary Policy Committee signaled that it will keep the benchmark interest rate at an



historic low of 0.5% for at least one year. Bank of England Governor Mark Carney stated that the recovery was too fragile to increase rates in the short term, as the U.K. continues to deliver mixed economic data. The unemployment rate rose slightly to 7.2%, which was higher than expected but lower than the 7.9% registered in recent months. The Office of National Statistics' estimate of 4th Quarter GDP growth was 0.7% on a quarterly basis, though the ONS cut its full year estimate by 0.1% to 1.8%. The Consumer Price Index (CPI) for the U.K. fell to 1.9% in January, registering below the Bank of England's 2% target for the first time in over four years.

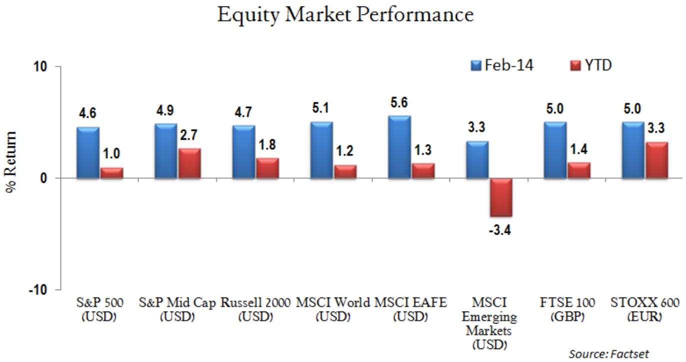
Japan reported 4th Quarter GDP growth of 1% on an annual basis, which fell significantly short of the 2.8% consensus forecast. These results are particularly concerning to Japanese government officials, as exports were weak and a coming sales tax increase is likely to tame consumer spending over the next several months. In China, the official PMI registered an 8-month low of 50.2, while the HSBC PMI hit a 7-month low of 48.3. Chinese inflation remained tame, as January inflation reports were unchanged from the 2.5% annualized rate in December. The official Chinese estimate for 2014 GDP is 7.5%, which would be the slowest growth for China since 1999.

The Reserve Bank of Australia (RBA) raised its economic growth and inflation forecasts, citing benefits from monetary stimulus and a declining Australian Dollar. The RBA's estimate for 2014 stands at 2.75%, and core inflation is expected to be in the range of 2.25%-3.25%. Australia stands to benefit from new real estate construction, as building permits and loan approvals have risen sharply in recent months.

Equity Markets

Equity markets rallied in February, with most markets erasing January's losses. Domestic large-cap stocks, as measured by the S&P 500, gained 4.6% in February. The S&P 500 is back in positive territory in 2014, up 1.0% so far this year, and is up over 25% over the last 12 months. Mid- and small-cap stocks gained 4.9% and 4.7% on the month, respectively. Global stocks also advanced, as the MSCI World Index rallied 5.1% and the MSCI Emerging Markets Index gained 3.3% in February. Emerging markets continue to lag equity markets in the developed world. The headline indices for Europe (STOXX 600) and the UK (FTSE 100) each gained 5.0% in February.

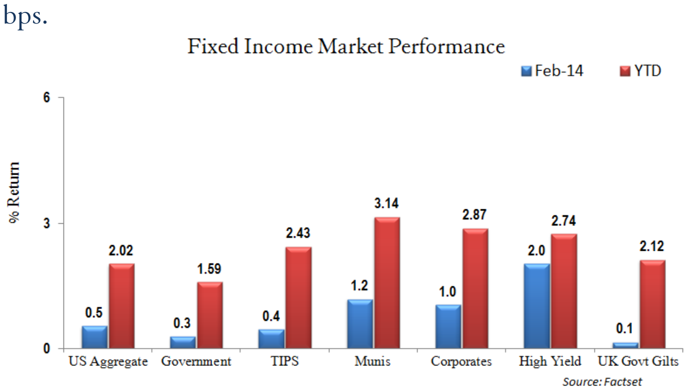
Stocks started February down sharply as the S&P 500 lost nearly 2.3% on the first trading day of the month after a weak ISM Manufacturing report fueled continued concerns of an economic slowdown. The market quickly reversed those losses, however, and only posted five days of losses during the rest of the month. Investors found reason to be optimistic, as economists blamed weak hiring, manufacturing, and retail sales data on unusually severe winter weather. Federal Reserve Chair Yellen asserted in her testimony to the Senate Banking Committee that the economy is improving, and signaled that the Fed views the most recent data as an aberration caused by the Polar Vortex and other cold snaps that hit the U.S. in December and January. The CBOE Market Volatility Index (VIX), a measure of expected future volatility, declined steadily throughout February, closing the month at 14 after spiking to over 21 on February 3rd.



Bond Markets

Fixed income markets rallied across the board for the second straight month in February, as unexpectedly strong Treasury auctions and growing unrest in Ukraine pushed bonds higher. The U.S. auction of 7-year notes drew a yield of 2.105%, the lowest since October and bid-to-cover ratio was 2.72, higher than the 2.56 average of the last 10 sales. The 10-year note auction showed increased interest from foreign investors, as indirect bidders, a category that includes foreign banks, bought nearly 50% of the 10-year on-the-run supply.

The U.S. bond market, measured by the Barclays U.S. Aggregate rose 0.5% in February, while the U.S. Government Bond index gained 0.3%. The U.S. High Yield index rallied 2.0% and U.S. High Yield credit spreads (measured by the Bank of America Merrill Lynch U.S. High Yield Master II Option-Adjusted Spread) tightened 40 bps.



The 30-year U.S. Treasury bond yield fell 2 bps and the 10-year yield was unchanged. The 10-2 Treasury spread flattened by 27.5 bps. The Barclays U.S. Government Breakeven Index, which measures future inflation expectations, was flat at 2.63%. The yield on German 10-year benchmark bonds fell 4 bps to end February at 1.62%. The yield on UK 10-year benchmark bonds rose by 2 bps to close at 2.72%.

Commodities

The S&P GSCI Total Return Index, a headline index of 24 commodities, gained 4.51% in February, as each of the 10 sub-indices finished in positive territory for the month. The Softs sub-index, which includes agricultural commodities like Cocoa and Sugar, was the strongest performing sub-index in February, surging 11.9%. The Softs sub-index was led by Coffee, which spiked over 40% in February, as well as Sugar and Soybeans, which both rallied over 11%. Brazil, the world's largest coffee and sugar producer and the second biggest grower of soybeans, is currently suffering the country's worst drought in decades during a crucial point in crop development. The Agricultural sub-index, which includes livestock in addition to Softs, rallied 9.3% in February, after an outbreak of swine disease caused a 12% increase in the prices for Lean Hogs.

The Precious Metals sub-index gained 7.1% for the month and is up 9.8% so far in 2014. Silver and Gold, the components of the sub-index, rallied 10.9% and 6.6%, respectively. February was the strongest month for Gold since July 2013 and the strongest month for Silver since August 2013. Precious Metals prices rose on growth concerns in China, poor economic data in the United States, and political unrest in Ukraine.

Currency

The US Dollar index weakened against all major currencies except the Chinese Yuan in February. The index declined 1.8%, the most since September, to close at 79.78. The GB Pound climbed the most since September against the Dollar amid speculation that the Bank of England may raise rates due to faster economic growth. The GB Pound closed at $1.67585, while the Euro closed at $1.38115.