

Capital Markets Flash Report

Overview

GDP grew at a 2.8% annualized rate in the fourth quarter and inflation remains tame. December consumer spending was up 0.1% year over year despite wages growing at a healthy 0.4% in the same month. The Fed recently announced its intention to keep short rates low through 2014 and signaled that it is prepared for QE3. This announcement led to renewed US dollar weakness and supported gold futures (among other commodities). Greece and the "Troika" appear to be nearing an orderly default deal. Despite pessimism on Monday about a delay in the deal, the market seemed unwilling to sell off meaningfully on this uncertainty. The latest Shiller housing data for the US came in below expectations, further evidence that we are still just bouncing along the bottom in real estate.

US Equity

It was a very strong start to the year for the S&P 500 which finished January up 4.5%, more than double its gain for all of 2011. Digging into the sectors a bit, financials led with a 7% gain, as big name banks like BAC, MS, and JPM have had impressive YTD run-ups (28%, 23%, 12% respectively). In contrast to these high-fliers, we have seen last year's winners stumble out of the gates. Utilities lost 3.2% and consumer staples dropped 1.6% in January. Small caps outperformed large caps this month by 250 bps. This follows a year where small caps trailed large caps by 600 bps.

Exchange volume has been anemic on both upside and downside moves as of late. It's early in the season still but earnings have been disappointing thus far with a "beat rate" under 60%, revenues generally in line with expectations, and weak guidance. The strong quarterly results and guidance provided by titans Apple and Caterpillar have certainly eased some of this disappointment.

International Equity

The MSCI EAFE Index jumped by 5.3% in January, making up for some of last year's disappointing performance. This return was boosted by a rebound in the Euro (up 1%) amid some signs of stabilization in the Greek debt crisis. Emerging markets ripped in January, adding over 11%. The SENSEX Index (India) added over 21% this month as investors piled into the most beleaguered EM markets of 2011.

Hedge Funds

January's trading environment, like that of December, was not the "risk-on" trading environment that characterized much of 2011. Rather, we saw "risk-on" with healthy dispersion amongst equity returns. Long-short traders benefitted from the market rally in line with their net exposure but greater equity return dispersion was the real driver for stock-pickers. Less nimble macro managers struggled to keep pace this month as Eurozone stress eased in both debt and equity markets. Finally, event-driven and distressed strategies likely benefitted from improved marks on distressed assets following some 2011 year-end markdowns.

Fixed Income

TIPS outperformed nominal Treasuries by 1.3% to start the year as investors once again showed an appetite for inflation protection on Fed easing. Munis benefitted from the usual reinvestment-driven demand spike in January, gaining 2.2%. Finally, high-yield debt rose 2.8%. This marks the second month in a row in which Treasuries, high-yield debt, and US equities all realized gains. With the Fed's latest announcement on short rates, we don't expect this flight to US dollar assets to continue much longer and once again, we should see less correlated returns between risk-free Treasuries and risky equities in the months ahead.

Real Assets

It was a volatile month in commodities. Gold rebounded 11% on an "easy" Fed meeting. Oil was basically flat while industrial metals soared in anticipation of the beginning to the "Year of the Dragon" in China. Despite many bullish headlines for natural gas in January (lower reserve estimates from IEA and plans by some major producers to curtail US production), spot prices fell another 17%. This loss was driven mainly by unseasonably high temperatures throughout the US. And so, the glut continues. It is encouraging that President Obama recently acknowledged natural gas as a solution to our oil dependency. Baby steps...

US Equity Markets	Jan-12	YTD
Large Stocks:		
S&P 500	4.48%	4.48%
Russell 3000	5.05%	5.05%
Russell 1000	4.87%	4.87%
Russell 1000 Growth	5.97%	5.97%
Russell 1000 Value	3.78%	3.78%
Small Stocks:		
Russell 2500	6.65%	6.65%
Russell 2000	7.06%	7.06%
Russell 2000 Growth	7.48%	7.48%
Russell 2000 Value	6.65%	6.65%
International Equity Markets**		
MSCI EAFE	5.35%	5.35%
MSCI EAFE Growth	5.48%	5.48%
MSCI EAFE Value	5.23%	5.23%
MSCI Europe	4.72%	4.72%
MSCI Japan	4.52%	4.52%
MSCI Emerging Markets	11.36%	11.36%
Hedge Fund Markets***		
HFRX Indexes:		
Convertible Arbitrage	2.04%	2.04%
Distressed	3.06%	3.06%
Equity Hedge	1.88%	1.88%
Equity Market Neutral	0.60%	0.60%
Event Driven	2.65%	2.65%
Macro	-0.08%	-0.08%
Relative Value Arbitrage	1.57%	1.57%
US Fixed Income Markets		
U.S. Treasury Bonds ⁽¹⁾	0.94%	0.94%
Treasury Inflation-Protected Securities ⁽²⁾	2.21%	2.21%
Tax-Exempt Bonds ⁽³⁾	2.19%	2.19%
Corporate Bonds ⁽⁴⁾	2.24%	2.24%
High-Yield Bonds ⁽⁵⁾	2.85%	2.85%
Real Asset Markets		
DJ UBS Commodity Index Total Return	2.47%	2.47%
FTSE NAREIT Equity Index	6.36%	6.36%

(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>