
Market Update

October 2009 Review

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Seven Month Advance Comes to a Halt in October

To read much in the media or blogs, it has been common to think that the tremendous run we have experienced in the investment markets since early March was “too far, too fast” and that we are due for a correction as the “economic fundamentals don’t support the rally.” While it appeared at the outset of October that the market rally would continue, investor sentiment cooled during the month that would result with the fourth quarter starting out on a mostly negative note. Would this mark the end to what some were calling the “dead cat bounce” or simply be a needed pause to a market rally that has more life?

Despite a consumer that continues to face major headwinds in the form of high unemployment, tight credit and nonexistent wage growth, there were positive signs that the economy was working itself out of the woes of one of the deepest recessions on record. It was reported in October that the U.S. economy expanded at a 3.5% annual rate in the third quarter marking the largest Gross Domestic Product (“GDP”) increase in two years and ending four quarters of declining GDP. Certainly helped by government led incentives such as the “cash for clunkers” program and first time home buyer credits, the GDP increase was also spurred by consumer spending, housing and inventories, which we highlighted as important components to watch closely in our September Update. It is noteworthy that Personal Consumption Expenditures (“PCE”) accounted for nearly 70% of the GDP gain in the third quarter as the consumer accounts for nearly 70% of GDP overall. However, questions still remain about the sustainability of this gain given the government-backed incentives largely subsidizing this rebound. We believe it will be important to track retail sales, particularly as we get into the all important holiday season, to gauge how much the consumer ultimately is back into the consumption mindset going forward. From the business perspective, real top line corporate earnings gains are necessary to convince the investing community that the recession is truly over and that companies can report positive earnings not just on an operating income basis but on revenue growth as well. In order to restore business spending outside the technology budget, the consumer will ultimately need to drive up sales, which will force companies to replenish inventories, and will eventually fuel earnings growth and serve as a catalyst to reestablish the positive trend we have seen in the investment markets since March.

With the exception of the Dow Jones Industrial Average’s 0.14% return, most major equity indices were negative in October. The large cap stock oriented S&P 500 Index lost 1.86% during October but is still positive year-to-date at 17.05%. The NASDAQ cooled slightly in October as well; declining 3.61%. Year-to-date, the NASDAQ is up 30.70% as tech stocks have posted sharp gains. The international equity markets took a step back in October as well with the MSCI EAFE index declining 1.25%. The index has advanced 27.50% year-to-date through October. The fixed

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income markets fared better than most equity indices during the month with the bellwether Barclays Capital U.S. Aggregate Bond Index up 0.63% for October and 6.57% for the year. Riskier strategies continued to outsize more safe haven strategies as the Barclays Capital U.S. Corporate High Yield Index was up 1.80% for the month and has advanced 51.67% for 2009.

So, where do the markets head for the rest of 2009? From a valuation perspective, market indices appear fairly valued and the economy is on more solid footing and may be ready to shed the recessionary hangover even as most economists believe the “official” recession probably ended in June or July. But, how sustainable the investment rally is will be of debate throughout the rest of this year and even into 2010. Weak consumer confidence, sluggish spending and the still deteriorating labor market are all creating worries about what a recovery will look like beyond the near term. Government stimulus programs have helped, but investors are concerned about what a recovery will look like without the help. The good news is that we did not mention inflation as a concern. We will save that for our 2011 market updates.

Definitions & Disclosures:

An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.