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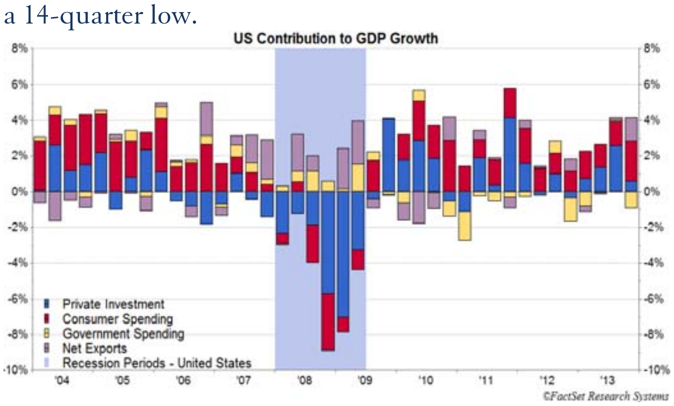
Market Review

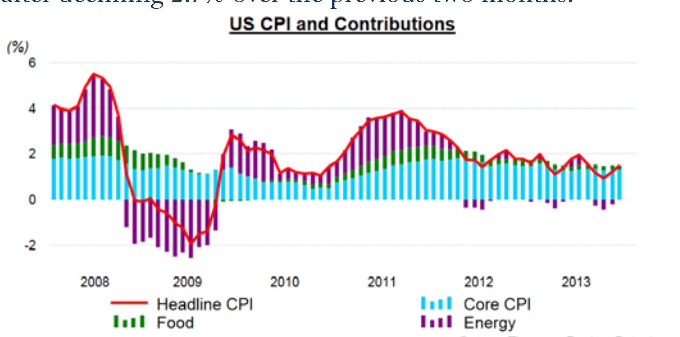
January 2014

Economic Review

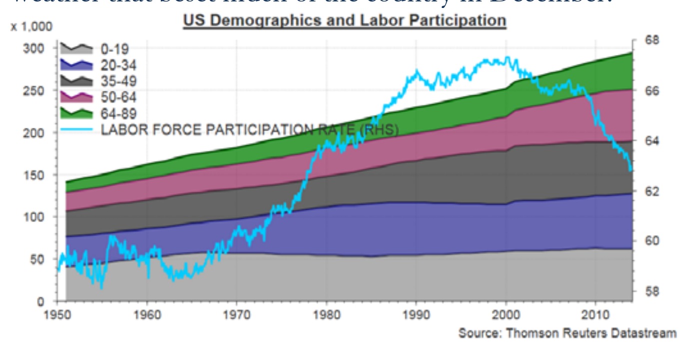
In January, the advance estimate of U.S. fourth quarter real GDP showed 3.2% annualized growth. The results indicate a 2.7% growth rate in 2013, the strongest rate in three years. Consumer spending, the largest component of GDP, grew 3.3% in the fourth quarter, a significant increase from the 2% growth in consumer spending in the previous quarter. The report also showed the impact of the government shutdown on GDP, as government spending fell at a 4.9% rate. The reduction in government spending cut fourth quarter growth by 0.3%. Surprisingly, housing detracted 0.33% from GDP, as fixed residential investment came in at a 14-quarter low.



The headline Consumer Price Index (CPI) rose 0.3% in December, capping off a 1.5% rise in 2013. The CPI for 2013 was slightly lower than the 1.7% increase in 2012 and substantially lower than the 2.4% average over the last decade. It was also below the Federal Reserve's stated inflation target of 2%. This also marks the first time since 1997-1998 that CPI has been under 2% for two consecutive years. Core CPI, which excludes food and energy costs, rose 0.1% in December and is up 1.7% in 2013. Food prices rose 0.1% in December, while energy costs rebounded 2.1%, after declining 2.7% over the previous two months.



Nonfarm payroll grew by 74,000 in December, well below the 197,000 estimate, and November payrolls were revised from 203,000 to 241,000. The unemployment rate, however, dropped from 7.0% to 6.7%, driven largely by a substantial decline in the labor-force participation rate. The Federal Reserve Bank of Chicago expects the participation rate to trend lower through 2020 due partially to an aging population. The labor force shrank from 155.3 million to 154.9 million, and the participation rate decreased from 63% to 62.8%. Retail continues to be a strong hiring sector, adding 55,000 jobs in December, while government (-13,000) continues to detract from job growth. The construction industry posted a loss of 16,000 jobs, which economists partially blame on the unusually severe winter weather that beset much of the country in December.



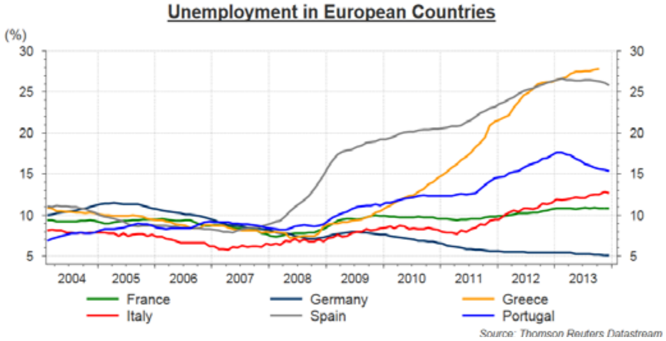
The Institute for Supply Management's (ISM) headline Purchasing Managers Index (PMI) for Manufacturing registered a reading of 57 in December, indicating strong expansion in the U.S. Manufacturing sector. A reading above 50 indicates expansion, while a reading below 50 indicates contraction. The solid headline number was driven by an increase in the New Orders sub-index, which rose from 63.6 to 64.2. The Manufacturing Employment sub-index also delivered a positive surprise, registering 56.9, up from 56.5 in November. The Prices sub-index continued a 5-month trend of expansion, growing in December from 52.5 to 53.5. The Inventories and Exports sub-indices reported negative surprises; the Inventories sub-index signaled contraction after substantial growth in previous months, while the Exports sub-index's value d from 59.5 to 55.

The Federal Reserve announced additional tapering of its accommodative monetary policy in January. The announcement reduced the Fed's monthly bond purchases from $75 billion to $65 billion. The Fed announced that it would reduce purchases of U.S. Treasury and mortgage bonds in equal $5 billion amounts, mirroring the committee's initial tapering decision in December. In a unanimous decision by the Fed's 10 voting members, the committee cited cumulative progress in the economy and labor market as reason to continue tapering. The January Fed meeting was the final policy meeting of Chairman Ben

Bernanke's tenure; Janet Yellen began her term as Federal Reserve Chair on February 3rd.

Eurozone unemployment fell for the third consecutive month in December, as the number of jobless fell by 129,000 to just over 19 million people. The unemployment rate remained unchanged at 12%. Youth unemployment fell by 23,000 to just over 3.5 million people and the youth unemployment rate fell slightly from 24% to 23.8%. A strong labor market in Germany (5.1% unemployment) continues to buoy the region, while crippling unemployment (over 25%) in Greece and Spain are a drag on the region. Greece and Spain also both have youth unemployment over 50%. Growth continues to elude the Eurozone, as the final third quarter 2013 GDP report showed a tepid 0.1% growth rate. In addition, policy makers are concerned about the threat of deflation, with the January reading of 0.7% indicating mild disinflation from the 0.8% reading in December.

Unemployment in European Countries



The Bank of England voted to hold its key interest rate unchanged at 0.5% and maintain the £375 billion quantitative easing program. In forward guidance, the Bank of England has signaled a 7% unemployment rate as a hurdle to reevaluate interest rate policy. British unemployment stands at 7.4%, and inflation has fallen to the Bank's 2% target for the first time in four years.

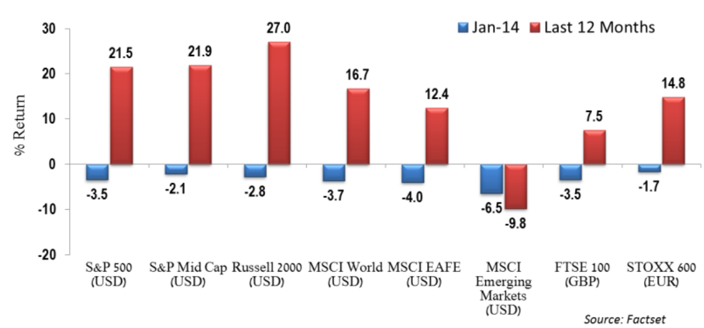
In Asia, China's reported growth hit a six-month low of 7.7%, narrowly beating expectations of 7.6%, which would have been the slowest since 1999. Chinese growth has struggled due to a decline in fixed-asset investment, which grew at 19.8% in 2013, the slowest full-year of growth since 2002. Japan, by comparison, saw positive economic surprises in January. The Japanese economy registered 1.3% inflation in December, and the unemployment rate fell to 3.7%. Retail sales expanded by 4.0%, though the increase in consumer spending is partially due to a rush of demand ahead of a major sales tax increase set to be enacted in April 2014.

Equity Markets

Equity markets struggled in January, as a poor start to the earnings season and speculation of further reduction in stimulus by the Federal Reserve pushed stocks lower. January was the worst month for stocks in over a year and the worst January return in four years. Domestic large-cap stocks, as measured by the S&P 500, lost 3.5% in January. Mid and small-cap stocks each lost over 2% on the month. Global stocks also declined, as the MSCI World Index lost 3.7%; the MSCI Emerging Markets Index lost 6.5% in January, as emerging markets continue to lag equity markets in the developed world. The headline indices for Europe (STOXX 600) and the UK (FTSE 100) lost 1.7% and 3.5% in January, respectively.

The U.S. equity market was relatively flat through mid-January, suffering most of the monthly losses in the last week of trading. A combination of weak economic data in the U.S. and China spurred concerns of a global growth slowdown. In addition, a weak start to 4th quarter earnings announcements, paired with an additional $10 billion monthly reduction in Federal Reserve bond-buying, contributed to a sell-off in stocks. The CBOE Market Volatility Index (VIX), a measure of expected future volatility, rose sharply in the final week of January. The VIX had a monthly low of 11.81 on January 15, and rose to close the month at 18.41. The spread between the monthly high and low of the VIX was 7.18, the highest value since October 2013.

Equity Market Performance

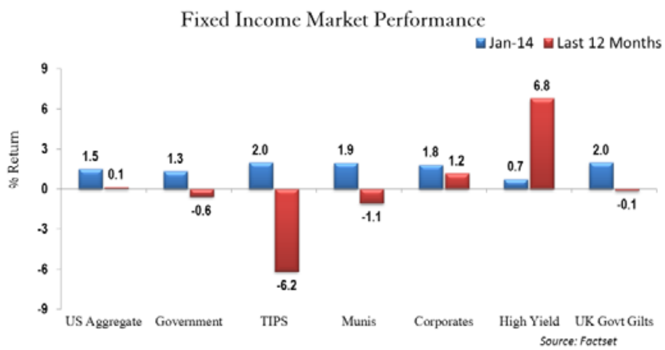


Bond Markets

Fixed income markets rallied across the board in January, as a flight-to-safety rally occurred in response to growth concerns and a weak equity market. The U.S. bond market, measured by the Barclays U.S. Aggregate rose 1.5% in January, while the U.S. Government Bond index gained 1.3%. Despite U.S. High Yield credit spreads (measured by the Bank of America Merrill Lynch U.S. High Yield Master

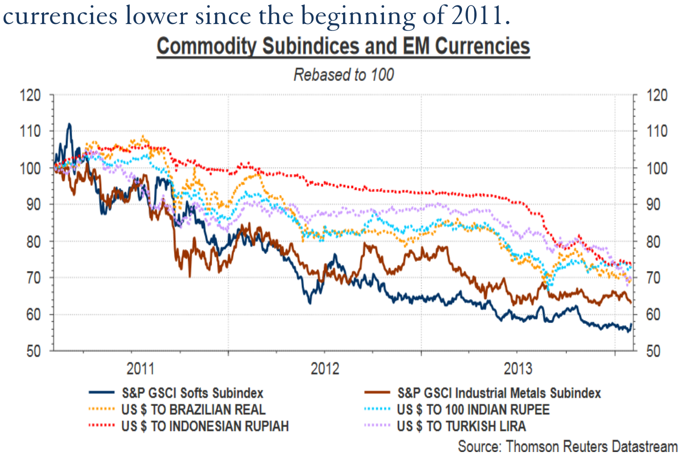
II Option-Adjusted Spread) expanding by 21 bps, the U.S. High Yield Index rallied 0.7%.

The 30-year U.S. Treasury bond yield fell 30 bps, the 10-year yield fell 32 bps, and the 10-2 Treasury spread flattened by 27.5 bps. The Barclays U.S. Government Breakeven Index, which measures future inflation expectations, declined 27 bps to 2.63%. The yield on German 10-year benchmark bonds fell 28 bps to end January at 1.66%. The yield on UK 10-year benchmark bonds declined 32 bps to close at 2.7%.



Commodities

The S&P GSCI Total Return Index, a headline index of 24 commodities, lost 1.64% in December, and has lost 6.89% over the last 12 months. The Petroleum and Industrial Metals sub-indices led the Index lower, losing 2.84% and 4.29%, respectively. Industrial Metals, along with Soft Commodities, have tracked the Emerging Market currencies lower since the beginning of 2011.



Aluminum pulled the Industrial Metals sub-index lower, losing 8.17% in January. Lead and Zinc each lost over 4%, while Copper lost 3.81%. Refined Petroleum products all fell in January, as Gasoline (down 5.98%), Gasoil (down 3.06%), and Heating Oil (down 1.56%) trended lower throughout the month.

Natural Gas rallied strongly in January, finishing the month 17.98% higher. An unusually cold winter, including the "Polar Vortex" cold snap in the United States, drove prices higher. Global supply concerns pushed the price of Cocoa 7.46% higher in January; Cocoa has rallied 28% in the last 12 months. Similarly, dry weather in Brazil caused supply concerns in the Coffee market, which drove prices 13.1% higher.

Currency

The global currency market was driven in January by reactions to Federal Reserve tapering and expectations of future reductions in the Fed's bond-buying program. The US Dollar Index, a measure of the Dollar against the currencies of six major trading partners, strengthened 1.52% in January. The index has risen 2.58% over the last 12 months.

In the developed world, the Euro lost 2.13% in January. The Canadian Dollar weakened 4.7% against the US Dollar after speculation that the Canadian Central Bank will cut interest rates. The Japanese Yen rallied 3.06% on strong price growth and speculation that the Bank of Japan will hold off on additional quantitative easing.

Emerging market currencies struggled across the board in January. The Brazilian Real weakened 2.58%, the Mexican Peso fell 2.13%, and the Malaysian Rand declined 2.12%. The Central Bank of Turkey raised short-term interest rates from 4.5% to 10%, which stabilized the Turkish Lira after the currency had weakened over 4% in January. Similarly, the South African Rand plunged 6.22% in January and the South African Central Bank responded by raising the repo rate from 5% to 5.5%.