

The PERAC Financial Bulletin



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Despite lingering concern about the economy, the stock market continued to race ahead, enjoying its best quarterly gain since late 1998, and the bond market continued to return to normalcy, with liquidity improving and interest rates declining.

Unemployment approached 10%, consumers remained constrained by huge debt, and the housing market—both residential and commercial—was still depressed, but the markets focused on the positive. The economy appeared to be at least stabilizing and corporate profits were exceeding expectations, even though they were largely due to cost cutting rather than sales growth.

Equity markets

Despite weakening during the final days of September in the wake of some unexpectedly soft economic reports, the Wilshire 5000 broad market index was up 16.1% for the quarter and 21.3% year-to-date. The S&P 500 large cap index was up 15.6% for the quarter and 19.3% year-to-date. At quarter-end, the index was up 56% from its March low but

still off 32% from its October 2007 high. Small caps outperformed as the Russell 2000 index was up 19.3% for the quarter and 22.4% year-to-date. The technology-laden NASDAQ Composite was up 15.7% for the quarter and has enjoyed a spectacular year-to-date, up 34.6%. In terms of style, value did better than growth for the quarter while growth has done substantially better year-to-date.

In terms of longer perspective, the market's two broad indices—the Wilshire 5000 and the Russell 3000—both showed annualized losses of about 6% and 5%, respectively, for the trailing one and three-year periods and, demonstrating the lasting damage done by the recent bear market, only very modest annualized gains of 2% and 1% over trailing five and ten-year periods.

Many of the quarter's best performing stocks were those that suffered the greatest losses during the financial crisis. Up 25%, financials were the best performing of the S&P 500's ten sectors for the quarter although information technology,

up 45%, has led the way year-to-date. WalMart and Exxon Mobil, two of the stocks that held up best during 2008, have both suffered corrections in 2009, down 12% and 14%, respectively.

International stocks have also been strong, with the MSCI-EAFE Index up 19.5% for the quarter and 29.0% for the year. The index has benefited from weakness in the dollar; in local currency terms, the index was in line with major US markets. Indications of economic growth appeared strongest in emerging markets and the MSCI-EM index has enjoyed returns of 21% and 64.5% for the quarter and year-to-date.

Bond markets

Although evidence of economic recovery remained mixed, the credit markets took another large step toward normalcy during the third quarter. Issuers rushed to market to take advantage of sharply lower interest rates in the corporate bond market. The yield differential between investment grade corporates and US Treasury bonds has narrowed dramati-

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cally from 6% at the beginning of 2009 to 2.35%. High yield “junk” bonds have been the best performers, up 15% for the quarter and nearly 50% year-to-date. Within the junk bond market, the riskiest bonds have actually performed the best.

Supported by purchases from overseas buyers and by the Federal Reserve, US Treasury yields also declined. At 3.31%, the quarter-end yield on the 10-year Treasury note was down from 3.52% at the end of June although still well above the historically low 2.08% at year-end 2008. Overall, the Barclays Aggregate Index was up 3.7% for the quarter and 5.7% year-to-date.

Other markets

Among other asset classes, hedge funds have also had a strong recovery this year,

with composite returns through quarter-end up about 15%. As in the stock and bond markets, the strategies that performed worst in 2008, such as convertible arbitrage, have done the best this year. In real estate, the NCREIF national property index is expected to show its fourth consecutive quarterly decline but publicly-traded REITs continue to rebound from 2008’s huge losses, up 33% for the quarter and 17% for the year. With the public equity market’s strong performance and the IPO market beginning to open up, returns from private equity may begin to stabilize after a very difficult period.

With projected double digit returns through the third quarter of 2009, most public pension funds are breathing a huge sigh of relief. While beginning to

recover some of the excruciating losses of 2008, the markets are far from out of the woods, however. With stocks fully priced relative to earnings and interest rates having declined substantially, further equity market gains and credit market improvement are unlikely in the absence of definitive signs of an economic turnaround, not just in corporate profits but also in employment, housing prices, and overall consumer health. As the government’s extraordinary amount of fiscal and monetary stimulus of the past year runs its course, only time will tell the effects on the economy’s continued revival. As events continue to unfold, we can at least be thankful for the first nine months of 2009.

TOTAL RETURNS | THIRD QUARTER, 2009

INDEX	THIRD QUARTER 2009	YEAR TO DATE
US EQUITY MARKET		
Dow Jones Industrial Avg.	+ 15.80%	+ 13.50%
Standard & Poor’s 500 (Large Cap)	+ 15.61%	+ 19.26%
NASDAQ Composite	+ 15.70%	+ 34.60%
Wilshire 5000 (Broad Market)	+ 16.12%	+ 21.28%
Standard & Poor’s Mid-Cap 400	+ 19.98%	+ 30.14%
Russell 2000 (Small Cap.)	+ 19.28%	+ 22.43%
GROWTH VS. VALUE		
Russell 1000 (Large Cap) Growth	+ 13.97%	+ 27.11%
Russell 1000 (Large Cap) Value	+ 18.24%	+ 14.85%
Russell Midcap Growth	+ 17.58%	+ 37.12%
Russell Midcap Value	+ 23.62%	+ 27.57%
Russell 2000 Growth	+ 15.95%	+ 29.12%
Russell 2000 Value	+ 22.70%	+ 16.36%
INTERNATIONAL EQUITY		
M.S.C.I. - E.A.F.E.	+ 19.47%	+ 28.97%
M.S.C.I. - Emerging Markets	+ 20.91%	+ 64.45%
FIXED INCOME		
Lehman Brothers Aggregate Index	+ 3.70%	+ 5.72%
Merrill Lynch High Yield Index	+ 14.55%	+ 47.70%
REAL ESTATE		
NAREIT - Equity Real Estate Investment Trusts	+ 33.28%	+ 17.01%
HEDGE FUNDS		
HFR Fund-Weighted Composite Index	+ 6.99%	+ 17.21%