

Capital Markets Flash Report

Overview

It was an incredible month for the Eurozone as socialists rushed to the ballots in France and Greece, sparking a paradigm shift in the balance of Eurozone political policy and in many investors' minds, upping the odds of a disorderly breakdown of the EU. Germany's Merkel is being pressured (by both internal and external forces) to issue Euro bonds aimed at stabilizing European banks and the flagging Euro, which has fallen below \$1.25. Upcoming elections in Greece will likely determine the country's future in the EU. Despite the alarming results of May's election, recent polls suggest that Greece may opt for the pro-bailout New Democracy Party.

On top of all of the Euro-chaos, US 1st quarter GDP growth came in at an unimpressive 1.9%, revised down from the previous 2.2% estimate. The silver lining in the data is that consumer spending grew 2.7%. On the flip side, government spending dropped and business spending was weak, signaling continued caution from CEOs - not a great prospective indicator for employment gains.

US Equity

In May, political turmoil and weak economic signals out of Europe drove risky assets lower and while US equities were among the best performers globally, the S&P 500 still lost 6% and small caps dropped 6.6%. The energy and financial sectors were hit hardest in May, losing 10% and 8%, respectively. Defensive sectors like utilities and consumer staples were closer to flat. Lastly, Facebook fell precipitously after its May 18th debut on the NASDAQ, erasing over \$20 Billion in market capitalization in just over one week. Undoubtedly, a painful valuation lesson for some investors.

International Equity

Over half of Eurozone is in recession with few signs of a meaningful recovery on the horizon. Weak economic conditions coupled with escalating uncertainty over the future of the monetary union, caved international equity markets and the Euro. For the month, MSCI EAFE was down 11.4%! The more modest losses experienced in local equity markets were amplified for US-based investors by the 7% drop in the Euro's value.

MSCI EM lost 11%, in line with developed international equities. China's 1st quarter GDP growth was 8.1%. Despite that enviable level of economic growth, policy makers are very concerned with domestic demand, increasing the likelihood of further easing. EM equities are now flat YTD and down 20% for the trailing 1-year period. By comparison, EAFE has also lost 20% over the last year but the S&P 500 is only down 2.6% for the same period.

Hedge Funds

Returns for most hedge strategies were modestly negative this month but all-told, the performance relative to long-only equity indices was superb. So far this year, our managers have generally have expressed caution by running low net exposure. This caution reflects the uncertainty of the macroeconomic and political backdrop and was rewarded handsomely this month. Macro strategies employing tail-risk hedging were particularly strong as European sovereign CDS spreads widened this month. M&A activity was subdued in May relative to April's favorable uptick.

Fixed Income

In May, amid the unrelenting rout in global equity markets, investors flocked to higher-quality assets. This drove US Treasuries and German Bunds to record low yields. 10-year US Treasury bonds are now trading below 1.6% and Germany just successfully issued 2-year Bunds with no coupon! High yield bonds slipped 1% this month but are still up a healthy 4.4% in 2012.

Real Assets

Investors (err...evil speculators) shunned commodities this month. The DJ-UBS Commodity Index dropped 9.1%. The real driver of this negative performance was an 18% drop in crude oil prices. Thankfully, Iran has not captured many headlines as of late and traders finally seem to be discounting the relative glut of oil in the US. Given the heavy selling pressure in May, many individual commodities are now oversold relative to their 200-day moving averages. Natural gas defied the overall commodity trend, adding 1% this month; the spot price is now 30% above its YTD low of \$1.87/MMBtu. Commodity-linked currencies also suffered this month as the Aussie dollar lost 7% and the Canadian dollar fell 5% (relative to the USD).

US Equity Markets

	May-12	YTD
Large Stocks:		
S&P 500	-6.01%	5.16%
Russell 3000	-6.18%	5.19%
Russell 1000	-6.15%	5.35%
Russell 1000 Growth	-6.41%	7.17%
Russell 1000 Value	-5.86%	3.54%
Small Stocks:		
Russell 2500	-6.83%	4.50%
Russell 2000	-6.62%	3.37%
Russell 2000 Growth	-7.13%	3.48%
Russell 2000 Value	-6.11%	3.26%

International Equity Markets**

MSCI EAFE	-11.35%	-3.43%
MSCI EAFE Growth	-11.18%	-1.20%
MSCI EAFE Value	-11.54%	-5.68%
MSCI Europe	-12.06%	-4.62%
MSCI Japan	-8.92%	-1.83%
MSCI Emerging Markets	-11.16%	0.20%

Hedge Fund Markets***

HFEX Indexes:		
Convertible Arbitrage	-0.68%	3.18%
Distressed	-1.19%	4.01%
Equity Hedge	-3.03%	0.70%
Equity Market Neutral	-0.35%	-3.47%
Event Driven	-1.90%	3.70%
Macro	0.35%	-0.52%
Relative Value Arbitrage	-1.42%	2.38%

US Fixed Income Markets

U.S. Treasury Bonds ⁽¹⁾	2.20%	3.14%
Treasury Inflation-Protected Securities ⁽²⁾	1.82%	4.64%
Tax-Exempt Bonds ⁽³⁾	0.68%	3.06%
Corporate Bonds ⁽⁴⁾	0.51%	4.20%
High-Yield Bonds ⁽⁵⁾	-1.01%	4.36%

Real Asset Markets

DJ UBS Commodity Index Total Return	-9.13%	-8.72%
FTSE NAREIT Equity Index	-4.41%	8.44%

(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>