FundQuest
BNP PARIBAS GROUP

Investment InSight

August 2010 Recap

Market Summary

In August, U.S. equity markets returned much of what was gained during July. The S&P 500 Index fell by 4.51%, resulting in a year-to-date total of -4.62%. Despite a strengthening US Dollar, developed international markets fared marginally better than domestic markets, as measured by the MSCI EAFE NR Index return of -3.10%. Emerging Markets also finished in negative territory for the month but managed to outperfom their developed counterparts. Additionally, the MSCI EM NR USD Index return of -1.94% forced year-to-date returns back into negative territory. However, this Index remains ahead at 18.02% over a 1-year period. Most fixed income markets benefited from the equity market sell-off, posting positive gains as measured by the Barclays Capital Aggregate Bond Index, which returned 1.29%. Furthermore, commodity spot prices generally rose despite the negative return on the Dow Jones-UBS Commodity Index. The Index's negative return resulted from a negative roll yield due to contango term structures.

Category Performance

Housing and Employment

Investors continued to focus their attention on macro-economic data points in order to better understand the direction in which the economy might be heading. Overall, investors turned bearish on economic growth prospects, driven largely by weak housing market and employment data. Furthermore, the release of the August Credit Suisse First Boston Monthly Real Estate Survey indicated prolonged weakness in the housing market based on falling demand and rising inventory levels. Most noticeably, this report highlighted the downturn since the expiration of home buyer tax credits, indicating that support to the housing market was likely a temporary fix.

Domestic Markets

In domestic markets, both large- and mid-cap equities significantly outperformed small-cap equities. Due to a relatively high exposure to regional banks, whose performance is tied closely to housing, small-cap equities were negatively impacted. Value stocks modestly topped growth stocks, despite an overall weakness among financial firms.

International Markets

Developed international equity markets fared better than their domestic counterparts despite the pressure of a stronger US Dollar. Both U.K. and Japanese markets provided most of the relative performance, while Eurozone countries continued to struggle.

Emerging Markets

Although emerging markets finished in the red, they outperformed developed markets on a relative basis.

Fixed Income

In August, U.S. fixed income markets posted a particularly strong month. The Barclays Capital US Treasury 20+ Year TR USD Index revealed that long-duration U.S. Treasuries significantly outperformed short-duration Treasuries. The Index posted an 8.08% return for the month, as compared to a 0.19% return on the similar 1-3 year index. Although U.S. corporate bonds were aligned with Treasuries, higher-yielding issuances slightly lagged in performance. In aggregate, municipal bonds generated positive returns.

Notable Sectors

Among the ten sectors within the S&P 500 index, only two managed to post positive returns during August: telecom and utilities. The main drivers of the month's negative return stemmed from the financial, industrials and technology sectors. Impacts to the financial sector resulted from continued bank failure activity coupled with negative news from the domestic housing market. Concerns of a weakening economy, as well as decreased consumer and corporate spending, weighed heavily on the economically sensitive industrials and technology sectors. Furthermore, upon release of the Commerce Department's weak July durable goods orders, industrial stocks mostly sold off, while shares of technology firms suffered from the negative future growth sentiment released by Cisco and Intel. Conversely, telecom and utility were supported by investor demand for stable dividend-paying growth stocks.

Government Policy

The Federal Reserve released the minutes from its June Open Market Committee meeting and offered investors insight into its management of the current economic environment. Fed officials reaffirmed their intention to maintain the Fed Funds rate and leave unchanged for an extended period due to potentially weak ongoing consumer spending and bank lending activity. Additionally, the Fed confirmed its plans to purchase $1.25 trillion of agency mortgage-backed securities and up to $200 billion of agency debt by year-end as well as $300 billion of Treasury securities. Most notably, the Fed highlighted the potential for more modest growth in 2H10 than anticipated as downside risks to growth and inflation outlooks have increased.

Economic Indicators

Economic indicators were largely negative during August. Second quarter GDP estimates were revised downward to 1.6% from the original estimate of 2.4% growth[1]. The U.S. unemployment rate held steady at 9.5%, however inflationary pressures remained in check, as measured by a 0.9% rise in the core Consumer Price Index. The ISM Manufacturing Index fell in June, highlighted by a sharp decline in durable goods orders. Moreover, the U.S. housing market softened during August, reflected by record lows for both new and existing home sales and the Pending Home Sale Index.

Index Overview

The *S&P 500 Index* is an unmanaged index comprised of 500 widely held securities considered to be representative of the stock market in general. The *S&P/Case-Shiller Home Price Indices* measure the residential housing market, tracking changes in the value of the residential real estate in 20 metropolitan regions across the United States. The *Morgan Stanley EAFE Index* represents 21 developed markets outside of North America. The *MSCI Emerging Markets Index* is a free float-adjusted market capitalization index that is designed to measure equity market performance in global emerging markets. The *Barclays Capital U.S. Aggregate Bond Index* is a market capitalization-weighted index of investment-grade, fixed-rate debt issues, including government, corporate, asset-backed, and mortgage-backed securities, with maturities of at least one year. The *Barclays Capital U.S. Corporate High Yield Index* covers the USD-denominated, non-investment grade, fixed-rate, 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 index may include emerging market debt. The *Barclays Capital Municipal Bond Index* is an unmanaged index comprised of investment-grade, fixed rate municipal securities representative of the tax-exempt bond market in general. The *Barclays Capital US 20+ Year Treasury Index* is an index that measures the performance of U.S. Treasury securities that have a remaining maturity of at least 20 years. The *DJ-UBS Commodity Index Total Return*℠ measures the collateralized returns from a basket of 19 commodity futures contracts representing the energy, precious metals, industrial metals, grains, softs and livestock sectors. The *Russell 1000 Index* is a market capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest U.S. companies). The *Consumer Price Index* (CPI) measures the change in the cost of a fixed basket of products and services. The *Gross Domestic Product* (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The *ISM Manufacturing Index* is an economic measure for the US business sector.

References

1. Bureau of Economic Analysis
2. US Department of Labor

Disclosure