

PMFA MARKET PERSPECTIVES

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FINANCIAL ADVISORS

Capital Markets

Roughly a year has passed since the financial crisis arguably reached its crescendo, even as risk assets including equities continued to tumble well into 2009. As is typical, economic indicators remained soft into the summer months after the market began to recover, and investors drove the prices of risk assets well off their March lows to hefty double-digit returns year-to-date. Those gains continued through the late summer months as stocks posted positive returns again in September, further enhancing investor gains for the third quarter.

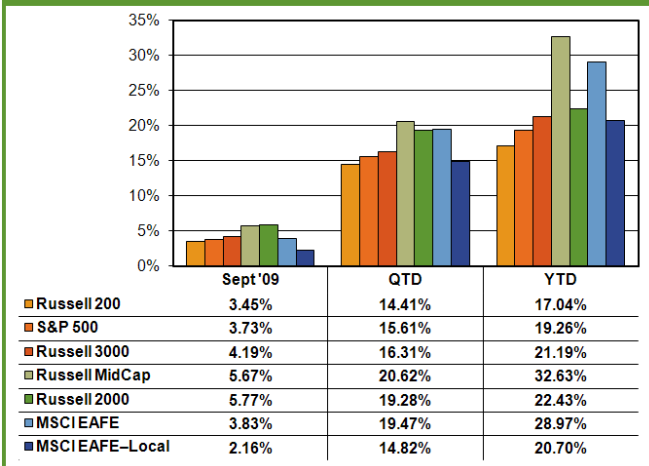
After another quarter of solid gains, the outstanding question remains: is this the start of a secular bull market that may have legs or merely the recapturing of losses that occurred as the financial system hung in the balance and fears of a global depression took root? As we write this commentary, the S&P 500 Index remains about 15% below its level of September 12, 2008. Why is that significant? That Friday, the market closed at 1251 with investors expecting that a merger between Lehman Brothers and one of a couple prospective suitors would reach fruition over the weekend. In the weeks that followed, the disorderly unwinding of Lehman and initial failure of the House of Representatives to pass the Troubled Asset Relief Program (TARP) legislation led to the broad market selloff. Despite the sharp rally that has taken the S&P 500 back from its March 6 intraday bottom of 667, the index remains well below its pre-Lehman level, let alone its cyclical peak of 1576 in October 2007.

What is needed for the rally to continue? As we head into the heart of earnings season, we anticipate that the markets will be closely watching those results to take their next cue. Cost-cutting measures have proven effective in propping up earnings to this point, but indications that companies are also experiencing revenue growth would be warmly received by investors as well. In a similar vein, we expect that the release of the advance estimate of third-

quarter GDP on October 29 could also provide further fuel if economic growth exceeds expectations that are already being revised upward.

Of course, the market has experienced a sharp, sustained rally that arguably is overdue for a breather. Tepid revenue growth or mediocre economic results could be negatively received, although equity investors may also react unfavorably if the economy signals that future growth will be unexpectedly strong, as the potential for the Fed to tighten sooner than expected would increase. It will be a delicate balance, but one that is still preferable to continued deterioration.

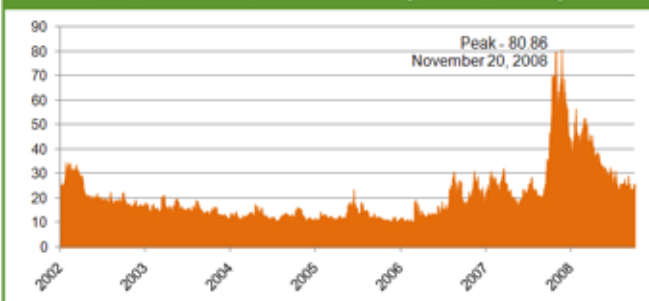
Equity Indices



Source: PMFA

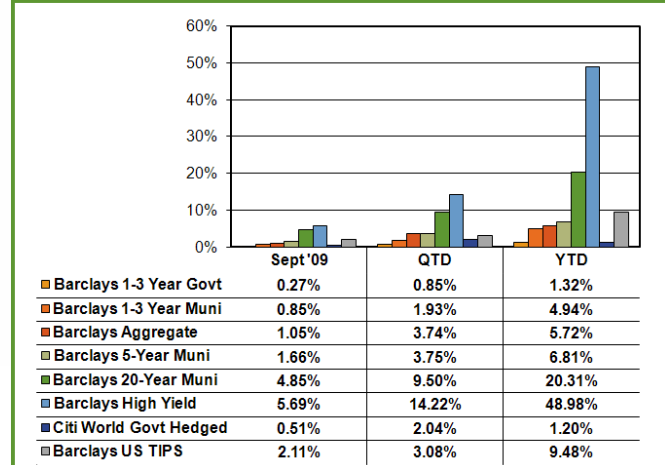
Concurrent with positive returns, market volatility remained well below its previously lofty levels. The CBOE S&P Market Volatility Index (or VIX) ended the third quarter at around 26, just fractionally below its level at the beginning of July. Just as investor fear stokes volatility, arguably contributing to a bit of a self-perpetuating cycle, the material decrease in volatility has also provided some basis for increased investor comfort in pushing capital back into riskier investments.

VIX - CBOE S&P Market Volatility Index - History



Source: PMFA, Yahoo Finance

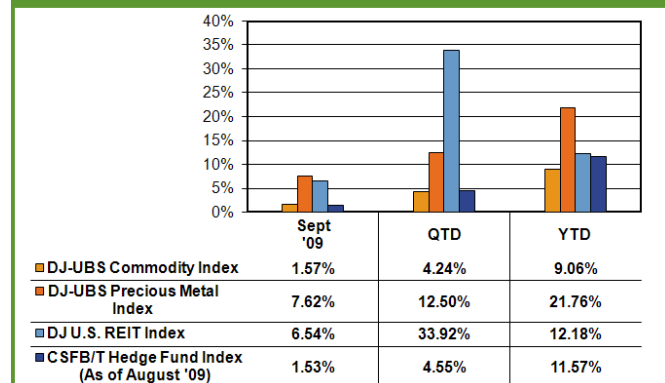
Fixed Income Indices



Source: PMFA

While stocks posted solid gains for the quarter, fixed income also performed well, particularly those at the riskier end of the bond spectrum. High yield bonds again outpaced their lower-risk brethren, gaining an equity-like 14% for quarter. Even the high-quality standard-bearer for the market – the Barclays Capital Aggregate Index – returned nearly 4% for the quarter. Long-term municipals also rallied as the muni yield curve continued its flattening trend.

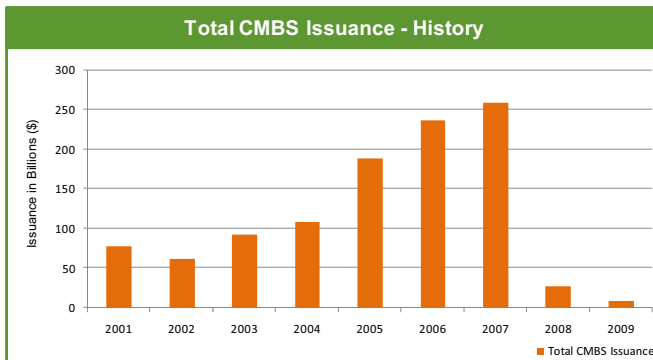
Alternative Indices



Source: PMFA

A range of factors continue to contribute to continued momentum across alternative investments. Fears of increasing inflation, along with a declining U.S. Dollar, helped to buoy returns in broad commodities and precious metals. Although the outlook for commercial real estate remains uncertain at best, Real Estate Investment Trusts (REITs) rallied furiously in the third quarter to propel year-to-date returns back into positive territory. Although bank financing for commercial real estate remains tight and the Commercial Mortgage Backed Securities (CMBS) market has virtually

disappeared, many large publicly traded REITs found the availability of direct debt and equity capital on the secondary market to be greater than anticipated in the past several months. This temporarily alleviated some anxiety about the ability of these companies to meet obligations. Further, this step was perceived as a positive as this capital may allow REITs to invest in distressed properties.

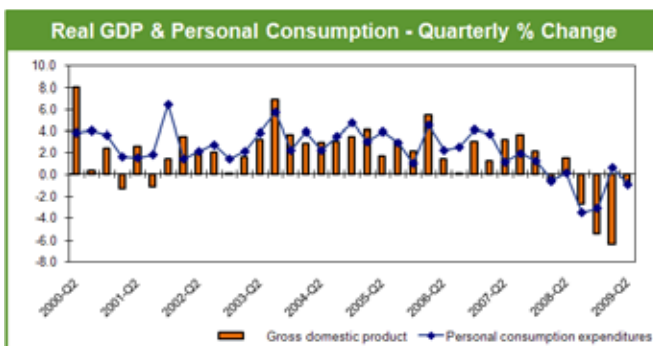


Source: Bloomberg

Economy

GDP

The economy shrank at an annualized rate of 0.7% in the second quarter, a significant improvement from the 6.4% decline in the first quarter. The improvement from the prior estimate of 1.0% resulted from small declines in business and inventory investment, exports, and housing, along with an increase in government spending.



Source: PMFA, Bureau of Economic Analysis (BEA)

At the end of this month, we'll get our first look at the advance estimate for third quarter GDP, which is expected to signal a return to growth. The improvement in multiple economic variables point toward an end of the recession; however, some economists continue to postulate that this recovery may be muted as compared to those following recent recessions.

INFLATION

The output gap – or excess slack within the economy – will likely continue to dampen cost pressures, leaving short-term expectations for inflation within acceptable ranges. Inflation increased in August at both the headline and core level. The 12-month headline rates moved higher last month, but remain below zero.

Index	Period Ending August 2009	
	One-Month % Change	One-Year % Change
All Items		
CPI	0.2%	-1.5%
PPI	1.7%	-4.3%
PCE	0.3%	-0.5%
All Items Excluding Food and Energy		
Core CPI	0.1%	1.4%
Core PPI	0.2%	2.3%
Core PCE	0.1%	1.3%

Source: PMFA, BEA, Bureau of Labor Statistics (BLS)

Excluding the Producer Price Index which is inherently more volatile, the year-over-year change for core indicators continue to slip toward 1%, the lower end of the Fed's preferred range. On a forward looking basis, other inflation indicators also currently reflect tame inflation expectations. The break-even inflation rate between nominal Treasuries and Treasury Inflation Protected Securities is one gauge of the market discounting future inflation. The 10-year breakeven rate is currently 1.7%, below its average of just over 2% since the introduction of TIPS in 1997.



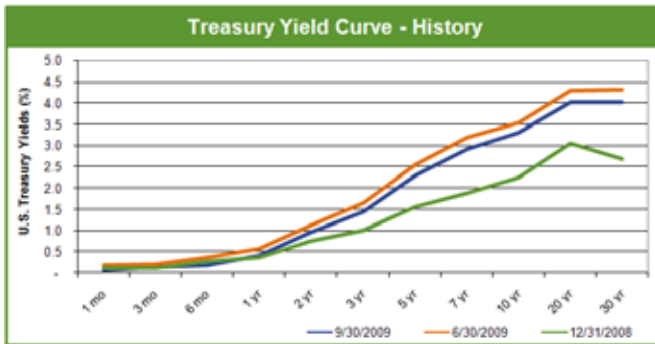
Source: PMFA, BEA, BLS

INTEREST RATES

The statement following the most recent meeting of the Federal Open Market Committee released on September 23 contained few, if any, surprises. The statement indicated that activity has increased throughout the economy and financial market conditions continue to improve. The Committee maintained the target range for the Federal Funds rate

at 0%-0.25%, as they anticipate the continued weakness following the severe downturn will warrant exceptionally low levels for an “extended period.”

Over the past year in particular, the Fed introduced massive intervention programs and are now focusing on their exit plan. “How” and “when” questions have moved to the forefront, as removal of this stimulus either too early or too late could have lasting implications on the economy and recovery.

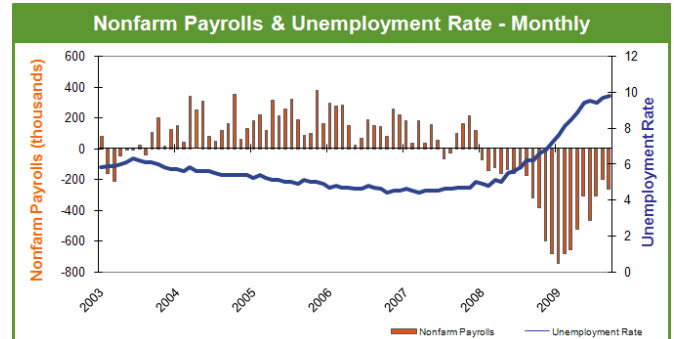


Source: PMFA, U.S. Treasury

The Treasury yield curve moved fractionally lower during the third quarter. The one-month Treasury yield fell by 11 basis points, while the 10-year Treasury declined by 22 basis points. The curve has steepened substantially from the low levels reached at the end of 2008, which in general has been a positive indicator for future economic growth. Current yield levels do not suggest that investors are pricing in meaningfully higher inflationary expectations yet.

EMPLOYMENT

Employers have been shedding jobs for 21 consecutive months -- a trend that is expected to continue for the coming months. In September, an additional 263,000 jobs were lost, bringing the tally to 7.2 million since the recession began. Pare-backs in construction and manufacturing employment continue to lead the decline.



Source: PMFA, BLS

Recent recessions have been followed by “jobless recoveries” in which hiring is subdued even after growth has resumed in other areas of the economy. Economists now debate the likelihood of this recovery following a similar course, although evidence leans toward a jobless recovery scenario. A historically high level of involuntary part-time workers is one important factor that will likely detract from new job creation, as employers first increase their utilization of their existing workforce before adding to their payrolls.

Gratuitously Unnecessary Perspective of the Month

This Will Make You Blush...

Amidst economic slowdowns, one segment of goods that typically enjoys a decisive surge in sales: cosmetics. Dubbed the “Leading Lipstick Indicator,” the theory is this: when budgets are squeezed, people substitute small indulgences for more significant purchases.

Two kinds of products have historically sold well in tough times: “inferior goods” (those that people are forced to buy in lieu of their more expensive favorites) and cosmetics. This trend has been present in all major recessions dating back to the Great Depression. That being said, there is no indication that the volume of makeup being used by an individual is an indication of their personal financial situation.

Source: www.investopedia.com

Past performance does not guarantee future results. All investments include risk and have the potential for loss as well as gain.

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