

The PERAC Financial Bulletin

Financial Market Review, First Quarter 2009



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Public Employee Retirement Administration Commission
Phone 617 666 4446 Fax 617 628 4002 TTY 617 591 8917

Five Middlesex Avenue, Suite 304, Somerville, MA 02145
Web www.mass.gov/perac

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Even with a closing rally of nearly 20%, the first quarter of 2009 marked the sixth consecutive quarter of stock market losses, the longest such period since 1970. One of the most severe recessions in decades continued its grip on the economy and the frozen credit markets saw only a modest thawing. Nevertheless, the quarter did end on a slightly more hopeful tone as the government's increasingly aggressive actions appeared to lessen the fear of a total systemic collapse and investors began to show some appetite for risky assets.

The economy was marked by continued gloom. Fourth quarter real gross domestic product saw a huge 6.3% decline and little improvement for the first quarter was seen. The unemployment rate for March rose to 8.5%, the highest level in 25 years.

Equity markets

At their lows in early March, stocks were off about 25% for the year and their loss of over half their value since their October 2007 high made it the worst bear market since 1929-32. The tide began to turn,

however, when Citigroup and other battered major banks offered some hopeful indications about their profitability and when the Treasury Secretary unveiled plans for a private-public partnership to buy "toxic" assets from financial institutions. The administration's declaration at month-end that bankruptcy remained an option for GM and Chrysler brought a halt to the market's rapid 20% March surge.

It was another quarter of unusually high volatility as more than a third of the trading days saw swings of plus or minus 2%.

Chart 1
S&P 500: First Quarter 2009

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For the quarter, the Wilshire 5000 and Russell 3000 broad market indices were down 10.6% and 10.8%, respectively. The S&P 500 (large cap) index was down 11.0% (total return) and the Russell 2000 Index (small cap) was down 15.0%. As seen in the accompanying table, the growth components of all these indices held up much better than value. Among the S&P 500's sectors, technology was actually up 4% while financials took another drubbing, down 29.5%, highlighted (or, more accurately, low-lighted) by Citigroup stock falling as low as \$1. Reflecting the strength of the technology sector, the NASDAQ Composite was down only 3.1% for the quarter.

Chart 2
S&P 500: Over Ten Years, Stocks are Down

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While the market had a better tone at month-end and during the first few days of April, the depths to which it has fallen cannot be overstated. As of quarter end, the S&P 500 needed to rally by 96% to get back to its 2007 high. Another ominous observation is that, although stocks remain down almost 50% from their highs, they are not significantly undervalued because actual and projected corporate profits have fallen by a similar degree.

Chart 3
S&P 500: Twenty-Year Perspective

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Some interesting decoupling occurred in overseas markets. While most European markets mirrored the continuing weakness in the US market, many developing markets --- including Brazil, China, and Russia--- showed strength. Reflecting a 4% negative effect from the dollar's relative strength, the MSCI-EAFE Index underperformed the US market, down 13.9%. MSCI's Emerging Markets index was up 1% for the quarter.

Bond market

In the fixed income markets, only modest improvement is visible so far from the government's efforts to stimulate the credit markets. Several high quality corporate issuers were able to access the market but yield spreads over Treasuries remain wide at an average of 6%. As the

economy continued to contract, the high yield market remained largely frozen as yield spreads over Treasuries improved only slightly from about 19% to 17%. Interest rates on US Treasury securities rose from 2.2% to 2.7% for the ten year note and from 2.8% to 3.6% for the thirty year bond. This reflected not only a slight increase in investors' appetite for more risky securities but also fears about massive future issuance of government debt. For the quarter, the Barclays Aggregate

Bond Index was about flat while high yield bonds had a positive return of about 5%.

Other asset classes

As all sectors and all regions of the commercial real estate market continued to show weakness during the painful economic downturn, Real Estate Investment Trusts were battered once again, down 32% for the quarter. When announced, the NCREIF index for private property investment will undoubtedly also show a meaningful decline.

Although composite returns were just slightly positive, hedge funds held up considerably better than the stock market, as they did in 2008, but perhaps the bigger concern was increased talk of new regulatory efforts emanating from Washington.

With the IPO market virtually ground to a halt (there were no venture-backed IPO's during the first quarter) and very little action in mergers and acquisitions, most of the action in alternative investments will likely involve continuing negative adjustments to existing partnership valuations.

Chart 4
Financials Woes Continue: Citigroup vs. the S&P 500, 18 Months

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As always, the PERAC Investment Unit welcomes the opportunity to be of assistance to retirement boards in any aspect of their investment programs.

Chart 5
U.S. Treasury 10-Year Notes: Rates are Creeping Up

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Chart 6
U.S. Treasury 10-Year Notes: Rates Still Historically Low

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TOTAL RETURNS | FIRST QUARTER, 2009

INDEX	FIRST QUARTER 2009	TRAILING TWELVE MONTHS
US EQUITY MARKET		
Dow Jones Industrial Avg.	- 12.48%	- 35.94%
Standard & Poor's 500 (Large Cap)	- 11.01%	- 38.09%
NASDAQ Composite	- 3.10%	- 32.90%
Wilshire 5000 (Broad Market)	- 10.56%	- 37.96%
Standard & Poor's Mid-Cap 400	- 8.66%	- 36.10%
Russell 2000 (Small Cap.)	- 14.95%	- 37.50%
GROWTH VS. VALUE		
Russell 1000 (Large Cap) Growth	- 4.12%	- 34.28%
Russell 1000 (Large Cap) Value	- 16.77%	- 42.42%
Russell Midcap Growth	- 3.36%	- 39.58%
Russell Midcap Value	- 14.68%	- 42.51%
Russell 2000 Growth	- 9.74%	- 36.36%
Russell 2000 Value	- 19.64%	- 38.89%
INTERNATIONAL EQUITY		
M.S.C.I. - E.A.F.E.	- 13.94%	- 46.31%
M.S.C.I. - Emerging Markets	+ 0.95%	- 47.07%
FIXED INCOME		
Lehman Brothers Aggregate Index	+ 0.12%	+ 3.13%
Merrill Lynch High Yield Index	+ 5.26%	- 19.95%
REAL ESTATE		
NAREIT - Equity Real Estate Investment Trusts	- 31.87%	- 58.16%
HEDGE FUNDS		
HFR Fund-Weighted Composite Index	+ 0.52%	- 15.69%