

Quarterly Market Review

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Financial Markets and Economic Analysis, First Quarter 2009

Perspective

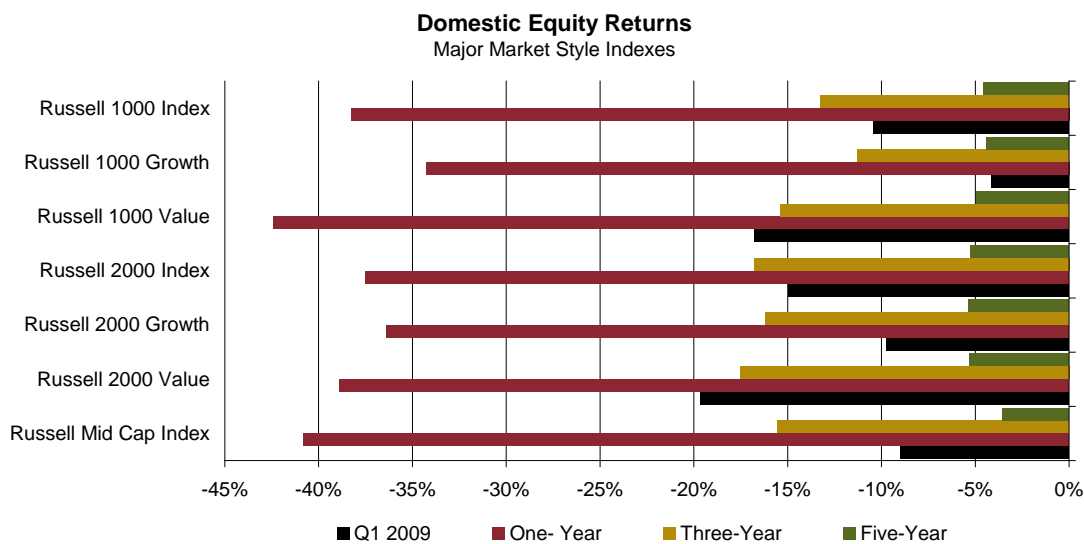
At year end the markets had begun to stabilize and participants were looking forward to 2009 with more optimism. Nonetheless, the new year started with two difficult months for equities on a global basis, and a return of the flight to quality mentality that dominated the second half of 2008. Earnings for the final quarter of 2008 were among the worst in history, with the S&P 500 actually recording negative earnings for the quarter. The new Administration unveiled a slew of government programs during the quarter to help the financial system, directly and indirectly, but it wasn't until the second week of March that the markets appeared to respond to the efforts. This may have been due to the way in which these programs were rolled out, often causing confusion rather than instilling confidence, or it may have been due to the overwhelmingly bad news reported across all sectors of the economy, and indeed across the globe.

These issues will continue to define the global markets for the remainder of the year. Although steps are being taken to coordinate the stimulus packages across the G20, not all of the governments are in a position to, or are willing to, commit to the level of spending currently being contemplated and executed in the U.S. and in China. And even within the countries willing to put forth spending programs, the details have been few and far between, and the execution questionable. And yet it is these programs, large and small, that are the likely bridge for the markets between the current environment and the next growth cycle. Without better clarity and better coordination, that bridge remains on a very shaky foundation.

Domestic Equity Markets Overview

Despite an eight to nine percent rally in the domestic indexes in March, the first quarter continued the significant losses of the previous two quarters, though the size of the loss varied widely. Although returns in the final month varied little between value and growth, the disparity in the first two months was enormous. For the quarter, growth outperformed value by 13% in the Russell 1000 Index, 11% in Russell Midcap Index and 10% in the Russell 2000 Index. This was largely due to returns in two sectors: Financials and Technology. Looking at the broader market, as represented by the Russell 3000 Index, Financials were down more than 24%, putting extensive pressure on the value indices, which have larger financial components than do their growth counterparts. For example, in the Russell 2000, Financials make up 40% of the Value index but just 14% of the Growth index. On the other end of the spectrum, the Technology sector was the lone positive performer for the quarter, generating a return of just under five percent.

Midcap stocks were the best performers during the quarter, narrowly outperforming large caps and substantially outperforming small caps, using the Russell indices as proxies for each asset class. Midcap growth (as represented by the Russell Midcap Growth Index) and large cap growth (as represented by the Russell 1000 Growth Index) both had losses less than 5%, while small cap value (as represented by the Russell 2000 Value Index) was down nearly 20%. None of the indices reflect positive returns over the past one, three and five year periods, and the large cap indexes still show losses over the last 10 years. Substantial market turmoil, certainly an apt description for the past 12 months, should allow good active managers to outpace their benchmarks. This was not the case in the second half of 2008, but appears to be more so the case in the first quarter of 2009. According to Morningstar, 85-95% percent of value managers, depending on the cap range, outperformed during the first quarter.



International Markets Summary

Despite the sharp rally in December, the international markets followed the U.S. markets during the first quarter. Substantial losses in the first two months were only partially offset by a decent rally in the final month. In dollar terms, the developed equity markets outside of the U.S. were down roughly 13%¹, a figure exacerbated by a stronger dollar against most currencies. The brightest spot among the developed countries was Norway, the only country with a positive return for the quarter², a return of just three percent. Still on the losing side, but one of the better performers was the Pacific region, excluding Japan. Hong Kong was essentially flat for the quarter, Australia was down less than two percent and New Zealand three percent. Finland, Italy and Spain were among the biggest losers.³

After investors fled the much riskier emerging markets in 2008, the first quarter showed some interesting, if mixed results. China announced a massive stimulus package early in the quarter, and managed a slightly positive return for the period. In fact, amongst Asian emerging markets, Thailand had the worst return, down just 5%, while markets in the Philippines and Taiwan both enjoyed positive returns in the quarter, of 6% and 8% respectively. Latin America's see-saw ride continued, with the region up roughly five percent headed by Brazil (+12%) and Chile (+13%). These gains however make only a slight dent in the 40%+ losses incurred in the final quarter of 2008.

Fixed Income Summary

The domestic fixed income markets showed mixed results in the first quarter, largely a correction on the excesses of the second half of 2008. The U.S. Treasury market, the dominant sector in 2008, was down during the quarter.⁴ The losses were slight for short to intermediate maturities, as the yield curve shifted

¹ MSCI World Index, net of tax transfers

² MSCI Norway Index, dollar returns net of tax transfers

³ MSCI Pacific Ex-Japan Index, Hong Kong, Australia, New Zealand, Finland, Italy and Spain country Indexes, dollar terms, net of tax transfers.

⁴ Barclay's US Treasury Index

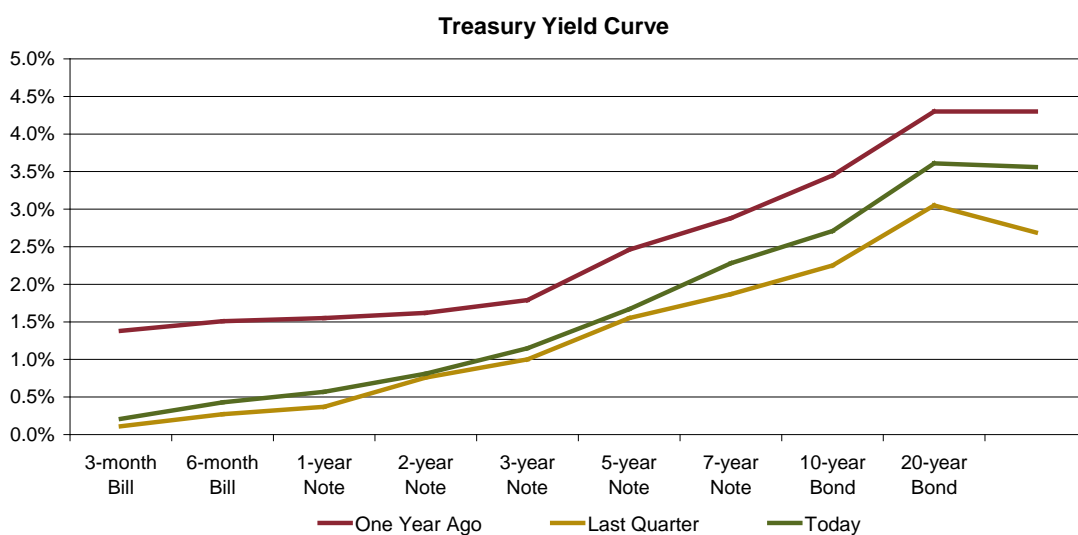
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upwards 10-15 basis points. However, the losses were quite large at the long end of the curve; the Barclays 20+ Year Index was down 10.9%, as the yield on the 30-Year moved more than 85 basis points. The MBS Index continued its rally, up 2.2% in the first quarter after a 4.3% return in the fourth quarter⁵. The real gains in the quarter however were outside the investment grade indices. The Barclays U.S. High Yield Index was up 6% in the quarter, and the High Yield Loan Index was up 10.5%. These two asset classes were due for a substantial rebound, but even with the first quarter returns, both Indexes are down substantially, 19% and 18% respectively over the last 12 months.

Although returns were mixed during the final month of the quarter, the municipal market showed positive returns for the first quarter across all maturities, credit qualities and regions. The Barclay's Municipal Index was up 4.2% for the quarter, with the peak returns coming at the long end of the curve, as the 22+ year sub-index was up 7.3%. In 2008, only AAA-rated securities had a positive return for the year, but in the first quarter the lowest rated securities had the best returns (up 7.2%)⁶ among investment grade bonds. Yields, as measured by yield-to-worst, fell sharply in the quarter. At the short end the yield to worst fell by 60 basis points to 1.44% and at the long end by 45 basis points to 5.97%.



Outlook

For any substantial positive movement in the global equity markets, confidence has to be restored both in the global financial industry as well as the general health of the global economy.

The second quarter of 2009, and indeed the remainder of this year, will be a struggle for investors to weigh the outlook for their investments going forward with negative news of the recent past. Domestically, the markets have a long way to go to erase the losses of 2008, and with uncertainty rather than optimism having the upper hand at the moment, it seems highly unlikely that even a fraction of those losses will be recovered this year. For any substantial positive movement in the global equity markets, confidence has to be restored both in the global financial markets as well as the general health of the global economy. This level of confidence will not be easy to restore, and will take a significant effort on the part of leaders of both government and industry in addition to time. However, Prima is of the opinion that there are an increasing number of opportunities available to investors with a truly long term perspective. Buying when others are forced to sell, which has certainly been the case through this period of de-leveraging, has paid off quite handsomely throughout time.

⁵ Barclay's US MBS Index

⁶ Barclay's US Municipal Index, AAA sub-segment