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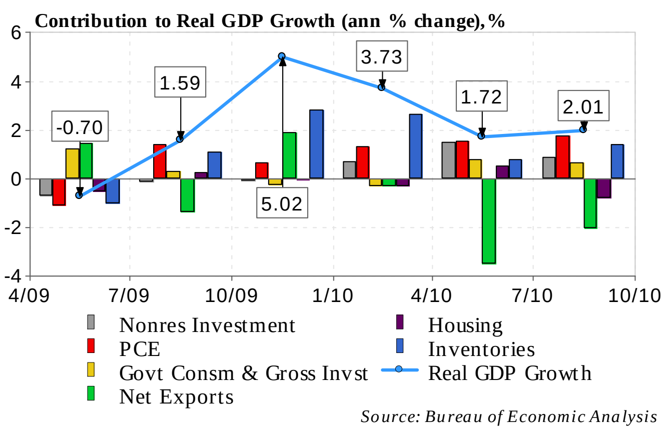
Market Review

October 2010

US Economic Data

The initial GDP numbers show that the US economy continues on its path towards a slow and sluggish recovery. The third quarter GDP (advance estimate) increased at an annual rate of 2%, close to the consensus estimate of 2.1% and a slight acceleration from the second quarter's 1.7%

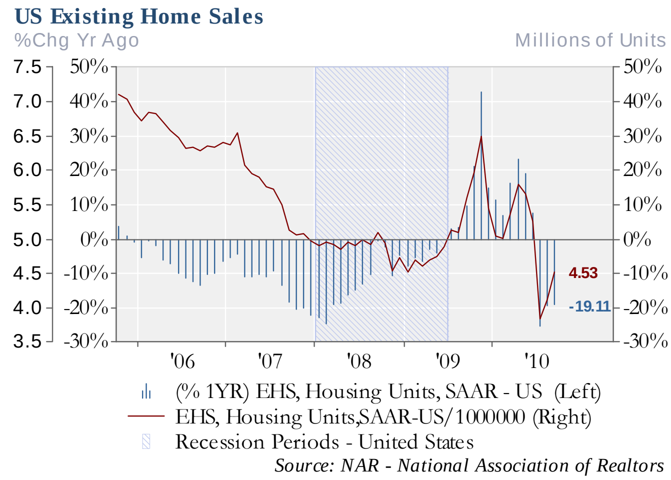
As with the previous few quarters, most of last quarter's recovery can be attributed to an increase in inventories and consumer spending (the blue and red bars respectively in the chart below). Despite the recent dollar weakness, net-exports (green bars) have been a significant drag during the last two quarters as the import growth outpaces the growth in exports.



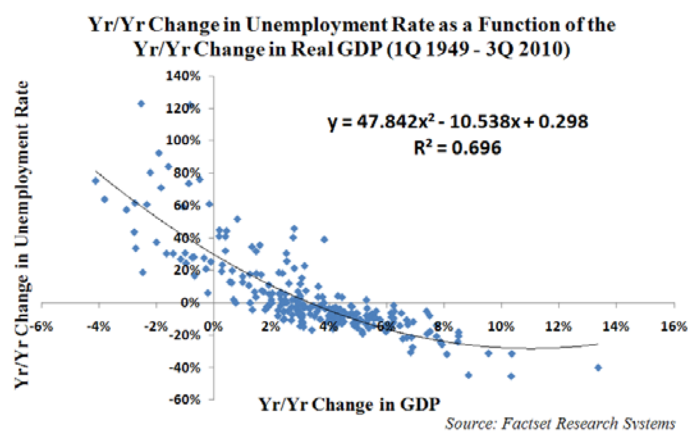
The ISM numbers for October came in at 56.9 indicating some growth in manufacturing. The economic recovery has so far been led by the inventory build-up. In order for the manufacturing segment to continue to increase output and thus encourage the companies to keep building inventories, consumers will have to spend more.

The leading economic indicators rose 0.3%, in line with the consensus in September. This is a third straight positive month. The August numbers were revised downwards from 0.3% to 0.1%. The LEI data combined with current GDP, manufacturing and other economic data support our belief of a slow economic recovery.

The September CPI rose 0.1% - less than the expected 0.2% estimate. The core rate (CPI ex-food and energy) was unchanged at 0.1%. Existing home sales for September jumped nearly 10% over August (4.53 M vs. 4.12 M). This number is still down nearly 20% from a year ago and the inventory of unsold homes is close to an all time high. The new home sales rose by nearly 7% (0.31 M vs. 0.29 M).



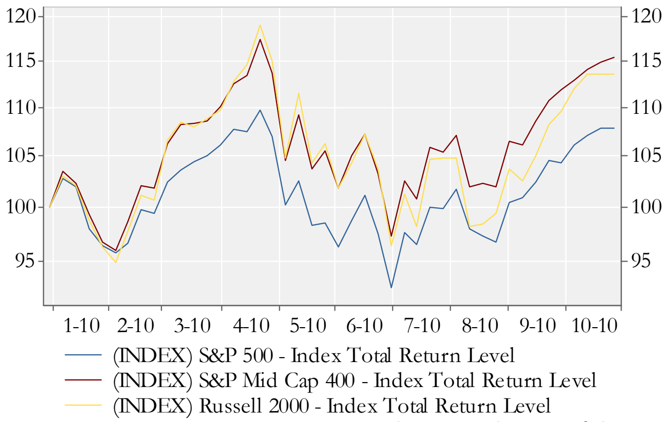
Beginning in May 2009, the unemployment rate has remained firmly above 9%. The chart below plots the historical relationship between employment growth and GDP. The trend-line indicates that a GDP growth rate of above 3% is required to make any kind of dent in the unemployment numbers.



Equity Markets

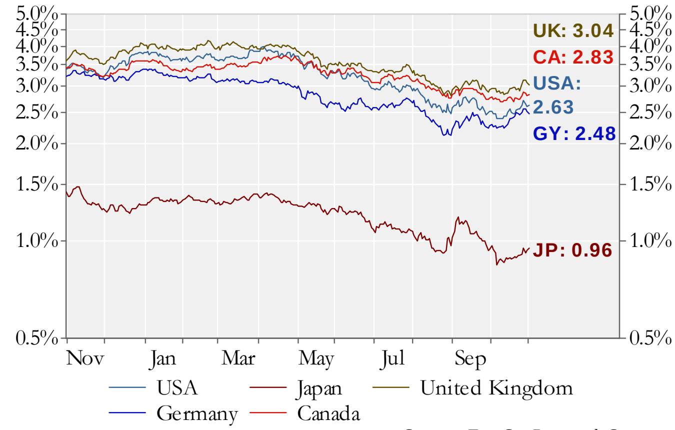
Equity markets delivered yet another month of strong performance. The unexpected announcement of a second round of quantitative easing by the Fed in late August is likely the driving force behind this rally. The S&P 500 was up 3.8% during the month and is up 7.8% YTD. The MSCI World index rose by 3.75% and MSCI EAFE by 3.62% in October. The FTSE 100 gained 2.42%, while the STOXX 600 recorded returns of 2.48%. The MSCI Emerging markets index was up 2.91% in October.

USA Equity Total Return - LCap vs MCap vs SCap



Source: FactSet Research Systems

Global 10Y Treasury Yields

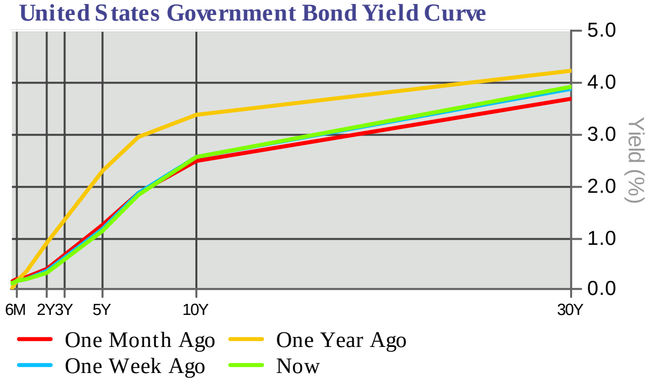


Source: FactSet Research Systems

Bond Markets

The market expects the Fed to announce the details of a second round of quantitative easing in the first week of November. US Treasuries had mixed reactions to this in October. The shorter term maturities posted slight gains in anticipation of further Fed purchases, while longer maturities sold off. Two year yields fell 8 bps to 0.34% (new record low) and the five year yield fell 10 bps to 1.17%. The yields on 10 year and 30 year bonds increased 9 bps and 30 bps respectively in October, closing at 2.61% and 3.99% respectively.

United States Government Bond Yield Curve

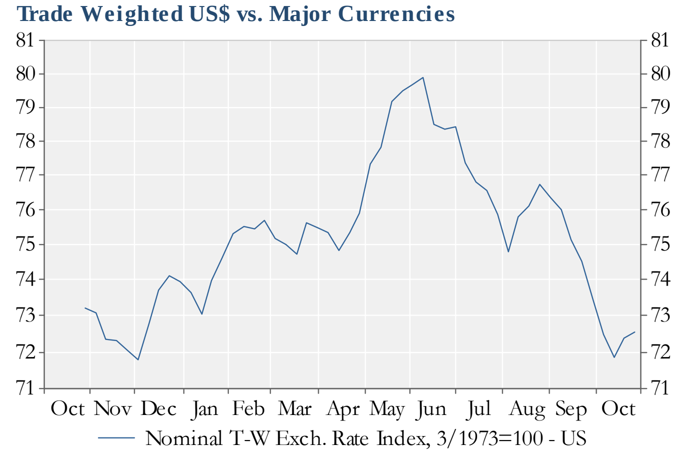


Source: Tullett Prebon Info.

The German 10 Year Bund yield rose by nearly 25 bps to close at 2.52%. The UK 10 Year & 30 Year GILT yields also increased closing at 3.08% and 4.12% respectively. The Barclays Capital US Aggregate Index returned 0.36% last month.

Currency

Trade Weighted US$ vs. Major Currencies



Source: Federal Reserve System

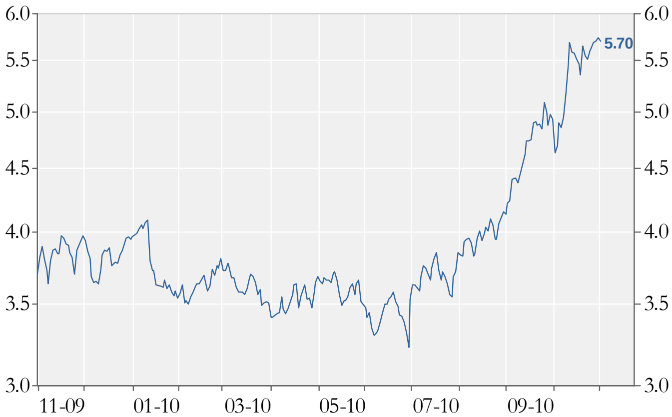
The DXY Index continued its downward trend in October. Euro appreciated 2.37% and British Pound appreciated 2.07% vs. the USD respectively. Japanese Yen is trading close to a 15 year high and the Australian dollar is close to a 28 year high vs. the USD.

Commodity Markets

The combination of a weakening dollar, a possible second round of quantitative easing and some strong fundamentals have helped the commodity markets continue to make gains in October after a big rally in September.

Softs enjoyed a strong rally with Cotton and Sugar up nearly 20% and 15% respectively. Coffee was up 11%. Cotton faced some tight inventories in China while lower than expected production in Columbia helped Coffee. The US Department of Agriculture scaled back Corn production forecasts resulting in nearly a 17% appreciation.

Corn - Spot Price - Central Illinois No 2 Yellow ($/Bu)



Source: Factset Research Systems

The weak dollar pushed precious metals up last month. Gold reached an all time high of $1387 on October 14th as investors bought the precious commodity as an inflation hedge. It closed the month at $1357.1, up nearly 4%. Silver and Palladium returned close to 13%.

Energy and industrial metals made small gains in October as the demand was not as strong as the agricultural and precious metals. Crude was up 1% while copper was up 2%.

Closing Note

As we prepare to send this Market Review, the Federal Open Market Committee concluded their two day meeting by announcing that the Federal Reserve will purchase $600 billion in US Treasury securities by June 2011, in addition to the $250-300 billion of purchases expected from principal payments associated with the Fed's current holdings of agency debt and MBS. The purchases will be concentrated in Treasury notes with maturities of 2.5 to 10 years with a target average duration of 5-6 years for the total program.