

Capital Markets Flash Report

US Equity Markets	Feb-10	Y-T-D
Large Stocks:		
S&P 500	3.10%	-0.61%
Russell 3000	3.39%	-0.34%
Russell 1000	3.30%	-0.42%
Russell 1000 Growth	3.44%	-1.08%
Russell 1000 Value	3.16%	0.26%
Small Stocks:		
Russell 2500	4.97%	1.46%
Russell 2000	4.50%	0.66%
Russell 2000 Growth	4.36%	-0.31%
Russell 2000 Value	4.64%	1.57%
International Equity Markets**		
MSCI EAFE	-0.68%	-5.05%
MSCI EAFE Growth	-0.03%	-4.24%
MSCI EAFE Value	-1.34%	-5.86%
MSCI Europe	-1.98%	-7.76%
MSCI Japan	1.12%	3.04%
MSCI Emerging Markets	0.37%	-5.21%
Hedge Fund Markets***		
HFRX Indexes:		
Convertible Arbitrage	-0.71%	-0.41%
Distressed	0.68%	2.10%
Equity Hedge	-0.01%	-0.85%
Equity Market Neutral	1.39%	0.90%
Event Driven	0.05%	0.70%
Macro	1.06%	-0.80%
Relative Value Arbitrage	-0.56%	1.06%
US Fixed Income Markets		
U.S. Treasury Bonds ⁽¹⁾	0.19%	2.33%
Treasury Inflation-Protected Securities ⁽²⁾	-1.08%	0.40%
Tax-Exempt Bonds ⁽³⁾	0.67%	1.21%
Corporate Bonds ⁽⁴⁾	0.10%	2.39%
High-Yield Bonds ⁽⁵⁾	-0.55%	0.28%
Real Asset Markets		
DJ UBS Commodity Index Total Return	3.71%	0.00%
FTSE NAREIT Equity Index	5.34%	-0.45%

Overview

US equity markets reacted positively to evidence of stronger-than-expected US economic growth as GDP growth in the 4th quarter was revised slightly upwards to 5.9%. While a strong number to be sure, reports indicate that over 2/3 of the total is attributable to unsustainable inventory rebuilding. The US Dollar re-asserted its status as the world's safe haven surging against most foreign currencies in the wake of the continuing debt crisis in Greece. In particular, the Euro took a terrible beating as the fragility of the EU became clear. Finally, we were all treated to a surreal round of Kabuki political theatre as the Democrats and Republicans met on live TV to "debate" the health care bill.

US Equity

US equities bounced back strongly in February, reversing most of their January losses. Economically-sensitive small caps surged as some investors appear to believe that recent economic strength is sustainable...we believe it is not. After gaining 9% in January, regional banks tacked on another 2% for the month. Hmm...it seems odd to us that these banks' stock prices would be rising while loan volume is at all time lows, the Fed raised the discount rate and commercial real estate loans on the books have yet to be marked down from par.

International Equity

February offered little relief for investors in International Developed and Emerging Markets. Both MSCI EAFE and EM Indices have lost roughly 5% so far in 2010. European equities were hard hit with European Union markets down 2% in February (adding to losses of nearly 8% for the year). EM Europe was down over 6% in the last month. Offsetting Europe's travails were Asia which rose by 2% and Latin America which rose by over 4%.

It is clear from international stock markets' performance that investors are fearful of the unsustainable levels of government debt around the world, especially in the UK and the European "PIIGS". Eventually, someone has to pick up the tab for deficit-driven spending and the natural outcome seems to be that austerity measures will be implemented, taxes will rise and interest rates will climb. US politicians would be well advised to observe what is happening in Europe as a harbinger of possible things to come.

Hedge Funds

Hedge managers, on the whole, generated positive returns and have seen fund inflows this year.

One encouraging sign is the solid performance posted by equity market neutral funds this month. These managers often own high quality stocks and short poor quality stocks. This strategy had not worked too well in 2008 or 2009 as company fundamentals mattered little. Perhaps this sector's solid performance in February indicates a partial return to sanity. Event-driven strategies should perform well this year, as many corporations, flush with cash, seek to gain market share by acquiring weaker competitors at attractive valuations. Unfortunately, this is also a bad sign for employees of these firms as mergers often lead to layoffs.

Fixed Income

Returns to major fixed income classes were mostly flat in February. Intermediate US Treasuries and Corporate Bonds are up over 2% for the year. Over the same period, TIPS have been flat. Given these results, interest rate risk and inflation fears appear to have taken a backseat for now.

Real Assets

Commodities recovered from the impact of China's surprise credit tightening in January, returning 3.7% in February. The rising US Dollar also gave a boost to commodities.

REITs are now flat for the year after strong returns in the past month (up 5.3%). However, US housing data has been discouraging as of late and the situation in the commercial real estate market is even more ominous. China is becoming an increasingly interesting case study in commercial real estate, even grabbing a few headlines recently. The country's skyrocketing real estate prices, largely driven by government intervention and stimulus coincides with alarmingly high vacancy rates. In some major cities, 50% of the office space is unused! Talk about unsustainable.

(1) Fidelity Spartan Intermediate Treasury Bond Index is used as a proxy for intermediate US Treasury bond funds. (2) Vanguard Inflation-Protected Securities Fund is used as a proxy for US Treasury Inflation Protected Securities funds. (3) Vanguard Intermediate-Term Tax-Exempt Fund is used as a proxy for tax-exempt bond funds. (4) Vanguard Intermediate-Term Investment Grade Bond Fund (Admiral shares) is used as a proxy for intermediate corporate bond funds. (5) Vanguard High-Yield Corporate Fund is used as a proxy for high-yield corporate bond funds.

*Data Source: Bloomberg ** The MSCI returns are gross returns calculated in US Dollars. *** Hedge Fund Index returns are reported using Simple Price Appreciation and are only available on a one day lag. For complete Index Descriptions, please go to <http://www.greycourt.com/indices.html>