Quarterly Market Update

September 30, 2012

Investment returns were remarkably uniform during the third quarter across many equity market segments. Large U.S. companies, as represented by the S&P 500 were up 5.8%. Large non-U.S. companies, as represented by the Morgan Stanley EAFE (Europe, Australia and Far East) Index were up 6.1%. NASDAQ was up 6.2%. Vanguard Funds investing in mid-size and small market capitalization companies were up 5.1% and 5.4% respectively. All these market segments experienced a nice rebound from declines during the second quarter of 2012.

Fixed income markets produced negligible returns during the third quarter. This quarter represented a plateau of positive returns generated during the first two quarters.

The economic environment during the third quarter can be fairly characterized as mixed. The housing market improved with prices rising modestly and the inventory of unsold homes remained manageable. Corporate profits, on the other hand, looked set to decline from the third quarter of 2011, the first time in many quarters. Profit margins were sustained at historically high levels, but the underlying revenue growth was lackluster.

Global economic trends continued to be mostly downward, with Europe in a recession and not making any headway in dealing with problem economies. China continued to see slowing growth as their largest export markets, Europe and the United States, saw very modest overall growth in demand.

The response of European central bankers was to announce "unlimited" availability of liquidity through purchases of debt issued by European Union member governments. The Federal Reserve announced "open-ended" purchases of mortgage backed securities, meaning the program will continue indefinitely. Most central bankers seemed to agree that adding more liquidity within their respective financial system was their only option until countries can get back on their feet on the fiscal policy side.

With most equity mutual funds up in the neighborhood of 15% year-to-date, the mutual fund industry reported a large increase in redemptions as it appeared investors wanted to lock in their gains for the year.

Amidst all these mixed economic data the most surprising piece of information was the University of Michigan poll of consumer sentiment which consistently showed U.S. households as being much more positive about the future than anyone had predicted. The current presidential campaign, with record amounts of negative advertising, did not seem to faze most Americans. Who says Americans aren't inherent optimists?

Raymond A Beplat
Chief Investment Officer