



Economic & Market Perspective | November 2011

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1. U.S. Economic Update: A Funny Thing Happened on the Way to Recession

This summer, with an escalation of the European sovereign debt crisis, high oil prices, a U.S. sovereign debt downgrade, and tremendous market turmoil, it seemed like the U.S. economy was surely headed back into recession, and soon. The economy had slowed to a near stall speed in the first and second quarter, bad news seemed to be flowing in from all over, and the most reliable prognosticators were forecasting doom and gloom.

But a funny thing happened on the way to the next recession. Instead of decelerating in the fall after this summer swoon, the U.S. economy seems to have accelerated. While Europe muddles its way into stagnation, the U.S. plowed ahead. Though the good times are hardly rolling, not possible given unemployment over 8.5% and housing prices an astounding –31% lower than their 2006 peak, there is some notable momentum building within U.S. economic indicators. The biggest risk to that momentum is, of course, a European meltdown, which would have significant contagion effects here in the U.S. Our own fiscal shenanigans are not helping matters either. But for now, these risks remain somewhat nebulous to the American consumer, who is doing their duty to keep the engine of our economy running, just

when we thought it might be out of gas.

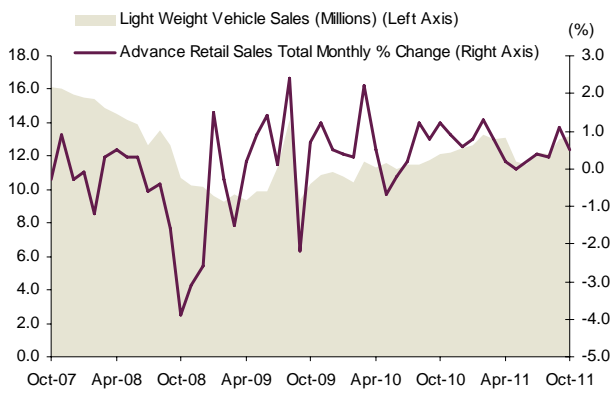
Indeed, the month of November saw the release of solid October retail sales data, as well as early indicators of a Black Friday sales blowout followed by a sensational Cyber



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David Fitzsimmons

Monday. In terms of specifics, October retail sales rose +0.5%, and, excluding automobiles, were actually up +0.6%. This rise in sales was broad-based, led by electronics (+3.7%), building materials (+1.5%), food and beverage sales (+1.1%), and health and personal care (+0.7%). Gasoline station sales were down -0.4%, but that was on a -4.5% drop in gasoline prices. Only furniture and clothing sales were truly weak, each falling -0.7%, versus +1.2% and +1.7% growth, respectively, in September. Regarding automobiles, sales remained strong in October, keeping up September's pace, though the small month-over-month change made them a slight drag on the final headline number.

October Retail and Vehicle Sales Hang In, But Black Friday Buzz Creating Higher Hopes for November



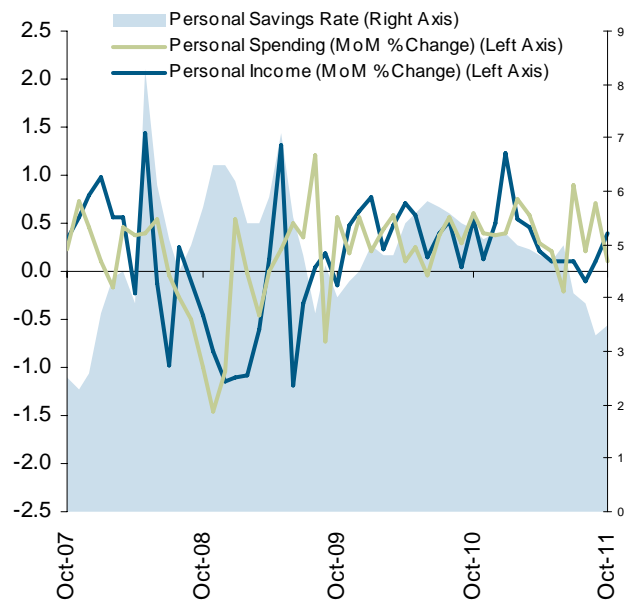
However, the real excitement in consumer spending news in November came from Thanksgiving weekend sales tracking. According to the National Retail Federation, Thanksgiving weekend sales were up +16% from last year, and spending rose +9.1% to \$400 per shopper. Of course, some of those gains were a result of the trend towards earlier and longer store hours. Indeed, the NPD Group's Chief Retail Analyst said that the retailers who participated in earlier store hours had a +22% increase in sales while those that did not saw sales drop -8%. Meanwhile, in a continuation of the shift toward online shopping, Cyber Monday sales were reportedly up +18% from a year ago.

Now, the big question is, will it last? The *New York Times* reported that "shoppers were using credit cards in large numbers, signaling that consumers were willing to sacrifice savings more than last year, when they paid with cash more frequently." With the personal savings rate only at 3.5% in

October, according to the personal outlays report, it would seem such behavior is not sustainable, especially in the context of weak income growth. It is also noteworthy that consumer spending has been choppy throughout this recovery, rising seasonally with holidays, only to give back ground later. The risk of a reversal is especially high if policy dysfunction in Washington means we will not see a renewal of the payroll tax cut and extension of jobless benefits for 2012.

Furthermore, while retail sales were strong, overall personal spending was weak in October, rising only +0.1% according to that outlays report, reflecting notable weakness in service sector spending. Though personal income did grow +0.4% month-over-month, year-over-year growth in income remains hampered by the difficult employment situation.

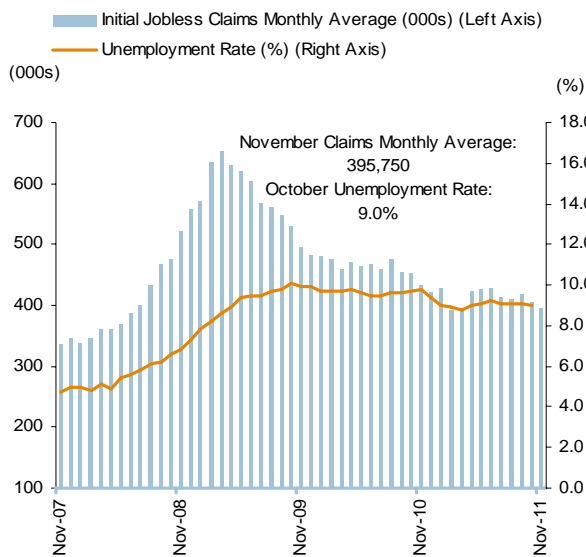
October Personal Spending Falls Off; Personal Income Growth is Channeled into Savings



Regarding employment, November saw the release of a weak October employment report, with non-farm payrolls rising by only +80,000 jobs, though the previous two months' job figures were revised higher. While October private payrolls were up +104,000, government job cuts continue to be a detractor, totaling -24,000 in October alone, mostly at the state and local government level. But on the bright side, the unemployment rate did dip to 9.0% in October, while the so-called "U6" measure of

underemployment fell by -0.3% to 16.2%. Also marginally optimistic on the employment front has been the sustained dip in weekly and continuing jobless claims, which continued until the week ending November 25, when both took an unexpected surge to 402,000 and 3.74 million, respectively. However, the four-week moving average on initial claims remains just below the critical 400,000 level.

The Dip in Initial Jobless Claims May Be Prescient About Labor Market Gains to Come



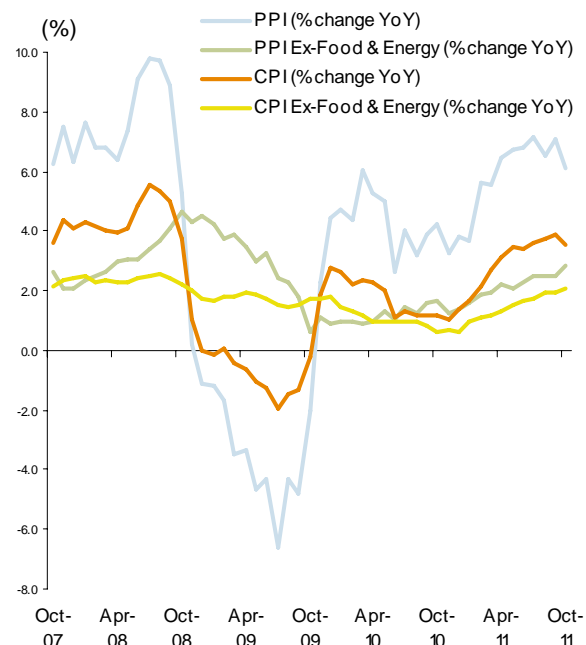
Other employment-related releases show continued pressure on workers, with non-farm productivity up +3.1% in the third quarter for this year's first productivity gain, as companies looked to squeeze more out of their workforce amidst the summer slowdown. As a corollary, unit labor costs fell by -2.4% for the quarter, the biggest decrease since the third quarter of 2008, showing companies are holding the line on worker pay.

This muted trend in wage inflation corresponds to other inflation barometers that were likewise softer in the month. For example, the Producer Price Index (PPI) was down -0.3% month-over-month in October, the first decline since June 2011, due to lower oil prices. Year-over-year, the headline PPI rose +6.1%, a full percentage point less than in August and the lowest annual growth since March. Excluding the volatile food and energy categories, the core PPI was unchanged in October and is up +2.8% year-over-year. On the consumer side, the headline Consumer Price Index (CPI) grew at a +3.5% year-over-year rate, down from +3.9% in September, though the core CPI has risen to

a +2.1% year-over-year growth rate, the fastest rate of core inflation since October 2008. However, the Fed's preferred inflation gauge, the core Personal Consumption Expenditure (PCE), is showing a year-over-year inflation growth rate of +1.7%, within their 1% to 2% target range.

Turning to business activity, while the summer slowdown raised concerns about the potential for a recession, broad market activity indicators continue to show expansion, albeit a muted one. Though the Institute of Supply Management (ISM) manufacturing report slipped from a 51.6 to 50.8 reading in October, it remains in expansionary territory. In fact, October's drop in the index came from lower prices paid and lower inventories, which could actually be positive developments if input costs are easing and the reduction of inventories moves in the opposite direction, providing a boost to overall production in future months. Meanwhile, the ISM non-manufacturing index of service sector activity was essentially unchanged at 52.9 in October.

Headline Inflation Lower on Falling Oil Prices, But Core Rates on the Rise

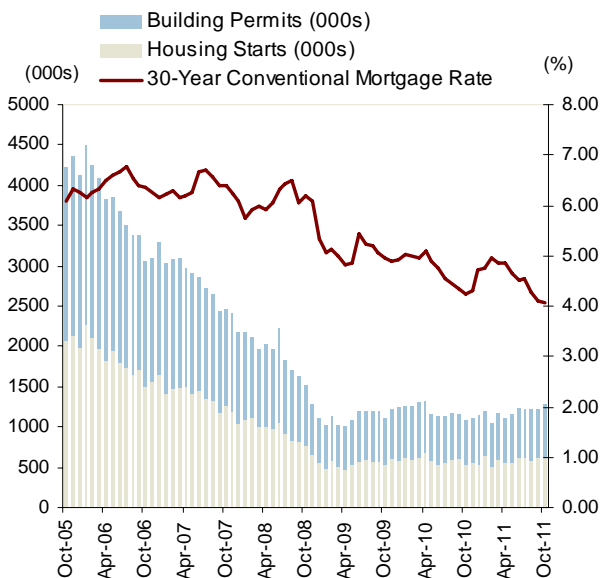


Most regional manufacturing surveys from Chicago and Dallas to New York and Richmond were slightly brighter, showing improvements from their summer slips. So too were factory orders and construction spending. While durable goods orders for October were off -0.7%, orders actually rose +0.7% excluding the volatile transportation

segment, exceeding expectations. Topping things off, U.S. industrial production advanced at a robust +0.7% rate in October, a notable signal manufacturing is contributing to fourth-quarter growth.

Regarding GDP growth, Q3's data was revised lower from 2.5% to 2.0%, as inventory contraction subtracted more than originally estimated from GDP. Personal consumption was also revised slightly lower. Early estimates for Q4 growth are higher, perhaps in the +3.0% growth range, though 2012 growth is being projected lower given expected fiscal tightening.

Spike in Building Permits Helps Maintain Housing Market Activity, But Material Gains Still a Long Way



Still dragging on this recovery is the housing market, though even this most tragic and perennially depressed sector of the economy may be showing a few signs of life. While housing starts were flat, building permits rose a dramatic +10.9% to a 653,000 annualized rate. Defying expectations, existing home sales rose +1.4% in October to a 4.97 million annualized rate, though new home sales were up less than forecast, rising only +1.3% to a 307,000 pace.

Unfortunately, however, home prices continue to languish. According to the latest S&P Case-Shiller home price report, September housing prices were down -0.6% month-over-month (seasonally adjusted) to bring year-over-year prices lower by -3.6%. Three cities hit new all-time lows,

surpassing the depths hit back in 2009: Las Vegas, Phoenix, and Atlanta. There were only three cities which saw improvements in prices, and they were marginal at best: Washington D.C. (+1.2%), New York City (+0.1%), and Portland (+0.1%). Distressed transactions continue to be the order of the day, such that the median home selling price has fallen all the way from \$230,300 in July 2006 to \$162,500 today.

While the Federal Housing Finance Agency (FHFA) released new guidelines for the “HARP” (Home Affordable Refinance Program), allowing for less onerous standards for the refinance of mortgages, there is no reason to expect the fundamentals of housing to change dramatically on this news. A true recovery in this sector of the economy is likely a decade in the making.

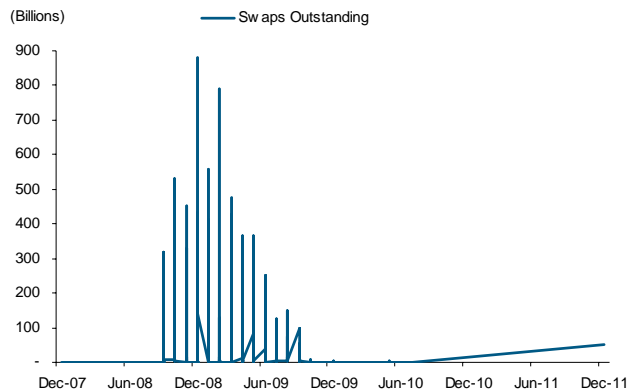
Even so, consumers were able to rally their sentiment enough in October such the University of Michigan confidence survey improved to a 64.1 reading. Even more notable was the surge in the Conference Board's measure of consumer confidence, which rose sharply from 40.9 in October to 56.0 in November.

Acting to aid confidence, per usual, was the Fed, which, in coordination with the central banks from Europe, England, Canada, Switzerland, and Japan, announced a surprise joint effort to boost liquidity worldwide at month-end.

The collective banks lowered pricing by 50 bps on existing USD liquidity swap agreements, and extended their authorization through February 1, 2013. While the reduced pricing and extension on swap lines is helpful to ease global liquidity conditions, the action was perhaps most significant as a clear signal of central banks' willingness to do whatever is necessary to create and sustain accommodative global financial markets.

As one could imagine, this move drew sharp criticism from some as a Fed-financed bailout of Europe, but officials publicly disputed that interpretation, framing the intervention instead as a firewall against contagion. The FOMC will meet again in December, when it is widely expected they will move to cut the discount rate on loans to banks. After all, it would not be right for European banks to have access to dollars at a lower rate than American banks!

Liquidity Swaps Only Utilized In Times of Severe Market Stress



While ancient history at this point, the November FOMC meeting was not very eventful, with no change to policy and only one dissent to this policy action, by Chicago Fed President Charles Evans, who preferred more accommodation. This is a stark reversal from the prior month's announcement which featured three hawkish dissents. The Fed did notably cut their longer-term economic forecasts, now targeting 2012 GDP growth at 2.5% to 2.9%, down from June's forecast of 3.3% to 3.7%. Expectations for 2013 were cut similarly and the newly minted 2014's forecast is for softer growth than previously existed for 2013.

It should be noted that the Fed also made headlines in the month by announcing tougher stress tests for the nation's largest banks. These new guidelines will likely halt any planned dividend hikes from the major players as they must now have enough capital to withstand a recession with 13% unemployment and an -8% decline in GDP. This so-called severe scenario goes far beyond the supervisory one from earlier this year that used 11% unemployment, a -1.5% decline in GDP, a -6.2% drop in housing prices and a -28% pullback in stocks.

Stress tests aside, the Fed's actions remain solidly aimed at galvanizing the economy, in stark contrast to the actions of our lawmakers in Washington. While hopes were not high for a grand compromise, the Deficit Super Committee could not even deliver on a partial agreement for budget cuts, presenting total failure to the American public. As such, \$1.2 trillion in failsafe automatic spending cuts, split evenly between discretionary and defense categories, will

be triggered in January 2013. Making matters worse, there are rumblings that some politicians are maneuvering to veto even these cuts. While it will be a hard hurdle to clear as such a veto will require 60 votes in the Senate – and the President has already said he will not allow the automatic cuts to be voted down - a case is being formed questioning the language of the bill that mandates the cuts.

As long as that scenario does not play out, Moody's and S&P stated they will retain their current ratings posture in light of the automatic spending cuts. Only Fitch made a move in response to the Super Committee failure, cutting its outlook on the U.S. sovereign to negative. This negative outlook implies a more than 50 percent chance that Fitch will cut the debt rating within the next two years, unless a material change in policy occurs. We can only hope the election cycle next year may bring such a change, where meaningful compromise can allow for progress on some of these overhanging issues.

Super Committee Not Able to Leap Tall Buildings in a Single Bound



John Pritchett

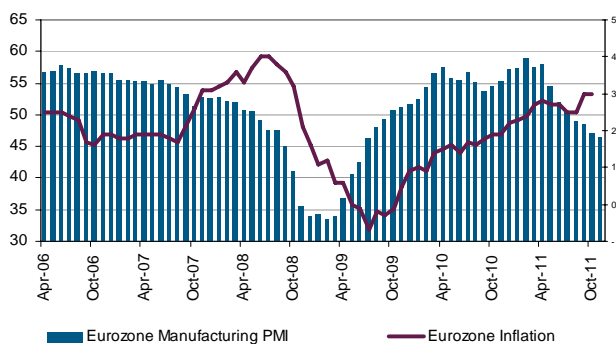
Needless to say, plenty can go wrong that would alter the recovery outlook for the U.S. economy. A full-on meltdown in Europe is the biggest short-term risk, but there should be no doubt that Washington politicking may also cause investors, consumers, and business owners alike to feel paralyzed to some degree in their decision-making regarding the future. For now, though, consumers and businesses forge on; but as the saying goes, *caveat emptor*.

2. International Economic Update: Same Summit, Different Day

November started off with quite a bang, as the European Central Bank took a big step towards accommodation, cutting rates and letting everyone know that Mario Draghi is the new sheriff in town. This change, along with new leadership in Greece and Italy and a freshly minted “comprehensive” package of measures aimed at stemming the sovereign debt crisis, provided little solace as the month wore on, however, and it became abundantly clear that Europe’s policy of implementing “too little, too late (if ever!)” moves was beginning to affect not only the periphery, but the core of Europe as well. Yields continued their march higher as auctions were met with less than enthusiastic responses; in fact, at one point during the month an auction of German 10-year bunds resulted in bids for only 65% of bunds offered, a disastrous outcome for a country accustomed to a free flow of capital from the debt markets. Combine this with a number of weak auctions around the periphery, an “accidental” and later redacted downgrade of French debt and looming maturities in Greece, it became increasingly more difficult to muster confidence as the month wore on.

There proved to be little to cheer about as it related to economic data out of Europe, either. The European economy, which had been holding up surprisingly well over the last several quarters despite the debt dislocation, finally has begun to show cracks which have been forming over the course of the last several months. Manufacturing PMI for the euro zone continues to trend downward, below the 50 mark for the fourth month in a row at 46.4 for November – its weakest reading since 2009. The detail

Eurozone Manufacturing Declines, But Will Inflation Follow?



revealed that all balances – output, new orders, export orders and employment – all fell in the month, indicating a widespread and marked slowdown. Unemployment in the eurozone also rose for the sixth month in a row, and now stands at 10.3%, its highest level since June 1998. Compounding the pain of the unemployed is inflation, which is still well above the ECB’s target of 2% with an October print of 3%. Although inflation should trend down given weakness in production and employment, it remains a challenge for policymakers.

It was against this backdrop that policymakers were scheduled to meet in the first full week of December. Not only was the European Central Bank holding their normal monthly meeting, but European Union policymakers were slated for yet another summit in Brussels to discuss ways to ease the uncertainty and provide a meaningful support system for troubled periphery nations. The ECB, which showed some gumption early in November by cutting benchmark interest rates by 0.25%, was unable to deliver such a resoundingly positive decision in early December.



"Psychiatry is like the Eurozone. We pretend to go forward, whilst maintaining the status quo."

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Although certainly accommodative, the ECB’s moves, which include a rate cut of an additional 25 basis points, relaxing of collateral eligibility requirements for borrowing from individual central banks, offering two three year longer term refinancing operations and reducing banks’ reserve requirements, will likely be viewed as close to the bare minimum that could have been expected in the meeting. In fact, it appears that any variety of quantitative

easing, whether it be in the U.S. or United Kingdom, is essentially off the table given the ECB's inflation mandate, despite comments earlier by Draghi in which he indicated that the bank could increase its role (perhaps to truly act as lender of last resort) if eurozone governments could commit to enforcing tougher deficit cutting. In fact, as part of a solution, Draghi urged the European Parliament to work hard towards implementing a "new fiscal compact."

“It remains unclear at this juncture as to how this latest compromise will be received, and if it will be successful in stemming the contagion. Underlying all of this policy is the reality that Europe is heading for a recession...”

Heeding these comments, and the less explicit but no less clear message from investors, it appears that the groundwork for a new fiscal framework has been laid, with 23 of the 27 leaders of the European Union consenting to the changes, as of the time of this writing. In fact, the most notable dissenter was the United Kingdom, as it appears that Prime Minister David Cameron came to the table looking for certain concessions for the British financial services industry, and these requests were reportedly dismissed as being less important in the context of the current situation. (Sweden, Hungary and the Czech Republic also dissented, stating that a consultation with their parliaments would be necessary for their assent.) As a result, the 17 euro countries, along with six other nations who profess their desire to join this (dysfunctional) union, agreed to several changes. These include automatic sanctions would be levied against any country breaking the deficit rules, unless 75% of states vote against the move and the incorporation of a balanced budget amendment as part of their national constitutions. The group also resolved to increase support mechanisms by 200 billion euros and to accelerate the implementation of the European Stability Mechanism to 2012. Perhaps most meaningful for investors was the agreement to drop demands (primarily from Germany) for bondholders to shoulder losses in the event of a bailout. This is consistent with International Monetary

Fund policies, and could increase interest in periphery sovereign debt should markets stabilize in the near term.

It remains unclear at this juncture as to how this latest compromise will be received, and if it will be successful in stemming the contagion. Underlying all of this policy is the reality that Europe is heading for a recession, and additional austerity measures, either in the periphery or core, are likely to deepen the recession and weigh on prospects for a recovery. Uncertainty still exists as to the ECB's role going forward, as even European policymakers remain divided over the rights and responsibilities of the central bank to intervene in what continues to be an ever evolving situation.

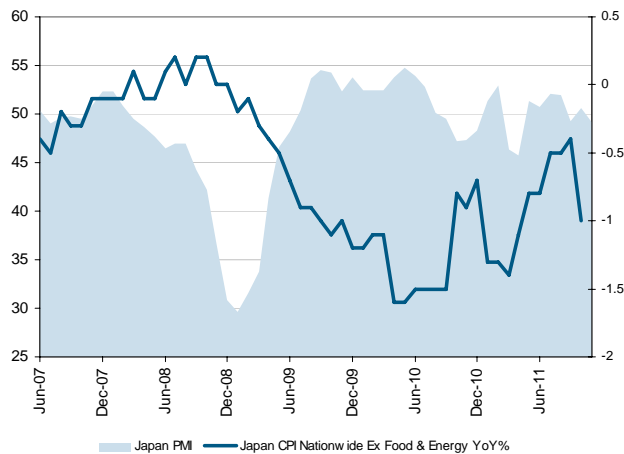
Switching gears to Asia, robust economic data over the past several months has led some to speculate that Japan's economy is finally geared up for a period of real expansion following March's natural disasters, and GDP for the third quarter was no exception. In fact, it expanded at +6% annualized clip, besting expectations of +5.9% growth, and positive for the first time in three quarters. The increase was led by a +6.2% quarter over quarter increase in exports, while private consumption also rose, up +1%. Consumers appear to have continued their purchasing into the fourth quarter, as retail sales gained +1.9% year-over-year in October, blowing away forecasts for a +0.7% gain, while confidence ticked up +0.1% to 38.6.

However, the news was not all positive, and in fact, it appears that there is evidence that the momentum from reconstruction is beginning to wane. For example, Japan's unemployment rose to 4.5% in October, well above September's 4.1% level and higher than expectations. Exports are expected to slow down as the strong yen dampens demand, and unemployment could continue to tick up as result. Companies would also appear to have increasing incentive to move production operations closer to end markets in order to lower labor costs given the growing percentage of exports destined for developing economies.

In addition, the Manufacturing Purchasing Managers' Index also fell into contractionary territory in October, dropping to 49.1 from 50.6 as production eased. Finally, deflation, which has beset the Japanese economy for many years,

appears once again to be a threat, as general CPI excluding food and energy fell by -1.0% year-over-year in October. It was therefore hardly surprising that the Bank of Japan revised down its assessment of the current economy, particularly against the global macroeconomic backdrop and given the continued strength of the yen.

Japanese Prices and Manufacturing Trending Down



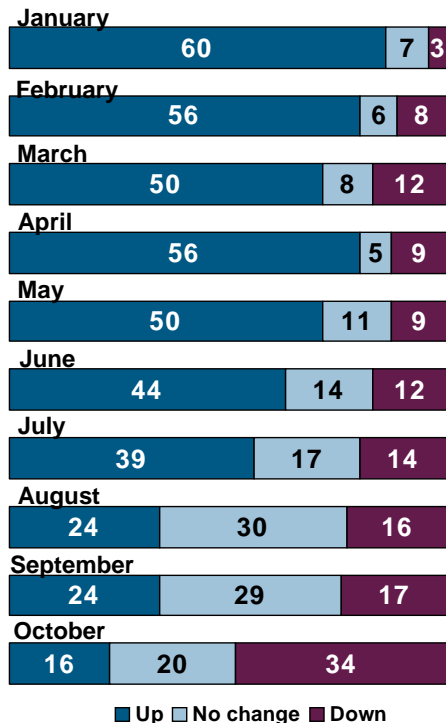
Meanwhile, economic data out of emerging economies, although still indicating robust growth versus the developed world, has also deteriorated due to the effects of both monetary policy tightening and weaker demand from end markets. China and India, in particular, have begun to show signs of cracking, as inflation fighting measures have effectively stifled growth to a point where further fiscal stimulus or looser monetary policy may be necessary. For example, Indian GDP came in at a disappointing, if expected, print of +6.9% for the third quarter; this marks the slowest growth rate in over two years. In addition, concerns are growing that a weak rupee will be a destabilizing force for companies already struggling with inflation. Indeed, slowing growth can most certainly be attributed to the Reserve Bank of India's efforts to slow inflation through rate hikes – 13 of them since March of 2010.

Chinese economic data was also mixed. Although inflation appears to be subsiding, with consumer prices rising only +5.5% in October versus +6.0% in September, manufacturing in turn has weakened. Both the government and HSBC's PMI readings declined for the month of November, with the latter falling from 51 to 47.7 – its sharpest decline since March of 2009. This was driven

Home Prices in China Moderating

Property Prices

Variation, month-on-month, in 70 major Chinese cities

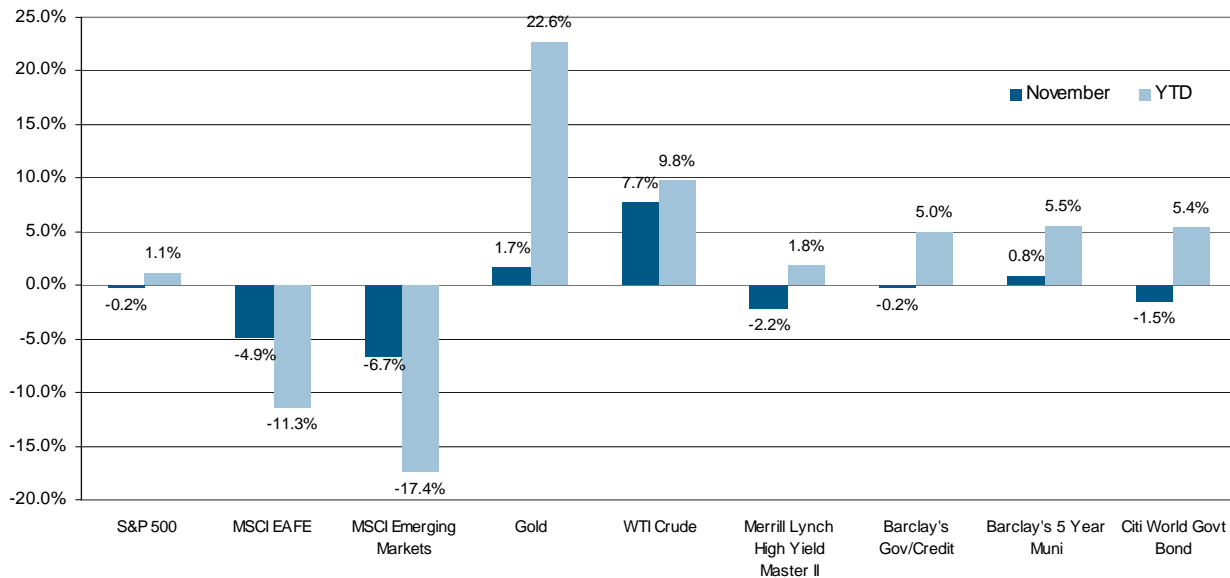


Source: China, National Bureau of Statistics

primarily on weakness in new orders, which in turn resulted from a decline in new export orders from 48.6 to 45.8. This deceleration can be attributed somewhat to seasonal factors, but is clearly being affected by the dislocation emanating from Europe. (As an aside, Korean exports grew +13.8%, better than the +10.4% forecast; this number is generally viewed as a bellwether for Asian and global trade, and may indicate a lessened impact for China.)

Anxiety surrounding a pop of the real estate bubble has also weighed on investors, although these concerns have eased a bit over the last few months as home price increases have moderated. In fact, of the 70 medium-to-large-sized Chinese cities surveyed, the number with declining month-over-month prices in October doubled to 34. Prices rose in only 16 cities versus 24 in September. Not altogether surprising, then, was the People's Bank of China's move to cut bank reserve requirements by 50 basis points. This marks the first cut since 2008, and follows six increases this year. As for Chinese monetary policy going forward, the central bank is unlikely to cut interest rates

Global Market Returns



again this year, but will likely look to loosen reserve requirements, especially for smaller banks, before taking any other significant steps.

3. Global Markets Overview: Pre-Holiday Hangover

After October's rousing rally, November was certainly a month full of fits and starts. Domestic equities were down for much of the month before the bears were quieted in the final days by economic data and a shower of liquidity from central banks. Financial stocks, both here in the United States and around the world, faced increased pressure as exposure to shaky sovereigns spooked investors.

International developed equities languished as Europe continued to deteriorate, and emerging markets equities, already down on the year on China concerns, took another blow as India's economy weakened.

Fixed income asset classes were mixed, as U.S. Treasuries and municipals continued to win out over credit sectors suffering from a flight to safety. REIT investors shied away from risk as well, forfeiting yield in an attempt to avoid the European sovereign debt crisis and a potential pop of the Asian real estate bubble. Commodities were mixed as agricultural commodities such as cotton, corn and soybeans lost ground in the month, while oil and gold managed to post positive returns. Hedge fund strategies, exposed across all of these sectors, remained for the most part poorly

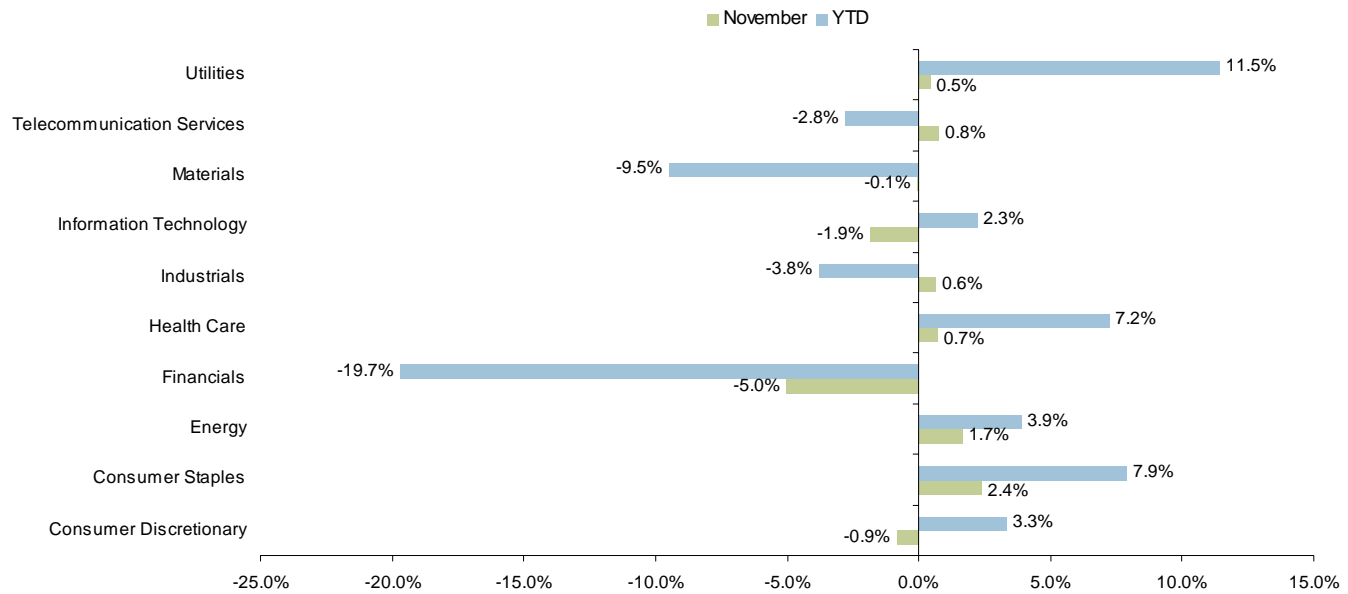
positioned, and all sectors within the universe posted negative returns for November.

4. Domestic Equities: Tug of War

The year-long tug of war that has ensued between the bulls and the bears continued through the month of November, as the end of earnings season brought renewed fears that the sovereign debt crisis was on the verge of spinning out of control. With it came a predictable sell-off in the equity markets, lasting right through the Thanksgiving holiday before sanguine U.S. economic data, and a concerted global effort by monetary authorities to help stem the flow of blood in Europe, helped to fuel a remarkable turnaround in the final week of the month. In fact, despite trading in a wide band between 1275 (November 8th) and 1158 (November 25th), the reversal helped the domestic equity markets recover substantially all of the month's losses experienced to that point, and culminated in only a small loss for the S&P 500 index of -0.2% for the month, bringing the year-to-date return to +1.1%. The Russell 2000 Index of small cap stocks followed suit, returning -0.4% for the month; small caps are now down -4.8% year-to-date.

There was little differentiation in equity sector returns in the month of November, with the exception of the financials sector which witnessed a decline of over -5% as

S&P 500 Sector Returns



concerns about U.S. bank exposure to European sovereign credits once again weighed on stock prices. Financials are now down a whopping -19.7% in 2011, as investors hark back to the dark days of 2008 and in turn recognize the challenge of increased regulation which lies ahead.

Looking forward, the market is likely to continue to be buffeted by these bearish European contagion concerns that obscure the solid fundamentals of the equity investments.

In support of higher prices, we would cite:

- Low P/E multiples and compressed valuations; in fact, the S&P 500 is on track to end the year with the lowest P/E ratio since 1988.
- Stabilizing and, in some cases, accelerating U.S. economic data.
- Solid balance sheets of large cap U.S. corporations

“The year-long tug of war that has ensued between the bulls and the bears continued through the month of November, as the end of earnings season brought renewed fears that the sovereign debt crisis was on the verge of spinning out of control.”

- Earnings expectations are higher for calendar year 2012 vs. expected earnings for 2011.
- Election years are generally good for the equity markets.
- Consumer spending has remained stable, if not strong, even while consumer confidence has eroded.
- Equity markets are under-owned, as tremendous cash balances remain on the sidelines.
- Fixed income yields are uninspiring.
- Global monetary stimulus measures are unprecedented.

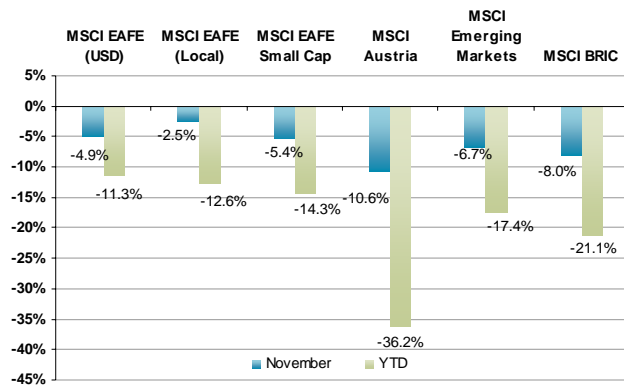
However, without credible actions to stem the near-term potential for European contagion to spread, the pall that currently hangs over the market may not lift for long.

5. International Equities: Cross Border Contamination

International developed markets significantly underperformed their domestic counterparts in the month, as investors continue to seek safe(r) havens as risk of a renewed global financial crisis emanating from Europe remains high. Not surprisingly, value and smaller capitalization equities underperformed, and while developed international equities underperformed U.S. equities, they trounced the performance of emerging

markets names. From a sector perspective, financials were the clear laggards for the month, driving much of the index underperformance, while consumer staples, health care and utilities names held up marginally better.

International Equity Returns

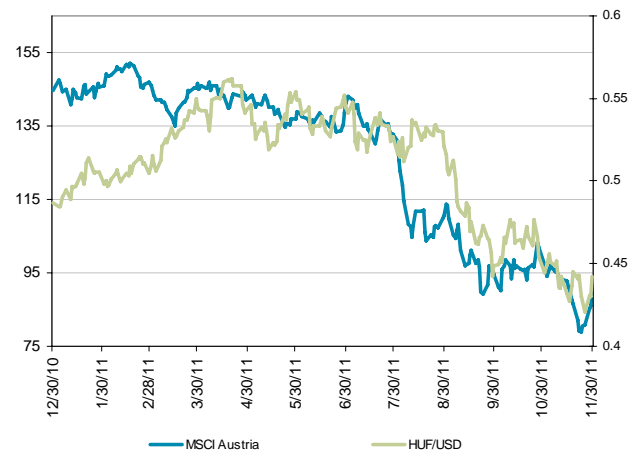


Underperforming at the country level for the month were the usual suspects of Greece, Portugal and Spain, down -21.1%, -8.7% and -8.3% respectively. In addition, Austrian stocks continue to suffer mightily despite their seemingly safe position as a AAA rated core European country. The country's issues are somewhat unique and relate to her symbiotic relationship with neighbor Hungary, where a plummeting forint and massive amount of foreign currency denominated debt have devastated the country's economy and forced government officials back to the IMF for their second bailout in the last three years. Combining the exposure to Hungary with the exposure to Europe's weak periphery, Austria's banks have come under intense pressure, and were significant contributors to the -10.6% decline in the month. Although smaller players on the European stage, this situation highlights the importance of stability, not only within a given country, but also for the country's trading and financing partners, and could unfortunately prove a harbinger of things to come for other "core" European countries should the current crisis go uncontained.

Only two countries in the developed world - Denmark and Ireland - outperformed the United States in November. Gaining +3%, Danish stocks benefited from renewed investor interest in the Nordic region, as evidenced by capital flows despite an early month interest rate cut by the country's central bank to 1.20% - less than the ECB's 1.25%. The move likely reflects Denmark's relatively

strong financial position and a desire to ease pressure on the country's economy from an appreciating krone. Irish stocks also posted a positive return, up +1.4% as the country differentiates itself from the other periphery laggards, having posted two quarters of GDP growth even in an environment hamstrung by austerity measures put in place following last year's bailout. Finally, Canadian stocks, which have at certain times of crisis suffered due to the country's large exposure to natural resources, performed fairly well during the month as a stable financial system coupled with better-than-expected Q3 GDP growth (led by a +14.4% gain in exports) attracted investors.

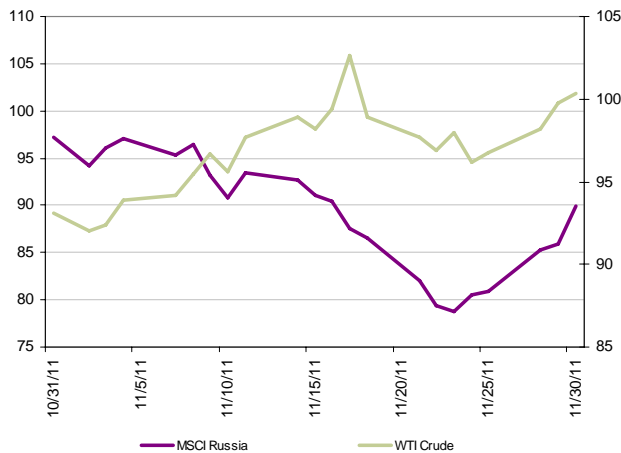
Austria and Hungary Remain Deeply Linked



6. Emerging Market Equities: India Indigestion

Emerging markets equities experienced a tough month in November, pulling back as country specific concerns created additional anxiety for investors already grappling with negative data from the developed world. While the broad MSCI Emerging Markets index declined -6.7%, BRIC countries performed even worse, falling -7.8% in the month. Leading the way down were Indian stocks, which lost -16.0% in their worst month drop since January as investors attempted to digest the distasteful data released over the course of the period. Jittery investors are also apprehensive about the effects on tightening on the Chinese economy, and sold off for much of the month as a result. The news was not all negative for the BRICs, as a 7+% move upwards in crude oil brought Russian stocks, led by oil exporters, along for the ride, particularly in the latter half of November; the MSCI Russia index lost only -0.3% as a result.

Crude Prices Drive Russian Equities Higher



Outside of the BRICs, Egyptian equities were also hit hard as the first parliamentary election since the end of Hosni Mubarak's rule brought widespread protests and the threat of renewed instability in the region, as demonstrators railed against the prospect of continued military rule. Taiwanese exporters moved down on concerns of lowered exports to their Asian trading partners within the context of slowing manufacturing growth. South African equities performed well in the month, posting the only positive return of all the countries which make up the MSCI Emerging Markets index and closing up +0.3%. Miners, and gold miners in particular, experienced a nice rally to close out the month, driving the South African index higher. Energy and materials names also acted as a buffer to European and Asian macroeconomic concerns in Peru, which experienced only a -0.6% drop in November.

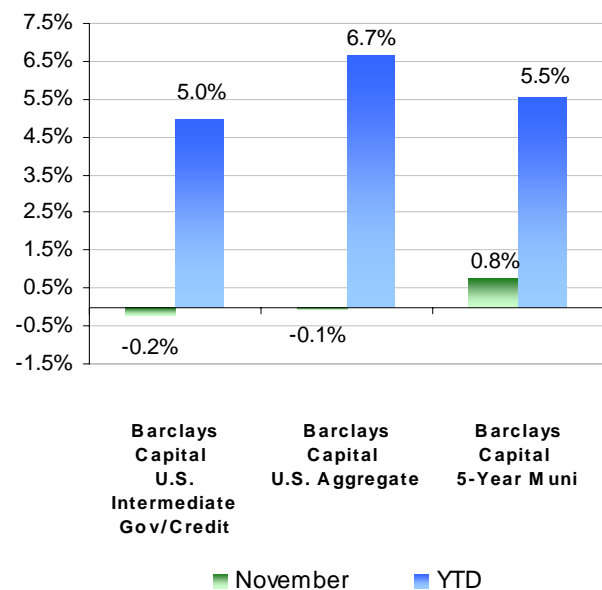
7. Fixed Income: Muni Mastery

Once again, the monthly pattern of returns in the bond market was largely determined by what happened in Europe, and the status of investor risk aversion. During most of November, markets were deteriorating and, as a result, the market for U.S. Treasuries rallied while credit sectors struggled. A sharp month-end rally on the news of coordinated central bank intervention was not quite enough to undo all the damage done to credit markets from earlier in the month, such that most fixed income credit assets were in negative territory. Even with a boost from U.S. Treasuries, fixed income broad market indices still posted negative results, with the exception of municipal bond

benchmarks, which returned to their winning streak after October's negative performance aberration.

Indeed, thus far in 2011, the municipal market has recorded returns that well exceed U.S. Treasuries on a tax-adjusted basis, benefiting from improving credit fundamentals and their relative immunity to the European crisis. Even the bankruptcy filing of Jefferson County, Alabama at the beginning of the month, as well as a heavy new-issue calendar, could not reverse this trend of solid performance. With yield curves especially steep, longer maturities have produced total returns of approximately four times those of the one- to three-year maturities. Also performing well are the lower quality grade sectors of the market as investors reach for yield.

Credit Spread Widening Overwhelms Treasury Rally; Munis Surge

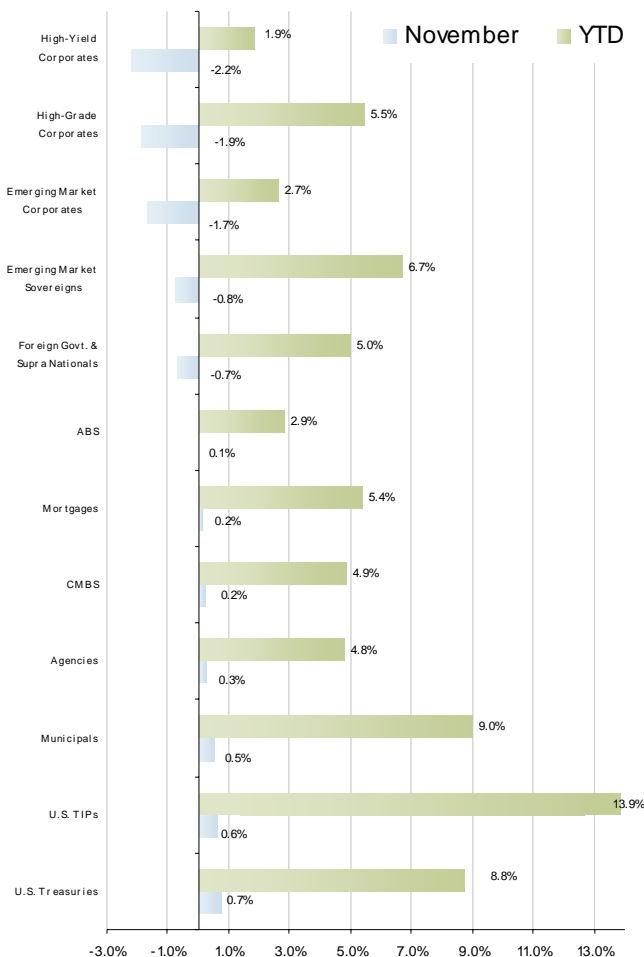


More volatile but also strongly positive has been the U.S. Treasury market. After negative returns in October, Treasury bonds posted positive results in November. The yield on the benchmark 10-year note has now remained firmly entrenched within a range of 1.90% to 2.25%, down sharply from the 3.25% yield at the start of 2011. U.S. TIPs were also buoyed, as deflation concerns receded on positive U.S. economic data trends and loose central bank policy raised the specter of inflation.

Meanwhile, the corporate bond markets continue to be inversely correlated with Treasuries. As would be expected, high yield bonds were under considerable pressure in November given equity market volatility, but it is notable that high grade bond performance was also incredibly weak. An overweight to financials within the space accounts for the significant performance drag.

Structured credit was notably insulated from these declines, delivering positive, if muted, results. International bond markets were lower on the uncertainty in Europe, and emerging markets, both sovereign and corporate, were very weak, as investor risk aversion has created heavy redemptions in this smaller, less liquid corner of the market.

Fixed Income Cross-Asset Returns



8. Real Estate: Recognizing Risk

Global REITs suffered during the month as continued uncertainty around both European sovereign debt issues and slowing growth in Asia reduced investor appetite even in spite of the sector's attractive yield. REITs domiciled in the Americas - specifically in the United States - as well as those in the Middle East/Africa region outperformed, as it remains unclear how significant the deterioration in European growth, and subsequent ripple effect, will be. In addition, investors in Asian REITs, while comforted by relatively strong sovereign balance sheets, remain concerned about a potential bursting of the easy money real estate bubble which has been growing over the past three years.

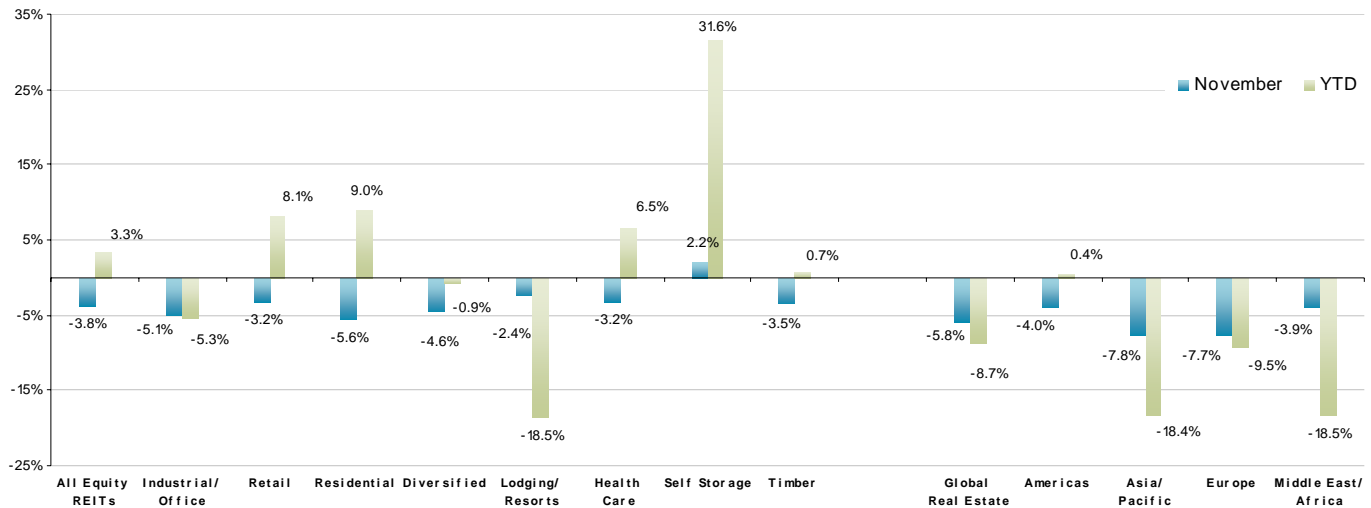
Besides their insulation from Europe, the relative outperformance enjoyed by U.S. REIT investors this year appears consistent with fundamentals. According to a report compiled by Moody's in October, U.S. investment grade REITs are in a better position to weather a potential recession than they were in 2008, based on their leverage ratios and capital position; average effective leverage stands at 44%, down from 51%, while dividends are still below their pre-2008 levels. Both of these should provide a greater cushion for REITs in the event the economy deteriorates from here.

Most notable among U.S. equity REITs in November was the self storage sector, which managed to post a positive return of +2.2%. Free standing retail eked out a positive return as well, gaining +0.1% while regional malls lost -2.2%, better than the broad FTSE NAREIT All Equity REITs index. Given very positive Black Friday data from the National Retail Federation, retail REITs could see some strength over the next couple of months should these shopping trends continue. Industrial REITs continue to lag, dropping another -5.7% amidst one of the shallowest economic recoveries on record.

9. Commodities: Driven Down by Deceleration

Commodity prices, like the equity markets, were whipsawed over the course of the month as investor emotions fluctuated from optimism to pessimism and back to optimism. Unlike the equity markets, however, most commodities were unable to recoup their losses and ended

Real Estate Returns



November mostly at lower levels from where they began the month. In fact, crude oil, gold and sugar were the only major commodities to close higher for the month, up +7.7%, +1.9%, and +10.0%, respectively.

Cotton prices led the declines with a return of -12.2% on the month, falling steeply due to expectations of both declining demand for cotton and much higher supplies through the first half of 2012. Meanwhile, corn and soybeans each lost -6.8% in the month, reflective of the steep price declines witnessed within most agricultural commodity markets this year.

Oil bucked the overall trend in commodity prices during the month, primarily due to rising tension levels in the Middle East, and in particular, concerns surrounding Iran's nuclear development efforts. The threat of further escalation in tensions between Western nations and Iran will likely cause continued volatility in the oil markets, and may set a near-term floor for oil prices above \$90 per barrel despite the prospect of a continued deceleration in global economic output.

Generally speaking, global economic deceleration is likely to keep a lid on commodity prices into 2012. However, significant price declines in many segments of the commodities markets, especially industrial metals such as copper and agricultural commodities, hint at more than just a deceleration in global GDP growth. Should a recessionary environment ultimately be contained within Europe and not spread to Asia and the United States, these

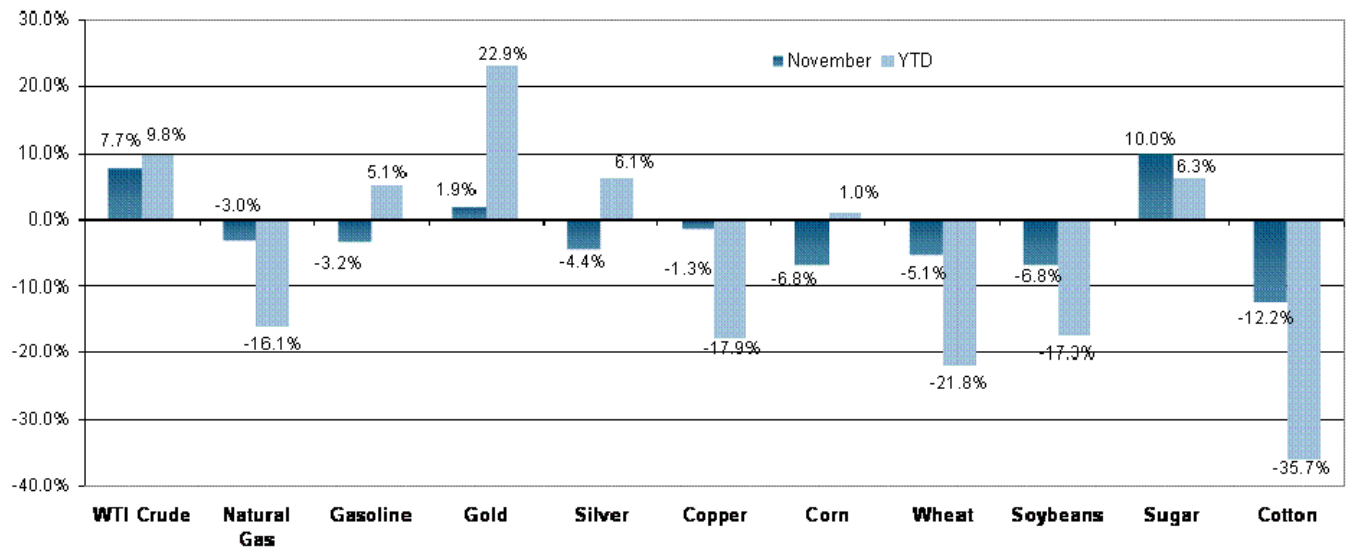
commodities may be poised to move higher in the months ahead.

10. Hedge Funds: Struggling Strategies

After a promising October, hedge funds struggled through November and posted declines for the fifth time in the past seven months with all strategies posting negative returns. Losses were concentrated in equity and credit sensitive strategies while relative value, event driven and macro managers posted only slight losses. After a brief period of euphoria, lack of clarity on policy resolution stemming from the European sovereign debt crisis returned, resulting in an increase of risk aversion and caution in investors. Investors fled to the U.S. for safety, as demonstrated by the Euro falling against the US dollar, thus decreasing U.S. yields. As a result, the HFRI Fund Weighted Composite Index finished the month down -0.9%, bringing year-to-date performance to -4.4%.

Long/short equity hedge fund strategies were among the least profitable strategies during November despite the very strong rally in the final days of the month. Throughout October, managers added to and established new positions in attractively valued companies, increasing gross and net exposures. Many felt that the market had already bottomed after policymakers in Europe looked to be taking a more proactive role in handling sovereign debt issues. Positive gains in October from fundamental value strategies were offset by declines in global equity markets with European markets losing -10% in the first three weeks of the month.

Commodity Returns



Fortunately, a strong late month rally helped managers recoup around half of their mid-month losses. As a result, the HFRI Equity Hedge Index was down -1.6% bringing year-to-date performance to -7.1%. Short biased, technical and behavioral focused strategies managed to do well with the HFRI EH Quantitative Directional finishing the month up +0.6%, and -5.3% year-to-date, and the HFRI EH Short Bias Index, which finished up +1.1%, and +0.2% year-to-date. Energy/basic materials-centric strategies continued to face challenging markets with the HFRI EH Energy/Basic Materials index finishing November down -2.5%, bringing year-to-date performance to -13.6%.

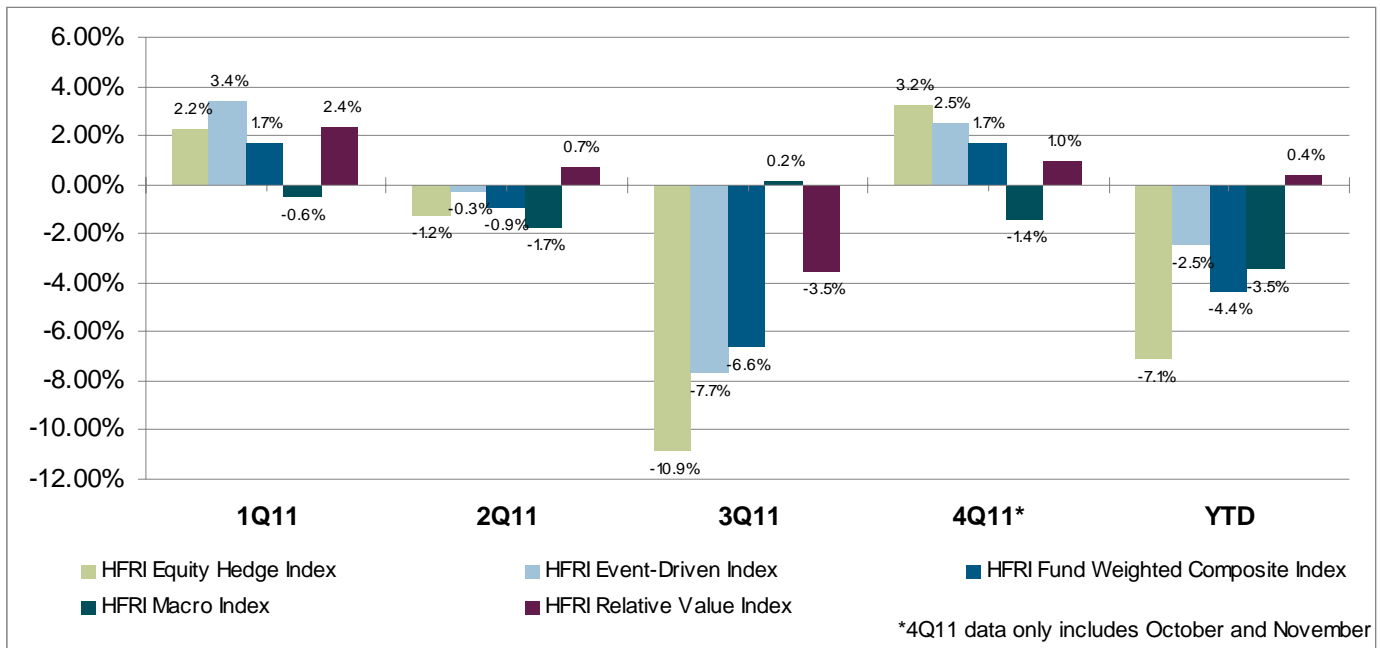
Event-driven hedge fund strategies also struggled throughout the month, but managed to post the largest single day gain in two years on November 30th with the HFRX Event Driven Index rising +61 bps. Uncertainty stemming from the ongoing European sovereign debt crisis returned to create volatility, while the bankruptcy filing of American Airlines caused credit spreads to once again widen. Weakness in the AT&T/T-Mobile transaction also caused risk arbitrage spreads to widen, further detracting from performance. As result, the HFRI Event Driven Index was down -0.7%, bringing 2011 performance to -2.5%.

Relative Value hedge fund strategies were unable to overcome declining U.S. interest rates as borrowing costs breached unsustainable levels for many indebted European sovereign issuers. As uncertainties related to Europe

returned, correlations once again increased and confidence fell, making mean-reversion trades more difficult. Despite the HFRI RV Fixed Income-Asset Backed index posting the best performance of any sub-strategy in November, +1.5% in November and +6.7% year-to-date, losses in yield alternatives and convertible arbitrage strategies caused the HFRI Relative Value index to finish the month down -0.2%, bringing year-to-date performance to +0.4%.

Macro hedge fund strategies also posted modest losses as early gains turned into late month losses. During the first three weeks of the month, European bond yields continued to increase, with French bonds coming under fire and a weak German Bund auction, all of which culminated in a very poorly received Italian bond auction where yields reached 7.5%. During the final three days of the month, the macro situation saw a dramatic turnaround with well-received Spanish and French bond auctions, and a somewhat surprising cut in reserve requirements by the People's Bank of China. Some commodity focused funds fared slightly better as oil continued to trend upwards, fueled by a breakdown between Iranian and U.K. officials. WTI Crude broke and held the \$100 level, further closing the gap between ICE Brent Crude, which closed the month around \$105. The Euro then mounted a strong month-end rally along with the broader commodities markets. Soft commodities and natural gas generally detracted from performance while U.S. Treasuries remained bid down, but

Hedge Fund Returns



flat. Gold was unable to breach the \$1,800 mark, making a high on November 7th at \$1,795, before briefly pulling back to under \$1,700. When all was said and done, the HFRI Macro Index finished November down -0.4%, bringing year-to-date performance to -3.5%.

11. A Final Word: A Grand Finale

Wall Street rocketed higher in the final trading session of a tumultuous November as traders cheered a surprise and coordinated action by central banks to buttress money markets. A Chinese interest rate cut and a bounty of bullish U.S. economic data did not hurt matters either, pushing the Dow and S&P 500 above psychologically-important levels.

Indeed, the Dow Jones Industrial Average soared 490 points, or +4.2%, to 12,046, while the S&P 500 jumped 51.8 points, or +4.3%, to 1,247. This impressive performance was the seventh best for the Dow since the blue-chip index was created in 1896 on a point basis, and the best on a percent basis since 2009. International and emerging stock market indices were also significantly higher on the news, as were most commodities. For domestic stock investors, the rally helped to offset most of the losses of the major market indices from earlier in the month.

So why exactly did a coordinated move by central banks to extend and cheapen the cost of dollar funding shake up world markets? For sure, this move did not represent a kind of terminal big bang event that marked the end of the Eurozone financial crisis. In the Fed's own words, "The purpose of these actions is to ease strains in financial markets and thereby mitigate the effects of such strains on the supply of credit to households and businesses and so help foster economic activity."

In our view, this action was important for three major reasons.

First, it helped address the short-term liquidity problems of banks, in particular European ones, where the cost of funding in dollars had risen to its highest level since Lehman Brothers filed for bankruptcy protection. In fact, this problem had become so severe that there was even speculation that a major European institution might have been on the brink of failure without such intervention.

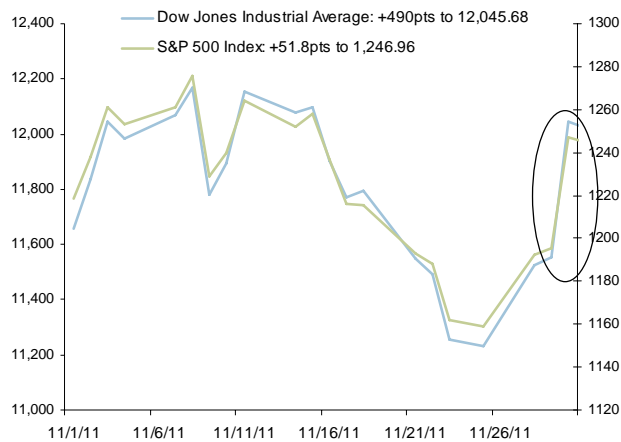
Second, it signals the first of what is likely to be many steps in restoring order to the global financial system.

We anticipate changes in collateral requirements, bank

recapitalizations, government capital infusions, and far-reaching fiscal reform to come.

Finally, the action was important in that it underscored a sense of urgency to address the broad issues ailing the global financial system, an appreciation of the systemic risks involved, and a willingness to tackle them.

Fantastic Finish



For now, this joint central-bank effort is just one step. Much more work needs to be done to address the fundamental problems associated with European government debt, namely solvency. As such, the dramatic rally at the end of November could easily be reversed if it becomes clear that there are no credible plans to stabilize the European bond markets forthcoming. But for the moment, hope springs, at least temporarily.