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DE Financial Market Highlights

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Decision Economics: *Treasury Yields and the Yield Curve*

Chart 1: Treasury Yields (Percent)

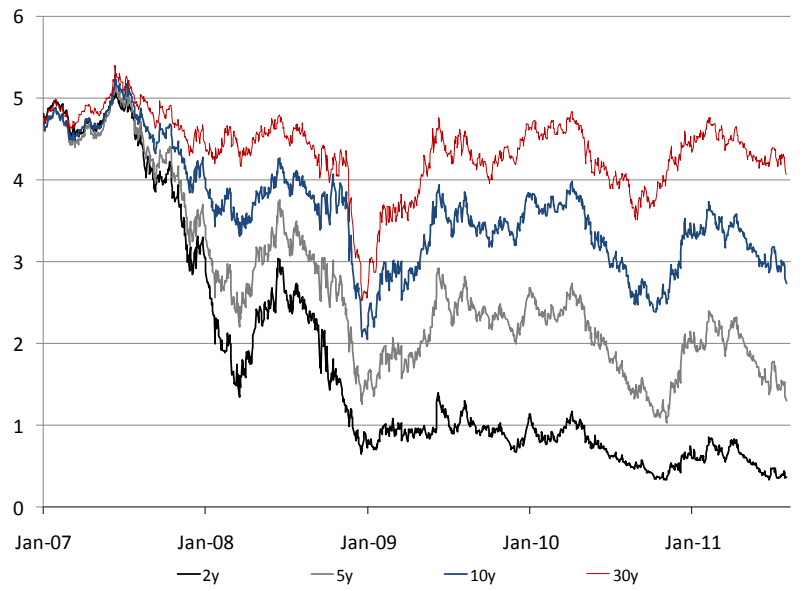
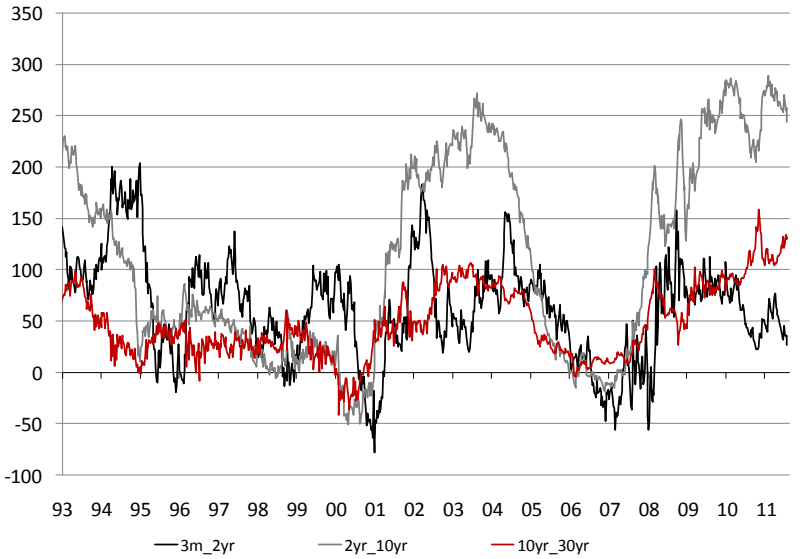


Chart 2: Treasury Yield Curve, Long Term (bps)



Treasury Yield Curve Matrix (bps)

Spread Levels

8/1/2011

	6m	2y	5y	10y	30y
3m	6	28	122	265	399
6m	--	22	116	259	392
2y		--	94	237	371
5y			--	143	277
10y				--	133

Month Ago

3m	8	46	176	317	437
6m	--	38	168	308	429
2y		--	131	271	392
5y			--	140	261
10y				--	121

Change

One Month Chg. (bps)

	6m	2y	5y	10y	30y
3m	-2	-18	-54	-51	-39
6m		-16	-52	-49	-37
2y			-36	-34	-21
5y				3	15
10y					13

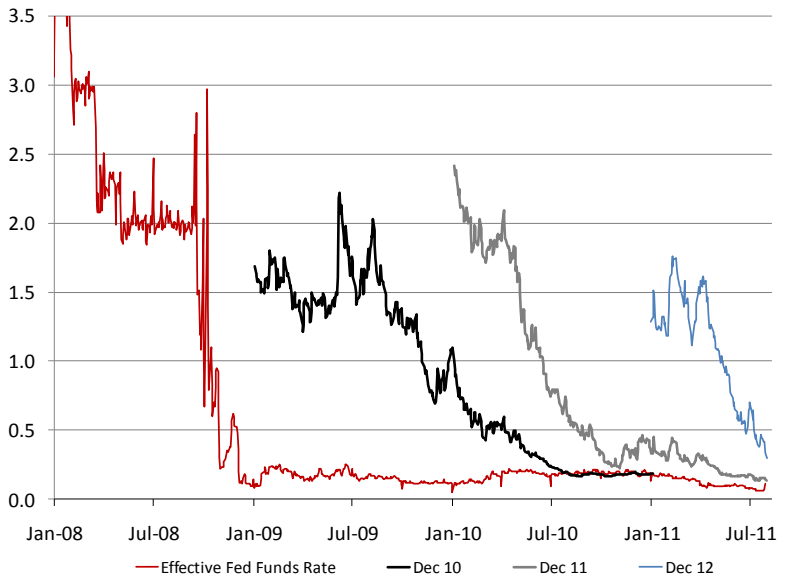
YTD Chg. (bps)

3m	0	-19	-66	-52	-22
6m		-19	-66	-52	-22
2y			-47	-33	-3
5y				14	44
10y					29

Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Fed Funds, GDP Expectations*

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



"Low for long" turning into "lower for longer".

Markets, and most economists, have consistently been disappointed in their expectation for higher rates.

Markets are pricing in little-to-no chance of a rate hike by Dec. 2012. The "median" economist is so far expecting a 1%+ rate by the end of 2012.

GDP expectations are being marked down as well.

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

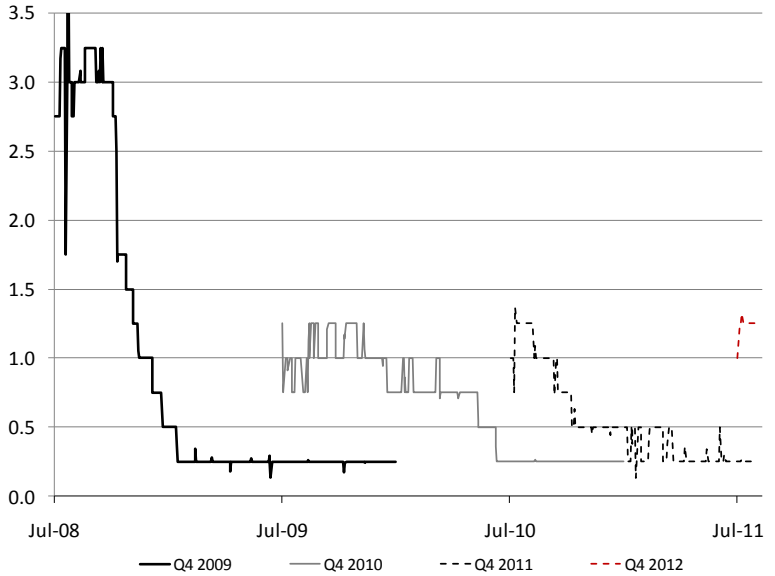
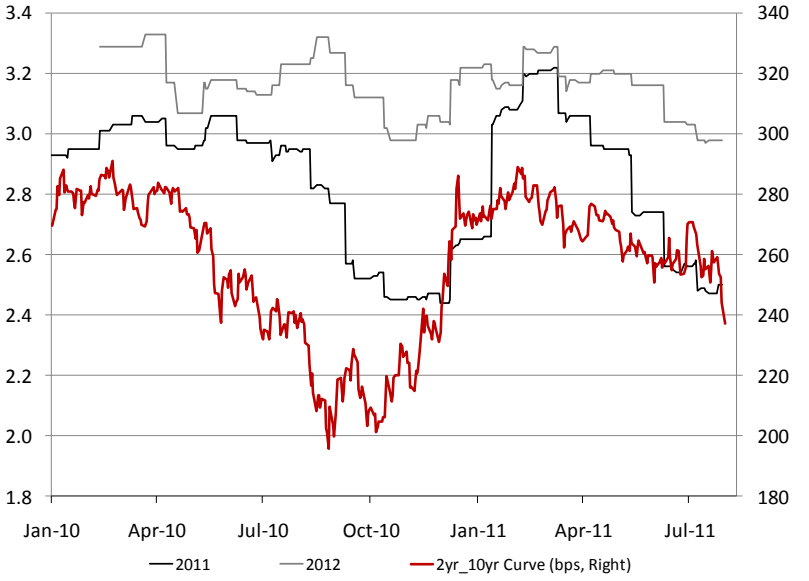


Chart 5: Bloomberg Survey Median – GDP Expectations, and the Yield Curve (Percent Y/Y, and bps)



Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Market Inflation Expectations*

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

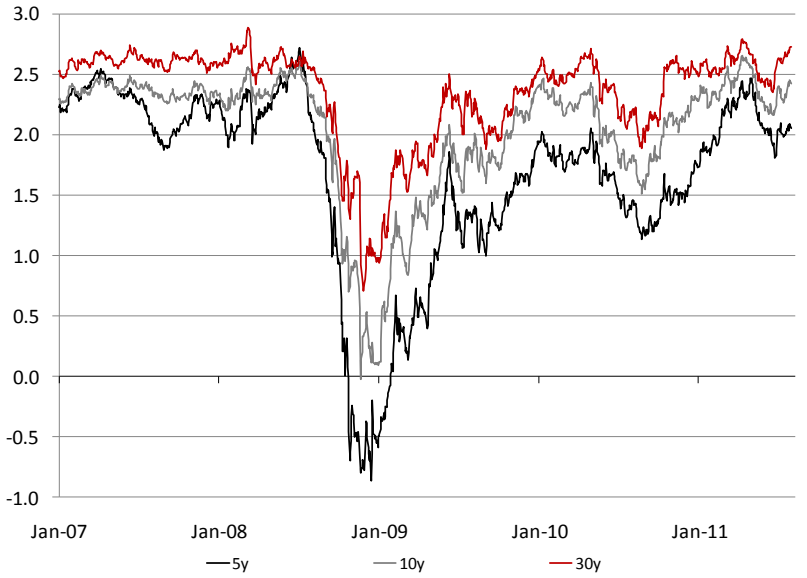


Chart 7: Fed 5yr x 5yr Forward Breakeven Inflation (bps)



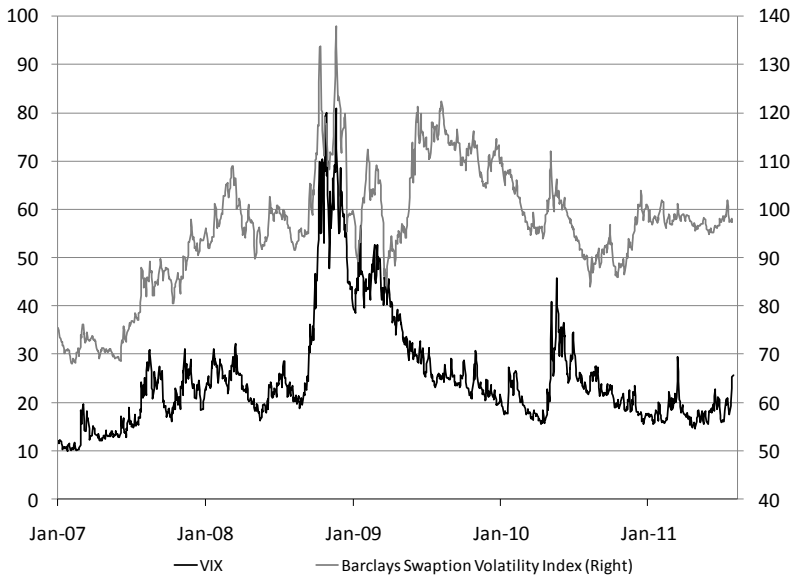
Inflation-indexed bonds are pointing to reasonably-anchored inflation expectations.

So far, the inflation/growth tradeoffs for another round of QE are less than appealing to the Fed. But the Fed is also far from meeting the employment half of its dual mandate.

5yr forward inflation compensation is elevated relative to pre-crisis levels, but isn't corroborating a runaway inflation scenario.

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

Chart 8: Implied Volatility Measures



Implied equity volatility has climbed in recent weeks, but is well off of Lehman and early-2010 sovereign debt-related highs. Still, investors are worried about tail risks.

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 imply higher "fear".

Chart 9: Equity Prices and Implied Investor Sentiment

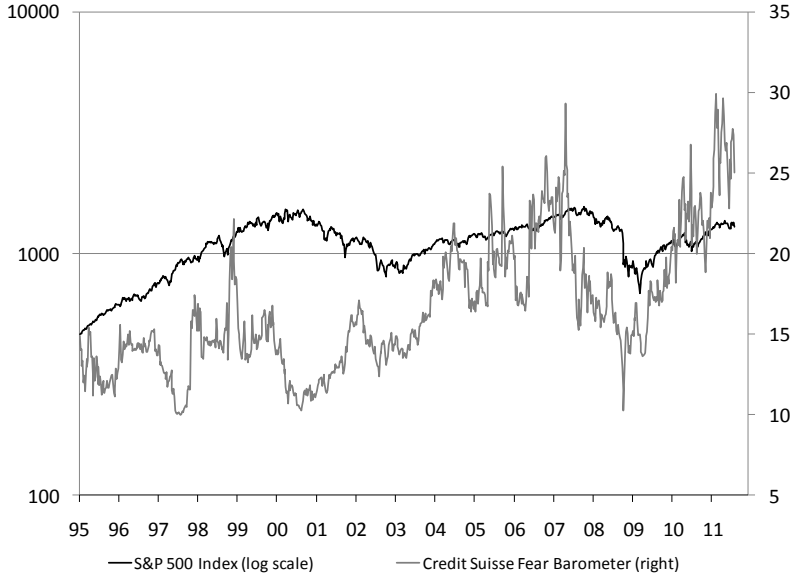
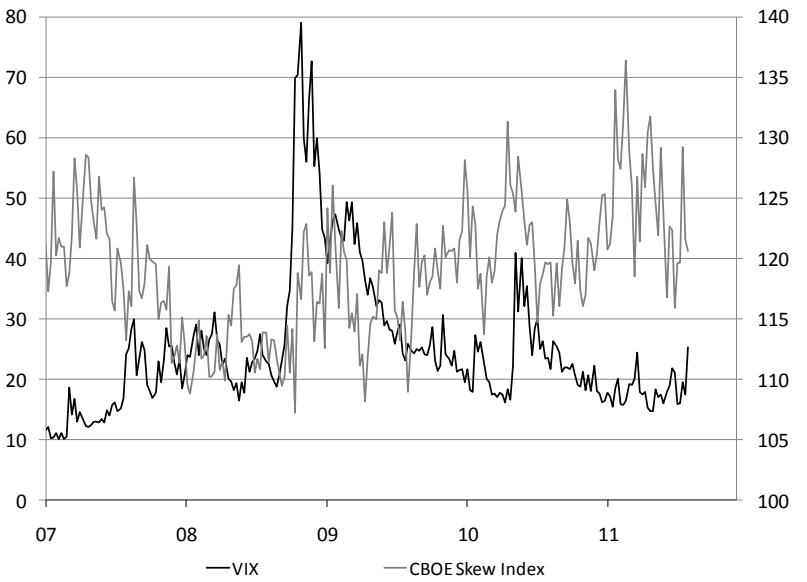
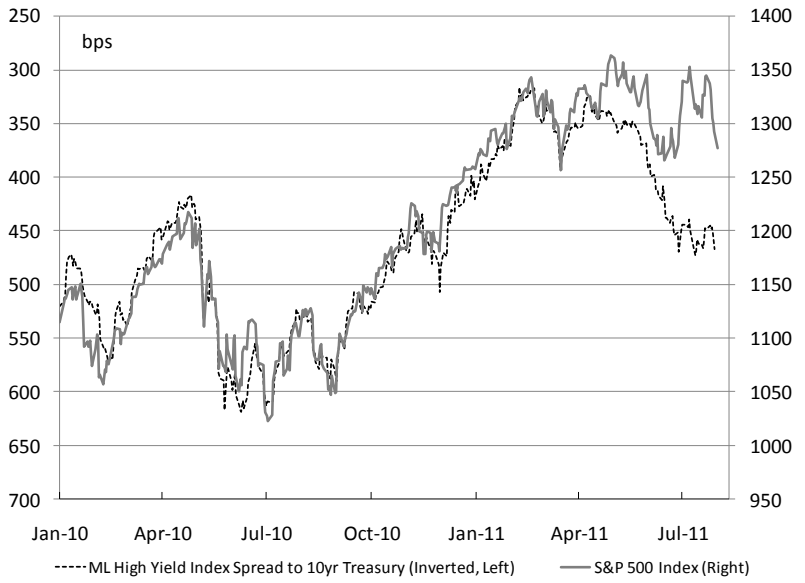


Chart 10: Low Implied Near-Term Volatility, Wary of Tail Risks



Sources: Bloomberg and Decision Economics, Inc

Chart 11: Credit Spread and Equities Disagree on Risk



Equities have treaded water since January, but the high yield quality spread is indicating a higher degree of risk aversion. The two tend to move together quite closely, making the recent divergence potentially worrying from an equity standpoint, in the short term.

Chart 12: S&P Sector Performance

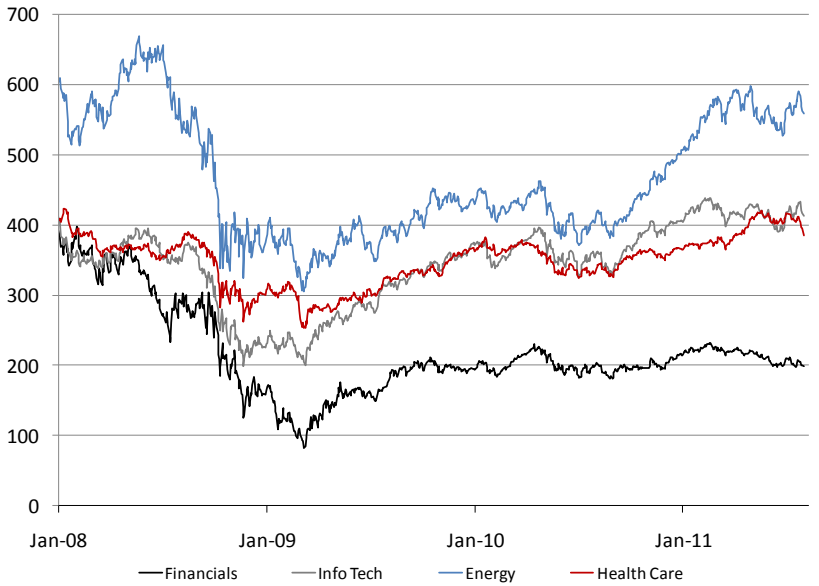
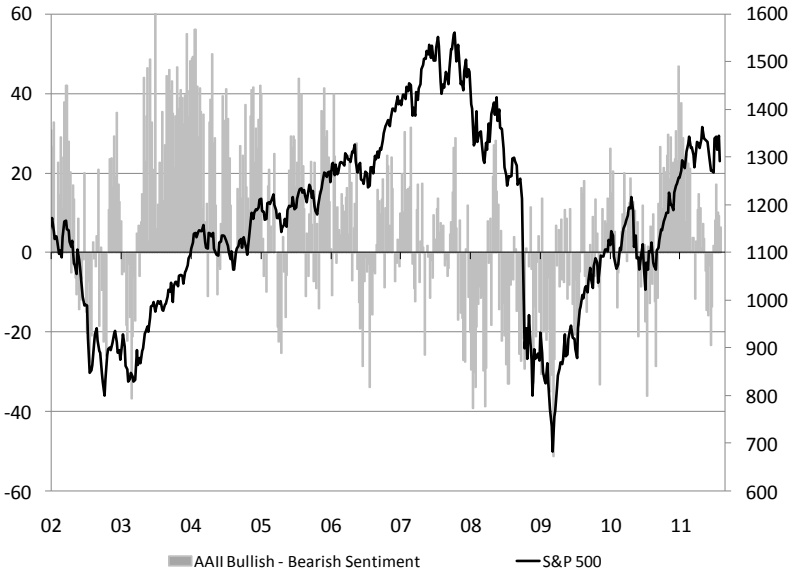


Chart 13: US Investor Sentiment (Percent Bullish less Bearish Over the Next Six Months)



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

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

Chart 14: Small Caps vs. Large Caps – Ratio of Russell 2000 to S&P 500 (Dec 2007 = 100)

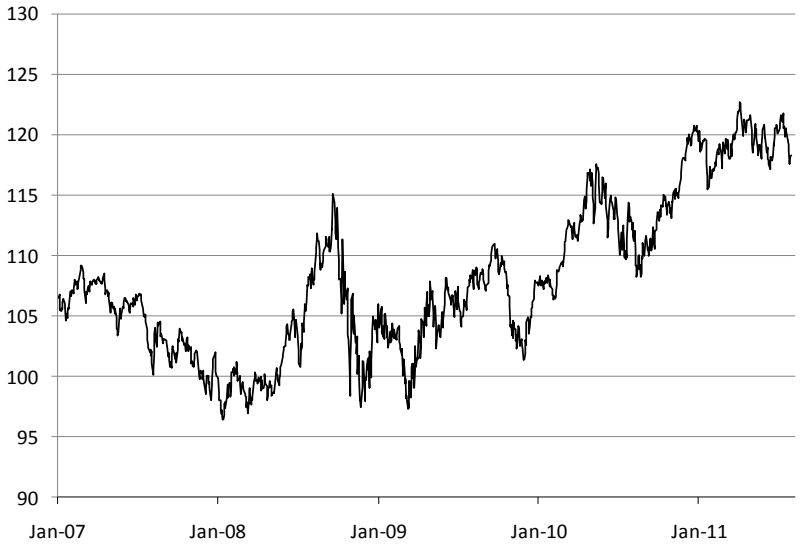


Chart 15: Consumer Discretionary vs. Consumer Staples – (Ratio, Dec 2007 = 100)



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". The indicator gave warning signs well before the recession began, and began to rebound well before the broader market.

No major red flags so far, but very subdued income growth, an uncertain evolution of housing wealth, and broad deleveraging remain clear risks.

Sources: Bloomberg and Decision Economics, Inc

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

Info Tech, defensively-minded sectors leading, Industrials and Materials lagging, reflecting macro risks. If the slowdown does prove less than serious in the second half, "growth" sectors should outperform. Plenty of risks remain. Monthly data (right) highlight relative movements over a longer period of time.

		Growth						Defensive		
	SP500	INFT	FINL	ENRS	MATR	INDU	COND	CONS	HLTH	UTIL
6/23/2011	**1.0**	1.1	0.5	-1.1	0.9	2.6	3.0	0.1	1.2	0.1
6/24/2011	**-0.3**	-0.7	-1.2	-1.6	0.9	1.3	2.2	-0.9	-0.4	-0.1
6/27/2011	**-0.6**	-0.6	-0.6	-2.9	-0.8	0.4	1.7	-1.5	-0.7	0.3
6/28/2011	**2.5**	2.6	2.0	2.0	3.3	3.3	5.1	0.3	2.1	2.0
6/29/2011	**3.1**	3.7	3.6	2.9	5.9	3.5	5.8	0.0	2.0	1.6
6/30/2011	**3.9**	5.4	3.0	4.7	7.3	4.8	6.0	0.3	2.1	1.4
7/1/2011	**4.8**	6.9	4.9	5.3	7.5	5.8	7.2	0.4	2.3	2.0
7/5/2011	**3.3**	5.0	2.6	3.9	4.9	3.6	5.5	0.4	1.4	1.4
7/6/2011	**4.0**	6.4	2.7	4.2	5.6	4.7	6.0	1.7	2.3	2.2
7/7/2011	**5.4**	7.0	5.3	6.8	7.3	6.1	7.0	3.3	2.3	3.5
7/8/2011	**5.9**	8.5	4.7	8.2	7.2	6.1	7.4	3.7	3.2	2.9
7/11/2011	**3.1**	5.1	0.6	5.2	4.8	3.2	4.0	2.5	1.2	1.0
7/12/2011	**1.3**	2.8	-0.1	2.1	2.7	0.7	1.7	1.8	-0.2	1.0
7/13/2011	**0.8**	2.3	-2.0	1.7	1.9	0.6	1.8	1.4	0.0	0.3
7/14/2011	**-0.9**	-0.1	-3.1	-0.3	-0.3	-2.0	0.1	0.0	-0.5	-0.5
7/15/2011	**-1.8**	-0.3	-5.0	1.1	-0.3	-3.6	-1.8	-0.5	-2.2	-1.6
7/18/2011	**-2.4**	-0.8	-5.5	0.2	-1.6	-4.1	-3.2	-1.0	-2.6	-1.9
7/19/2011	**-0.9**	1.4	-3.7	2.0	-0.5	-3.4	-1.0	-0.1	-2.0	-1.3
7/20/2011	**-2.0**	-0.5	-4.2	0.3	-2.0	-4.1	-2.8	-1.2	-2.3	-1.1
7/21/2011	**0.0**	0.5	-0.5	3.0	-0.2	-1.6	-1.1	-0.1	-0.4	0.8
7/22/2011	**1.9**	3.6	2.1	5.7	1.4	-0.7	1.3	0.4	0.8	1.3
7/25/2011	**1.8**	4.4	1.5	5.5	1.5	0.2	1.1	-0.2	-0.3	1.2
7/26/2011	**1.1**	4.6	1.2	4.2	-0.4	-2.1	0.4	-0.5	-1.4	1.0
7/27/2011	**-0.3**	2.4	-0.4	2.8	-1.8	-3.8	-0.6	-1.1	-3.0	1.1
7/28/2011	**-1.2**	1.0	-0.1	-0.2	-2.9	-4.7	-1.2	-1.3	-2.6	0.2
7/29/2011	**-1.0**	0.5	1.0	-0.9	-2.9	-4.1	-0.6	-1.3	-2.3	0.2
8/1/2011	**-3.8**	-3.3	-1.1	-3.4	-5.3	-6.7	-4.0	-3.7	-5.6	-0.8

*Trailing 2 week return
Green shading represents relative outperformance; red underperformance

		Growth						Defensive		
	SP500	INFT	FINL	ENRS	MATR	INDU	COND	CONS	HLTH	UTIL
Aug-08	**-8.4**	-8.6	-14.3	-12.8	-12.2	-9.5	-5.7	-1.3	1.7	-9.0
Sep-08	**-8.9**	-12.1	-0.1	-24.9	-22.9	-9.1	-1.0	4.1	0.0	-18.7
Oct-08	**-23.6**	-26.8	-27.7	-28.5	-37.4	-27.6	-20.4	-10.3	-16.0	-23.6
Nov-08	**-30.1**	-36.5	-40.5	-27.6	-42.8	-34.2	-32.9	-14.3	-23.3	-20.3
Dec-08	**-22.6**	-26.0	-37.6	-21.0	-31.4	-24.7	-23.4	-13.5	-12.7	-11.9
Jan-09	**-14.7**	-12.7	-40.7	-6.7	-18.3	-18.8	-15.3	-10.2	-2.3	-0.9
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

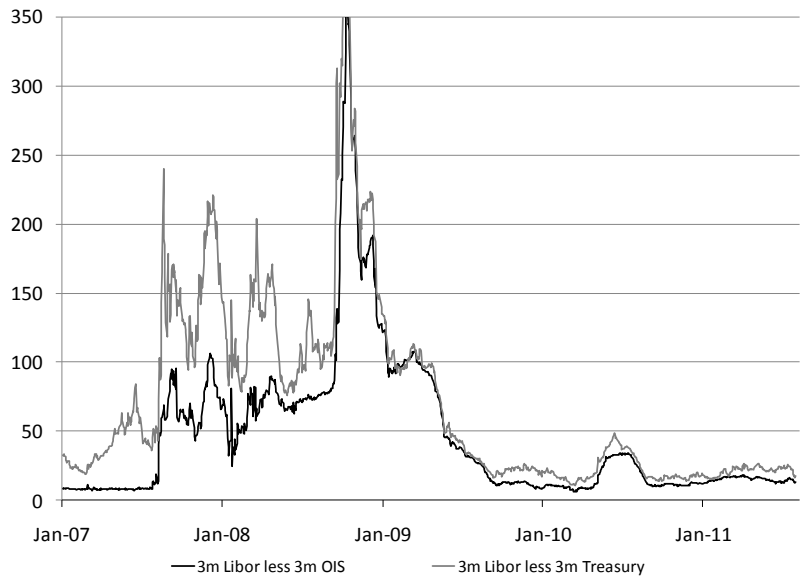
*Trailing 3 month return
Green shading represents relative outperformance; red underperformance

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 16: USD Libor-OIS, TED Spread (bps)



Little sign of significant strains in the credit market, but there are plenty of potential pitfalls – most notably of course, the European and US debt situations.

Chart 17: 10yr Swap Spread (bps)

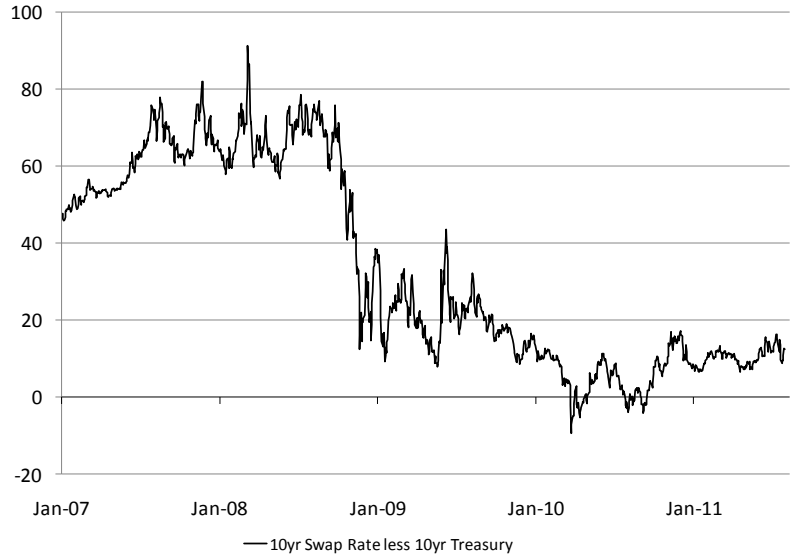
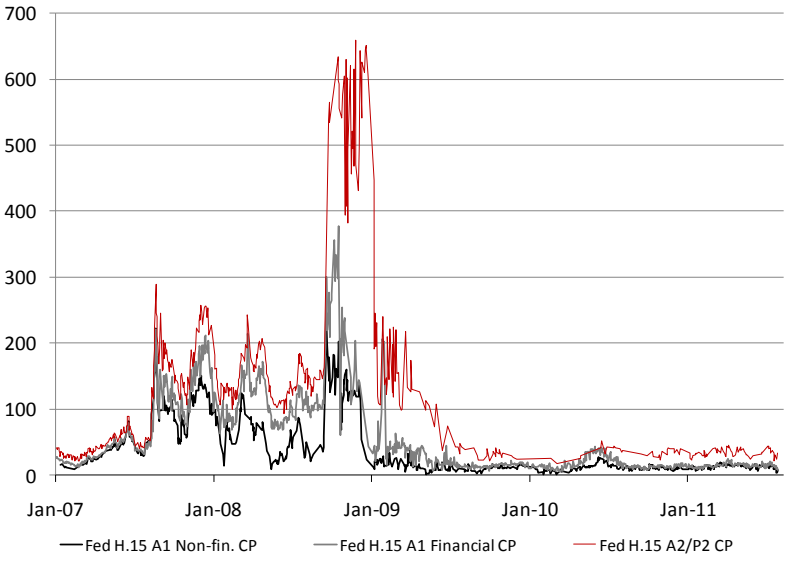


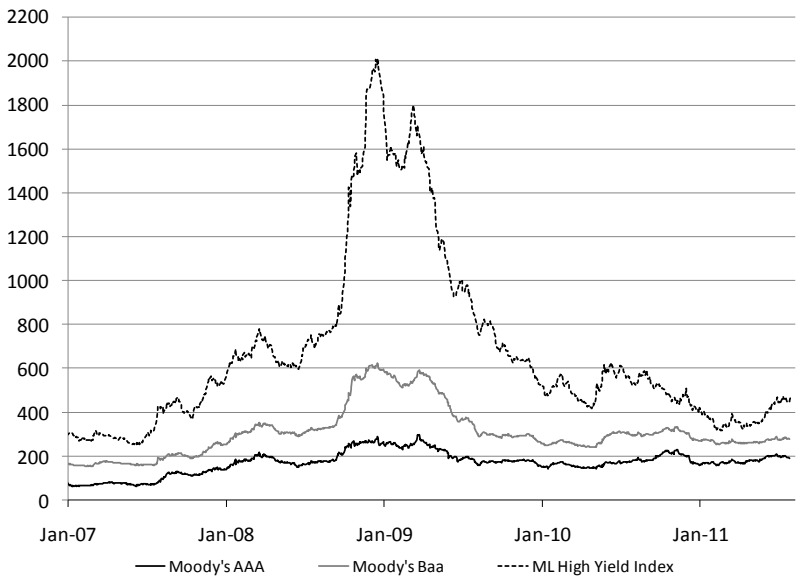
Chart 18: 90D Commercial Paper Spread to Treasury Bill (bps)



Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Credit Conditions, Quality Spreads*

Chart 19: Corporate Spreads to 10yr Treasury (bps)



Relative to higher-quality issues, high yield bonds had so far seen the most significant recovery relative to pre-crisis levels as investors searched for income.

Worries about credit risk are rising, though spreads are still narrower than those seen in early 2010.

Chart 20: Spread to Treasury (Ratio, May 2007 = 1.0)

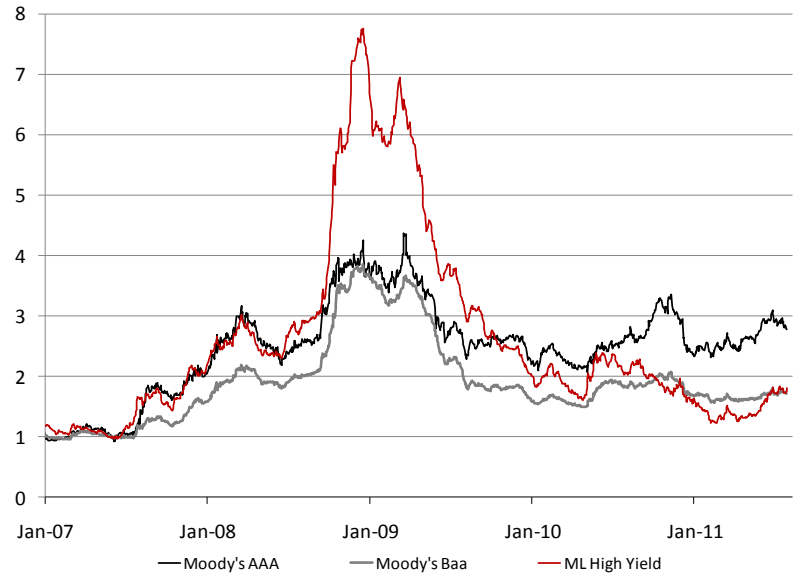
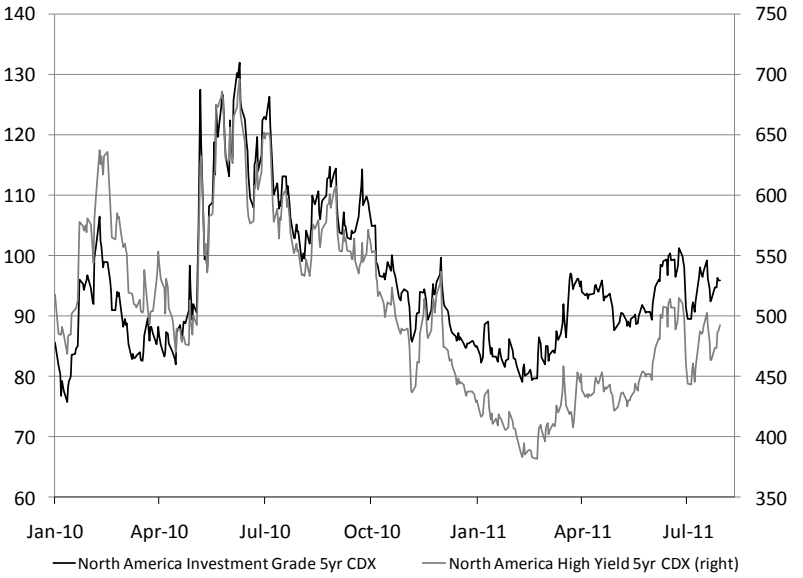


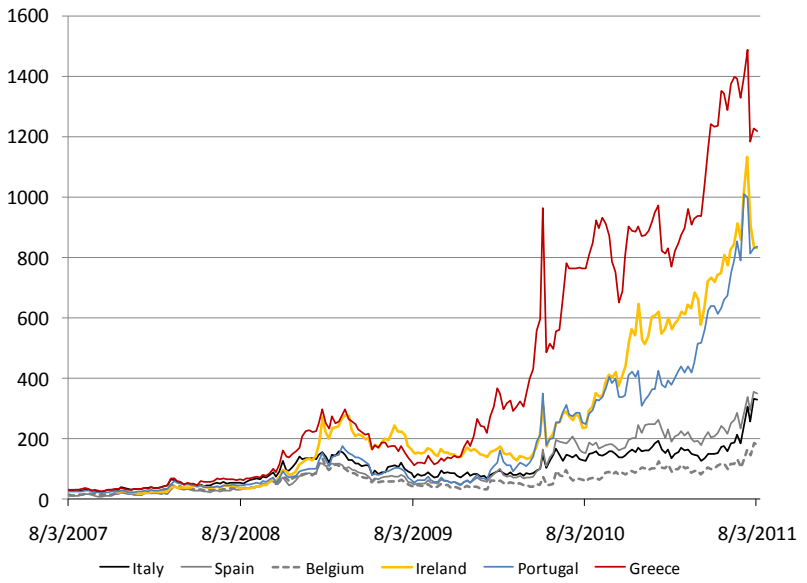
Chart 21: Markit CDX Indices



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

Decision Economics: *Global Sovereign Spreads*

Chart 22: 10yr Spread to German Bund, Weekly (bps)



Short-term fixes or long-term solutions to debt crisis in the Eurozone? So far, the former.

Italy, Spain, Belgium still seeing spreads widen as investors bet the current bailout plan is still insufficient.

Chart 23: G7 - 2yr Yield Spreads to US Treasury, Weekly (bps)

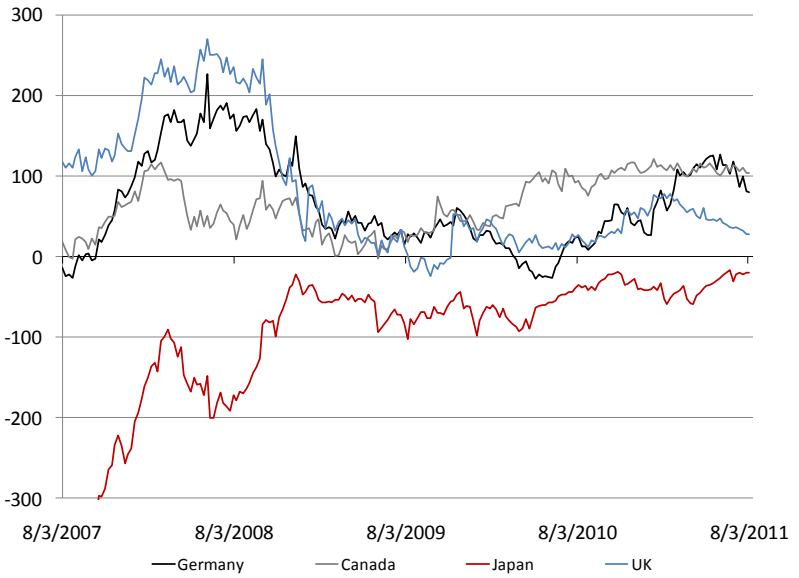
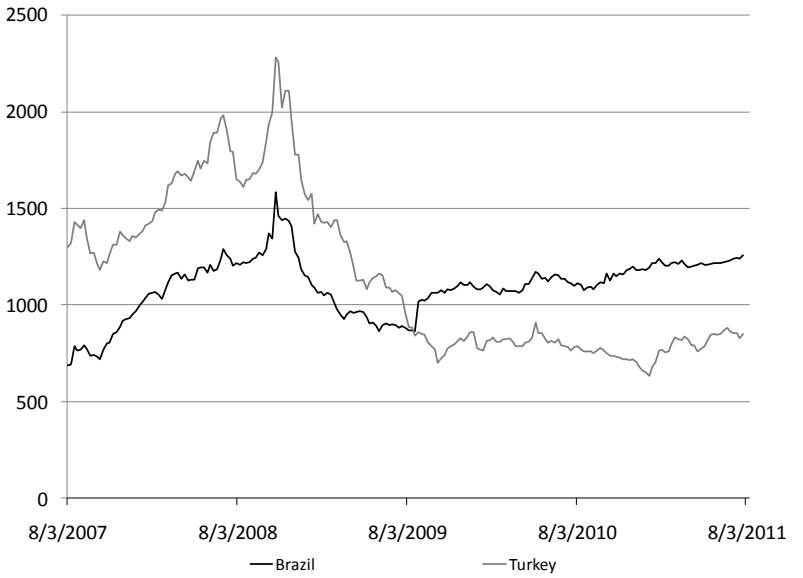


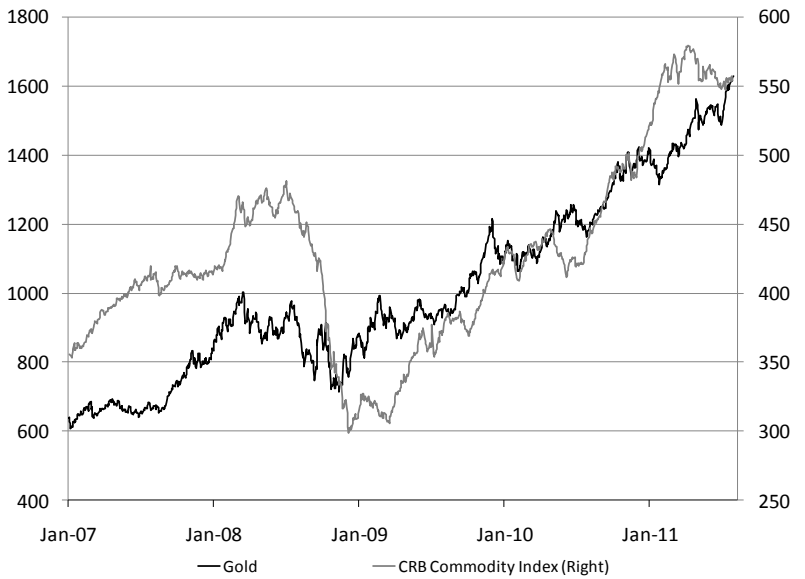
Chart 24: Emerging Mkts - 2yr Spreads to US Treasury (bps)



Sources: Bloomberg and Decision Economics, Inc

Decision Economics: *Commodities, Gold, the Dollar*

Chart 25: CRB Commodity Index (bps)



Broad commodity indices flatten, gold hits new highs in dollar terms.

Nominal oil prices are high, but not when priced in gold.

Dollar hits new lows in real terms.

Chart 26: WTI Crude Priced in Dollars, and Gold

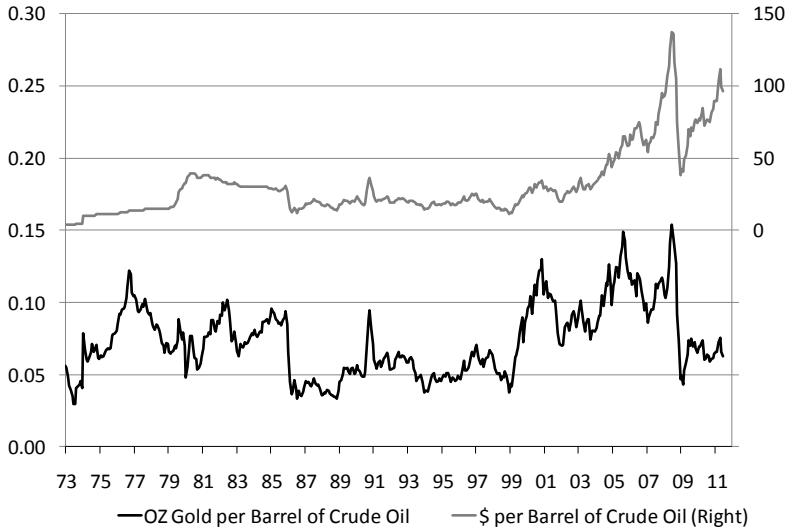
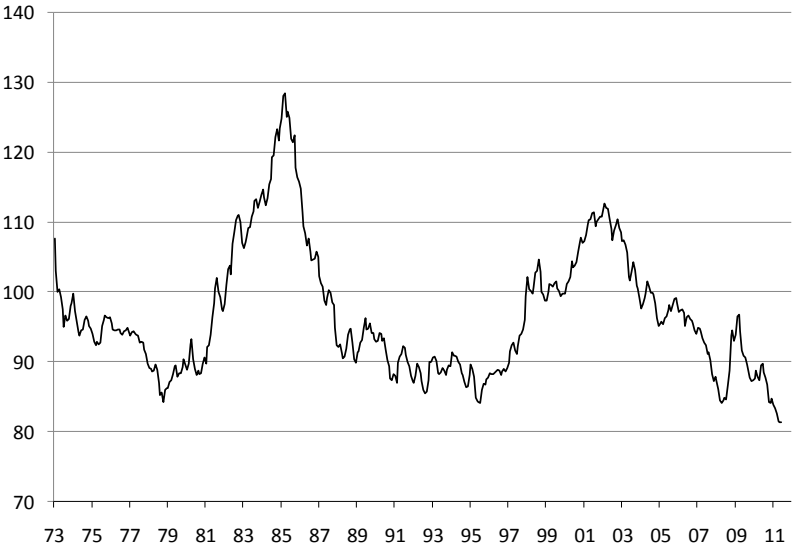


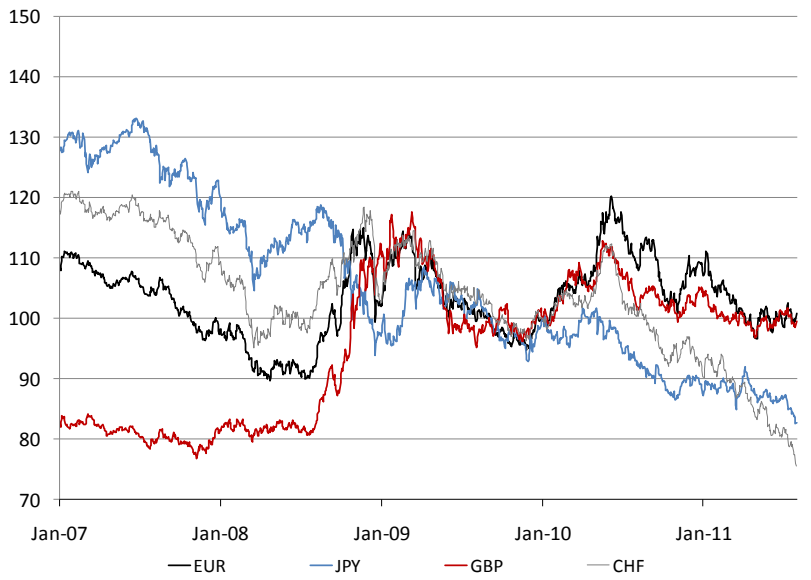
Chart 27: Real Trade-Weighted Broad Dollar Index (1973=100)



Sources: Bloomberg, FRB, and Decision Economics, Inc

Decision Economics: *Currencies Versus the US Dollar*

Chart 28: Dollar Performance (Dec 2009 = 100)



Basket of fiscally-sounder, 'commodity-currencies', and gold a better store of value than the USD.

USD will hold "crisis" currency status, until it doesn't.

Chart 29: Dollar Performance (Dec 2009 = 100)

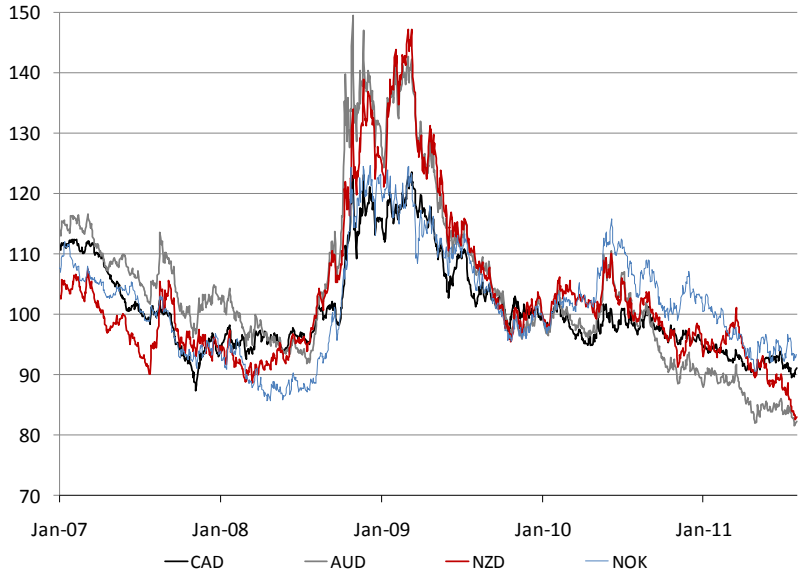
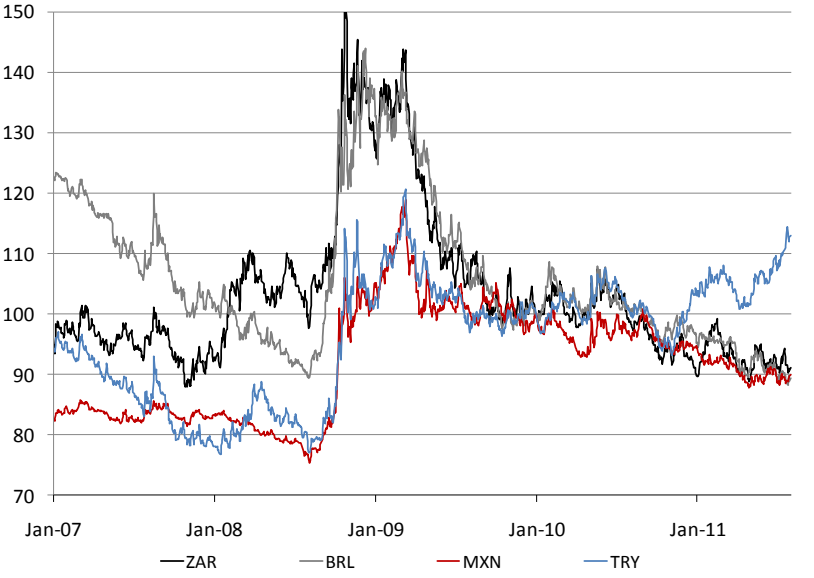


Chart 30: Dollar Performance Against Emerging Market Currencies (Dec 2009 = 100)



Sources: Bloomberg and Decision Economics, Inc