

## Historic financial market fallout sends equities sharply lower

Amid an environment that reshaped the United States' financial landscape, stocks declined sharply and economic concerns mounted. Record volatility sent stocks gyrating in both directions, but the broad U.S. market, as defined by the S&P 500 Index, ultimately finished down -8.4% during the third quarter. Through nine months, equities are down -19.3% and on pace for the worst annual return in decades.

Recession-resistant consumer staples outperformed during the quarter, perceived by investors as a safe haven during uncertain economic times. Financials and health care stocks finished marginally higher. Falling commodity prices sent energy and material shares down sharply, eradicating their gains made earlier in the year. Utilities and telecom stocks also lagged the broad index. All ten sectors have declined year-to-date, with only consumer staples holding up relatively well. Telecom and financial shares are down most dramatically through nine months.

All capitalization sizes of U.S. equities declined in the quarter, but small-cap stocks were best able to mitigate losses, falling -1.1%. Due in part to the relative rebound in financial shares, large-cap value stocks outperformed large-cap growth stocks,

returning -6.1% and -12.3% respectively. Mid caps depreciated the most sharply, by -12.9%. Year-to-date, small caps have fared relatively well by declining -10.4%. Large-cap value and growth stocks are down -18.8% and -20.3%, and mid caps have retreated by -19.5%.

Equity market turmoil sent investors into safe, government-backed U.S. Treasuries, pushing bond yields lower across all maturities. The prospect for easing by the U.S. Federal Reserve, along with the potential for lower inflation, also reversed the second-quarter trend of rising bond yields. Yields among short-term maturities slipped most noticeably during the third quarter. The 3-month U.S. Treasury-bill declined to 0.92% from 1.90% a quarter ago, while the 30-year U.S. Treasury bond fell less dramatically to 4.31% from 4.53%. The 2-year U.S. T-note moved lower to 2.00% from 2.63%, while the 10-year U.S. T-note inched lower to 3.85% from 3.99%.

Oil prices declined for the first time in seven quarters as the prospect for a sharp consumer slowdown reduced demand expectations. Closing the quarter at \$101 per barrel, oil prices were down considerably from \$140 a quarter ago, but are still up a bit from the year-end level of \$96.

### Economy

Bolstered in part by the stimulus plan, the U.S. economy grew at a 2.8% annualized pace during the second quarter. Despite providing a positive boost, consumer spending was weaker than expected; meanwhile, business investment and homebuilding were down. Though strong exports could meaningfully impact the economy in the coming quarters, growth is expected to be weak as curbed lending has prevented the economy from growing at a healthy pace.

The consumer price index was up 5.4% year-over-year in August as food prices continued to rise and oil prices remained above levels a year ago. Airplane tickets and clothing prices were also higher, while automobile and hotel prices declined. Core-CPI, which excludes volatile food and energy prices, increased at an annualized rate of 2.5%. Rents, comprising 40% of core inflation, were up amid continued mortgage fallout.

### Earnings

Corporate earnings growth continued to decline sharply, falling for the fourth consecutive quarter and dragged down solely by financials and consumer discretionary stocks. Earnings growth in all other sectors was positive year-over-year. As measured by the broad S&P 500 Index, year-over-year earnings growth declined by -29.3%. Though financial and consumer discretionary earnings are expected to continue being weak, year-over-year growth for the broad index should improve for the third quarter due to a lower year-ago earnings base. As measured by the S&P 500 Index, the stock market is currently trading at 13 times projected 2008 operating earnings.

Market Data	3 <sup>rd</sup> Quarter	Year-to-Date
S&P 500 Index	(8.4)%	(19.3)%
Nasdaq Composite Index	(9.0)%	(20.9)%
Russell 1000 Growth Index	(12.3)%	(20.3)%
Russell 1000 Value Index	(6.1)%	(18.8)%
Russell Midcap Index	(12.9)%	(19.5)%
Russell 2000 Index	(1.1)%	(10.4)%
MSCI EAFE Index (US Dollar)	(20.5)%	(28.9)%
MSCI World Index (US Dollar)	(15.1)%	(23.8)%
LB Aggregate Bond Index	(0.5)%	0.6%

Data as of September 30, 2008. Data source: FactSet

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