
Market Update

February 2009 Review

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“Houston, We Have a Problem”

Unlike the dramatics of the Apollo 13 moon mission, captured forever in the Ron Howard movie *Apollo 13*, the dramatic problems we are currently experiencing in the economy and financial markets do not have a clock associated with a final outcome. We seem to be in a vicious downward spinning cycle that, like the Apollo 13 mission, had the genesis of its problems years before the actual problem came to light. Washington, Wall Street and governments throughout the world are in a similar thought process to that of the hundreds of professionals of Houston’s Mission Control Center when, looking for a status check of the disabled vehicle, were asked by Flight Director Gene Kranz “what do we have on the ship that’s working?” The answer, not unlike this current economic situation we are in, was that not much was functioning at the time, but this did not deter Kranz and his staff at Mission Control. It took their collective dedication, determination and ingenuity to discard the original flight plan and determine a new way, under the most harrowing of circumstances, to bring about what was later deemed a “successful failure,” in that they failed to make it to the moon, but were successful in returning to earth safely. Their success was inspirational to the world and, for a brief moment, brought bickering people together.

The analogy on the surface seems remote, yet the challenges facing the economy and the investment markets seem as dire and unsolvable as a broken down capsule in space. Numerous attempts to relight the engine of the economy have come and gone without any stimulating effect. The U.S. Government, through the Administration, the Fed and the Treasury have launched no less than 31 attempts at either preserving, fixing or stimulating the economy and investment markets since early 2008 with the results being that the U.S. economy in the fourth quarter had its biggest drop in the Gross Domestic Product (“GDP”) in 25 years and the investment markets are now at levels not seen since the mid 1990’s.

The original catalyst for this downward surge, the housing bubble, continues to be a problem as housing prices fell another 19% and home sales fell another 5% in January, at their lowest levels since 1997. While we know the catalyst that helped get us into this situation, we have yet to find a catalyst to help get us out. The cycle occurring in the economy is evident and painful; the consumer has stopped consuming as confidence has plunged to a record low of 25, the poorest in the four decades this measure has been used. Consumer expectations now sit at an unprecedented reading of 27.5, significantly below its previous low of 45.2 back in December 1973. Unemployment continues its climb to record monthly numbers as new claims hit 667,000, the most in 27 years, while continuing claims rose to 5.1 million, a record high

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since 1967 and up from 2.8 million one year ago. The number of new claims reported in February is anticipated to be as high as 750,000. Contraction in manufacturing was evident in the January numbers as durable goods orders fell 5.2%, while U.S. auto makers reported February sales were down 41%.

The doom and gloom outlook shows a weakened, frightened and retrenched consumer, eager to rebuild their net worth, deathly afraid of taking on new credit and determined to live their lives within their means as opposed to the “borrow and spend” lifestyles of the last couple of decades. Combine this with a business community eager to manage expenses to preserve profit margins in a challenging economic environment; the doom and gloom projections emanating across the country would suggest a struggling economy for years to come.

Is this the scenario that must play out, or can the \$3.6 trillion 2010 budget and the 31 past and current acts, as well as potential further stimulus actions by our government bodies, eventually take hold and work their way through to stimulate both the economy and the investment markets? We certainly are troubled by the depressing economic numbers rung up for the first two months of 2009, and the investment returns have been equally troublesome. February was a down month for equities as domestically the Dow Jones Industrial Average lost 11.2%, the S&P 500 Index lost 10.7%, the NASDAQ Composite lost 6.5%, while internationally the MSCI EAFE Index lost 10.3%. Fixed income was not a safe haven for all investments as the intermediate term benchmark, the Barclays Capital Aggregate Index, lost 0.4% for the month. Treasury bonds also experienced headwinds in February in anticipation of new bond issues to fund the stimulus programs, while investment grade corporate and high yield bonds were also mostly down for the month as well.

	February	YTD
DJIA	-11.24%	-18.92%
S&P 500	-10.65%	-18.18%
NASDAQ	-6.50%	-12.44%
MSCI EAFE	-10.27%	-19.08%
Barclays Aggregate	-0.38%	-1.26%
Barclays U.S. Corp. High Yield	-3.10%	3.30%

Back to the question, so what do we have on the ship that works? Certainly, the Commercial Paper Funding Facility (“CPFF”), which has benefited commercial paper yields and the Federal Reserve’s purchase program for agency-backed mortgage loans, in our opinion, have been the major policy successes to date. Modest improvements in the credit markets continued through February as high grade, marquee-name companies such as Cisco, Chevron and Abbot Labs managed to successfully float mega size debt issues. Investors showed a willingness to snap up a variety of corporate bond offerings during the month, reflecting a modest shift from the flight-to-treasuries initiative that had permeated the markets over the last several months. Finally, while equity returns are decidedly negative and a floor has yet to be clearly identified, the overall voracity of fright to get out of the markets has not been evident and the daily volatility in the markets, as measured by the VIX, has subsided significantly since the end of 2008. Overall consensus is that the markets are well oversold and are due for something more than a subtle bounce.

It seems the ultimate question is how to restore a level of confidence in the economy, and eventually the capital markets, such that the consumer starts consuming and the investor starts investing. After all, there is now approximately \$8 trillion residing in cash and cash equivalents, which is more than the combined value of the companies in the S&P 500 Index. This money is earning close to zero percent and once there is a level of confidence for the investors to return to investing, the impact on equity and non-government bonds could be substantial. So what moves can restore

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the confidence necessary to boost the economy and the markets? Absent consumer and business spending, the government is committed to finding that catalyst, but so far it remains undiscovered. We unfortunately seem to be back into a political debate and disagreement over the stimulus packages, budgets and deficits which take up far too much of the limited time the legislators spend in Washington. If these debates lead to nothing more than disagreements, attaining a higher level of confidence necessary to move the markets in a positive direction will be difficult. To solve his seemingly impossible task, Flight Director Krantz demanded input and cooperation from not only his direct reports but, in fact, anyone who ever worked on the Apollo 13 capsule. It will take this same kind of collective wisdom engaging in constructive debate combined with strong management and decisive action to lead us to a safe landing of the economy and markets in 2009.

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.

The Chicago Board Options Exchange Volatility Index (VIX) shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options.

