

# monthly investment overview.

## August 2009

### The Economy

US Real Gross Domestic Product for 2008: +0.4%  
US Real Gross Domestic Product for 2Q'09: -1.0%  
Consumer Price Index Y/Y: -2.1%  
Consumer Price Index June 2009: +0.0%

Economic activity picked up, and in some cases turned positive in August. France, Germany, and Japan all reported a positive annual pace of GDP growth for the three months ending June 30th. China remains the clear pace setter for emerging markets, with industrial output growing 10.8% yr/yr in July and 2Q annualized GDP growth up 18%. The consensus among economists is that the U.S. recession ended sometime during the current quarter, with U.S. real GDP suffering a sizable 3.9% peak to trough decline. The housing market extended its recent string of positive news with existing home sales up 7.2% m/m and new home sales up 9.6% m/m in July. Industrial ISM numbers are now showing increases, driven by new order activity, after several months of companies cutting back on inventory. The global ISM as well as the U.S. ISM surged above the 50 mark in August, to 53.1 and 52.9 respectively. The ISM or Institute for Supply Management uses surveys to construct an index of national factory activity, where a reading above 50 indicates expansion in the manufacturing sector. Looking underneath the government band-aid of record fiscal stimulus and creative monetary policy, the FDIC reported that the U.S. banking industry swung back to a \$3.7 billion aggregate net loss in 2Q after reporting a profit of \$7.6 billion in the first quarter. While the steep yield curve has helped net interest margins improve, indicators of underlying asset quality continued to deteriorate in 2Q. The FDIC now has 416 institutions on its "Problem List", up from 305 at the end of last quarter. Credit problems are also moving from subprime borrowers into prime borrowers, who account for ~80% of consumer loans. Prime borrowers experienced a 5.8% rise in mortgage delinquencies during the second quarter and were responsible for driving the total mortgage delinquency rate to a record 9.2%.

### The Stock Market

Dow Jones Industrial Average YTD Total Return: +10.8%  
Standard & Poor's 500 Index YTD Total Return: +15.0%

The S&P 500 continued to advance through August, up 3.4% for the month to a new recovery cycle high off the market lows set back in early March. The stock market exhibited its typical light volume trends in August, with many investors away on summer vacations. The financial sector was a big outperformer for the month, driven by better than expected economic news and further signs of stability in the financial system. The market experienced some consolidation in sectors like energy and materials, while more defensive sectors like consumer staples, utilities, and telecommunications services underperformed.

### The Bond Market

Federal Funds Rate: Target 0% - ¼%  
10-Yr US Treasury Yield: 3.4%  
Barclays Intermediate-Term US Gov't Bond Index: YTD +4.0%

Confidence in an economic recovery has resulted in a narrowing of credit spreads. Credit spreads are measured in basis points (or 1/100 of 1%) and reflect the difference between the yield on a particular bond and that of a Treasury security with the same maturity. The Merrill Lynch Investment Grade Corporate Index finished August at a spread of 185 bpts over the 10-year Treasury, down from 530 bpts last March, while the Merrill Lynch High Yield Index closed August at a spread of 800 bpts over the 10-year Treasury, down from 1700 bpts last March. Companies have been quick to take advantage of more attractive borrowing conditions. The worldwide issuance of corporate bonds has exceeded \$1 trillion for the first time ever this year, already a single year record. At the same time however, the amount of corporate debt in default has already hit \$450 billion for the year, surpassing the previous annual record set in 2001.