

Market Update

February 2011 Review

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An Early Spring?

On February 2, 2011, Punxsutawney Phil, the famous groundhog, did not see his shadow; signaling that spring is coming early. If history repeats itself, this is warm news for the S&P 500 Index. Since 1944, when Phil does not see his shadow, the average S&P 500 Index return from Groundhog Day to the first day of spring (this year the first day of spring is March 20) is 4.1%, with positive returns 82% of the time.¹ The S&P 500 Index is certainly on target, as the U.S.-based index gained 3.4% for the month of February and the Dow Jones Industrial Average ("DJIA") broke through the 12,000 barrier; ending the second month of the year with a positive 3.16% return. Let's hope the positive trend continues into March.

Economic data released during February was relatively strong and helped drive the positive market returns. Though the second estimate of fourth quarter GDP growth was revised down to 2.8%, this is still higher than the 2.6% growth we saw in the third quarter of 2010. The outlook remains bright for the U.S. economy as the Federal Reserve raised their forecast for economic growth to be in the range of 3.4% to 3.9%; a good deal higher than the November estimate of 3.0% to 3.6%.

	February	YTD
DJIA	3.16%	6.11%
S&P 500	3.43%	5.88%
NASDAQ	3.16%	5.02%
MSCI EAFE	3.32%	5.77%
MSCI Emerging Markets	-0.92%	-3.59%
Barclays Aggregate	0.25%	0.37%
Barclays Corp High Yield	1.31%	3.55%

On the job front, February's employment report came in relatively strong as the unemployment rate dropped again to 8.9% from 9.0% in January. Further, total payroll grew by 192,000; with 222,000 jobs generated in the private sector.

Job data seems to be a driving force with regard to both consumer behavior and consumer perception of the markets. Not surprisingly, the Conference Board's Consumer Confidence Index rose to 70.4 in February, the highest level in three years, and has risen steadily and significantly for the last three months. Moreover, consumer spending increased 0.1% in January as consumer confidence has continued to gain strength since the beginning of the year. While the increase was small, the fact that it was positive is still a good sign; given that 70% of Gross Domestic Product ("GDP") is attributed to consumer spending.

The Consumer Price Index ("CPI") increased 0.4% in January and core CPI, which excludes energy and food prices, rose only 0.2%. The inflation data for February will be released mid March and we may see a greater jump in prices as oil and food prices continue to rise and the story in the Middle East/North Africa region continues to unfold. However, the American consumer has already started to feel the impact as prices at the pump have continued to increase over the past few weeks.

News abroad was in the spotlight for most of February. Tensions in the Middle East and North Africa began in Tunisia and have expanded to neighboring countries. We have already seen a change in power in Egypt and are currently witnessing a power struggle in Libya between Moammar Gadhafi and the rebels. Libya, the 18th largest oil producer in the world, is a heavy exporter of oil to Europe

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and the turmoil in Libya, and the rest of the region, has driven oil prices to over \$100 per barrel. Further, the unrest in the region has negatively contributed to the MSCI Emerging Markets Index return of -0.92% during February.

In addition to the troubles in the Middle East/North Africa region, high inflation in the Asian developing markets has caused emerging market investors to be more cautious. China continues to raise rates to combat inflation, which is near 5.0%

The international developed markets, as measured by the MSCI EAFE Index, seemed to avoid some of the negative news as the index returned 3.32% in February. A proposed merger between Deutsche Borse and NYSE Euronext was announced during February. This is currently being examined by anti-trust authorities as the merger would create one of the largest exchanges in the world. In addition, January retail sales in Germany gained a healthy 1.4%; beating analyst estimates. Not all is perfect in Europe, as the Eurozone is also experiencing inflation that has increased at the fastest pace since 2008. The European Central Bank ("ECB") has continued to keep rates low, but if inflation persists, a rate hike could be in order. In addition, Ireland was downgraded by Standard and Poors from A to A-. Europe has seemingly taken a back seat to the Middle East/North Africa turmoil at the moment.

For fixed income investors, 2011 continues to be lackluster. The broad-based Barclays Capital U.S. Aggregate Index stayed fairly flat for February, posting a 0.25% rise. Investors are worried about the eminent rise in interest rates and the impact that will have on bond prices. On the bright side, the Barclays Capital U.S. Corporate High Yield Index fared better, returning 1.31% during February. The high yield bond market has seen tremendous inflow this year. The Wall Street Journal reported through the first six weeks of the year, \$6.7 billion has flowed into the high yield market; half of the entire 2010 flow. This is not surprising given the double digit returns of the past two years for the high yield market. However, what was trading at 55 cents on the dollar is now trading at 104 cents on the dollar posing the question: "has the easy money been made?"

Overall, February brought positive domestic economic news. Unfortunately, this was mostly overshadowed by the conflicts in the Middle East and North Africa and the concern for oil prices. Until the turmoil subsides, the uncertainty will remain. Thus, proving how fragile the sustainability of the continuation of the recovery can be. The results in March will ultimately determine how reliable Punxsutawney Phil is this year in determining the market's movement as we move towards the end of the first quarter.

¹From Bespoke Investment Group, Wednesday February 2, 2011. <http://www.bespokeinvest.com/thinkbig/2011/2/2/the-groundhog-day-indicator.html>

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 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 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.