
Market Update

September 2009 Review

Market Update is a monthly publication circulated by USI Advisors, Inc. and is designed to highlight various market and economic information. It is not intended to interpret laws, regulations or to address specific client situations.

This report has been prepared solely for informational purposes, based upon information generally available to the public from sources believed to be reliable, but no representation or warranty is given with respect to its completeness. This report is not designed to be a comprehensive analysis of any topic discussed herein, and should not be relied upon as the only source of information. Additionally, this report is not intended to represent advice or a recommendation of any kind, as it does not consider the specific investment objectives, financial situation and/or particular needs of any individual client.

Securities offered through USI Securities, Inc., Member FINRA/SIPC. Investment Advice provided by USI Advisors, Inc., 95 Glastonbury Blvd., Glastonbury, CT 06033, (860) 652-3239.

Who Has the Baton Now?

The market's rally continued in September, albeit at a more subdued rate than seen in the previous two months, shaking off prognostications that seasonal trading patterns would lead to a halt of the current bull market run. Improving fundamentals and better than expected corporate profits helped to finish off the best two quarter performance in the Dow Jones Industrial Average ("DJIA") since March 1987. Even though not all economic indicators suggest an immediate and strong recovery, the recovery process does seem to be well on track. This update will review the performance in September and the third quarter and examine the markets' potentials and risks that lie ahead.

Both domestic and international equity markets continued to rise in September with the DJIA and the S&P 500 index advancing 2.4% and 3.7% respectively, while the NASDAQ rose 5.7%. The DJIA is now up 11% in 2009 and is up 48% since the March 9, 2009 low, while the S&P 500 had its best quarter since 1998, up 17% year-to-date and 56% since the year lows in March. Volatile stocks (those with a beta greater than 1) continued to shine. A basket of the 20 highest beta stocks in the Russell 1000 gained 53% in the third quarter and 141% year-to-date after a 75% decline in 2008. The international markets continued to perform strongly with the MSCI EAFE index advancing 3.8% in September and 19.5% for the quarter, while the MSCI's emerging market index rose 20% in the quarter. Many established European shares rose on anticipation of a full-blown economic recovery and overshadowed the gains posted by emerging markets. France, Germany and the U.K.'s markets were up sharply, while China's market shed 6% on signs that the economy had not yet bottomed out. The fixed income markets were also positive during the month and quarter with the bellwether Barclays Capital U.S. Aggregate Bond Index advancing 1.1% for the month and 3.7% for the quarter. Treasury bonds rallied during the quarter as overseas buyers and the Fed's purchase of Treasury and mortgage-backed securities helped support prices. However, the real strength of the bond markets continued to reside within the riskier securities as the Barclays Capital U.S. Corporate High Yield Index rose 5.7% in September and 14.2% for the quarter. Taking on even more risk in the high yield environment produced more dramatic returns as the credit riskier Barclays Capital CAA U.S. High Yield Index was up 7.4% in September, 20.6% for the quarter and 75.4% for 2009 year-to-date.

Can this powerful rally continue through the rest of this year and into 2010? Those wanting to be positive would point out that equity valuations, in absence of any financial market collapse, still seem to have an upside, although significantly less than when measured in March of this year. Both dividend discount modeling and price/earnings multiples suggest an upside to prices and a significant distance from a top that usually leads to a bear market correction. Economic growth is another factor that would suggest the continuation of this rally with consumer

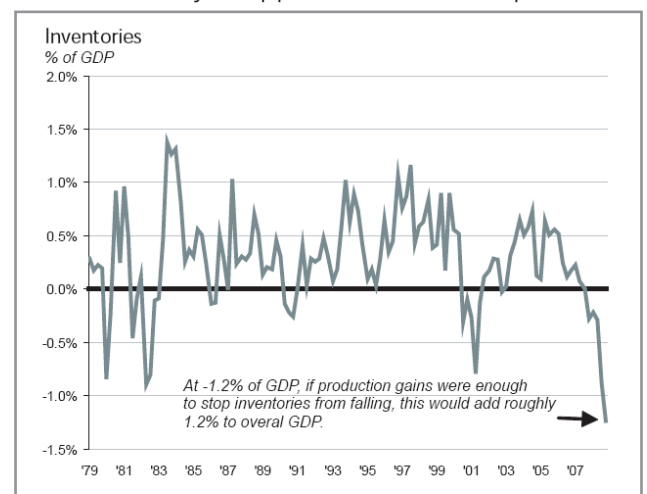
Market Update

confidence well off its low, business sentiment indices recovering and better news being reported in housing activity. There is growing sentiment that corporate earnings could surprise on the upside, particularly given the low starting point with the collapse of profits last year. Finally, bulls point out that credit conditions continue to slowly improve with the financial sector the biggest recipient, and public policy is expected to continue to be accommodative, in the near term, in providing liquidity and maintaining a low short-term interest rate environment even as evidence shows that the recession has, or is, coming to an end.

Are there risks to this positive view? Geopolitical risks, such as a domestic terrorist threat, renewed tensions in the Middle East that could shut down the flow of oil, and trade wars that could alter the growth of countries such as China, are to be constantly evaluated. However, the real challenge to a positive outlook is whether the economic growth both here and abroad is real and sustainable. To create profits, companies need to eventually generate sustainable revenue growth as opposed to focusing exclusively on cost cutting initiatives. As noted in our August, 2009 Update, the consumer supported the growth of the economy for years, representing nearly 70% of the Gross Domestic Product ("GDP") this decade, largely through the availability of easy credit. The credit crisis vastly reduced the availability of credit and the stock market's collapse significantly reduced consumer's net worth, causing the consumer to focus on savings rather than spending. It will take some time to rebuild consumer confidence and spending power such that they can once again support the growth of the economy to its past levels. Current unemployment rates are likely to continue to produce a headwind to meaningful and sustained consumer spending. As such, other economic stimulus needs to be tapped.

To get us through the first leg of this race to recovery, the government carried the baton by providing a variety of corporate and consumer stimulus. It appears that while successful, the steam of what the government can do is nearing an end and thus to continue the path to economic recovery, the baton needs to be passed off to another willing and able body runner. Unfortunately, the consumer appears better suited to be the last leg of this race and thus the handoff from the government appears to be set for the legs of business spending. Can business spending carry the day?

It appears that businesses do have the capabilities to grow. Nonfinancial U.S. companies' cash holdings, as a percentage of tangible assets, are at their highest levels since the mid 1950s. Cash flows analysis appears to be above post WWII levels and the freeing up of credit at low interest levels have allowed companies to once again refinance debt at an elevated pace this year. Companies are unlikely to embark on a hiring spree in the near term and are more likely to continue to get more production out of existing employees. Absent a rise in wage growth, companies do have the ability to readily rehire, and easing credit conditions are making it easier for companies to issue debt to finance long-term projects. Should companies begin to replenish inventories or, at the very least, stop inventory levels from falling, as much as 1.2% could be added to the GDP levels (see chart). Industry and businesses have been responsible for roughly two thirds of the output generated this year and will have to play the next critical role in support of the economic recovery until the consumer comes back into play.



Source: J.P. Morgan

Will consumers be able to take the baton and run their leg of the race? For an indication of their readiness, continue to watch the unemployment statistics, consumer confidence numbers and retail sales figures. While unemployment continues to be projected to top out at around 10%, other measures indicate the real number of people unemployed is closer to 17%, or 26.5 million people. An inability to begin to turn this number around could greatly affect the desire of consumers to consume, both for those currently out of work and for those fearful they may be next. While the investment markets have been bullish about an economic recovery, the transition from a government led recovery to a

Market Update

sustained economic recovery supported by both business investment and consumer spending will be tested. It is critically important for the business community to take the baton and further the progress of the recovery until the consumer is ready to run their anchor leg of the race.

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 MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The Barclays Capital CAA U.S. High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified in this index if the rating of Moody's Fitch, and S&P is CAA.

