

# Market Background

## 2<sup>nd</sup> Quarter 2009

### Economy

What a difference a quarter makes! Global equities, real estate securities and commodities surged in the second quarter following first quarter losses. The resilience of these markets surprised many investors given the nation's lingering economic woes: a severe recession, rising unemployment, a crash in housing prices, a fractured banking system and a ballooning Federal budget deficit. The volatile performance of the markets re-enforces key investment management principles: the risks of timing the market, the benefits of adhering to a long-term asset mix with a rebalancing discipline, the need to quantify the organization's risk tolerance and the importance of maintaining a long-term investment view. The quarter marked a period of healing for financial markets around the world as credit markets, which had been the center of the financial crisis, continued to improve.

- The Federal Reserve held rates at virtually zero during the second quarter of 2009.
- The Consumer Confidence Index rose substantially in the second quarter reaching 49.3, which marked an 83.3% increase from the beginning of the quarter.
- Through June year-over-year, the CPI was down 1.4%, but rose at a 3.3% annualized rate for the quarter. It is still too early to determine whether inflation is starting to materialize, despite a loose monetary policy by the Federal Reserve.
- GDP contracted at an annual rate of -5.5% during the first quarter of 2009. The largest drag on GDP was business investment, which fell at a 37.3% annual rate. The largest positive contributor was net exports, which rose at a 2.4% annual rate.
- The unemployment rate jumped from 8.5% to 9.5% at the end of the second quarter. Most sectors continued to shed jobs, with only the Government and Health Care sectors posting gains.

### Stocks

The Dow Jones Industrial Average ended the second quarter of 2009 up 11%, marking its best quarterly performance since the fourth quarter of 2003. The Dow was also up 29% from its 12-year low recorded on March 9<sup>th</sup>, and experienced its first quarterly gain in over a year and a half. Despite the Dow's significant gains during the second quarter, it still remained down 3.8% year to date.

- The broad benchmark S&P 500 Index gained 15.9% for the quarter. Over the full year, it experienced a 26.2% loss. (see Table I).
- All ten of the S&P 500 economic sectors posted positive results for the quarter. The best performing sectors were Financials (up 35.1%) and Information Technology (up 19.4%).
- The worst performing S&P sectors for the quarter included Telecom Services (up 1.9%) and Health Care (up 8.3%). The sector that recorded the worst one-year performance was Energy, losing 42.7%.
- Large-cap value stocks slightly outperformed large-cap growth issues, returning 16.7% compared to 16.3% for the quarter. For the trailing-year period, the Russell 1000 Value Index fell 29.0%, while the Russell 1000 Growth Index fell 24.5%.
- Small-cap growth equities outperformed value for the quarter. The Russell 2000 Growth Index gained 23.4%, while the Russell 2000 Value Index gained 18.0%. For the trailing-year period, the Russell 2000 Growth Index outpaced the Russell 2000 Value Index, posting a return of -24.8% compared to -25.2%.

**TABLE I: Total Return Statistics for Select Market Indices**

	Second Quarter	12 Months Trailing
S&P 500 Index	15.9%	-26.2%
Russell Mid Cap Index	20.8	-30.4
Russell 2000 Index	20.7	-25.0
MSCI EAFE Index	25.4	-31.4
MSCI Emerging Markets Index	34.7	-28.1
NAREIT Index	28.9	-43.3
DJ-AIG Commodity Index	11.7	-47.1

**TABLE II: S&P 500 Sector Performance & Allocation**

	Second Quarter	12 Months Trailing	Allocation
Financials	35.1%	-40.7%	13.6%
Information Technology	19.4	-19.3	18.3
Industrials	18.0	-36.8	9.9
Cons. Discretionary	17.7	-18.5	9.0
Materials	15.5	-40.7	3.2
Energy	10.1	-42.7	12.4
Consumer Staples	8.9	-13.1	12.0
Utilities	8.8	-31.4	4.1
Health Care	8.3	-13.6	14.0
Telecom Services	1.9	-23.7	3.5



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Stocks rose around the globe in the second quarter, particularly in emerging market areas of the world. Market gains in developing countries such as Russia and China outperformed stocks in the U.S. and U.K. The quarter closed on a down note, and some global markets dipped in June as marketplace doubt resurfaced ahead of second-quarter earnings reports.

- The MSCI EAFE Index, a proxy for developed international markets, gained 25.4% for the quarter, but was still down 31.4% for the trailing-year period. In local currencies, the index was up 16.9% for the quarter, but down 25.5% for the trailing year. The dollar posted a 5.3% loss against the Euro, and a 2.7% loss against the Japanese Yen for the quarter.
- The MSCI Emerging Markets Index gained 34.7% for the quarter, but declined 28.1% for the trailing year. India led the way with the Sensex Index rising over 49%. Key indexes in China and Brazil also posted double-digit gains.

### Fixed Income

In the second quarter of 2009, lower quality credits staged a long awaited rally, while U.S. Treasuries posted record declines. This turn of events punished investors seeking safety in the battered credit markets. At its most recent meeting, the Federal Reserve held interest rates at virtually zero and also held firm to its initial targeted amount of purchases of U.S. Treasuries, Agencies and MBS. While the Fed noted some stabilization of consumption and inventories, it remains wary of an economic slide once fiscal and monetary stimulus subsides.

- The Barclays U.S. Aggregate Index posted a return of 1.8% during the second quarter. The Global Aggregate gained 4.9%. For the full year, the U.S. Aggregate earned 6.1%, while the Global Aggregate gained 2.8%.
- Asset-backed securities were again boosted by liquidity in the marketplace, provided from the Term Asset-Backed Securities Loan Facility program (TALF), and gained 7.6% for the quarter. High Yield issues continued to bounce back from record lows in 2008, and gained 23.1% for the quarter.
- U.S. Treasuries and Agencies suffered as an increase in investor risk appetite ruled the quarter (-3.0% and -0.1% respectively). Mortgage-backed securities posted a gain of 0.7% for the quarter. U.S. Corporate Investment Grade issues flourished, gaining 10.5% for the quarter.

**TABLE III: Bond Market Returns and Duration**

	Second Quarter	12 Months Trailing	Modified Duration
Three-month Treasury Bills	0.1%	0.6%	0.3
Barclays 1-3 Year Treasury	-0.1	4.5	1.9
Barclays G/C Intermediate	1.7	5.3	3.9
Barclays U.S. Aggregate	1.8	6.1	4.3
Barclays Government/Credit	1.9	5.3	5.2
Global Aggregate (Unhedged)	4.9	2.8	5.3

**TABLE IV: Bond Market Sector Returns and Duration**

	Second Quarter	12 Months Trailing	Modified Duration
U.S. Treasuries	-3.0%	6.5%	5.2
Agencies	-0.1	7.3	3.4
Asset-Backed Securities	7.6	3.9	3.1
Mortgage-Backed Securities	0.7	9.4	3.0
U.S. Corporate Investment Grade	10.5	3.8	6.2
U.S. Corporate High Yield	23.1	-2.4	4.3

**CHART I: Treasury Yield Curve at 6/30/09 and 3/31/09**

