Market Background

3rd Quarter 2009

Economy

Markets worldwide posted their second straight quarter of gains during the third quarter of 2009. Signs of recovery in the economy and improvement in investor confidence re-enforced the validity of these gains. Yet the markets still face major risks because serious structural problems continue to plague economies worldwide. Unemployment remains stubbornly high, bad loans still choke the banking system, and looming government deficits might deprive businesses of growth capital. Investors cannot dismiss the recurrence of potentially severe losses on a near-term or long-term basis. The recent stability in the markets provides investors with an opportunity to conduct a rigorous re-evaluation of their investment strategies. Such a review should address several issues: Does the strategy address the investor's unique financial and liquidity requirements? Can the portfolio withstand potentially large losses in equity and credit markets? Is the portfolio positioned for growth opportunities if markets continue to advance?

- The Federal Reserve held rates at virtually zero during the third quarter of 2009.
- The Conference Board's Consumer Confidence Index rose slightly in the third quarter reaching 53.1, a 7.7% increase.
- Through September year-over-year, the CPI was down 1.3%, but rose at a 0.1% annualized rate for the quarter. The quarterly gain was broad based, although tempered by a decline in the food index. Year to date, the CPI was up 2.7%.
- GDP contracted at an annual rate of -0.7% during the second quarter of 2009. The largest drag on GDP was business investment, which fell at a 9.6% annual rate. The largest positive contributor was net exports, which rose at a 1.7% annual rate.
- The unemployment rate jumped from 9.5% to 9.8% at the end of the third quarter, marking a 26-year high. The economy has lost approximately 7.2 million jobs since December 2007.

Stocks

The Dow Jones Industrial Average ended the third quarter of 2009 up 15%, marking its best quarterly performance since the fourth quarter of 1998, and its best third quarter performance since 1939. At quarter end, the Dow remained 31% below its October 2007 record high, but was up 48% from its March 9th low and up 11% year to date. The Dow's 28% gain over the past six months marked its best performance over two consecutive quarters since March 1987.

- The broad benchmark S&P 500 Index gained 15.6% for the quarter. Over the full year, it experienced a 6.9% 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 25.5%) and Industrials (up 22.0%).
- The worst performing S&P sectors for the quarter included Telecom Services (up 5.6%) and Utilities (up 6.2%). The sector that recorded the worst one-year performance was Financials, losing 23.5%.
- Large-cap value stocks outperformed large-cap growth issues, returning 18.2% compared to 14.0% for the quarter. For the trailing-year period, the Russell 1000 Value Index fell 10.6%, while the Russell 1000 Growth Index fell 1.9%.
- Small-cap value equities outperformed growth for the quarter. The Russell 2000 Value Index gained 22.7%, while the Russell 2000 Growth Index gained 16.0%. For the trailing-year period, the Russell 2000 Growth Index outpaced the Russell 2000 Value Index, posting a return of -6.3% compared to -12.6%.

TABLE I: Total Return Statistics for Select Market Indices

	Third Quarter	12 Months Trailing
S&P 500 Index	15.6%	-6.9%
Russell Mid Cap Index	20.6	-3.6
Russell 2000 Index	19.3	-9.5
MSCI EAFE Index	19.5	3.2
MSCI Emerging Markets Index	20.9	19.1
NAREIT Index	33.3	-28.4
DJ-UBS Commodity Index	4.2	-23.7

TABLE II: S&P 500 Sector Performance & Allocation

	Third Quarter	12 Months Trailing	Allocation
Financials	25.5%	-23.5%	15.2%
Industrials	22.0	-12.7	10.2
Materials	21.5	-4.2	3.5
Cons. Discretionary	19.3	-0.1	9.2
Information Technology	17.0	8.5	18.7
Consumer Staples	11.4	-4.6	11.5
Energy	10.1	-14.4	11.7
Health Care	9.5	-3.6	13.1
Utilities	6.2	-7.1	3.7
Telecom Services	5.6	0.0	3.2

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Stocks rose around the globe in the third quarter, continuing to climb off of bear-market lows. Many established European markets outpaced the previous quarter while some emerging markets rose at a slower rate. Major indexes in the U.K., Germany and France all finished the quarter on a high note, despite choppy results throughout the period.

- The MSCI EAFE Index, a proxy for developed international markets, gained 19.5% for the quarter, and was up 3.2% for the trailing-year period. In local currencies, the Index was up 14.8% for the quarter, but down 1.7% for the trailing year. The dollar posted a 4.1% loss against the Euro, and a 6.8% loss against the Japanese Yen for the quarter.
- The MSCI Emerging Markets Index gained 20.7% for the quarter, and was up 19.1% for the trailing year. Gains slowed in some markets, including India, Brazil and Turkey, compared to previous quarters.

Fixed Income

In the third quarter of 2009, credit markets continued to recover as investors' desire to put cash to work outweighed their concerns about the economy. A combination of strong investor demand and low interest rates sparked a rush by companies to raise cash by selling debt. Corporate bonds extended their gains from the previous quarter, while U.S. Treasury issues and short-term debt markets also benefited from improved conditions, helping to keep rates low. Low short-term rates and meager returns from money-market funds provided an incentive for investors to move money into higher yielding and riskier assets.

- The Barclays U.S. Aggregate Index posted a return of 3.7% during the third quarter. The Global Aggregate gained 6.2%. For the full year, the U.S. Aggregate earned 10.6%, while the Global Aggregate gained 13.5%.
- Asset-backed securities gained 6.3% as continued support from the U.S. Federal Government's TALF program bolstered returns for the quarter. High-Yield issues continued to bounce back from record lows in 2008, gaining 14.2% for the quarter.
- U.S. Treasuries and Agencies were positive (2.1% and 1.8% respectively) but trailed other sectors as an increase in investor risk appetite ruled the quarter. Mortgage-backed securities posted a gain of 2.3% for the quarter. U.S. Corporate Investment Grade issues flourished, gaining 8.1% for the quarter.

TABLE III: Bond Market Returns and Duration

	Third Quarter	12 Months Trailing	Modified Duration
Three-month Treasury Bills	0.0%	0.2%	0.3
Barclays 1-3 Year Treasury	0.8	3.6	1.9
Barclays G/C Intermediate	3.3	10.0	3.9
Barclays U.S. Aggregate	3.7	10.6	4.4
Barclays Government/Credit	4.2	11.5	5.3
Global Aggregate (Unhedged)	6.2	13.5	5.4

TABLE IV: Bond Market Sector Returns and Duration

	Third Quarter	12 Months Trailing	Modified Duration
U.S. Treasury	2.1%	6.3%	5.3
Agencies	1.8	8.1	3.2
Asset-Backed Securities	6.3	14.7	3.2
Mortgage-Backed Securities	2.3	9.9	3.1
U.S. Corporate Investment Grade	8.1	21.8	6.4
U.S. Corporate High Yield	14.2	22.3	4.3

CHART I: Treasury Yield Curve at 9/30/09 and 6/30/09