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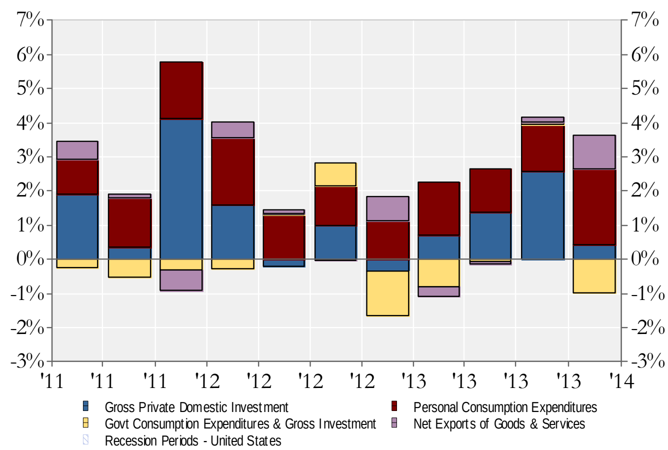
Market Review

March 2014

Economic Review

The Bureau of Economic Analysis (BEA) revised fourth quarter 2013 U.S. real GDP higher to 2.6%, from the second estimate of 2.4%. Real GDP growth in the fourth quarter came principally from personal consumption expenditures, exports, and nonresidential fixed investment. These were partly offset by federal government spending and residential fixed investment. Real GDP increased 4.1% in the third quarter. The slowdown in fourth quarter vs. the prior quarter primarily reflected a downturn in private inventory investment and a larger decrease in federal government spending, offset by accelerations in PCE and exports. First quarter 2014 GDP is expected to be in the 1.0% to 2.0% range.

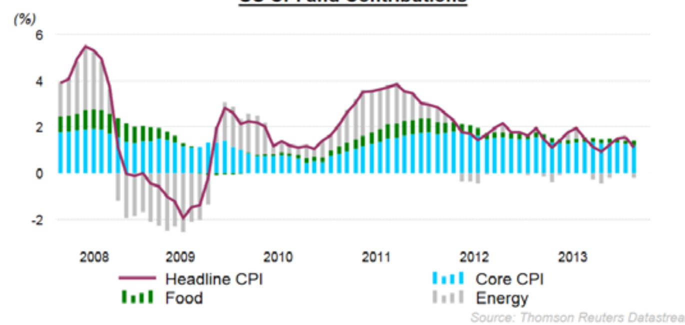
US Contribution to GDP Growth



Total nonfarm payrolls rose by 175K in February, significantly above December (84K) & January (129K) data. Job growth averaged 189K per month over the prior 12 months. The unemployment rate increased 0.1% to 6.7%, up from a five-year low of 6.6%. The civilian labor-force-participation-rate (63%) and the employment-population ratio (58.8%) were unchanged in February. The broadest measure of unemployment, U6, fell to 12.7%, down from 13.1% in December. The average workweek for all private nonfarm payrolls edged down by 0.1 hour to 34.2 hours, while the average hourly earnings rose by 9 cents to $24.31. Real average hourly earnings for all employees rose 0.3% from January to February, as the average hourly earnings increase of 0.4% was offset by a 0.1% increase in CPI.

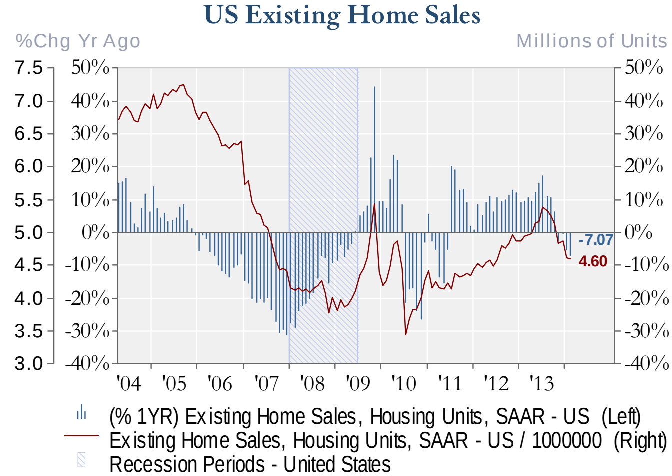
The Consumer Price Index (CPI) and the Core CPI advanced 0.1% in February, matching January's increase. Over the last 12 months, CPI increased less than the anticipated 1.1% while Core CPI rose 1.6%. The Producer Price Index (PPI) fell 0.1% in February and gained 0.9% year-over-year, the smallest rise since May 2013. The 5 year/5year forward breakeven inflation rate was unchanged at 2.34%.

US CPI and Contributions



Housing starts fell -0.2% in February to 907K units, while building permits rose 7.7% to 1.02 million units. Existing home sales declined -0.4% to 4.6 million units, the weakest since summer of 2012. New Home Sales fell 3.3% to 440K. The S&P Case Shiller Home Price Index declined 0.1% in January after rising 0.8% in December, and increased 13.2% y/y, the smallest gain since August. Many economists believe that cold weather throughout the U.S. continued to affect the housing market.

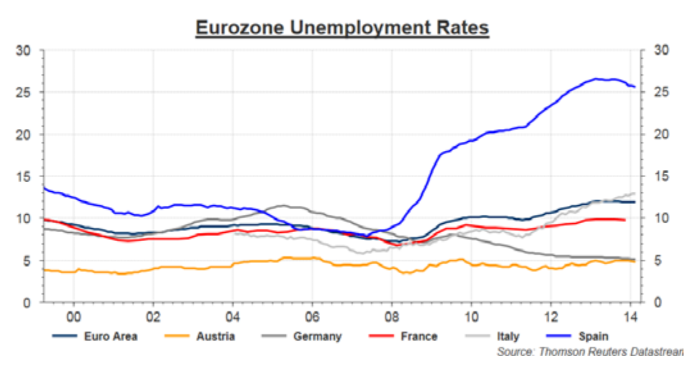
US Existing Home Sales



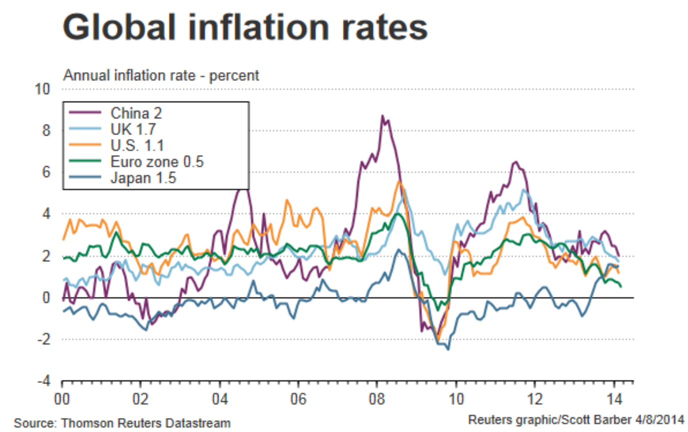
The Federal Open Market Committee switched to qualitative from quantitative guidance with respect to future monetary policy by including a broader set of measures to gauge the unemployment and inflation in the economy. Prior to the amendment, explicit language linked increases in the Fed Funds rate to a 6.5% unemployment rate and/or a 2.5% inflation rate. The Fed announced a further $10 billion tapering of asset purchases to $55 billion a month, suggesting a termination of this program in the fall of 2014. Fed Chair, Janet Yellen, indicated the Fed's key lending rate may begin to rise six months after the conclusion of Quantitative Easing. Despite weak employment and inflation data, the Fed's decisions to continue to taper may suggest that Fed is recognizing that the costs of QE program outweigh the potential benefits.

The final revision for Eurozone 4th Quarter 2013 GDP, released in early April 2014, was revised downward to 0.2% quarter-over-quarter. The year-over-year growth remained unchanged at 0.5%, an improvement over the previous quarter's contraction of 0.3%. The European Commission, the executive branch of the European Union, predicts an increase in growth to 1.1% by the end of 2014. Eurostat's advance estimate of March inflation was 0.5%, significantly below the ECB's target rate of 2% and lower than the 0.6% forecasted by analysts. March marks the sixth consecutive month of sub-1% inflation for the Eurozone. At its March meeting, the ECB left interest rates unchanged at 0.25% for the fourth straight month.

Eurozone unemployment was reported at 11.9% in February, slightly lower than the analyst expectations of 12%. The number of jobless people fell by 35,000, according to the report. Eurostat revised the previous month's unemployment down to 11.9%, indicating that unemployment has been stable at that rate since October 2013. Austria registered the lowest unemployment rate at 4.8%, while Spain and Greece continue to deal with unemployment over 25%. In the larger 28-nation European Union – which includes members that do not use the Euro currency – the unemployment rate dipped to 10.6 percent from 10.7 percent in January.



In March, the Bank of England announced that it would take into account a larger range of factors, including excess economic capacity, labor productivity, and wage growth, when deciding to reduce the current stimulus program. This announcement, a step away from previous forward guidance linked to unemployment, is seen as a potentially dovish signal by the central bank. March marked the fifth anniversary of the record-low interest rates in Britain. Though unemployment has fallen to 7.2%, UK inflation finished March at a four-year low of 1.7% and growth remains tepid.

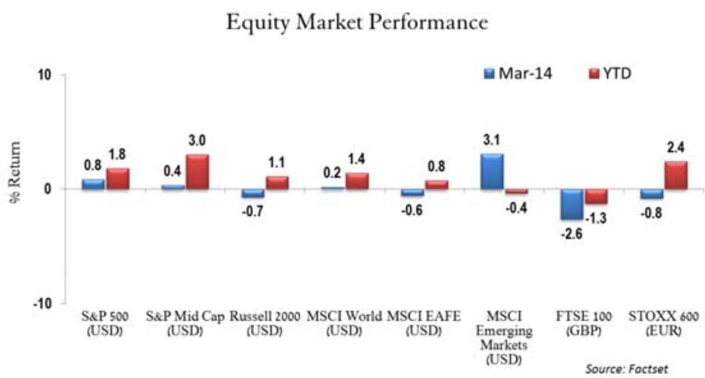


In Asia, Chinese economic data came in surprisingly weak, as the HSBC and Markit Purchasing Manager's Index (PMI) came in at 48, the lowest reading in nearly a year, signaling potential contraction in the Chinese economy. The official government PMI was 50.3, up from an eight-month low of 50.2 in February. Chinese Premier Li Keqiang commented on upcoming "difficulties and risks" for China's economy because of rising debt and pollution. In Japan, the country's first tax increase since 1997 took effect in the form of the long-awaited sales tax hike. Seen as a way to pay for the historically aggressive stimulus, dubbed "Abenomics" after Prime Minister Shinzo Abe, the tax hike also is a potential headwind for the Japanese economy moving forward.

Equity Markets

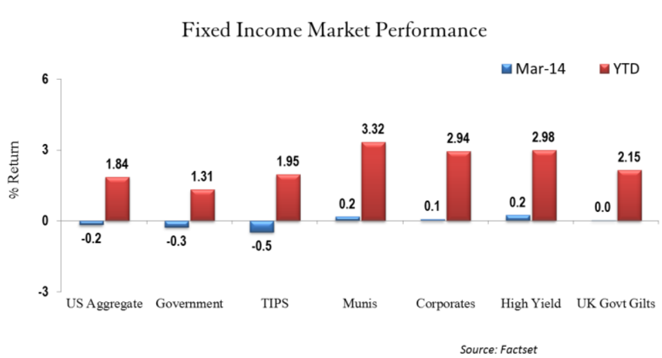
Equity markets were mixed in March, as most developed markets finished the month in negative territory. Domestic large-cap stocks, as measured by the S&P 500, gained 0.8% in March, adding to February's gains to stand at +1.8% in 2014. Domestic mid-cap stocks, measured by the S&P 400 gained 0.4%, while the Russell 2000 small-cap index lost 0.6%. Global stocks were mostly negative, with the exceptions of the MSCI World and MSCI Emerging Markets, which gained 0.2% and 3.1%, respectively. The MSCI EAFE (Europe, Africa, and Far East) Index lost 0.6%, while the headline indices for Europe (STOXX 600) and the UK (FTSE 100) lost 0.8% and 2.6% in March, respectively.

March was a choppy month for stocks, as the S&P 500 started the month by rallying over 1% through March 10th. The S&P then lost 1.9% over 4 days, as investors weighed potential ramifications of the Crimean referendum and subsequent annexation of Crimea by Russia. In addition, the markets reacted poorly to a telegraphed rise in interest rates by Fed Chair Janet Yellen. In a press conference, she indicated that the market could expect the Fed to consider a short-term rate hike within six months of the end of the stimulus program. The CBOE Market Volatility Index (VIX), a measure of expected future volatility, finished March relatively unchanged, moving down slightly from 14 to 13.88. March saw a significant mid-month VIX spike: the VIX moved to an intraday high of 18.22 on March 14th during the height of the Russian intervention in Crimea.



Bond Markets

The U.S. bond market as measured by the Barclays U.S. Aggregate declined 0.2% in March and is up 1.8% for the year. The Treasury yield curve witnessed a sharp bear flattening during the month as markets perceived the Fed's actions and Chair Yellen's post-meeting comments as less accommodative. The 30-year Treasury yield fell 3 bps during March, the 5-year yield rose over 20 bps while the 2-year yield rose 10 bps. Investment grade credit spreads tightened 3 bps to an OAS of +103 bps over Treasuries on demand for new supply issued last month.



The 30-year U.S. Treasury bond yield fell 3 bps to close at 3.56%, while the 10-year yield increased 7 bps to close at 2.73%. The yield on German 10-year benchmark bonds fell 5 bps to end March at 1.57%. The yield on UK 10-year benchmark bonds rose by 1 bp to close at 2.73%.

Commodities

The S&P GSCI Total Return Index, a headline index of 24 commodities, gained 0.14% in March, and is up 2.94% so far in 2014. The Softs sub-index, which includes agricultural commodities that are grown (cocoa and sugar, for example), and the larger Agriculture sub-index were strong performers in March, up 2.2% and 7.5%, respectively. Coffee, which is included in both sub-indices, rallied nearly 6% on continued production concerns. Brazil, the world's largest coffee producer, is currently suffering the country's worst drought in decades during a crucial point in crop development.

The Precious Metals sub-index lost -3.4% for the month, and is down -21.37% over the last 12 months. Precious Metals continue to be driven lower on tame global inflation and tapering of stimulus in the United States. Low inflation expectations also hurt the Industrial Metals sub-index, which lost 2.4% in March and is down over 5% year-to-date in 2014. Copper and Zinc each lost over 5%, while Tin and Lead each fell by over 3%.

Currency

The US Dollar index was up a modest 40 bps in March to close at 80.11. The index weakened slightly against the Euro during the first half of the month, and then strengthened following the Fed meeting. The British Pound depreciated 0.5% to close at $1.66715, and the Euro depreciated 0.21% to close at $1.37825.