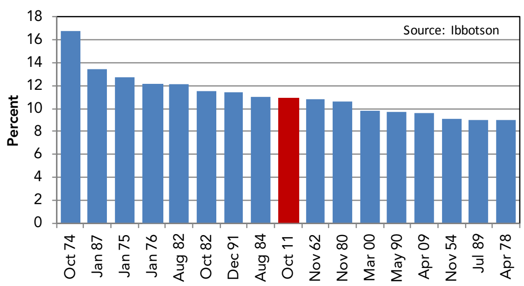
# Economic Review

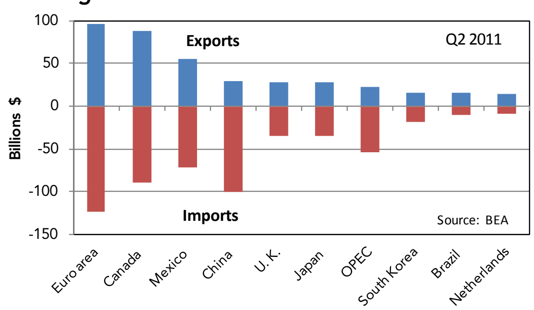
**October 2011**

Stocks rallied in October, posting some of the best monthly gains on record. The S&P 500 returned 10.9% for the month, erasing much of the loss tallied in the third quarter. Market sentiment turned decidedly positive as news of a European bailout surfaced. The newest European bailout focused on two main points. First, banks and private holders agreed to a 50% write-down on the face value of Greek debt, or about €100 billion. The second point was to increase the European Financial Stability Facility to €1 trillion. The facility provides funds to governments in financial difficulty, and may also buy debt of troubled countries outright, such as Greece. The agreement was not without controversy, as many details were left to be resolved in the future. The facility does not actually hold €1 trillion; it expects to raise the money from European governments, private investors, and potentially China. Greece, whose debt troubles have routed markets, is expected to cut its debt to only 120% of GDP by 2020. Italian lawmakers had strong differences on cuts needed to bring their deficit under control. Highlighting the difficulties of making public sector cuts, Greek citizens staged multi-day strikes, and Italian Parliament members resorted to fistfights. Because many European countries continue to spend well beyond their means, the debt crisis is likely to cause further market turmoil. At month's end, Greek Prime Minister Papandreou called for putting the settlement to a public referendum, threatening the entire agreement.

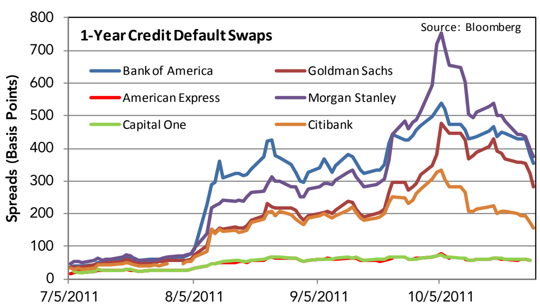
**S&P 500's Best Post-War Months**




**US Foreign Trade**




**Banks' Credit Risk Rises**




## Market Returns

As of October 31, 2011

| | October | 3 Months | YTD |
|---|---|---|---|
| S&P 500 | 10.9% | -2.5% | 1.3% |
| Russell 1000 Value | 11.5% | -3.4% | -1.1% |
| Russell 1000 Growth | 11.0% | -2.6% | 3.0% |
| Russell 2000 | 15.1% | -6.7% | -4.5% |
| MSCI EAFE | 9.6% | -9.8% | -6.8% |
| Emerging Markets | 13.3% | -11.9% | -11.3% |
| Barclays Agg | 0.1% | 2.3% | 6.8% |
| 3-Month T-Bills | 0.0% | 0.0% | 0.1% |

GDP grew at a 2.5% annual rate in the third quarter. The strongest contributors to growth were recreational goods and vehicles, healthcare, housing and utilities, and industrial and transportation equipment spending. The biggest detractors from growth were cuts in state and local government spending and a large slowdown in inventory growth. Export growth was depressed for a second quarter, owning to troubled economic conditions in other countries.

As the US's largest trading partner, the Euro-zone countries' financial problems remain a worry for export-based companies. Free trade agreements with South Korea, Colombia, and Panama were signed into law after several years of delay. The Bank of Japan again intervened to support the Yen after reaching a record high of ¥75.8/$ on October 28th. The Bank of England raised its bond purchasing limit by £75 billion, as it attempts to stave off weakening economic growth. UK trade has been hampered by a weak Euro-zone and higher borrowing costs as banks have had to increase reserves to deal with fallout from bad sovereign debt holdings.

Bond rating agency Fitch downgraded debt from Spain and Italy, while Moody's downgraded Italy amidst ongoing deficit spending and weak growth. US Treasury bonds benefited as investors sought a safe haven, pushing 30-year yields below 3%. US banks faced widening risk premiums as money markets tightened due to uncertainties over sovereign debt valuations.

President Obama unilaterally altered terms to the Home Affordability Refinance Program (HARP) and federal student loans. Changes to HARP are expected to open up refinancing options to more borrowers, provided they are current on their payments, employed, and the loans are backed by Fannie Mae of Freddie Mac. The most pronounced changes are a removal of the 125% loan-to-value ratio cap and a cut in fees. Changes to student loans lower the maximum required payment from 15% to 10% of discretionary income and forgives the remaining debt after 20 years, down from 25 years.

Investors are cautiously watching progress of the Congressional Super Committee, whose twelve members are set to present a debt-reducing proposal immediately prior to Thanksgiving. Current proposals remain split along party lines, as Republican members have focused on Medicare and Medicaid cuts and premium increases, while Democrat members proposed over $1 trillion in tax increases. Each side has vehemently opposed ideas currently posed by the other. The disagreements, if they become more pronounced, are likely to add uncertainty to markets, which initially cheered plans to cut the budget deficit.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