

OCTOBER 2011		
Market Index	October Change	Year to Date
Standard & Poor's 500	10.9%	1.3%
Dow Jones Industrial Average	9.7%	5.4@
Russell 2000 (small company)	15.1%	-4.5%
MSCI EAFE (international)	9.6%	-6.4%
Barclays Intermediate Gov/Credit Index	0.3%	5.2%
3-Month Treasury Bill	0.0%	0.1%

After five volatile and painful months in which the S&P 500 Index declined over 16%, investors enjoyed a record-setting October. The S&P 500 posted its largest monthly percentage gain (10.9%) since December 1991, and the Dow Jones Industrial Average gain of 1,042 points was its largest ever. The rally was driven primarily by three factors: reduced recession fears as a result of improving economic data, relatively strong corporate earnings, and perceived progress in the efforts to resolve the European debt crisis. However, a sharp selloff on the last day of October and first day of November served as a reminder of the many risks confronting investors. The bond market recovered at the end of the month as a result of these fears, erasing earlier losses to end the month slightly positive.

The month was the first since October 2006 in which the S&P 500 Index did not post 2 consecutive days of declines, which was a nice reprieve for investors still reeling from the recent volatility. The rally was broad-based, as all 10 sectors and 127 of 129 sub-industries rose in October, with cyclical sectors such as materials, energy, financials, and industrials leading the way. Commodities mostly rose in the month, led by crude oil (18%) and copper (15%). Gold rose 6% in October, and has now jumped 21% in 2011.

During the month there was modest improvement in economic data and fears of a new recession began to fade. U.S. GDP grew by 2.5% in the third quarter, and job growth data showed some mild improvement. Vehicle sales were strong, and manufacturing data were encouraging. Retail sales were also resilient despite lower levels of consumer confidence. While the U.S. economy continues its slow recovery, the outlook for global economic growth remains weaker. Many of the developed countries are exhibiting minimal growth or are even tipping into recession, and there are worries of a slowdown in some emerging markets, which in past years have been important drivers of global growth.

There was some speculation during the month that the Federal Reserve (Fed) would implement a third round of quantitative easing (QE 3.0) in the near future in a further attempt to stimulate the economy. The program's success of boosting the real economy has been limited, but it has provided a boost to riskier assets in the first two rounds. Just the hint of that program's continuation can move the markets in the short term. Also, the Fed once again urged leaders in Washington to implement fiscal policy reforms to speed the recovery. That places more pressure on the bipartisan deficit "super committee" which will soon propose budget reforms aimed at easing the nation's debt burden and enacting sustainable fiscal policy.

Another bright spot during October was the continued health of many corporations. So far corporate earnings reports for the third quarter have been better than expected, although the outlook given by companies has been somewhat mixed. The quarter is on pace to mark the S&P 500's eleventh consecutive positive earnings surprise, but the strength of revenue and earnings growth is likely to be lower than in past quarters. Corporations are seeing some underlying strength in their businesses but remain cautious due to the macro-economic and political concerns dominating the headlines. Many are reluctant to hire new workers until they receive more clarity on the domestic economic recovery, government policies, and the situation in Europe.

The focus on Europe continued in October, and some progress toward a potential solution aided the stock market rally. However, skepticism abounds regarding the ability of Euro area leaders to fully resolve the crisis in an orderly manner. The market rallied sharply at the end of the month after a new plan was unveiled only to sharply pull back in subsequent days after concerns arose regarding the specifics. Some of the main issues that need to be settled are the terms of a Greek bailout, the level of recapitalization of European banks, and the structure of the "bailout" fund (the European Financial Stability Fund). Highlighting the uncertainty of the situation, the Greek ruling party unexpectedly called for a public referendum on the bailout plan but then quickly reversed course under international pressure. Sharp divisions remain between many Europeans as governments grapple with restoring fiscal health without stunting economic growth, and popular unrest continues against proposed and enacted austerity measures. There is still a long way to go before the crisis is resolved, so the tame levels of volatility experienced in October probably will not last.