

**Week of: November 2, 2009**

## **2009 MARKET VIEWS – SUMMARY**

### **Economy**

- We believe the U.S. economy is stabilizing and there may be modest growth by year end 2009.
- Our forecast conclusions include sustained low inflation and interest rates, weak consumption activity, and relatively weak corporate earnings during the next 18 months.
- In our view, the U.S. unemployment rate will probably not peak until 2010, and may remain persistently high as consumer retrenchment causes dislocation in employment.

### **Equity Markets**

- Beginning in the second half of 2009 and extending into 2010, we anticipate domestic equities may lead most global equity markets in terms of price recovery.
- We believe the domestic equity market's rebound from March lows seems to reflect investors' belief of a return to economic and market normalcy and provides a degree of optimism regarding the unfolding global recovery.
- We anticipate that emerging markets may lead developed international markets over the near and intermediate term.

### **Fixed Income Markets**

- Current rates on Treasury securities appear to be too low and may represent a risk to investors; rates are likely to rise.
- The credit markets, outside of Treasuries, may represent a potentially attractive opportunity for investors.
- Non-Treasury spreads narrowed during the first half of 2009, but are still historically attractive in investment grade and high yield corporate debt.

### **Commodity Markets**

- We expect commodity prices to track the global economy.

### **Real Estate Markets**

- Residential real estate may be near its nadir, but high unemployment and housing supply will likely keep prices low.
- Commercial real estate seems to be weakening and we anticipate this weakness could track into 2010.

## **CURRENT ECONOMIC UPDATE**

### **Domestic**

- Real Gross Domestic Product (GDP) rebounded for third quarter to an annualized 3.5% rate.
  - This improvement is mostly due to upturns in personal consumption, inventory investment, exports, residential fixed investment, and a smaller decrease in nonresidential fixed investment.
    - > Inventories did add to third quarter growth, but the increase was actually less of a decline in the change in inventories.
    - > Businesses are still facing lean inventories and any rise in demand could help boost production of inventories.

# Market & Economic Update

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## CURRENT ECONOMIC UPDATE, Cont'd.

### Domestic, Cont'd.

- > Cash-for-Clunkers did add substantially to third quarter growth as motor vehicle output added 1.66 percentage points to the change in GDP.
- These improvements were only partly offset by a rise in imports, a downturn in state and local government spending, and a deceleration in federal government spending.
- On a year-over-year basis through third quarter, GDP improved to negative 2.3% from negative 3.8% in the second quarter.
  
- Coincident and lagging indicators, but not leading indicators, gave a big lift to the Institute of Supply Management's (ISM) manufacturing index, which jumped more than three points in October to 55.7.
  - Employment, a lagging indicator, was a standout at 53.1 (a nearly seven point gain) which likely indicates that manufacturers actually added to payrolls during the month.
    - > The rise in the workforce appears to be in response to output needs as the production index, a coincident indicator, rose more than seven and one-half points to 63.3.
  - Inventories, also a lagging indicator, gave a big lift to the index by rising nearly four and one-half points to 46.9 as the destocking phase in manufacturing begins to move to a restocking phase.
  
- The consumer sector softened in September, both in income and spending.
  - Personal income for September was unchanged, but the wages and salaries component declined 0.2%.
  - Following the August expiration of Cash-for-Clunkers, consumer spending in September fell significantly, based primarily on a plunge in motor vehicle sales.
  
- Durable goods orders in September rebounded by 1% (following August's 2.6% drop) and reports seem to indicate manufacturing is still on track for a moderate recovery and forward momentum.
  - It is likely that businesses may be investing in equipment more in the coming months as orders for nondefense capital goods rebounded by 2.5% in September, which follows a 7.7% drop the month before.
  - Year over year, overall new orders for durable goods improved to negative 19.6% in September from negative 20.4% the previous month.

### Global

- Britain's economy contracted by 0.4% during the third quarter, which surprised most observers who had expected the data to show Britain had pulled out of recession.
  
- Norway raised its main interest rate by 25 basis points (to 1.5%) and became the first country in Europe to increase rates since the height of the global financial crisis.
  - Norway's huge oil revenues have seemingly helped cushion it against the effects of a severe downturn.
  - Other European countries are not expected to follow this trend.
  
- The Central Bank of India took its first step toward tightening monetary policy by holding interest rates steady, and adding a requirement for banks to set aside more bonds as reserves.
  - The statutory liquidity ratio was increased by one percentage point to 25%, the first step intended to help unwind some of the generous monetary stimulus previously provided to help the economy weather the recent global downturn.
    - > The decision to raise the statutory-liquidity ratio will likely soak up some liquidity from India's banking system, which has threatened to magnify inflationary pressures and undercut a nascent recovery in India's economy.

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## CURRENT ECONOMIC UPDATE, Cont'd.

### Global, Cont'd.

- The inflation estimate for India was also sharply increased to 6.5% from a previous forecast of 5% for the upcoming fiscal year end.
- The growth forecast for this fiscal year remains at 6%, with an upward bias.
- No change was made to the key lending rate, which remains at 4.75%.

## MARKETS AT-A-GLANCE

|                                   | Fed Funds Target Rate | 10-yr Treasury Yield | S&P 500 Close   | DJIA Close      |
|-----------------------------------|-----------------------|----------------------|-----------------|-----------------|
| <b>LAST WEEK</b> (10/30/09 close) | <b>0.00 – 0.25%</b>   | <b>3.39%</b>         | <b>1,036.20</b> | <b>9,712.73</b> |
| Prior Week (10/23/09)             | 0.00 – 0.25%          | 3.48%                | 1,079.60        | 9,972.18        |
| Last Month (09/30/09 close)       | 0.00 – 0.25%          | 3.31%                | 1,057.08        | 9,712.28        |
| Year End (12/31/08)               | 0.00 – 0.25%          | 2.25%                | 903.25          | 8,776.39        |

Data Source: Factset

## CURRENT MARKET EVENTS

### Equity Markets

- The broad market averages traded lower last week likely due to investor concerns about the sustainability of the recovery.
  - For the month of October, the Dow Jones Industrial Average (DJIA) ended down slightly, which is the first down month since February 2009.
  - Volatility in market prices has again elevated, which generally indicates a degree of uncertainty has moved into the marketplace.
- Mid-cap (as measured by the S&P 400 MidCap) and small-cap (as measured by the S&P SmallCap 600) stocks lost only slightly more ground than the larger cap names as of the end of last week.
  - Brazil was off more than the U.S. markets, but Asia remained strong.
  - There are early indications that the fund flows into emerging markets by investors is reaching a bit of a boiling point.
    - > Fund flows through the end of September have almost equaled the entire year of 2007 (which was a record year).
  - It appears that equity investments into the emerging markets are getting very popular.
- Third quarter earnings reports are now peaking in terms of frequency.
  - Revenues and earnings are down approximately 8% and 17% on a year-over-year basis.
    - > However, there are indications that momentum is building on important quarter-over-quarter growth rates, but the strength and sustainability of these growth rates are in question.
    - > It's possible to make the case that the market is over bought technically and sentiment has reached a near-term high.
  - The economic fundamentals remain solid (with a few exceptions) and 80% of the S&P 500 companies that have reported have exceeded expectations.
  - We would place the recent market trading action as "the pause that refreshes" as opposed to something more long lasting and problematic for equity investors.

# Market & Economic Update

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## CURRENT MARKET EVENTS, Cont'd.

### Fixed Income Markets

- Despite auctioning off a record \$123 billion in Treasuries last week, the bond market rallied on mixed economic data and weak equity markets.
  - The benchmark 10-year Treasury note ended at 3.38% on October 30<sup>th</sup>, down from 3.49% the previous week.
  - The \$300 billion purchase program of Treasuries by the Fed ended last week.
- The Federal Open Market Committee (FOMC) meets this week to discuss the timing of a Fed Funds rate increase.
  - Our view is that the Federal Reserve Bank will not raise rates anytime in the near term, but could certainly change the language of the duration of when such an increase could occur.
    - > With an unemployment rate near 10%, it becomes politically difficult for the Fed to act.
    - > Also, inflation continues to remain low for the time being.
- The Federal Home Loan Bank (FHLB) had a combined loss of \$165 million in the latest quarter, according to *The Wall Street Journal*.
  - The 12 regional home loan banks are reportedly owned and operated as cooperatives and generally report individually. However, every quarter they report on a combined basis.
    - > The FHLBs in Boston, Chicago, Pittsburgh, San Francisco and Seattle all reported losses this quarter.
- Quarterly debt issuance in the fourth quarter may hit \$444.5 billion, according to *The Wall Street Journal*.
  - On November 2<sup>nd</sup>, the U.S. government will disclose the funding needs for fourth quarter and on November 4<sup>th</sup> they will detail additional funding needs for maturing debt.
  - This avalanche of Treasury debt (that grows even more significantly in 2010) is adding to our concerns that interest rates may rise through the remainder of 2009 and forward.
- On the corporate bond front, CIT Group filed for bankruptcy, as expected.
  - Debt holders did approve the pre-packaged re-organization that will allow for a speedy emergence of CIT through Chapter 11 as early as year end.
  - The presence of the federal government is also posing further problems for GMAC Financial Services as it struggles to rebound from its weakened state.

### Real Estate Markets

- Case-Shiller composite index readings show steady improvement in home prices, which is a big plus for the outlook on housing, a sector where indications have recently been bumpy.
  - Reports have been showing steady improvement over the past four months, reflected in year-over-year rates which have moved from high double-digit declines in the Spring to currently low double-digit declines.
  - New home sales took a step backward in September, showing a much lower-than-expected annual rate of 402,000.

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## CURRENT ASSET ALLOCATION STRATEGY

- The Asset Allocation Committee made no changes to our tactical asset allocation guidance this week.

### Balanced Portfolio Strategy – Tax Aware

#### Equity – 69% / Overweight

Domestic Large Cap: Overweight  
Domestic Mid-Cap: Overweight  
Domestic Small-Cap: Neutral  
Developed International: Overweight  
Emerging International: Overweight  
Private Equity: Neutral  
Hedged Equity: Overweight

#### Fixed Income – 26% / Underweight

Investment Grade: Underweight  
High Yield: Overweight  
TIPs\*: Underweight  
Foreign Debt: Neutral  
Hedged Fixed: Neutral

\*Treasury Inflation-Protected Securities

#### Real Estate – 0% / Underweight

#### Commodities – 5% / Overweight

*If you have questions regarding this information or wish to receive definitions of any of the terms used in this commentary, please contact your Wealth Management Advisor.*

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## DISCLOSURES

|  |                  |                |                     |
|--|------------------|----------------|---------------------|
| NOT A DEPOSIT                                | NOT FDIC INSURED | MAY LOSE VALUE | NOT BANK GUARANTEED |
| NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY |                  |                |                     |

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- **Equities:** Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. **Fixed income securities:** Investing in fixed income securities are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors. Investment in debt securities typically decrease in value when interest rates rise. The risk is usually greater for longer term debt securities. Investments in lower rated and non rated securities present a greater risk of loss to principal and interest than higher rated securities. **Commodities:** There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes, and the impact of adverse political or financial factors. **Real Estate:** Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties, such as rental defaults. **Hedge Funds:** An investment in a hedge fund involves a substantially more complicated set of risk factors than traditional investments in stocks or bonds, including the risks of using derivatives, leverage and short sales, which can magnify potential losses or gains. Restrictions exist on the ability to redeem units in a hedge fund. Hedge funds are speculative and involve a high degree of risk. **International:** International investing involves special risks, including foreign taxation, currency risks, risks associated with possible difference in financial standards and other risks associated with future political and economic developments. **Emerging Markets:** Investing in emerging markets may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. **Small/Mid Cap:** Stocks of small- and mid-cap companies pose special risks, including possible illiquidity and great price volatility than stocks of larger, more established companies. **High-Yield Bonds:** Investments in high-yield bonds offer the potential for high current income and attractive total return, but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer's ability to make principal and interest payments. **Treasury Inflation-Protected Securities:** A special type of Treasury note or bond designed to offer protection from inflation. Interest payments vary with the rate of inflation. These securities offer a lower return compared to other similar investments. The principal value may increase or decrease with the rate of inflation. Gains in principal are taxable in that year, even though not paid out until maturity. The original principal of such a security issued by the U.S. Treasury will be repaid at maturity during periods of deflation. Other issuers may not provide such a guarantee, and the principal repaid at maturity may be less than the original principal value. **Private Equity:** Consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Potential investors should remember that investments in private equity are illiquid by nature and typically represent a long-term binding commitment. The investments made by private equity funds are not readily marketable and the valuation procedures for these positions are often subjective in nature.