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# INSIGHTS

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# 2012 Q3 Market Recap

*Written on September 30, 2012 with the S&P at 1440.*

**RECAP:** In the third quarter, stocks not only reversed the Q2 downward trend but also recouped all earlier losses from 2012. Stocks pushed through recent highs and continued their advance, elevating the bull market to price levels last seen in January 2008. The S&P 500 finished the quarter below its highest levels but still up over 6% (78 points) at 1,440.

The equity market's recent strength can be attributed largely to policy rather than underlying fundamentals. Mediocre economic data (the latest Q2 GDP estimate came in at 1.3%) was brushed aside and the equity market instead looked to the actions of global central banks. In late July, the president of the European Central Bank, Mario Draghi, pledged to do "whatever it takes" to save the Euro. In mid-September, the Fed launched "QE3", the third round of Quantitative Easing (attempts to stimulate the economy by buying fixed income assets to lower interest rates). Chairman Bernanke's latest efforts had some new wrinkles—short-term interest rates are now pledged to remain low through 2015, bond purchases will focus on mortgages rather than Treasuries, and, unlike prior QEs, this latest bond buying is both unlimited and open-ended. In response, some pundits are referring to the program as "Q-*Eternity.*"

Investors that followed the long-held market axiom "Don't fight the Fed" were rewarded as global pledges of additional stimulus (Europe, U.S., Japan, Australia, China, Brazil, and India are all engaging in various forms of economic stimulus) trumped a sluggish global economy.

| | Notable Sectors | Q3 | YTD |
|---|---|---|---|
| Stocks | Global Equity | 6.84 | 12.88 |
| | U.S. S&P 500 (Large Cap) | 6.35 | 16.44 |
| | U.S. Russell 2000 (Small Cap) | 5.25 | 14.23 |
| | International Equity | 7.40 | 10.38 |
| | Emerging Markets Equity | 7.74 | 11.98 |
| Bonds | Global Bonds | 3.27 | 4.82 |
| | U.S. Aggregate (High Quality) | 1.58 | 3.99 |
| | U.S. High Yield (Low Quality) | 4.53 | 12.13 |
| | International Aggregate | 4.37 | 5.18 |
| | Emerging Market Debt | 6.84 | 14.13 |
| Other | Gold | 10.58 | 13.22 |
| | Oil | 8.51 | -6.72 |
| | Inflation | 0.11 | 1.80 |

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**EQUITY:** All of the major US indices posted gains in Q3 and are up double digits for the year. Some trends continued (large caps once again outperformed small caps) while others reversed (overseas markets finally outpaced the U.S. after several quarters of underperformance). Growth and value stocks performed similarly but individual sectors varied significantly—offensive sectors outperformed defensive sectors with energy leading the way. However, the rising tide of the bull market did not lift all boats. Due to fears of a prolonged European recession and a softening Chinese economy, equities tied to strong global demand (Brazil, China, coal, steel, and Industrials) lagged.

**FIXED INCOME:** The Fixed Income market behaved in line with the equity market as "riskier" fare outperformed more "safe and stable" sectors. High yield and Emerging market debt in particular outpaced U.S. Treasuries as well as other high-grade sovereign debt markets (Germany, etc.). The yield on the 10-Year Treasury Bond gyrated throughout the quarter setting a record low yield of 1.38% but ended Q3 virtually where it began, near 1.65%. If inflation stays near 2%, Treasury investors will be accepting *negative nominal rates of return* in exchange for holding "safe" securities—only time will tell whether "safe" should indeed be in quotes.

**ALTERNATIVES:** The QE extension not only sparked inflation fears but also drove the U.S. Dollar down towards its lowest points of 2012. Real assets were the beneficiary. Gold rallied and was one of the best performing assets in the quarter while other "real assets" such as Commodities (including Oil) and Master Limited Partnerships posted near double digit returns.

**OUTLOOK:** Focus will shift to Washington D.C. in the upcoming quarter with the Congressional and Presidential elections. In December, the spotlight will shift from monetary policy to fiscal policy as Congress reconvenes to resolve or at least provide clarity on the upcoming year-end fiscal cliff.

Historically, Q4 on average has been by far the strongest quarter of the year. Over the last 100 years, the Dow Jones Industrials has averaged a Q4 gain of over 2% with positive returns 67% of the time. Over the last 50 years, the numbers are even stronger—nearly 3.5% gain with positive returns 76% of the time. Over the last 20 years, the numbers are very bullish with the Dow up over 5% with positive returns 80% of the time. Although past performance is not necessarily indicative of future results, for the upcoming quarter, when news may turn dire, it is encouraging to remember that we are in a friendly time for capital markets.

For additional copies of *Insights* or the *SEIA Report* please contact Allison Crandall at (800) 723-5115.

We at SEIA thank you for your continued support.

Sincerely,
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