

MEMORANDUM

To: **Wurts & Associates Clients**
 From: **Curtis Yasutake, Research Analyst**
 Date: **January 14, 2010**
 Re: **December 2009 Market Commentary**

MARKET PERFORMANCE REVIEW

Asset Class	Benchmark	Dec.	1-Year	3-Year	5-Year
Domestic Stocks	S & P 500	1.9%	26.4%	-5.6%	0.4%
International Stocks	MSCI EAFE	1.5%	32.5%	-5.6%	4.0%
Emerging Market Stocks	MSCI EM	4.0%	79.0%	5.4%	15.9%
Aggregate Bonds	BC Aggregate	-1.6%	5.9%	6.0%	5.0%
Treasury Bonds	BC Treasury	-2.6%	-3.6%	6.1%	4.8%
High Yield Bonds	BC High Yield	3.3%	58.2%	6.0%	6.5%
Real Estate	FTSE NAREIT All	6.4%	27.5%	-13.1%	-0.9%
Commodities	Dow Jones - UBS	2.0%	18.9%	-3.9%	1.9%

Periods longer than one year are annualized.

MACRO COMMENTARY. Three themes drove capital markets in 2009: 1) Massive fiscal and monetary stimulus, 2) economic stabilization, and 3) high correlations among asset classes. These themes led to a flight to risk and market rally that have been as sweeping to the upside as the flight to quality and market collapse were on the downside. The S&P 500, MSCI Emerging Markets, and Barclays High Yield indices have rallied over 54% since February. The sheer magnitude and velocity of the current rally worry some experts, especially given the apparent dependence of economic growth on government stimulus and debt. Still, markets overlooked any concerns in December as risky assets again outperformed.

Data were mixed in December, indicating continued economic stabilization while also serving as a reminder of the fragility of the recovery. Employment data disappointed as the Department of Labor estimated 85,000 jobs were lost in December, leaving the unemployment rate at 10%. Continued active layoffs are a somewhat troubling sign as many analysts had predicted job losses to slow in December and to begin turning around. The Institute of Supply Management's December services and manufacturing indexes slightly increased and remain above 50, indicating marginal growth. Indexes at these levels indicate improving, but relatively low activity as companies do not yet feel the need to meaningfully ramp up supply.

Real estate remains a drag on consumer wealth as November new home sales unexpectedly fell by 11 percent month over month and prices remain well below their highs. Additionally, foreclosure activity continues to increase along with the percentage of seriously delinquent mortgages. As expected, the Fed held its key rate at record low levels and retained its pledge to keep them there for an "extended period." The FOMC said that economic activity has continued to pick up but

substantial resource slack will keep inflation in check. This news enabled the risk-rally to proceed unabated.

As we head into what could be the eleventh month of this rally, you may be asking, how long can this last? The answer may be, as long as the government allows. When the Fed decides to start hiking rates, riskier assets will lose much of their current relative appeal unless strong economic growth continues without government assistance. This means the U.S. consumer will need to recover and fill in the void left by the government once it slows spending. However, consumer and business demand face major headwinds in record-high unemployment, a weak housing market, and tight credit. Much of the government stimulus plans are set to expire in 2010 and many experts expect the Fed to increase rates sometime this year as well. So it may not be long before the resilience of economic growth is put to the test—but for now, the economy and the market continue to ride the wave of government money and the risky rally presses on. ■

ASSET CLASS COMMENTARY. Major equity indices rose in December. The S&P 500 was led higher by information technology and utilities while energy and financials lagged. Emerging markets outperformed developed. Increased exports in China and a \$10 billion cash infusion from Abu Dhabi to Dubai World helped international equities while a slight increase in the dollar hurt returns for U.S. investors.

Safer fixed income instruments turned in negative performance while high yield rose as investors chased relatively higher yields.

REITs outperformed all other asset classes for the second month in a row as investors sought out bargains in the sector. Commodities rose as oil moved up to around \$80 per barrel, partly due to speculators betting on increased demand from colder weather.

Assets remained highly correlated over the last 10 months, but with pending stimulus exit plans and assets closer to fair value, markets may soon be due for a regime change. ■