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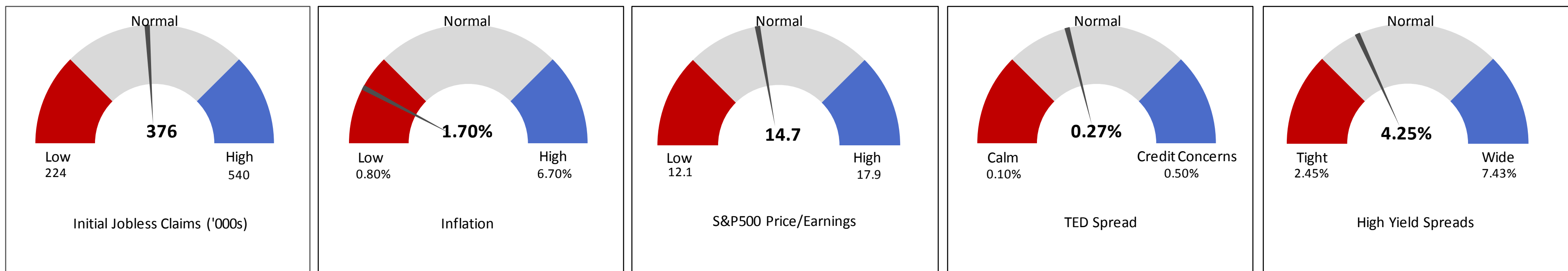
Market Digest

Third Quarter 2012



Fiscal Cliff Notes

What is the Fiscal Cliff?

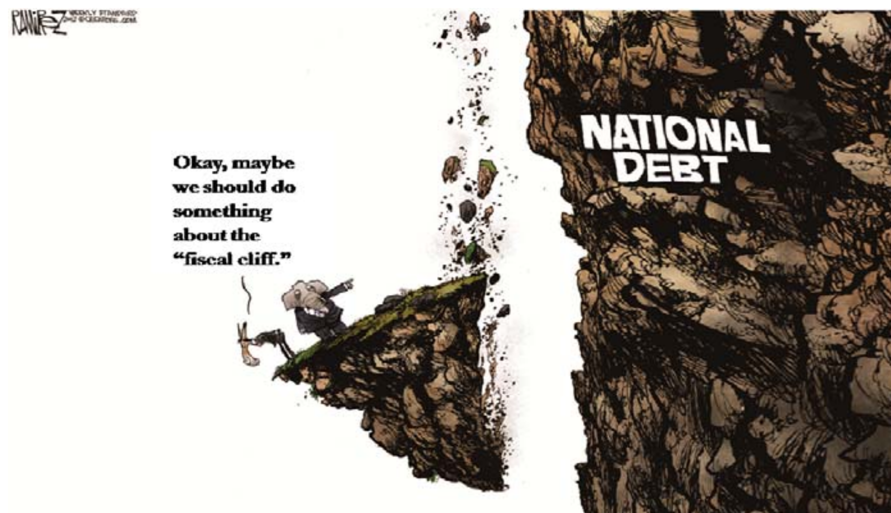
The US government and taxpayers face three major political and fiscal events going into 2013. First is a series of tax increases under "Taxmageddon." These include the expirations of the 2001/2003 Bush tax cuts and the 2% temporary cut in the payroll tax at year-end, together with new healthcare-related taxes on higher income taxpayers that go into effect in January. Second is a series of spending cuts that go into force on January 1, 2013. These include the cessation of extended unemployment benefits and the imposition of across the board spending cuts mandated by the Budget Control Act of 2011, after the Simpson-Bowles Commission "Super Committee" failed to reach a bipartisan compromise on deficit reduction. Third is the expected Congressional wrangling over raising the Federal debt ceiling in early 2013.

Collectively, these events are known as the fiscal cliff, and they are expected to have a highly destabilizing effect on markets going into 2013. Here is a timeline of key dates:

Fiscal Cliff Timeline

Date	Event
Oct 1, 2012	Begin 2012/2013 fiscal year
Nov 6, 2012	US Election Day
Nov 13, 2012	Lame duck Congress convenes
Dec 14, 2012	112th Congress adjourns
Dec 31, 2012	Fiscal cliff takes effect
Jan 2, 2013	Sequestration rules activated
Jan 3, 2013	113th Congress takes office
Jan/Feb	US debt ceiling limit reached
Feb 15, 2013	Semi-annual payment on US government debt due
Mar 31, 2013	End temporary extension of discretionary spending authority

Source: Staring Down the Fiscal Cliff, Goldman Sachs, Aug 8, 2012



Source: IBD, Jun 11, 2012. Reprinted by permission of Michael Ramirez and Creators Syndicate, Inc.

According to the Congressional Budget Office, the fiscal cliff will reduce the Federal deficit, by $607 billion for the 2012/2013 fiscal year through a combination of higher taxes and lower spending. As shown below, higher taxes will account for roughly two-thirds ($399 billion), spending cuts will amount to one-sixth ($103 billion), and miscellaneous changes in revenues and spending

Federal Deficit Reduction in FY 2013

Item	Amount	%
2001/2003/2010 Tax Cuts and AMT Patch Expirations	$221B	36%
Other Revenue and Spending Increases/Reductions	$105B	17%
Payroll Tax Cut Expiration	$95B	16%
Automatic Sequestration Cuts	$65B	11%
Other Expiring Provisions	$65B	11%
Unemployment Benefits Expirations	$26B	4%
Affordable Care Act Tax Increase	$18B	3%
Medicare "Doc Fix" Expiration	$11B	2%
Total	**$607B**	**100%**

Source: Council on Foreign Relations. What is the Fiscal Cliff, Aug 1, 2012.

will make up the remaining one-sixth ($105 billion). We will examine each of the three components of the fiscal cliff in turn below.

Tax increases

Here is a simplified comparison of the current tax rates to the 2013 rules as currently mandated, along with the competing proposals proposed by each presidential candidate:

The 2013 Tax Cliff

Tax rates under current law in 2012, in 2013 without changes in law, and in 2013 as proposed in the Obama budget and Romney economic plan

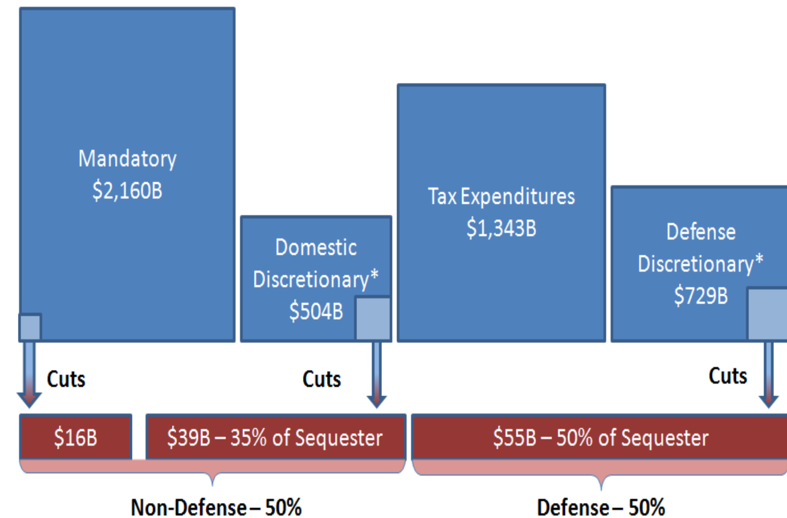
Income	2012	2013	Obama	Romney
Over $388,350	35%	39.6%	39.6%	28%
$217,450-388,350	33	36	36	26.4
$142,700-217,450	28	31	28	22.4
$70,700-142,700	25	28	25	20
$17,400-70,700	15	15	15	12
Top dividend tax rate	15	43.4*	43.4*	15
Top capital gains tax rate	15	23.8*	30	15
Estate tax rate	35	55	45	0

* Includes the 3.8% investment tax under the Affordable Care Act.
Source: ISI Group

Sequestration

Sequesters, the automatic spending cuts mandated by the Budget Control Act of 2011, are especially of concern. The Bipartisan Policy Center established by former Senators Baker, Daschle, Dole and Mitchell has released a study showing that the brunt of the cutbacks will be borne by the discretionary side of the Federal budget, affecting military spending and expenditures for healthcare, science and education.

Distribution of Sequestration Spending Cuts

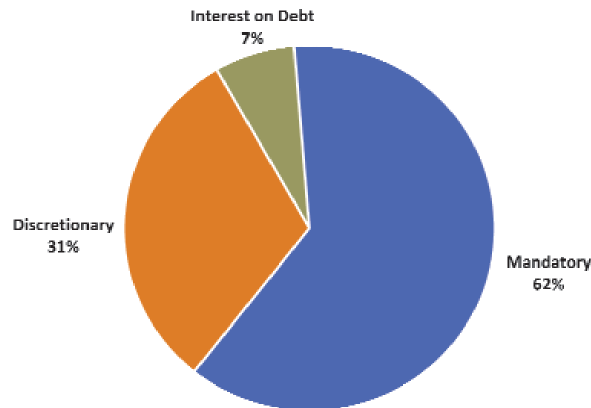


Source: Bipartisan Policy Center, White Paper, June 2012.

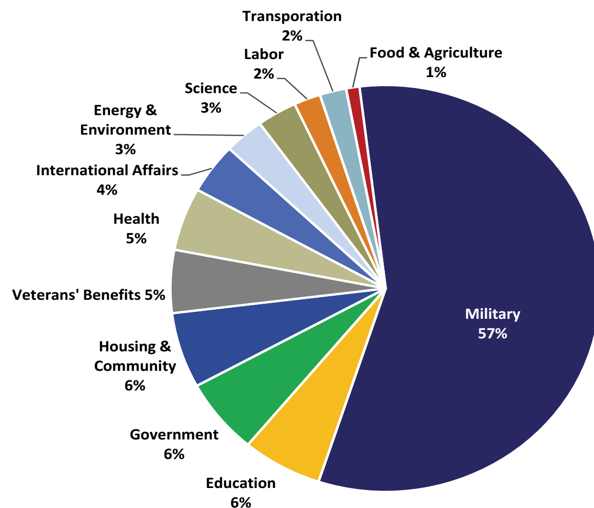
Some perspective on the Federal budget might be helpful here. All told, the US government expects to spend $3.67 trillion in the current fiscal year. Of this figure, mandatory spending on entitlement programs such as Social Security and Medicare represents 62% and interest on the national debt accounts for a further 7%, leaving 31% for discretionary programs. As detailed in our 2012 Outlook, mandatory programs cannot be modified without new legislation, whereas discretionary programs are subject to the annual authorizations process and are therefore easier to cut.

Fiscal Cliff Notes

FY 2013 Federal Budget



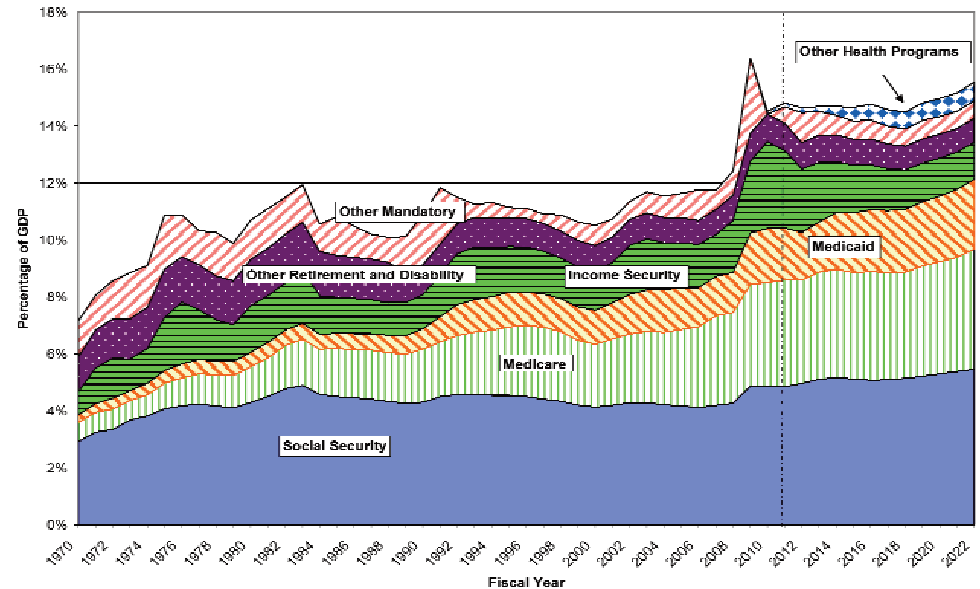
FY 2013 Discretionary Spending



Source: Federal Budget Dashboard FY2013, National Priorities Project

As we see on the chart below, mandatory spending consumes an ever-growing share of the US budget, but it cannot be modified without new legislation. Cutting discretionary spending is easier, but it does little to address the underlying causes of our chronic budget deficits.

Mandatory Spending Before Offsetting Receipts as a Percentage of GDP (FY 1970 - FY 2021)



Source: Austin & Levit, Mandatory Spending Since 1962, Congressional Research Service, 6/2011.

Debt ceiling

Per the US National Debt Clock, the total Federal debt outstanding is $16.17 trillion as of Oct 15, 2012. The debt ceiling was set at $16.349 trillion in 2011, and we are quickly bumping up against this limit. Unless the ceiling is raised, the government will be precluded from further borrowing and it may be forced to

furlough workers and shut down certain nonessential services to conserve cash. As we saw in 2011, a large group of lawmakers is unwilling to raise the debt ceiling without a commitment to reduce government spending, but it will be difficult to reduce overall spending if mandatory programs are not part of the equation.

The government relies on borrowing to fund its functioning because there is a mismatch in timing between revenue (tax) collection and expenditures. If the government spends more than it takes in each year, it creates a budget deficit, which is funded by borrowing. According to the Campaign to Fix the Debt (a bipartisan group created by Erskine Bowles and Senator Alan Simpson after the failure of the Super Committee), US public debt has averaged less than 40% of GDP over the past 40 years; it now stands at 70% of GDP and is forecast to exceed 100% of GDP in the next decade and 200% of GDP by mid-century.

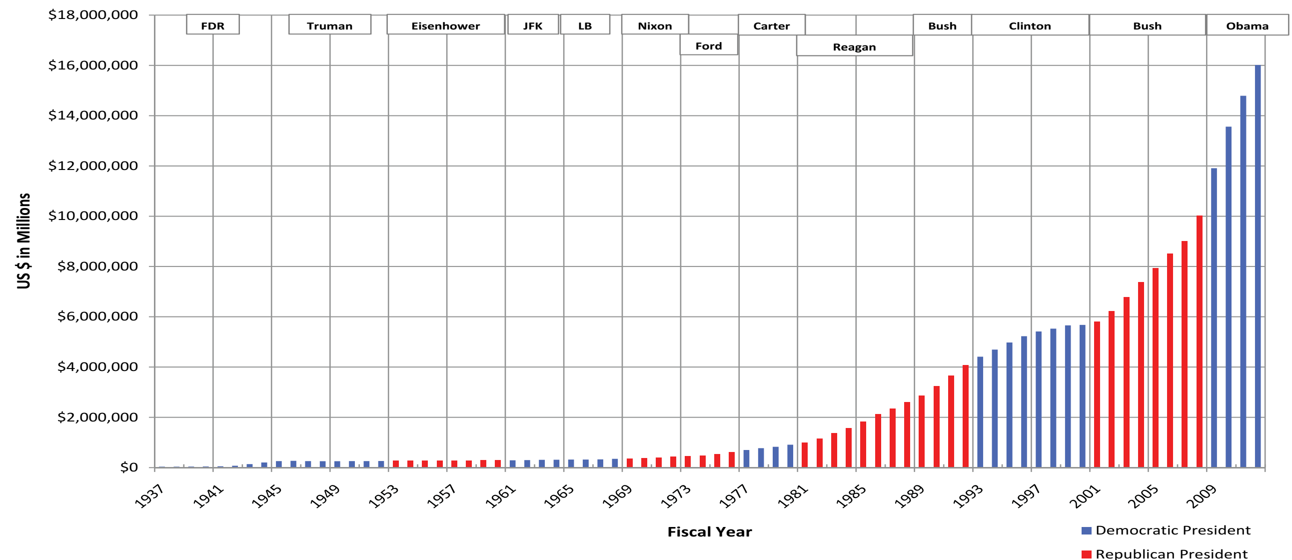
As recent events in Europe have shown, at some point investors will turn away from buying the debt of countries with high debt burdens. At that point, these countries either have to offer a much higher rate of interest to investors or they find themselves shut out of the capital markets. As long as the US is viewed as a safe haven by overseas investors, this is not an issue, but as we have seen, once investors became nervous about the peripheral Eurozone countries, it was not long before the contagion spread to the core nations that had previously been viewed as highly creditworthy.

With interest rates at historically low levels, interest payments on our national debt are easy to manage. At more normal levels, debt service will take up a significantly greater portion of the budget, leaving less funding for essential and nonessential services.

How did we get here?

The following chart shows the level of Federal debt from the FDR administration to the present. We see that the Federal debt remained relatively steady until about 1980, but has risen steeply thereafter. It has been suggested that a fundamental shift occurred during the Volcker era, when the Federal Reserve stopped printing money to fund budget deficits and instead began to rely on Treasury debt to fill the budget gaps.

US Federal Debt by President / Political Party

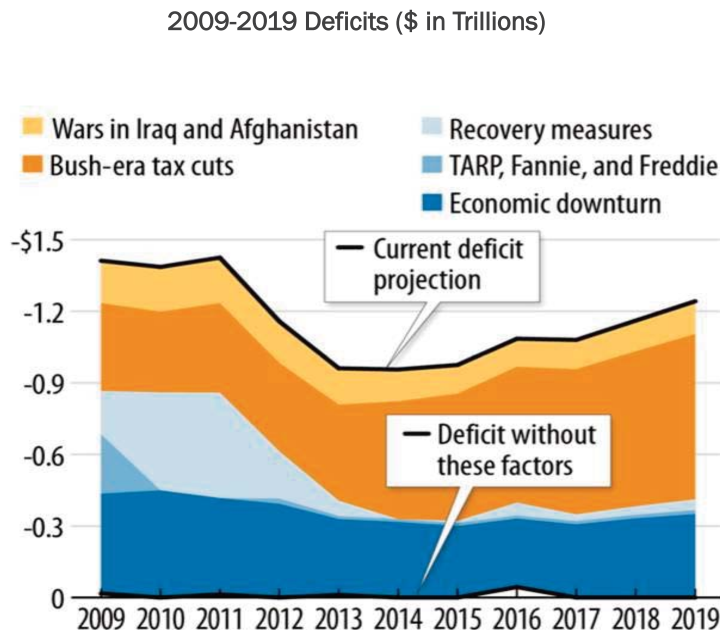


Source: Truthful Politics, Sep 22, 2012.

Fiscal Cliff Notes

Since 2000, the US economy has undergone a number of fiscal shocks, including two wars, two recessions and two bear markets. More recent attempts to jumpstart the economy through tax cuts and stimulus measures have further added to the deficit. The combined impact of these events can be seen below:

2009-2019 Deficits ($ in Trillions)



Source: Ruffing & Horney, Economic Recovery Watch Center for Budget & Policy Priorities, May 10, 2012.

A recent study by Jack Goldstone at George Mason University argued that no single president, party or policy can be held responsible for the growth in the US debt. Rather, the problem is rooted in the period from the 1930s to the 1970s when the US economy was growing rapidly and bipartisan majorities supported expansion of popular programs such as Social Security and Medicare. We should also note that at that time, roughly half the population died before reaching age 65 and becoming eligible for these programs. By contrast, today 87% of the population lives to start collecting Social Security starting at age 62.

Goldstone concludes that the core problems contributing to the deficit are aging demographics and escalating healthcare costs. His recommended solution is threefold: induce people to retire later; adjust eligibility ages to reflect changes in life expectancy; and find ways to limit healthcare costs. He also suggests higher income caps on Social Security to bring in more revenues and means testing to reduce outlays to wealthier individuals who have access to other assets and funding sources.

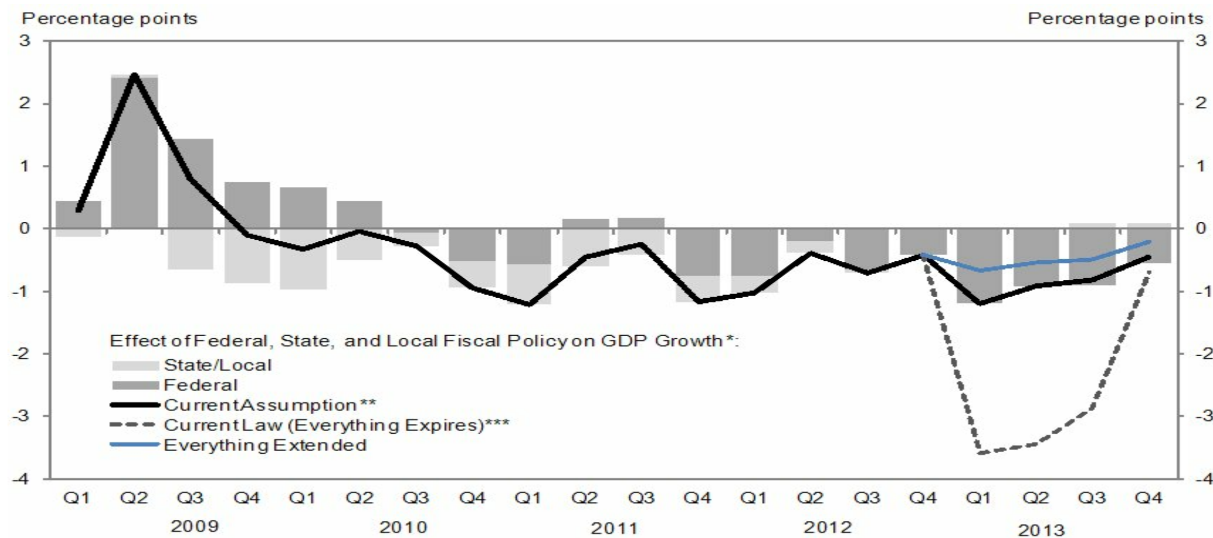
Composition of the fiscal cliff

In its latest analysis on the fiscal cliff, Goldman Sachs has identified three potential outcomes:

The Not So Good: Temporary extension of 2001/2003 tax cuts; phaseout of emergency jobless benefits; temporary delay of sequestration spending cuts; expiration of 2% payroll tax cut; Medicare surtax goes into effect. Under this scenario, GDP growth would be reduced by 1½% in 2013 but a recession could be averted.

The Bad: Congress allows the upper income tax cuts (incomes > $250k) and jobless benefits to expire. All other scheduled changes take effect at year-end but would be reversed by the new Congress. Under this scenario US GDP would be 1% lower in 2013, which is better than the base case above; however, it is considered a worse outcome: It assumes Congress will restore most of the expiring provisions in early 2013 (with the possible exception of the upper income tax cuts), thereby kicking the proverbial can down the road.

Current Fiscal Assumption vs. Alternative Scenarios



* Annualized: excludes second round effects.

** Current assumption; Payroll tax cut expires after 2012; jobless benefits phased down to a maximum of 59 weeks; income tax cuts extended through 2013; automatic spending cuts do not take effect.

*** Current Law; Payroll tax cut. 2001/2003 tax cuts, and jobless benefits to expire after 2012, "sequester" spending cuts and the new 3.8% tax on certain passive income take effect January 2013.

Source: Goldman Sachs Research, US Daily: Breaking Down the Fiscal Cliff, Aug 7, 2012.

The Ugly: Congressional inaction allows all of the scheduled tax increases and spending cuts to take effect. This is the worst case scenario as a recession is all but assured and US GDP would be reduced by as much as 4%. Fortunately, this is viewed as the least likely outcome – to avoid blame for causing a recession, politicians are likely to avert the fiscal cliff.

Along with most other market observers, Goldman dismisses a fourth "Good" scenario – a grand bargain, or bipartisan compromise that provides for meaningful reform and incorporates both spending cuts and revenue raising measures. While this would be the best outcome, it is considered highly unlikely in the current partisan environment.

The chart above illustrates Goldman's 3 scenarios – Not So Good (blue line), Bad (solid Black line) and Ugly (dashed line). The dashed line illustrates the full impact of the fiscal cliff, whereby the 2001/2003 tax cuts, 2% payroll tax cut and extended unemployment benefits all expire, while the new 0.9% payroll tax, 3.8% Medicare surtax and sequestration spending cuts take effect. Under this scenario, the US economy will experience a 4% reduction in GDP and likely fall

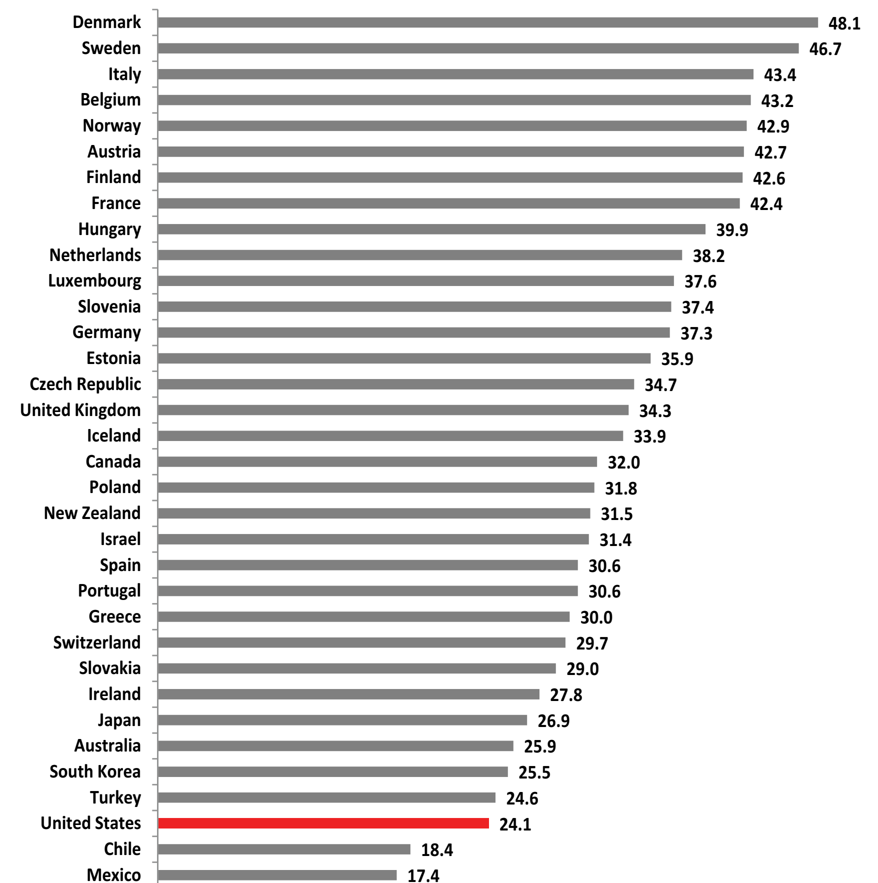
into recession in 2013. The solid black line shows the scenario where Congress extends the 2001/2003 tax cuts into 2013 and puts the automatic cuts under sequestration on hold, but allows the 2% payroll tax cut and extension of jobless benefits to expire.

The blue line shows that if all of the current tax provisions are extended, the economy could avoid a recession. This might lead one to believe that the best solution would be to extend the current tax laws permanently; however, there is widespread consensus that simply extending the current provisions, while beneficial in the short run, will be the worst outcome for the country long term. Indeed, the CBO's own analysis shows that if all the expiring tax provisions are extended and the automatic spending cuts mandated by BCA 2011 are rescinded, we can expect $1+ trillion deficits annually into the next decade, greatly adding to the debt burden. Far better for the US to suffer through a recession in 2013 if that provides Congress with the impetus to enact meaningful fiscal reforms in two primary areas – tax revenue and entitlement spending.

Tax revenue

On the tax front, it is widely accepted that the US tax code is riddled with complexity, preferences and loopholes. The cost of compliance is a burden on both corporate and individual filers, and there is universal demand for simplification of the code. Simplifying the tax code will require bipartisan support, and that is unlikely in the current partisan environment. Democrats argue that the deficit gap cannot be closed without raising taxes and that higher income taxpayers are benefiting at the expense of low wage earners due to tax preferences. Republicans argue that the crux of the problem is the growth of entitlement programs. In their view, wealthier taxpayers are already paying a disproportionate share of taxes, and raising taxes further will be a deterrent to economic growth. Let us examine each of these positions in turn below.

If we examine the aggregate level of taxation in the US against other nations, we see that taxes represent a smaller portion of GDP in this country than in most other countries:



Source: Foreign Affairs, Council on Foreign Relations, Sep/Oct 2012.

According to the Brookings Tax Policy Center, 46% of US households paid no income taxes for 2011 (although they do pay social security and payroll taxes as well as state, local, sales and excise taxes, all of which have a greater impact on lower income). Aside from low income households, this figure includes students and retirees, for whom Social Security is exempt from Federal tax at the $25,000 single or $32,000 joint threshold. Numerous credible studies have shown that even raising taxes on higher income taxpayers to confiscatory levels will be insufficient to close the budget gap. Thus, any meaningful reform measures will require that the tax base be broadened to the majority of the population.

Entitlements

In simple terms, Americans are living much longer and their need for medical care rises sharply with age. At the same time, the financial downturn has depleted the value of their homes and retirement accounts, so they are much more reliant on Social Security and Medicare payments. All of these factors are contributing to a steady rise in entitlement spending. As part of the solution, we believe policymakers will have to consider some or all of the following issues:

1. Introduce means testing for Social Security and Medicare and reduce payments to wealthier taxpayers. We recognize that there is an element of moral hazard and there will have to be some mechanism to discourage people from depleting their assets just to qualify for Social Security or Medicare.

2. Remove caps on Social Security tax. For 2012, any income above $110,100 escapes Social Security taxation. Conversely, there is no limitation on taxable earnings for hospital insurance taxes under Medicare. Rather than a flat 4.2% rate (6.2% without the 2% cut expiring at year-end), a graduated rate might be more acceptable to higher income taxpayers, such as 4.2% on the first $110,100, 3.2% from $110,1000 to $250,000, 2.2% from $250,000 to $500,000, 1.2% from $500,00 to $1m and 0.5% on income over $1m. In return, perhaps workers who do not tap into Social Security or Medicare could be allowed to transfer their unused contributions to their heirs.

3. The current retirement laws were put in place when average life expectancies were much lower. Today, someone retiring at age 65 can reasonably expect to be retired for 25 years or more, but few Americans have sufficient retirement savings. Raising the retirement age to reflect longer life spans would be the solution for most workers, except perhaps those in hazardous jobs such as firefighting or mining, who could still retire earlier.

4. Retirement planning needs to be improved. The introduction of 401k plans in the early 1980s led many companies to terminate their pension plans. The combination of low participation rates, lack of investment knowledge and the harsh market environment has left workers unprepared for retirement. Since companies are unlikely to reestablish defined benefit pension plans, one possible solution would be to make professionally managed 401k plans mandatory for all participants in the workforce.

5. Healthcare spending has grown from 5% of GDP in 1960 to 17% in 2008. As a share of GDP, the Congressional Budget Office projects that healthcare spending will reach 31% by 2035, 37% by 2050 and 46% by 2050. While it is difficult to make accurate long-range predictions, these numbers are clearly unsustainable. The Dartmouth Atlas of Health Care estimates that patients with chronic illness in their last two years of life account for 32% of total Medicare spending and 78% of that spending

occurs in the last month of life. Surveys show that the elderly do not necessarily want extraordinary measures taken to prolong life in their last months if their quality of life will not be improved. It may be time to put demagoguery aside and have a rational discussion about rationing or restricting healthcare.

Portfolio implications

We address the portfolio impact of the fiscal cliff on our six major asset classes in turn below. As a general rule, investors should look at ways to accelerate the recognition of income and capital gains in 2012. Losses can be deferred as they will be more valuable to offset income under the higher tax rates.

1. Cash
   a. Cash will continue to be a valuable buffer against portfolio volatility.
   b. Cash on hand will allow investors to take advantage of buying opportunities without having to liquidate other investments at less favorable prices.
2. Fixed Income
   a. We see more downside than upside in US Treasury securities at current rates and valuation levels. While Treasurys are likely to benefit from any deterioration in the US or global economy in 2013, we feel much of this upside is already factored into current prices.
   b. Municipal bonds yields remain higher than comparable Treasury yields. Rising tax rates will make municipal bonds more attractive for higher income taxpayers. However, tax revenues are highly correlated with economic conditions, and investors should be mindful of worsening credit quality if economic conditions deteriorate.
   c. High yield bonds have been an attractive investment for investors seeking yield. If economic conditions deteriorate, investors should keep an eye on default rates and swap into higher quality bonds for added safety.
3. Equities
   a. Historically, companies have compensated for higher tax rates on dividends by boosting payout ratios. We believe companies will continue to do so in 2013.
   b. In anticipation of higher tax rates on dividends, companies may elect to pay accelerated or special dividends in 2012 before the higher rates take effect.
   c. The proposed sequestration cuts will affect companies with the most exposure to government contracts. The following table shows the percentage of revenues derived from government contracts for certain industry sectors that will likely feel the greatest impact of the spending cuts.

Industry Exposure to Government Spending

Industry	%
Aerospace & Defense	70%
Health Care Equipment & Supplies	60%
Commercial Services & Supplies	41%
Construction & Engineering	40%
Electrical Equipment	39%
Health Care Providers & Services	31%
Health Care Technology	30%

Source: Goldman Sachs Research, US Daily. Aug 28, 2012.

d. Investors should consider swapping their equity long-only exposure into long/short strategies with better downside protection. Similarly, we would suggest switching from equity ETFs and index funds into active managers who can provide downside protection.

4. Real Return Assets

a. Slower economic growth would reduce the demand for commodities in 2013. Due to the inherent unpredictability of markets, we do not recommend eliminating commodities exposure totally, but investors should be mindful of commodity prices as the year progresses.

b. As with equities, we suggest investors swap out of commodity ETFs and index funds into actively managed strategies and structured notes with added downside protection.

5. Hedge Funds

a. In anticipation of higher capital gains rates in 2012, M&A activity is expected to remain strong for the balance of 2012. Funds with access to event driven strategies will benefit from the pickup in mergers.

6. Private Equity

a. PE managers have large pools of uninvested cash. We believe that a deteriorating economy will allow these firms to pick up assets at attractive prices.

Conclusion

The US economy faces profound challenges going into 2013. Companies and individuals are hesitant to make investment decisions as they are unsure of the future. A credible plan to address the deficit could help to reduce uncertainty, improve investor confidence and restore some faith in government. However, concerted bipartisan action will be essential to come up with a comprehensive plan that addresses both revenue raising and expenditure reductions, and bipartisanship is in short supply in the current political environment.

Some observers believe that lawmakers will be much more inclined to work together once they are past the elections and no longer vulnerable to demonization for voting to raise taxes and/or reduce spending, or for cooperating with lawmakers from the other side of the aisle. If history is our guide, a comprehensive resolution is unlikely just yet.

Source: Christopher Weyant, politicalcartoons.com. Reprinted with permission.

Third Quarter Performance Summary

Asset Class	Benchmark	3Q12 Return	YTD Return	Performance Summary
Cash	Citi 3-month T-bill	0.02%	0.05%	With inflation running below its 2% target and unemployment still high, Fed has stated that monetary policy will remain accommodative for the foreseeable future. Cash yields to remain at historical lows.
Domestic Gov't / Agency	BC U.S. Gov't & Related 5-7	0.62%	1.70%	Fed's announcement of open-ended mortgage purchases under QE3 lifted the mortgage-backed sector, while improved investor appetite for risk in Q3 caused Treasurys to underperform risky asset classes.
Domestic Tax-Exempt	BC Municipal Bond 5-Year	1.36%	3.18%	Despite concerns about rising municipal bankruptcies and credit downgrades, municipals bonds benefited from strong demand by investors seeking higher yields and muted new issuance in the quarter.
TIPS	BC TIPS	2.12%	6.25%	Despite negative yields on 5, 10 and 20-years issues, TIPS had a strong Q3 as investors sought out investments offering some measure of inflation protection.
Investment-Grade Debt	BC Inv. Grade Intermediate	1.58%	3.99%	Corporate bond returns benefited from improving economic fundamentals and the overall boost to the bond market from expanded government bond purchase programs.
High-Yield Debt	BC High-Yield Intermediate	4.40%	11.69%	Low default rates and quantitative easing spurred investors into high yield. Yields dropped to a record 6.15% in September, while primary issuance reached a record $48 billion.
Global Bonds	Citi World Gov't Bond Index (Hedged)	2.99%	3.41%	Q3 ended on a strong note after the ECB, Bank of England and Bank of Japan all announced expansions of their bond purchase programs in September.
Emerging-Markets Debt	Morningstar EM Composite Bond Index	5.76%	13.01%	EM debt experienced further strong inflows from investors attracted by attractive macroeconomic conditions, higher yields, lower debt/GDP ratios and better risk/return characteristics relative to developed markets.
Large-Cap Equity	S&P 500	6.35%	16.45%	Large cap US equities benefited from greatly improved investor sentiment in Q3, following the announcement of QE3, and the extension of the Fed's low interest rate policy through at least mid-2015.
Small/Mid-Cap Equity	Russell 2000	5.25%	14.23%	Improved investor sentiment led small and mid-cap equities to rally in Q3, but they continue to lag large cap returns based on earlier concerns about a US economic slowdown.
International Equity	MSCI EAFE	7.00%	10.53%	EAFE equities posted large gains in Q3 as investors took comfort in the unveiling of the ECB's Outright Monetary Transaction bond purchase program, proposals for a European Banking Union and support for the Eurozone from the German constitutional court.
Emerging-Markets Equity	MSCI EM	7.90%	12.19%	EM equities experienced a strong September rally on the back of encouraging developments in Europe (a key export market) and China's announcement of a major infrastructure construction initiative to counteract the domestic slowdown.
Real Estate	DJ Composite REIT Index	0.63%	13.39%	Although fundamentals remained positive, REITs underperformed other asset classes in Q3 due to a combination of strong REIT equity issuance and improved investor interest in other asset classes.
Commodities	DJ UBS Commodity Index	9.66%	5.56%	Energy, agriculture and metals prices rallied to provide a strong quarter for commodities, erasing losses from earlier in the year.
Private Equity	S&P Listed Private Equity	8.49%	23.79%	US experienced very strong transaction activity in Q3 as PE sponsors took advantage of improved markets to complete deals ahead of higher capital gains tax rates in 2013. As with Q2, attractive valuations led to higher deal making activity in Europe, while Asia experienced a further slowdown in fund raising.
Hedge Funds	HFRX Global Hedge Fund Index	1.45%	2.69%	Although September represented the strongest monthly performance since February, hedge fund returns lagged the broader markets in Q3. Returns for equity-based strategies (other than short-biased) were boosted by higher equity markets. Credit strategies benefited from expanded bond purchase programs and signs of progress on the Eurozone crisis.

Source: Bloomberg; Data as of 10/12/12.

Third Quarter Market Summary

		1Q12	2Q12	3Q12	YTD	Annualized 1-Year	3-Year	5-Year	10-Year
US Equity Benchmarks	**Price**								
Dow Jones Industrial	13,437.13	8.84%	-1.85%	5.02%	12.19%	25.40%	14.16%	2.14%	8.04%
Nasdaq Index Composite	3,116.23	18.98%	-4.76%	6.54%	20.73%	26.65%	14.75%	3.90%	10.74%
S&P 500	1,440.67	12.59%	-2.75%	6.35%	16.45%	27.99%	13.00%	0.99%	7.50%
Russell 1000 (Large Cap)	793.74	12.91%	-3.11%	6.32%	16.31%	27.79%	13.12%	1.19%	7.89%
Russell 1000 Growth	670.30	14.69%	-4.02%	6.11%	16.80%	25.95%	14.67%	3.20%	7.89%
Russell 1000 Value	710.86	11.12%	-2.20%	6.50%	15.74%	29.55%	11.52%	-0.98%	7.72%
Russell Mid Cap	1,098.27	12.95%	-4.19%	5.63%	14.30%	25.54%	14.33%	2.27%	10.91%
Russell Mid Cap Growth	496.24	14.52%	-5.60%	5.35%	13.88%	22.65%	14.75%	2.48%	10.81%
Russell Mid Cap Value	1,118.36	11.41%	-3.26%	5.80%	14.03%	27.59%	13.67%	1.67%	10.60%
Russell 2000 (Small Cap)	837.45	12.44%	-3.47%	5.25%	14.23%	30.34%	12.44%	2.00%	9.95%
Russell 2000 Growth	482.20	13.28%	-3.94%	4.84%	14.08%	28.63%	13.80%	2.75%	10.37%
Russell 2000 Value	1,102.58	11.59%	-3.01%	5.67%	14.37%	32.07%	11.03%	1.12%	9.41%
S&P GICS Sectors	**Weight**								
Consumer Discretionary	9.6%	15.96%	-2.60%	7.45%	21.36%	31.63%	21.52%	6.84%	8.25%
Consumer Staple	11.5%	5.54%	2.88%	3.83%	12.74%	24.07%	15.71%	8.18%	8.51%
Energy Sector	11.4%	3.88%	-5.99%	10.14%	7.56%	25.33%	12.32%	0.90%	13.97%
Financials	14.6%	22.04%	-6.83%	6.95%	21.61%	33.73%	2.67%	-12.76%	-0.78%
Health Care	13.0%	9.06%	1.75%	6.16%	17.80%	28.85%	14.04%	4.67%	6.19%
Industrials	10.5%	11.31%	-3.56%	3.62%	11.23%	27.15%	13.48%	-0.59%	7.55%
Information Technology	19.4%	21.46%	-6.68%	7.45%	21.79%	28.14%	14.82%	4.77%	10.86%
Materials	3.5%	11.19%	-4.19%	5.10%	11.96%	24.49%	9.70%	-0.16%	9.85%
Telecommunication Services	3.0%	2.08%	14.13%	8.05%	25.89%	35.46%	19.24%	2.56%	11.05%
Utilities	3.6%	-1.62%	6.55%	-0.53%	4.27%	13.41%	11.99%	2.13%	11.19%
Global Equity Benchmarks	**Price**								
MSCI World Index	1,311.50	11.73%	-4.85%	6.84%	13.58%	20.37%	8.12%	-1.50%	8.28%
MSCI AC World x-USA	331.58	12.01%	-5.36%	6.98%	13.39%	19.77%	7.84%	-1.47%	8.82%
MSCI EAFE	1,510.76	11.00%	-6.93%	7.00%	10.53%	12.56%	2.74%	-4.61%	8.55%
MSCI EAFE Growth	1,148.94	12.12%	-7.14%	6.45%	10.83%	12.95%	4.85%	-3.69%	8.10%
MSCI EAFE Value	2,431.45	9.87%	-6.78%	7.53%	10.14%	12.07%	0.59%	-5.62%	8.89%
MSCI Emerging Markets	1,002.66	13.99%	-8.79%	7.90%	12.19%	15.88%	6.18%	-1.04%	16.65%
MSCI BRIC	279.94	13.87%	-11.61%	6.93%	7.62%	9.55%	0.65%	-5.51%	18.18%
Nikkei 225	8,870.16	20.44%	-10.62%	-0.72%	6.88%	5.06%	-2.07%	-10.39%	0.90%

Global Equity Valuation Summary

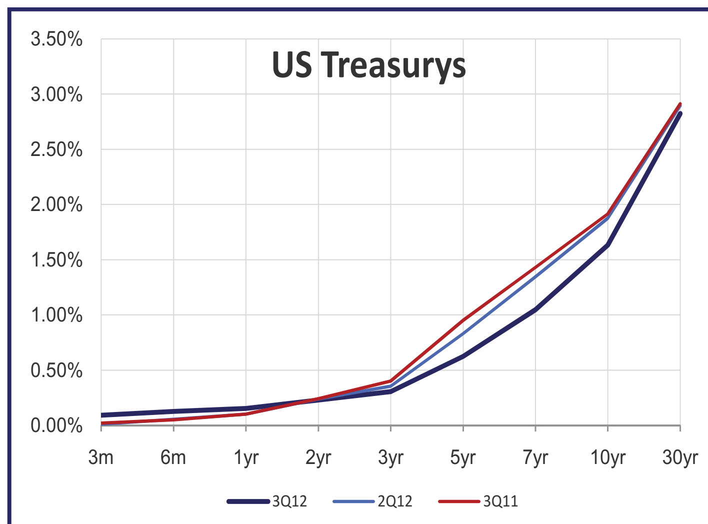
Benchmarks	2Q12	3Q12	QoQ
S&P 500			
Price	1,362.16	1,440.67	78.51
Trailing P/E	13.7	14.7	0.9
Est P/E	13.1	13.9	0.9
Trailing 12m Earnings	99.3	98.3	(1.1)
Est Forward 12m Earnings	104.3	103.4	(0.9)
Implied 1yr Earnings Growth	5.0%	5.3%	0.3%
Russell Mid Cap			
Price	1,044.59	1,098.27	53.68
Trailing P/E	17.0	17.8	0.9
Est P/E	15.5	16.5	1.0
Trailing 12m Earnings	61.6	61.6	0.1
Est Forward 12m Earnings	67.5	66.8	(0.7)
Implied 1yr Earnings Growth	9.6%	8.3%	-1.3%
Russell 2000			
Price	798.49	837.45	38.96
Trailing P/E	31.5	29.0	(2.5)
Est P/E	19.6	21.5	1.9
Trailing 12m Earnings	25.4	28.9	3.5
Est Forward 12m Earnings	40.8	39.0	(1.9)
Implied 1yr Earnings Growth	61.0%	35.0%	-26.1%
MSCI EAFE			
Price	1,423.38	1,510.76	87.38
Trailing P/E	12.9	14.3	1.4
Est P/E	10.5	11.2	0.8
Trailing 12m Earnings	110.6	105.6	(5.1)
Est Forward 12m Earnings	136.2	134.5	(1.7)
Implied 1yr Earnings Growth	23.1%	27.4%	4.3%
MSCI Emerging Markets			
Price	937.35	1,002.66	65.31
Trailing P/E	11.3	12.5	1.2
Est P/E	9.3	10.1	0.9
Trailing 12m Earnings	82.8	80.2	(2.6)
Est Forward 12m Earnings	101.1	99.1	(2.0)
Implied 1yr Earnings Growth	22.1%	23.5%	1.4%

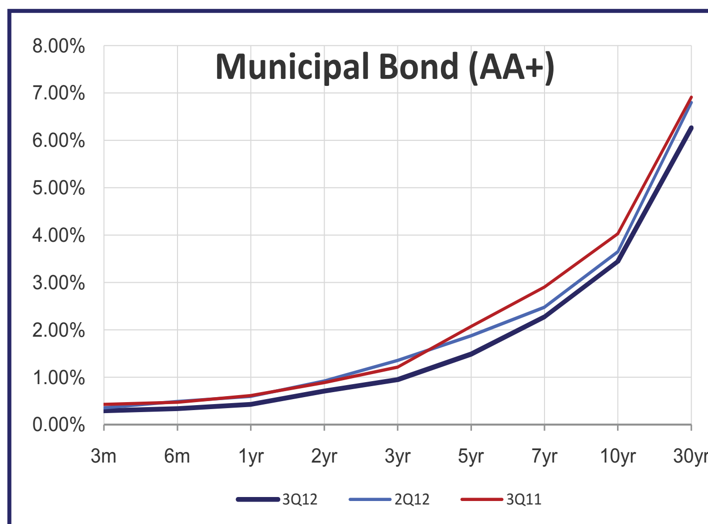
Source: Bloomberg; Data as of 10/12/12.

Third Quarter Market Summary (Continued)

		1Q12	2Q12	3Q12	YTD	Annualized 1-Year	Annualized 3-Year	Annualized 5-Year	Annualized 10-Year
Interest Rates	**Yield**								
Prime Rate	3.25	0.00	0.00	0.00	0.00	0.00	0.00	-4.50	-1.50
3m Treasury Bill	0.09	0.01	0.01	0.01	0.08	0.09	0.01	-3.60	-1.55
US LIBOR 3m	0.36	-0.10	-0.10	-0.10	-0.22	-0.01	0.08	-4.87	-1.44
US Treasury 3m	0.10	0.01	0.01	0.01	0.08	0.08	-0.01	-3.61	-1.55
US Treasury 10yr	1.65	-0.02	-0.02	-0.02	-0.24	-0.38	-1.66	-2.93	-2.14
US Treasury 30yr	2.82	0.07	0.07	0.07	-0.07	-0.25	-1.21	-2.01	-1.91
Fixed Income									
Citi 3-month T-bill		0.01%	0.02%	0.02%	0.05%	0.05%	0.09%	0.64%	1.73%
BC U.S. Gov't & Related 5-7		-0.38%	1.45%	0.62%	1.70%	2.39%	4.09%	5.20%	4.20%
BC Municipal Bond 5-Year		0.58%	1.21%	1.36%	3.18%	4.68%	4.68%	5.72%	4.37%
BC TIPS		0.86%	3.15%	2.12%	6.25%	9.10%	9.29%	7.93%	6.64%
BC Investment Grade Intermediate		0.30%	2.06%	1.58%	3.99%	5.16%	6.19%	6.53%	5.32%
BC High Yield Intermediate		5.16%	1.74%	4.40%	11.69%	19.03%	12.42%	8.93%	10.55%
Citi World Gov't Bond Index		-0.51%	0.92%	2.99%	3.41%	2.76%	4.29%	6.60%	6.84%
Morningstar EM Composite Bond Index		4.86%	1.90%	5.76%	13.01%	17.62%	11.07%	9.12%	
Real Estate	**Price**								
Dow Jones Composite REIT Inde	203.47	9.19%	3.20%	0.63%	13.39%	26.10%	13.24%	-3.38%	4.48%
FTSE EPRA/NAREIT Europe	1,397.69	9.58%	2.30%	5.59%	18.37%	18.78%	7.82%	-6.80%	6.43%
Commodities	**Weight**								
DJ UBS Commodity Index		0.87%	-4.57%	9.66%	5.56%	3.68%	6.25%	-3.74%	3.42%
Energy	21.0%	-6.11%	-8.96%	11.85%	-4.39%	-4.85%	-8.18%	-17.56%	-6.36%
Agriculturals	33.0%	3.16%	2.23%	9.77%	15.77%	13.55%	15.76%	3.49%	3.27%
Livestock	6.7%	-5.19%	3.09%	-5.78%	-7.91%	-8.98%	0.70%	-12.12%	-5.55%
Softs	8.3%	-2.20%	-11.88%	-3.28%	-16.65%	-20.71%	8.03%	3.21%	-0.09%
Industrial Metals	20.2%	5.75%	-9.04%	8.55%	4.42%	2.21%	3.72%	-6.41%	10.81%
Precious Metals	10.8%	8.49%	-6.83%	13.39%	14.62%	9.78%	22.66%	18.28%	16.97%
Private Equity / Hedge Funds	**Price**								
S&P Listed Private Equity Index	139.58	17.09%	-2.55%	8.49%	23.79%	32.83%	8.97%	-7.36%	
HFRX Global Hedge Fund Index	1139.19	3.14%	-1.86%	1.45%	2.69%	1.88%	0.36%	-3.00%	
Currencies	**Price**								
ICE Dollar Index	79.94	-1.46%	3.32%	-2.07%	-0.30%	2.68%	1.23%	0.40%	-2.94%
Euro / US Dollar	1.29	2.95%	-5.07%	1.52%	-0.78%	-5.04%	-4.19%	-1.90%	2.78%
Pound / US Dollar	1.62	2.99%	-1.88%	2.93%	4.01%	3.80%	0.59%	-4.43%	0.37%
US Dollar / Yen	77.96	7.75%	-3.72%	-2.29%	1.37%	1.76%	-4.54%	-7.58%	-4.38%

Source: Bloomberg; Data as of 10/12/12.





Municipal bond yields are shown on a comparable, adjusted basis using a 35% tax rate.

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