

Market Update

September 2011 Review

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Falling Back into a Recession?

The stock market continued its summer slide all the way into September and the beginning of the fall season. In fact, the Dow Jones Industrial Average ("DJIA") has posted five straight months of negative returns and has not seen a positive month since we were all making our summer plans back in April. Investors remain skittish as fears of another recession resurfaced and the European debt crisis continued to be a black cloud hovering over head.

On the domestic front, the Department of Labor's Bureau of Labor Statistics released its annual "Consumer Expenditures Survey" for 2010. Interestingly, the survey showed that consumer spending fell 2.0% in 2010, which is only the second time it has fallen since the government began the survey in 1984. The only other time it fell was 2009, indicating two straight years of declining consumer spending. Moreover, the survey showed that incomes declined 0.6% in 2010 following a drop of 1.1% in 2009. For an economy essentially driven by the consumer, where consumer spending accounts for over 70% of our nation's Gross Domestic Product ("GDP"), this data is disturbing. Consumers have been facing inflation in the form of higher gas and food prices, a struggling job market that has led to shattered consumer confidence, and a flailing housing market that has many homeowners underwater. Is it any wonder our economy is sputtering?

Even worse, is it any wonder the recession whispers are getting louder? The Economic Cycle Research Institute ("ECRI"), which has been rather accurate in predicting past recessions, indicated last week that the U.S. economy is sliding back into a recession and stated that there is nothing policymakers can do to avoid it. The Institute's weekly leading index is moving lower based on fundamental factors which are "now collectively behaving as they did on the cusp of full-blown recessions, not 'soft landings.'" With the consumer facing headwinds and no clear fix for the job market, ECRI's prediction is not far-fetched.

As economic news continued to disappoint, domestic equity markets continued their free fall in September, as the blue chip DJIA plunged 5.9% for the month and has fallen into the red on a year-to-date basis at -3.9%. The broader S&P 500 Index fared even worse, posting a loss of 7.0% for the month and a return of -8.7% year-to-date. Finally, the tech-heavy NASDAQ composite dropped 6.4% in September and is down 9.0% thus far in 2011. In the equity world, there was nowhere to hide.

	September	YTD
DJIA	-5.91%	-3.90%
S&P 500	-7.03%	-8.68%
NASDAQ	-6.36%	-8.95%
MSCI EAFE	-9.50%	-14.62%
MSCI Emerging Markets	-14.56%	-21.66%
Barclays Aggregate	0.73%	6.65%
Barclays Corp High Yield	-3.27%	-1.39%

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International investment market returns were actually hit harder than domestic markets. Fears that a resolution on the Greek debt crisis would not come to fruition any time soon led international developed markets significantly lower. Investors also worried that Greece is only the first in a line of bailouts with Spain, Portugal and Italy on the short list. As a result, the MSCI EAFE Index plummeted 9.5% for the month and is down just under 15% for the year. Emerging markets also struggled, falling 14.6% in September as fears of a China slowdown resurfaced.

Despite the carnage in the equity markets, fixed income markets continued to perform well, perhaps as a result of a flight to quality and perceived less risk. The exception was high yield, which fell 3.3% as investors fled riskier assets. The Barclays Aggregate Bond Index added 0.7% for the month and is now up 6.7% in 2011. Bond prices for U.S. Treasuries and other taxable high credit quality bonds were mostly higher again in September, driving bond yields lower. As evidence, the benchmark 10-year U.S. Treasury rate closed at 1.92%, far below its year-end 2010 rate of 3.30%. Add in the Federal Reserve's "Operation Twist," where the Fed sells short-term bonds and purchases long-term bonds to drive longer yields lower, and we may see lower rates for an extended period of time.

Just last month, Federal Reserve Chairman Ben Bernanke reassured the nation that there are still a few tools in his bag of tricks and that the economic recovery remained on track. At his latest testimony to the congressional Joint Economic Committee given earlier this week, Bernanke indicated that the economy is growing at a slower rate than the Federal Reserve had expected and said the economic recovery "is close to faltering." Just like that, our economy moved from "on track" to almost derailed.

For a consumer-driven economy, the perfect storm is approaching in the form of lower wages, higher inflation and a stalled job market. We've already seen consumer spending fall for two straight years and when looking at the current economic condition of the country, it wouldn't be a surprise if consumer spending falls yet again in 2011 when all is said and done. Interestingly, according to some polls many Americans believe that we never escaped the original recession. Technically, most economists would argue that the recession was over in 2009, but for all intents and purposes, the perception of a recession feels like a reality for many struggling individuals. There is no doubt that GDP growth has slowed significantly, even from the sluggish 3% growth we experienced in 2010. With the headwinds facing consumers, growth may stall altogether. If the Federal Reserve does indeed have a few tools left in their bag of tricks, maybe this would be a good time to pull them out. Or maybe, just maybe, it's time for the Fed to take a step back and let the economy play out on its own.

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 cannot 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.

The CBOE Volatility Index® (VIX®) is a measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.