



*December 15, 2008*

**Weekly Market Commentary**

In terms of weather, it is called “misting:” That not unpleasant feeling of airborne moisture drifting in from a harbor. So, it was misting on Wall Street last week, the barest drizzle that almost qualified as partly sunny. With stocks finishing the week mixed, it almost seemed as if flat might be the new up.

The lack of losses by the market was a wonder. The market didn't come unwound despite that fact that \$14 billion in financial aid to the automakers was voted down in the Senate, raising the risk of imminent bankruptcy filings in the auto industry. Weekly initial jobless claims reached 573,000, while continuing claims hit 4.43 million – both 26-year highs. Financial stocks dove after J.P. Morgan and U.S. Bancorp warned of troubled earnings for the quarter. Still, the S&P 500 Index and NASDAQ Composite Index registered slight gains.

There were some positive developments: Procter & Gamble reaffirmed its earnings guidance and core producer prices firmed up. There was a generally positive reaction to President-elect Obama’s proposed stimulus package, which centers on improvement to the nation’s infrastructure. While currency traders didn't seem all that enthusiastic – the dollar dropped versus the

Euro – the stock market rallied on the news last Monday before giving way to a roller coaster ride the rest of the week. Despite all of the bad news, the stock market digested it with relative ease. It wasn't that long ago that this battery of adverse reports would have produced a week of material losses. In this respect, it can be argued convincingly that market sentiment has improved.

Consequently, the market's resilience in the midst of the bad news is attracting buyers who see this calm behavior as a sign of a bottoming process – a point we have underscored over the past few weeks.

<b>Key Market Data</b>			
Week ending			
	12/12/08	12/05/08	Change
Dow Jones Industrial Average Index	8,629.68	8,635.42	-0.07%
S&P 500 Index	879.73	876.07	+0.42%
NASDAQ Composite Index	1540.72	1,509.31	+2.08%
10-Year Treasury Note Rate	2.58%	2.70%	-0.12%
NYMEX Crude Future (Barrel)	\$46.28	\$40.81	+\$5.47
Euro/U.S. Dollar	\$1.3360	\$1.2718	+\$0.0642

**The broader view**

However, the piling up of bad fundamental news and the continued flight-to-safety trade in the Treasury market leaves some room for second-guessing whether this newfound perspective can be maintained.

With the Senate rejecting the auto bailout, we believe it is unlikely that Congress will revisit this issue until the newly elected Congress convenes in early January. We still think it is likely, in the meantime, that auto companies will receive money from the Troubled Assets Relief Program (TARP) to forestall bankruptcy filings for the next week or two. The use of TARP funds for the auto companies has two important implications for TARP itself. First, it would draw on the already rapidly dwindling funds; and secondly, it would set the precedent that the TARP can be used for non-financial companies. Both Republicans in Congress and the current administration have objected strongly to the latter in the past. Nevertheless, it is highly unlikely that policymakers will let Detroit cease operations.

On the fixed income side of the equation, we are concerned that the flight to quality and desire for liquidity are reaching extremes. How low can Treasury yields go? We saw yields of 0.01% and below, including negative rates, on Treasury bills last week. (Think about this for a second: Investors are willing to pay the U.S. government for the privilege of putting their money under Uncle Sam's mattress – instead of their own. What a deal!) Treasury money market funds are starting to turn customers away because they cannot cover even basic operating expenses. Conventional wisdom would suggest the 10-year Treasury is well below values associated from the current economic data. Fair value, based on consensus estimates from the International Strategy & Investment Group, Inc. (ISI), states that 10-year Treasuries should be closer to 3.50% instead of the current 2.60%. However, we

believe that, over the next few months, our economic reports and year-over-year deflation readings could push the 10-year Treasury down to 2.00%-2.25% despite such 'fair value' readings.

We believe we will not see Treasury yields climb back to values associated with underlying economic data on inflation and growth, until it appears the Federal Reserve is ready to tighten monetary policy. Likewise, corporate bond yields will probably not decline significantly until investors see a sign or two that the economy is on its way to recovery. Nevertheless, we believe investment grade corporate bonds over the next 12 to 24 months could be one of the best-performing asset classes. While it is widely expected that the Fed will cut rates again, we know that other options are being discussed, including the creation of a committee to study unconventional policy options.

#### **A look ahead**

The Bush administration's decision on whether to use TARP funds to help the automakers and the success, or lack thereof, of GMAC's bid to become a bank holding company should get things started in the coming week. Major news reports this week will likely include the industrial production report, and earnings reports from Best Buy and Goldman Sachs. News is also expected from the Federal Open Market Committee (FOMC) meeting on Tuesday and OPEC on Wednesday. General Electric's Annual Outlook Meeting takes place on Wednesday, followed by Friday's quarterly options expiration.

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All index references and performance calculations are based on information provided through Bloomberg. Bloomberg is a provider of real-time and archived financial and market data, pricing, trading, analytics, and news.

The Dow Jones Industrial Average Index<sup>®</sup> is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Standard and Poor's 500 Index<sup>®</sup> (S&P 500<sup>®</sup>) is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Standard & Poor's offers sector indices on the S&P 500 based upon the Global Industry Classification Standard (GICS<sup>®</sup>). This standard is jointly maintained by Standard & Poor's and MSCI. Each stock is classified into one of 10 sectors, 24 industry groups, 67 industries and 147 sub-industries according to their largest source of revenue. Standard & Poor's and MSCI jointly determine all classifications. The 10 sectors are Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunication Services, and Utilities.

The NASDAQ Composite Index<sup>®</sup>. Stocks traded on the NASDAQ stock market are usually the smaller, more volatile corporations and include many start up companies.

NASDAQ - National Association of Security Dealers Automated Quotations. The NASDAQ is a computer operated system owned by FINRA that provides dealers with price quotations for over the counter stocks.

Bear market calculations and interpretations are derived from data supplied by Ned Davis Research, Inc.

The CBOE Volatility Index<sup>®</sup> (VIX<sup>®</sup>) is a key measure of market expectations of near-term volatility conveyed by S&P 500 Index option prices. VIX uses a weighted average of options with a constant maturity of 30 days to expiration.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. As of June 2007 the MSCI World Index consisted of the following 23 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

International Monetary Fund is an organization set up in 1944 to lower trade barriers between countries and to stabilize currencies by monitoring the foreign exchange systems of member countries, and lending money to developing nations.

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