



Perspective on the Latest Market Events

Message from Jim McDonald, Director of Equity Research

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While recent stock market price action doesn't have many investors dancing in the street, equity prices have become less volatile of late. The Standard & Poor's (S&P) 500 seems to be trading in a range bounded by about 740 on the downside and 940 on the upside. Despite recent weakness, the S&P 500 is still up 12% from its low set November 21, 2008. The Volatility Index or VIX, which measures expected price volatility for the S&P 500, has been relatively steady during this period at a level of 43, down from the historic high of 90 set on October 24, 2008. U.S. Treasuries have drawn significant buying interest, with the interest rate on the benchmark 10-year bond dropping to 2.89% at the time of this writing from around 3.75%. The stock market's slight calming has occurred despite continued grim economic news – house prices down 25% from their peak, unemployment jumping to 7.6%, and global industrial production reported down 21% during the fourth quarter 2008. Reflecting increased concerns about credit losses, the KBW Bank Index has fallen 33% since December 1, 2008, even while the S&P 500 is basically unchanged. The economy and banking system need attention, and our elected and appointed officials have been busy at work.

To great expectations and lesser reviews, the Treasury secretary unveiled plans last week to further bolster the banking system. The three main initiatives are a public-private investment fund to buy bad assets from the banks, a capital assistance program to inject further capital into those banks that can't pass a financial "stress test," and an expansion of the Term Asset-Backed Securities Loan Fund, or TALF program, to buy asset-backed securities. These programs all are intended to support areas of the financial system that are under stress and impeding the flow of capital and economic growth. The lack of detail in the announced programs left investors uncertain about the efficacy of the programs, but this may just set us up for a positive surprise if they work as the Treasury hopes.

The well-discussed and debated stimulus bill was signed into law on February 17, 2009, with a final total of about \$787 billion. Due to considerable scrutiny of the speed at which these monies will be spent, the bill was written so that 74% of the funds will be spent by September 30, 2010, according to the impartial Congressional Budget Office. Specific provisions were added to target areas of economic weakness and include tax breaks for first-time home buyers, deductibility of sales tax for many car purchases and reduced withholding taxes for many taxpayers. While this plan won't suffice on its own to ensure a sustained economic recovery, the government does need to ramp up its spending at this point to help offset the slowdown in consumer and business spending.

Current efforts by the Obama administration to bolster economic growth through the stimulus plan and bank-strengthening programs are necessary actions to try to stabilize the U.S. economy. On a near-term basis, when credit creation returns to some level of normalcy – enabling us to project with increased



confidence a sustainable economic recovery – then we would recommend an increase in risk-taking and a reduction in our defensive holdings. On a longer-term basis, the Group of 20 nations ultimately must come to grips with the new nature of global growth and financial markets. The global growth of the last 10 years, led by a U.S. consumer under an increasing debt load, won't recur and will need to be replaced by increased consumption outside the United States.

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