DECISION ECONOMICS, INC.

Information for Decisions™

October 31, 2011

DE Financial Market Highlights

Andrew Husby
Associate Economist
212-884-9447

Treasuries and Yield Curve	3
Fed Funds, GDP Expectations	4
Inflation Expectations	5
Volatility and Implied Risk Measures	6
Equities, Risk, Sentiment	7
S&P 500 Sector Returns	9
Liquidity and Money Market	10
Credit Conditions, Quality Spreads	11
Munis, Mortgages	12
Global Sovereign Spreads	13
Commodities, Gold, Dollar	14
Currencies	15

Decision Economics: *Treasury Yields and the Yield Curve – Rates Low, Steeper Curve Recently*

Chart 1: Treasury Yields (Percent)

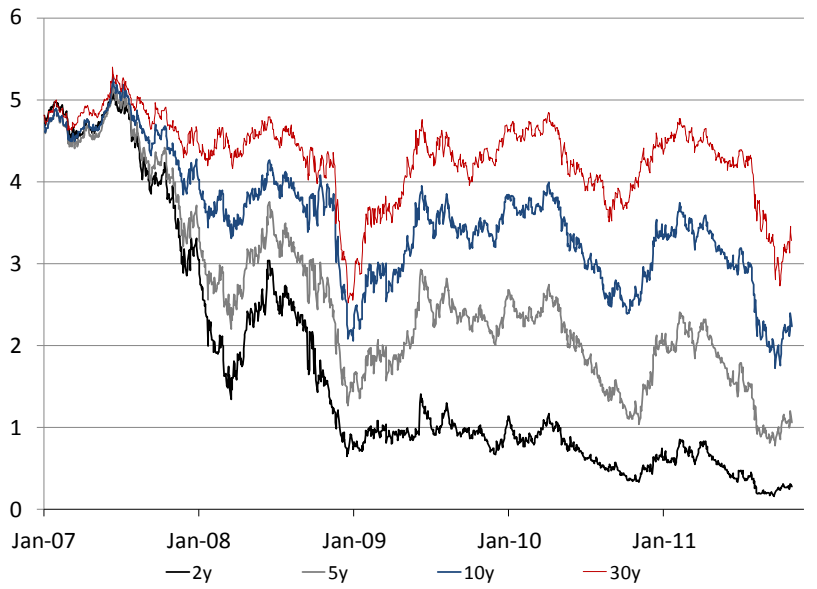
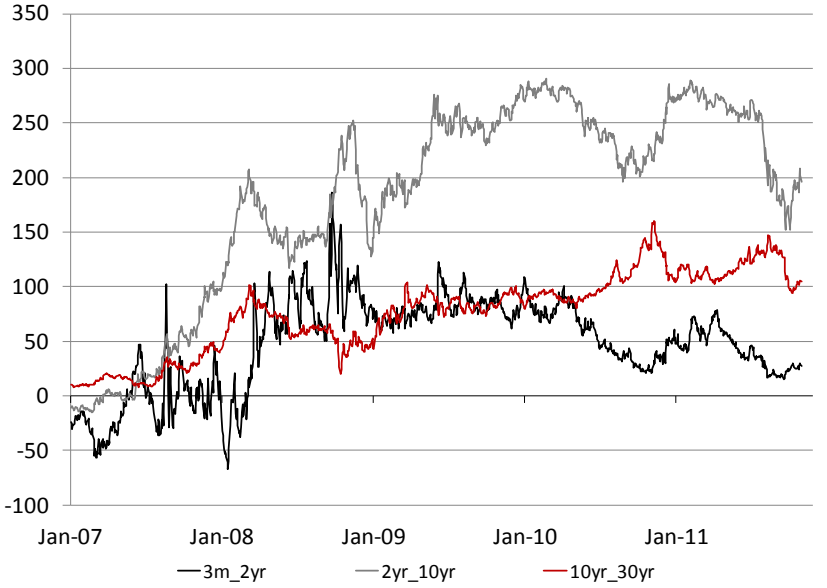


Chart 2: Treasury Yield Curve, Long Term (bps)



Treasury Yield Curve Matrix (bps)

Spread Levels

10/31/2011

	6m	2y	5y	10y	30y
3m	5	27	105	223	328
6m	--	22	99	216	320
2y		--	78	196	298
5y			--	118	222
10y				--	104

Month Ago

3m	3	22	93	189	289
6m	--	19	90	186	286
2y		--	71	167	267
5y			--	96	196
10y				--	100

Change

One Month Chg. (bps)

	6m	2y	5y	10y	30y
3m	2	5	12	34	39
6m		3	9	30	34
2y			7	29	32
5y				21	25
10y					4

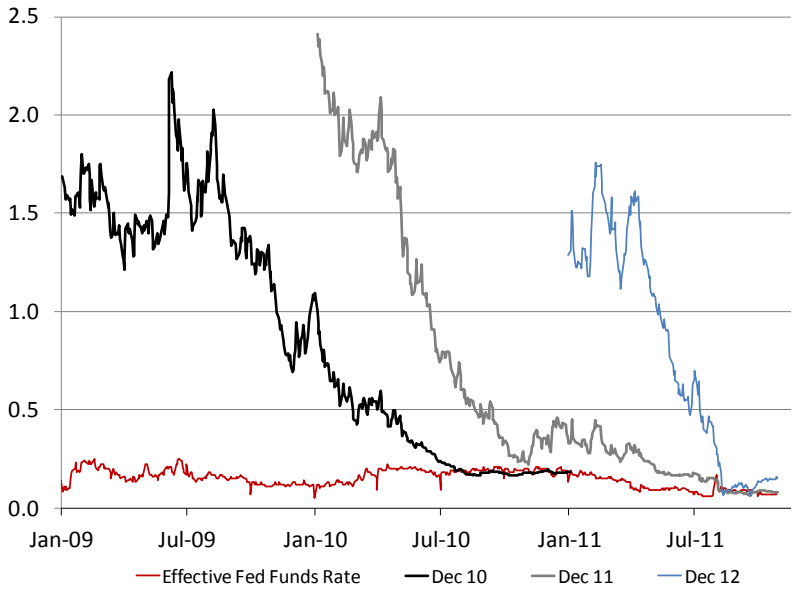
YTD Chg. (bps)

3m	-1	-20	-83	-94	-93
6m		-19	-84	-95	-95
2y			-64	-74	-75
5y				-11	-11
10y					0

Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Fed Funds, GDP Expectations*

Chart 3: Fed Funds Futures – Implied Rate at Year-End



Rates on hold through mid 2013. And now "Operation Twist".

"Standing pat" in October? Some change in communication strategy possible.

Consensus GDP expectations look to be bottoming out for Q4 and Q1. DE projections are a bit firmer.

Chart 4: Bloomberg Survey Median – Expected Year-End Fed Funds Rate (Percent)

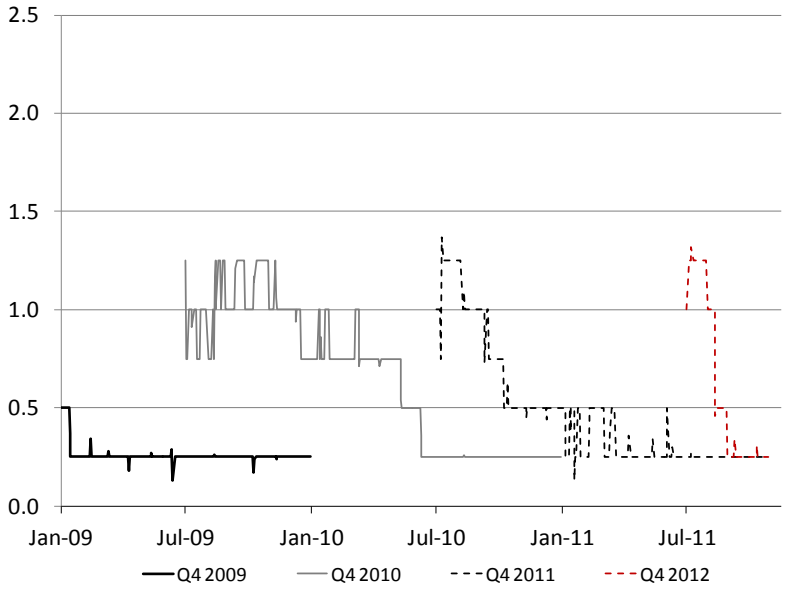
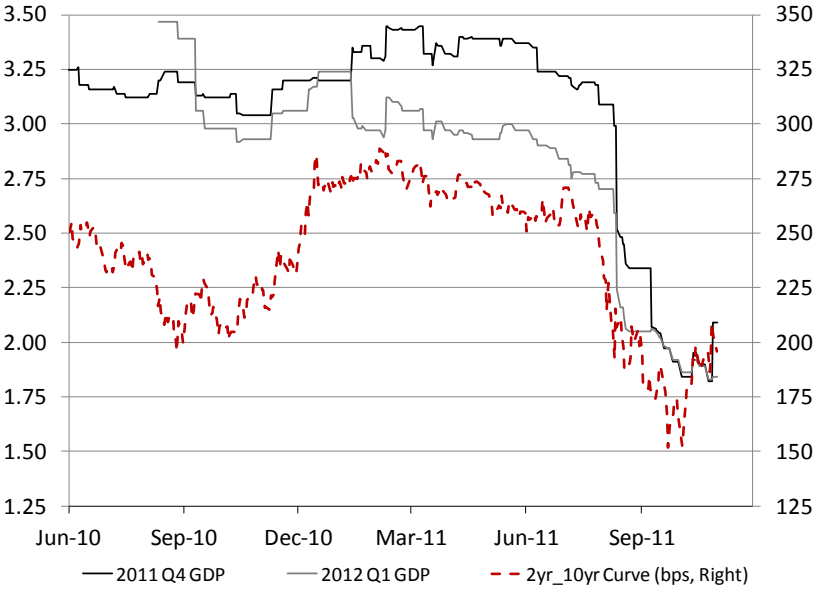


Chart 5: Bloomberg Survey Median – GDP Expectations, and the Yield Curve (Percent annualized, and bps)



Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Market Inflation Expectations*

Chart 6: Inflation Breakeven Rates (Nominal Treasury Yield less Inflation-linked Yield, Percent)

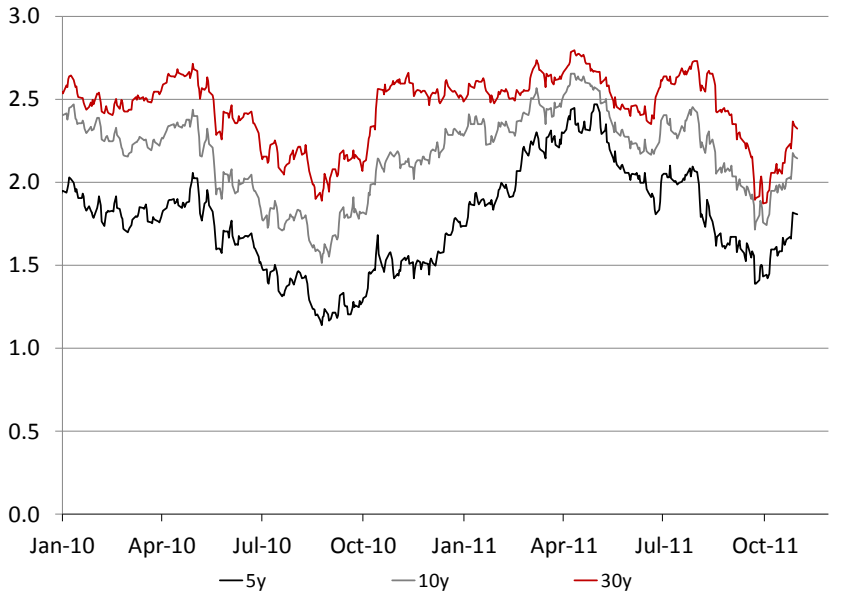
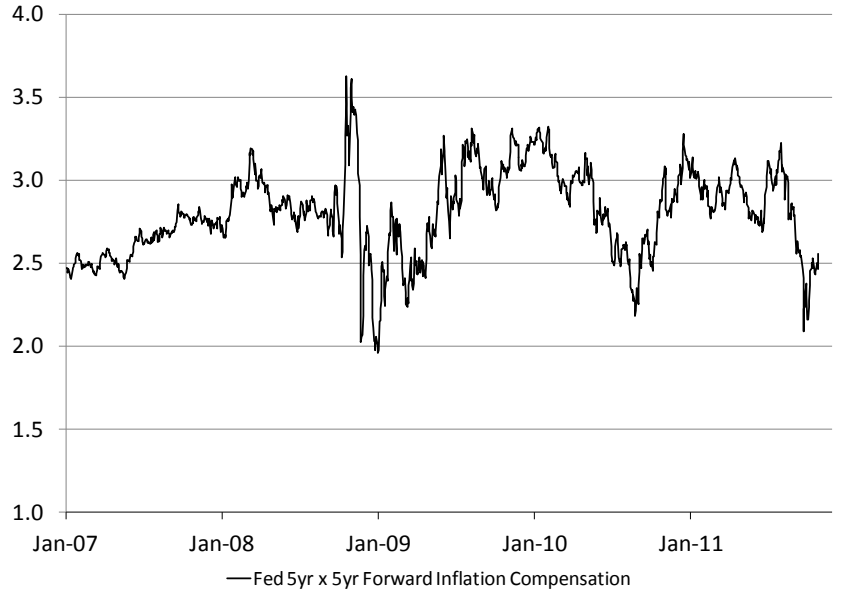


Chart 7: Fed 5yr x 5yr Forward Breakeven Inflation (Pct)

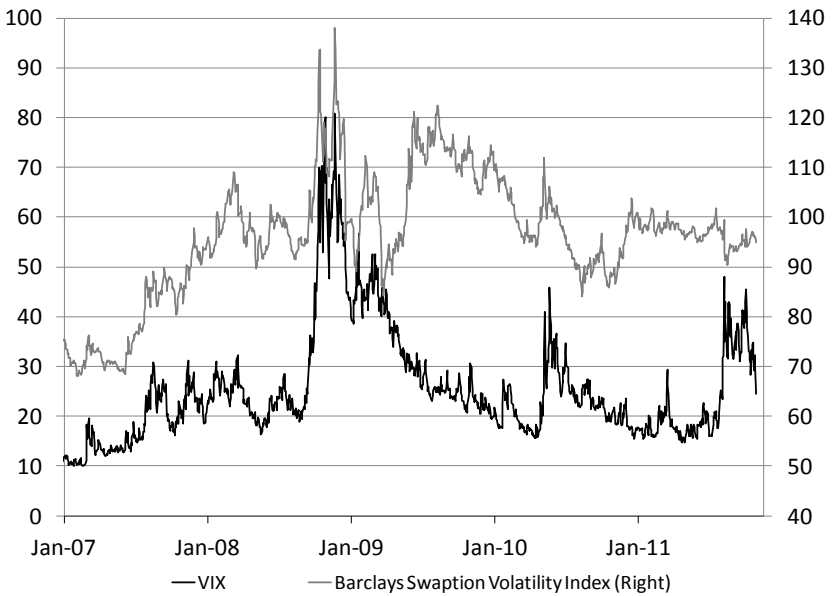


Market inflation expectations signal little in the way of inflation worries.

Sources: Bloomberg, Federal Reserve, and Decision Economics, Inc

Decision Economics: *Volatility and Implied Risk Measures*

Chart 8: Implied Volatility Measures



Implied equity volatility remains elevated, but down from peaks.

The CS Fear Barometer measures investor sentiment by pricing a 3-month zero-cost S&P 500 Index collar. Index values represent how far out of the money a put would have to be in order to be financed by selling a 10% OTM call. Higher values can be interpreted as higher "fear," but effectively just measures the relative cost of downside protection.

Chart 9: Equity Prices and Implied Investor Sentiment

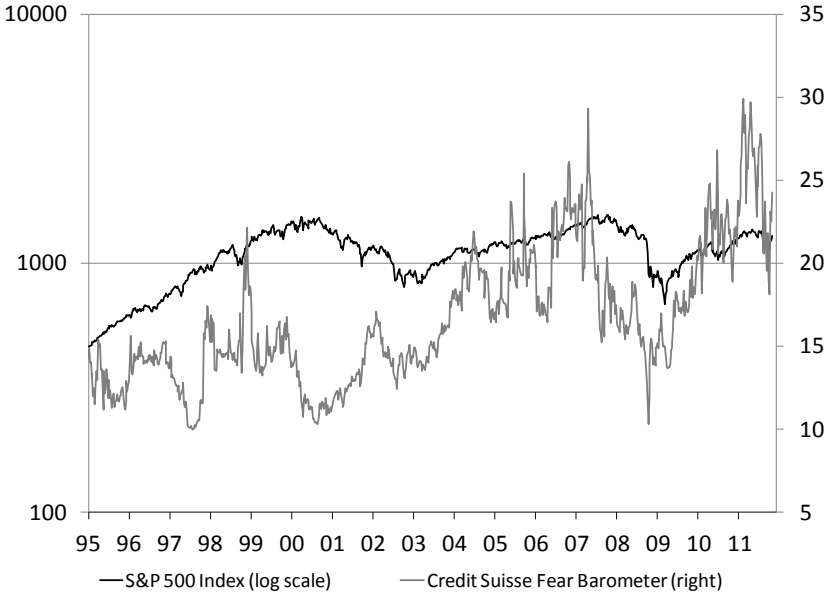
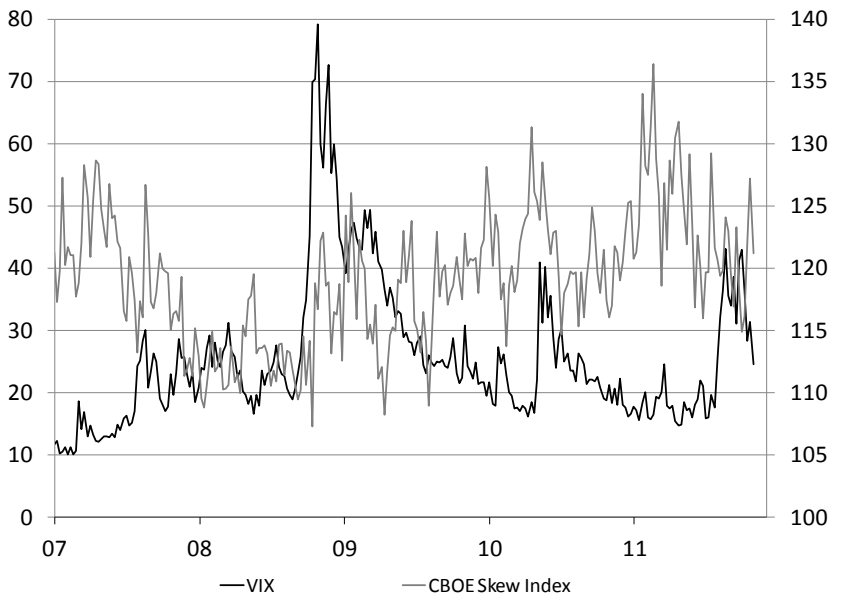


Chart 10: VIX Still Elevated



Sources: Bloomberg and Decision Economics, Inc

Chart 11: Snap-Back in Credit Less Pronounced Than Equities

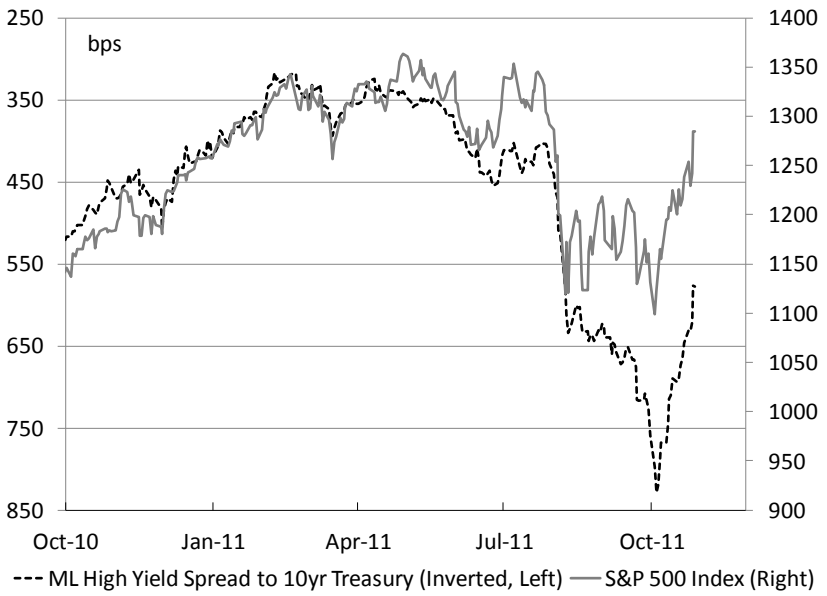
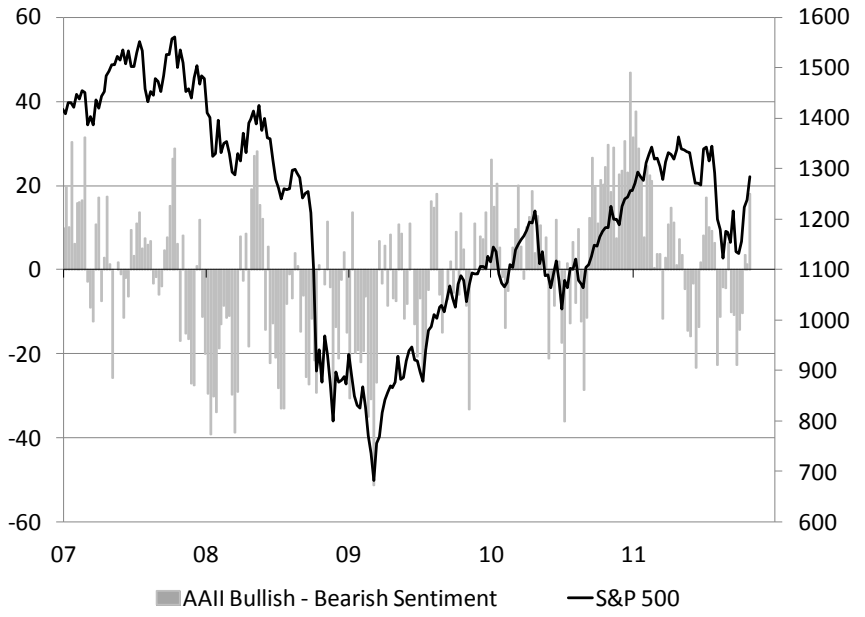


Chart 12: US Investor Sentiment (Percent Bullish less Bearish Over the Next Six Months)



High yield quality spread may still be indicating a higher degree of risk than equities are pricing in. The two tend to move together quite closely, and credit continues to lag relative to the year's highs.

Investor sentiment typically turns very bearish near bottoms, but only obvious in hindsight.

Sources: Bloomberg, Merrill Lynch, and Decision Economics, Inc

Decision Economics: *Equities, Risk, Sentiment (2)*

Chart 13: Small Caps vs. Large Caps – Ratio of Russell 2000 to S&P 500 (Dec 2007 = 100)



Chart 14: Consumer Discretionary vs. Consumer Staples – (Ratio, Dec 2007 = 100)



Small cap outperformance topped out in early 2011.

As a proxy for consumer health, relative performance of the consumer discretionary sector versus staples makes some sense, measuring the shift in the perceived balance between what consumers "want", relative to what they "need".

Very subdued income growth, an uncertain evolution of housing wealth, and broad deleveraging remain clear risks.

For now, the situation looks more like the subdued growth of 2010 than the crash of 2007-08. But 2008 did not look like 2008 before it happened either.

Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *S&P 500 Sector Returns* – Growth vs. Defensive*

Clear emphasis on cyclically-defensive sectors, but everything beaten down amid macro risks. Monthly data (right) highlight relative movements over a longer period of time.

		"Growth"						"Defensive"		
	SP500	INFT	FINL	ENRS	MATR	INDU	COND	CONS	HLTH	UTIL
9/27/2011	**-1.1**	1.2	-2.5	-5.3	-5.8	-2.1	0.2	-0.3	-0.2	1.7
9/28/2011	**-4.8**	-1.9	-7.7	-10.0	-11.5	-6.3	-3.1	-3.3	-2.8	-0.5
9/29/2011	**-4.6**	-3.3	-5.3	-8.7	-11.8	-5.4	-4.9	-2.8	-2.5	0.0
9/30/2011	**-6.0**	-6.0	-6.0	-9.9	-13.8	-7.6	-7.6	-3.1	-2.9	-0.7
10/3/2011	**-8.6**	-7.8	-10.0	-12.3	-15.2	-9.8	-9.7	-4.7	-6.8	-4.3
10/4/2011	**-3.7**	-4.6	-1.5	-5.8	-8.0	-3.6	-4.0	-2.3	-3.4	-3.0
10/5/2011	**1.3**	0.9	2.8	2.8	1.5	2.4	1.1	-0.2	0.3	-1.2
10/6/2011	**2.5**	1.5	4.9	5.3	4.4	3.6	1.7	0.9	1.2	-0.6
10/7/2011	**-0.6**	-0.3	-3.3	0.4	-0.3	0.6	-0.6	-0.3	-0.5	-1.0
10/10/2011	**1.7**	2.0	1.3	3.3	1.8	2.6	2.1	0.6	0.5	0.7
10/11/2011	**3.9**	4.1	4.3	6.6	6.7	5.5	4.1	2.2	1.9	0.6
10/12/2011	**4.0**	5.1	4.1	5.9	7.8	5.3	6.1	2.0	1.3	-1.1
10/13/2011	**6.4**	9.2	5.3	8.6	11.3	7.9	9.0	3.1	2.6	0.0
10/14/2011	**11.4**	14.1	11.9	16.3	17.2	13.3	14.2	5.4	6.8	3.3
10/17/2011	**6.8**	9.8	3.9	10.9	9.5	7.5	8.6	3.7	4.0	3.5
10/18/2011	**7.1**	8.3	7.8	10.5	7.7	8.2	8.6	4.3	3.2	4.2
10/19/2011	**3.9**	4.2	2.6	7.8	1.9	4.6	4.7	2.8	1.7	2.7
10/20/2011	**5.2**	4.2	8.4	9.8	4.5	5.8	5.3	2.7	2.0	2.8
10/21/2011	**3.6**	2.1	5.6	7.1	2.9	4.0	4.6	2.7	1.3	2.5
10/24/2011	**4.9**	3.4	7.9	8.2	5.1	5.5	5.8	2.4	3.1	3.1
10/25/2011	**1.8**	1.1	1.9	5.3	1.5	2.0	2.3	0.4	0.9	2.0
10/26/2011	**3.2**	0.5	6.4	8.0	4.0	3.7	2.1	1.4	2.4	2.6
10/27/2011	**4.9**	1.5	11.4	8.3	6.8	6.4	3.1	2.0	3.8	3.9
10/28/2011	**7.0**	3.6	15.0	10.6	11.0	9.3	4.4	2.7	5.9	3.5
10/31/2011	**3.2**	1.3	7.2	3.7	4.9	4.5	1.6	1.4	3.9	2.6

*Trailing 2 week return

Green shading represents relative outperformance; red underperformance

		"Growth"						"Defensive"		
	SP500	INFT	FINL	ENRS	MATR	INDU	COND	CONS	HLTH	UTIL
Feb-09	**-18.0**	-5.7	-40.5	-18.7	-16.1	-27.9	-14.2	-15.0	-8.3	-15.8
Mar-09	**-11.7**	4.0	-29.5	-12.1	-2.8	-21.8	-8.6	-11.3	-8.5	-11.9
Apr-09	**5.7**	20.2	17.3	-4.8	20.6	5.4	21.2	-1.0	-8.1	-10.7
May-09	**25.0**	28.6	62.6	19.7	39.6	31.9	31.4	12.5	12.3	5.7
Jun-09	**15.2**	19.4	35.1	10.1	15.5	18.0	17.7	8.9	8.3	8.8
Jul-09	**13.1**	16.3	20.3	9.5	13.7	9.5	8.6	12.2	15.5	12.4
Aug-09	**11.0**	16.2	20.0	-0.2	9.9	11.1	13.4	7.2	10.7	9.2
Sep-09	**15.0**	16.7	25.1	9.5	21.0	21.2	18.8	10.5	8.9	5.0
Oct-09	**4.9**	6.5	8.1	8.3	1.1	5.8	6.0	5.2	0.6	-2.0
Nov-09	**7.3**	9.3	-0.2	11.0	10.4	10.4	9.4	8.3	7.5	1.9
Dec-09	**5.5**	10.4	-3.7	5.0	6.9	4.8	8.6	4.2	8.5	6.1
Jan-10	**3.6**	1.5	1.0	-2.8	3.1	8.6	8.1	1.9	11.6	4.0
Feb-10	**0.8**	0.6	0.2	-3.7	-3.5	4.5	6.6	0.8	2.4	-2.0
Mar-10	**4.9**	1.7	10.8	0.1	2.4	12.5	10.0	5.0	2.9	-4.6
Apr-10	**10.5**	13.0	13.9	9.5	12.6	18.5	20.2	4.7	-1.5	3.0
May-10	**-1.4**	-0.4	0.0	-5.3	-2.4	2.2	6.0	-2.9	-8.4	-1.5
Jun-10	**-11.9**	-12.5	-13.6	-13.2	-15.7	-12.8	-11.2	-8.8	-12.3	-4.8
Jul-10	**-7.2**	-7.8	-9.0	-10.3	-5.8	-7.6	-9.8	-2.0	-7.6	-0.3
Aug-10	**-3.7**	-6.7	-7.7	-3.1	1.3	-5.0	-6.8	1.2	-2.4	7.2
Sep-10	**10.7**	11.5	4.1	12.3	17.3	13.7	14.7	9.8	8.2	11.1
Oct-10	**7.4**	10.8	-1.1	9.8	11.3	5.7	12.1	6.6	9.1	4.5
Nov-10	**12.5**	17.2	6.5	21.1	15.7	14.9	19.7	6.9	7.5	-0.2
Dec-10	**10.2**	10.0	11.2	20.9	18.5	11.2	12.1	5.3	3.1	0.0
Jan-11	**8.7**	7.7	12.7	22.9	11.0	13.0	5.7	0.6	1.4	0.1
Feb-11	**12.4**	11.6	16.8	24.8	12.7	14.4	9.2	4.5	7.7	4.6
Mar-11	**5.4**	3.2	2.8	16.3	4.1	8.2	4.4	1.7	5.0	1.6
Apr-11	**6.0**	2.0	-0.1	10.0	6.4	6.6	9.2	8.8	11.3	4.4
May-11	**1.4**	-1.6	-6.0	-1.8	0.7	1.3	2.8	8.7	10.6	5.3
Jun-11	**-0.4**	-1.6	-6.3	-5.1	-1.4	-1.2	3.1	4.5	7.3	5.0
Jul-11	**-5.2**	-2.9	-9.7	-5.9	-6.6	-10.6	-2.2	-2.2	-3.2	0.0
Aug-11	**-9.4**	-7.2	-15.6	-11.2	-10.4	-14.1	-7.1	-4.1	-7.5	0.1
Sep-11	**-14.3**	-8.0	-23.1	-20.9	-25.0	-21.5	-13.3	-4.9	-10.5	0.4
Oct-11	**-2.1**	1.6	-7.2	-7.1	-7.7	-2.9	-1.0	1.6	-0.8	5.6

*Trailing 3 month return

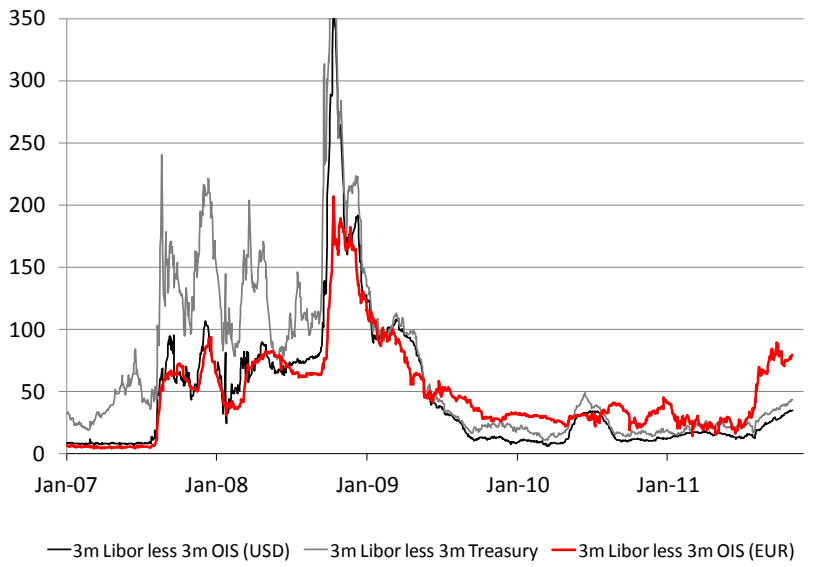
Green shading represents relative outperformance; red underperformance

INFT – Information Technology
FINL – Financials
ENRS – Energy
MATR – Materials
INDU – Industrials
COND – Consum. Discretionary
CONS – Consum. Staples
HLTH – Healthcare
UTIL – Utilities

Source: Bloomberg and Decision Economics

Decision Economics: *Liquidity, Money Market*

Chart 15: USD and EUR Libor-OIS, TED Spread (bps)



Uptick in credit market strains amid numerous potential pitfalls.

Central bank liquidity backstops keeping Libor-OIS spread from widening more sharply.

Chart 16: 10yr Swap Spread (bps)

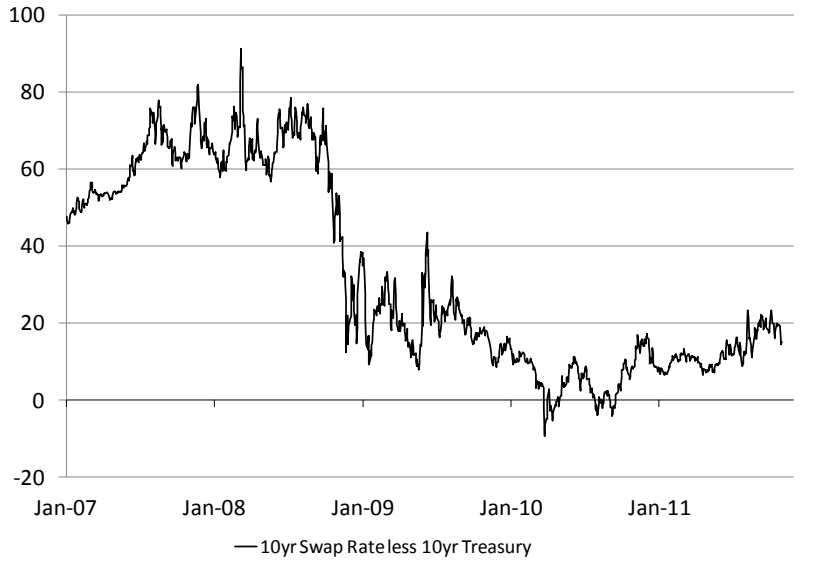
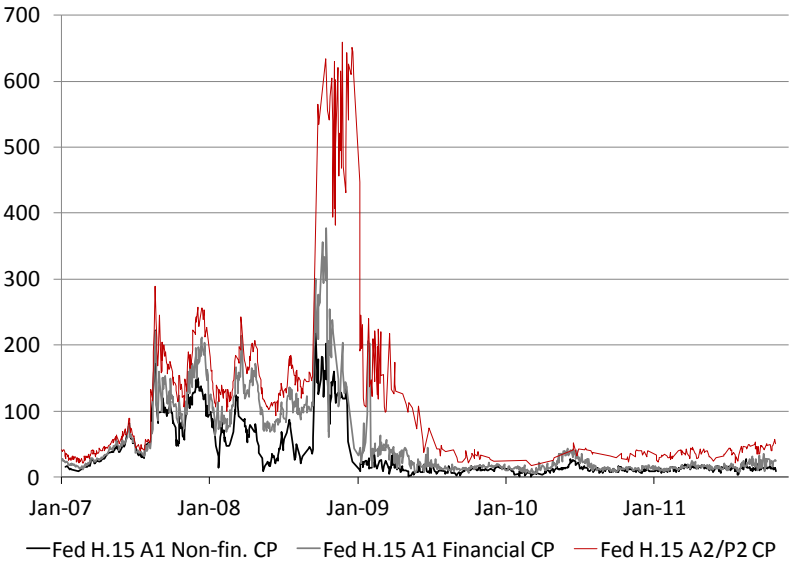


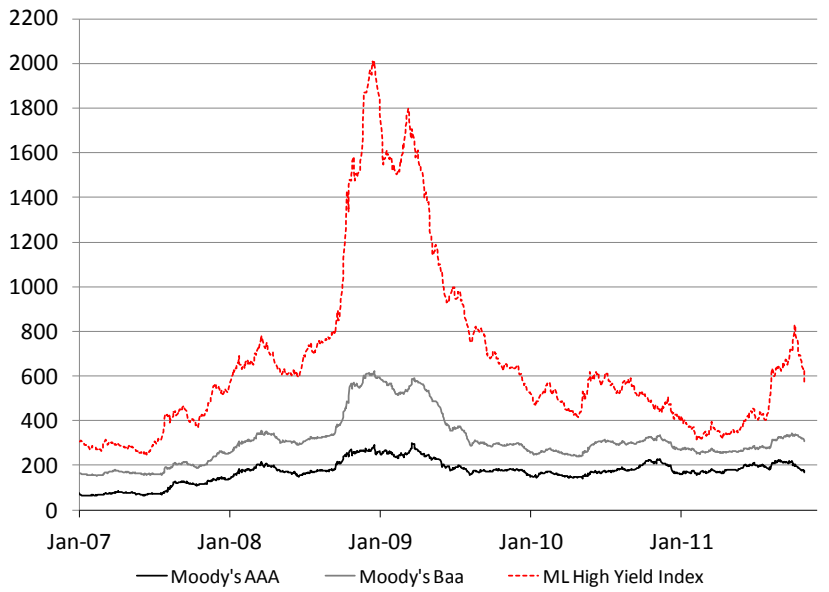
Chart 17: 90D Commercial Paper Spread to Treasury Bill (bps)



Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Credit Conditions, Quality Spreads*

Chart 18: Corporate Spreads to 10yr Treasury (bps)



Corporate quality spreads to Treasuries have come off recent highs, but remain wide.

The HY spread remains at early-2008 levels. Pricing in slow growth or recession-like period ahead.

Chart 19: Spread to Treasury (Ratio, May 2007 = 1.0)

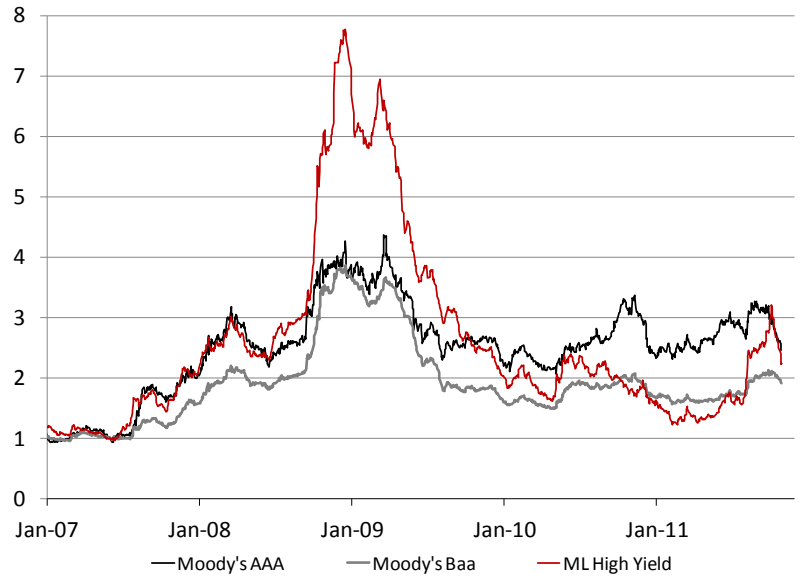
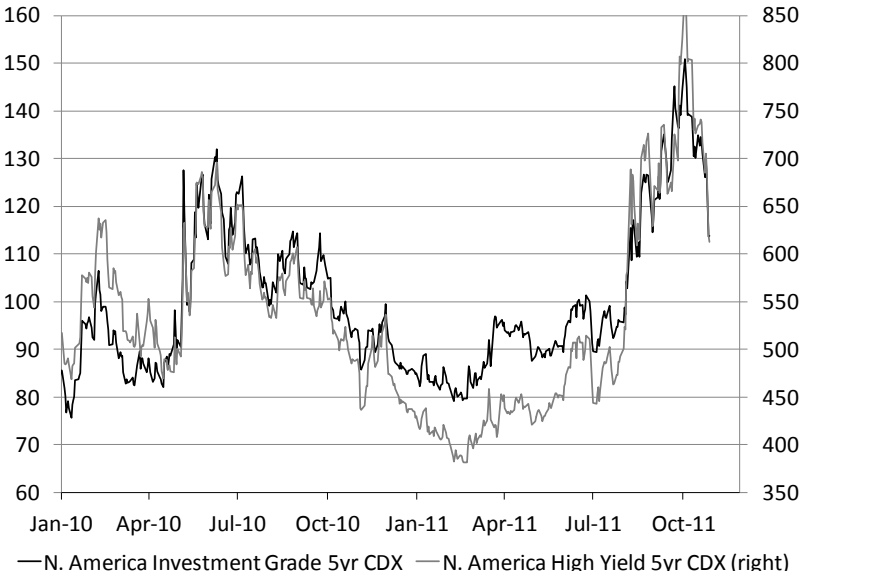


Chart 20: Markit CDX Indices



Sources: Bloomberg, Moody's, Merrill Lynch, and Decision Economics, Inc

Decision Economics: *Munis, Mortgages*

Chart 21: AAA Municipal Bonds, Ratio to Treasuries

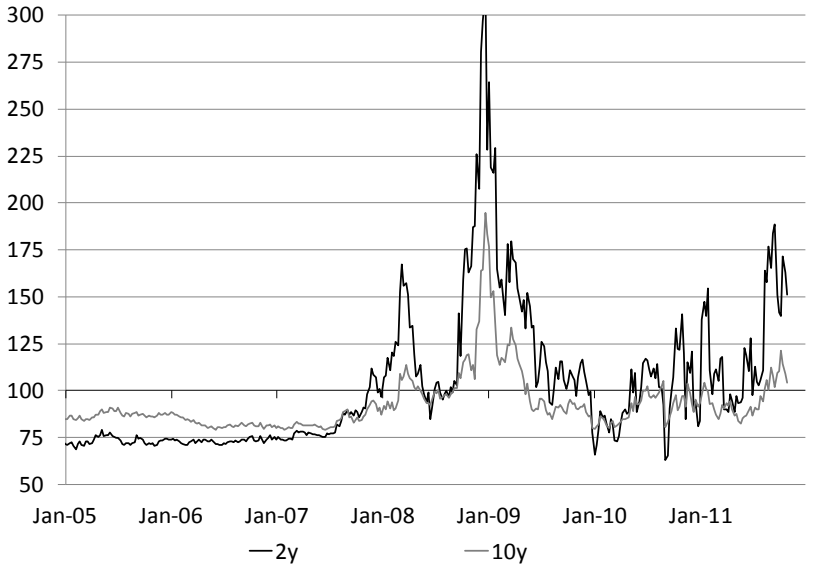
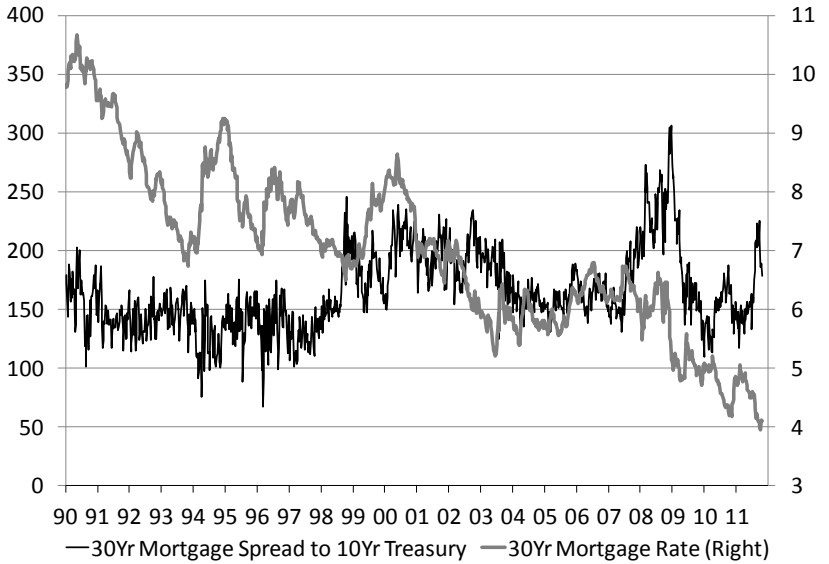


Chart 22: 30Yr Mortgage



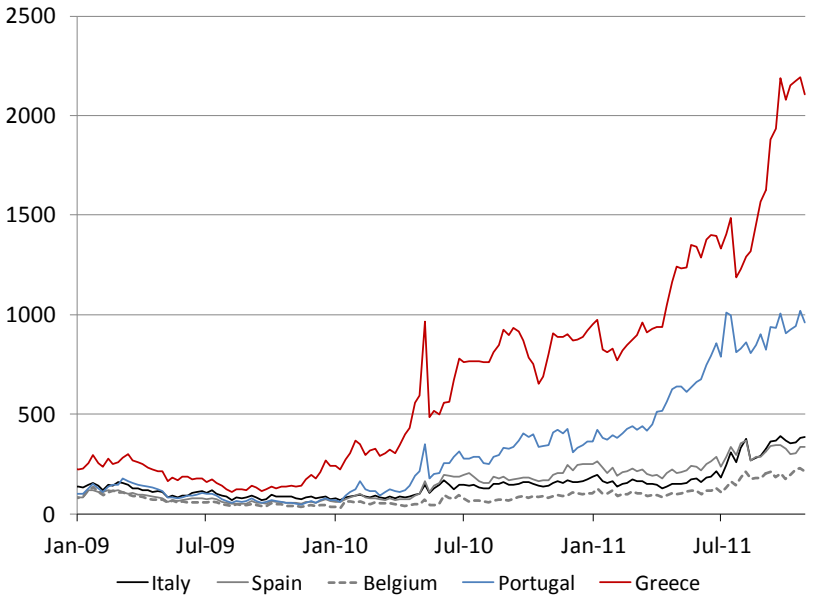
Municipal bonds have historically traded at a lower yield than Treasuries due to tax advantages. There are opportunities to be had, but legitimate fiscal concerns have upended "normal" relationships.

Mortgage rates lowest on record. Even so, Fed to target MBS?

Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Global Sovereign Spreads*

Chart 23: 10yr Spread to German Bund, Weekly (bps)



Europe struggles to contain debt crisis. Resolution another matter.

Peripheral spreads continue to widen as the newest bailout mechanism both (a) has many details left to be ironed out, and (b) appears to work best if it isn't tapped, making it a bit less than robust.

Chart 24: G7 - 2yr Yield Spreads to US Treasury, Weekly (bps)

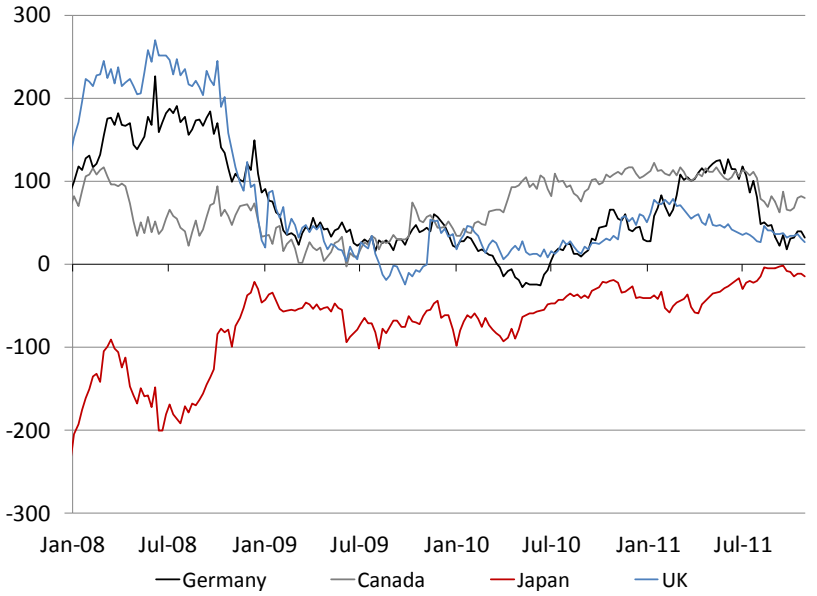
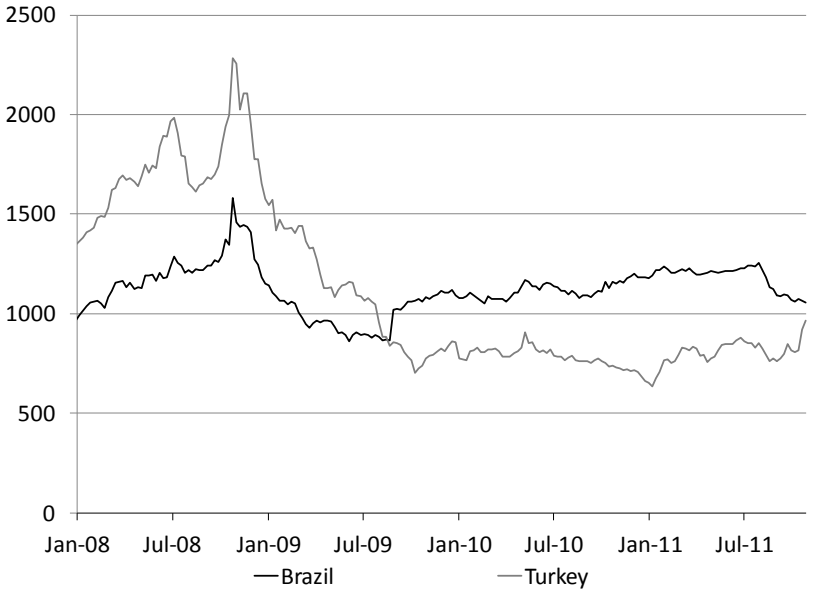


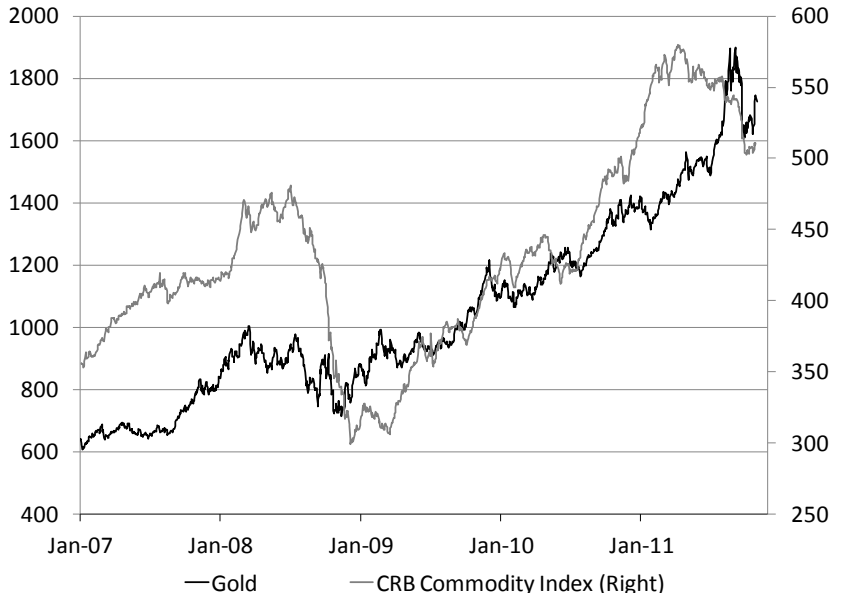
Chart 25: Emerging Mkts - 2yr Spreads to US Treasury (bps)



Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Commodities, Gold, the Dollar*

Chart 26: CRB Commodity Index, Gold Price



Broad commodity indices slip further. Gold resumes climb .

Dollar rises a bit off lows.

Gas prices ease a bit, helping consumers.

Chart 27: Real Trade-Weighted Broad Dollar Index (1973=100)

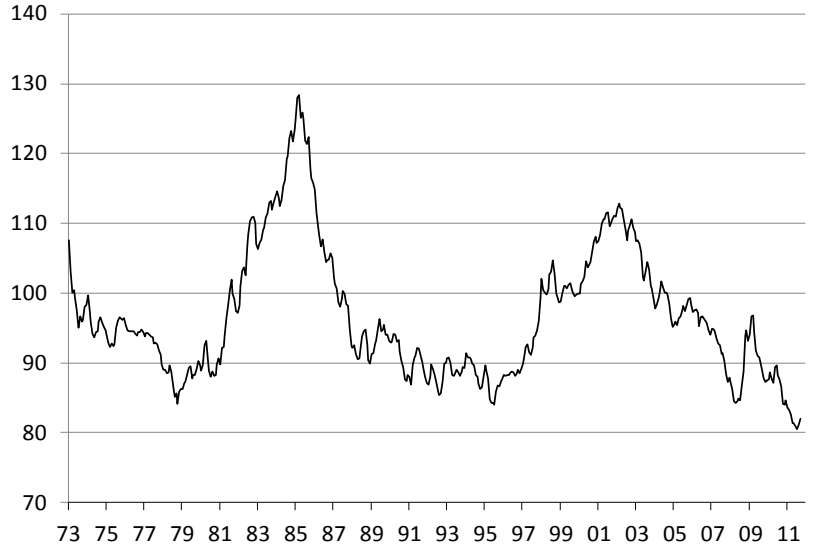
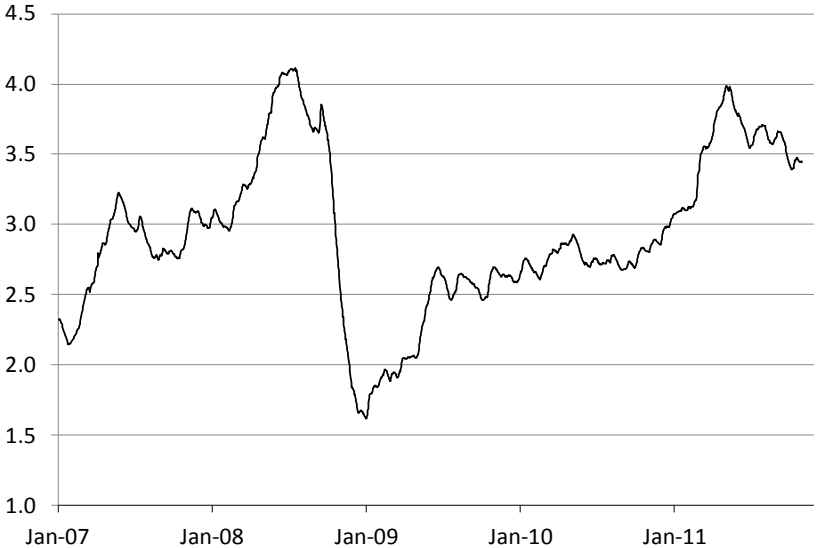


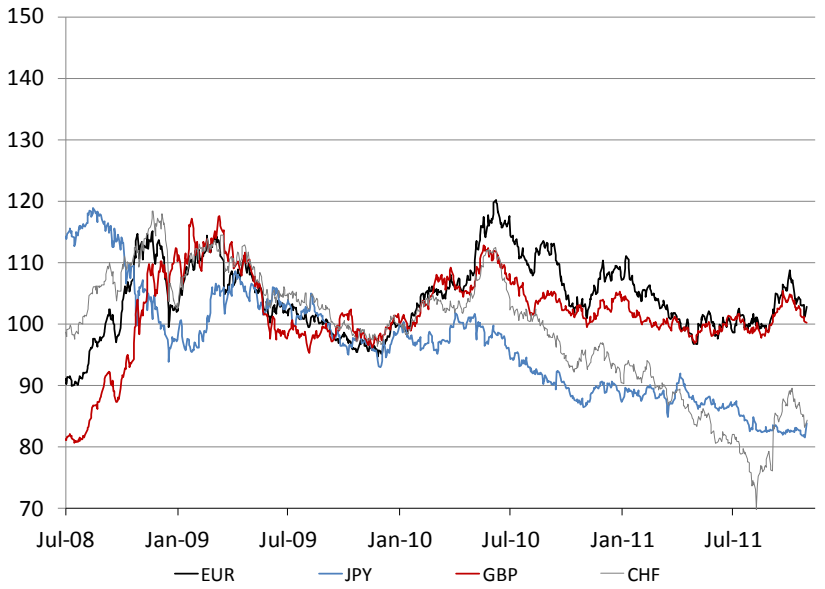
Chart 28: Average Regular Unleaded Gasoline Price ($/Gal.)



Sources: Bloomberg, FRB, and Decision Economics, Inc

Decision Economics: *Currencies Versus the US Dollar*

Chart 29: Dollar Performance (Dec 2009 = 100)



Basket of fiscally-sounder, some commodity-currencies, and gold perhaps a better store of value than the USD over the long term.

But, USD still holds "crisis currency" status.

Chart 30: Dollar Performance (Dec 2009 = 100)

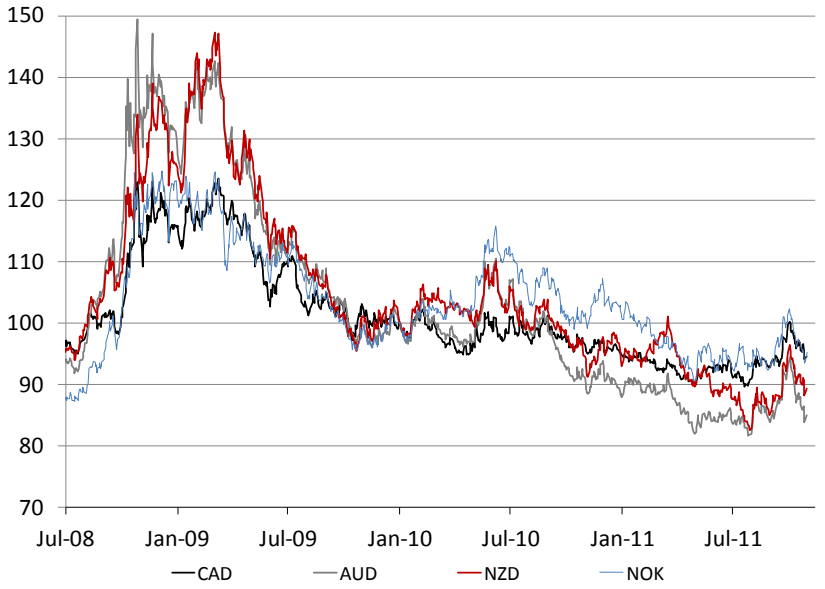
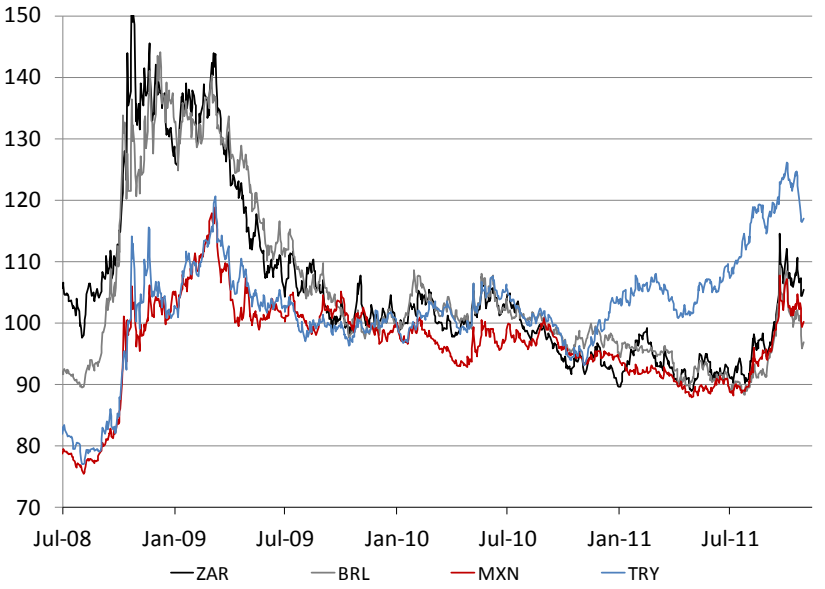


Chart 31: Dollar Performance Against Emerging Market Currencies (Dec 2009 = 100)



Sources: Bloomberg and Decision Economics, Inc