

WEEKLY Market Update

FEBRUARY 21, 2012

Recap for the week ended February 17, 2012



MOODY'S CAUGHT THE MARKET'S ATTENTION WHEN IT ANNOUNCED THAT IT MAY DOWNGRADE 17 GLOBAL AND 114 EUROPEAN FINANCIAL INSTITUTIONS.

The rating agency said some entities may be cut by as many as three notches citing new capital requirements and regulatory challenges, which could cut future growth. Spreads on corporates in the financial sector widened on the news, but narrowed by the end of the week following the announcement. **NEWS FOR THE WEEK UNDERSCORED THE EXPECTATION THAT THE U.S. ECONOMY WILL CONTINUE TO IMPROVE.** Coming in at 348,000, the number of initial jobless claims dropped for the third week in a row. The reading was the lowest since 2008. Housing starts rose more than expected to a 699,000 annual rate. Building permits, an indicator of future construction, also climbed. Despite the strong housing indicators, there remains a glut of houses in foreclosure, which continues to weigh on the housing sector.

INFLATION IS RISING, BUT APPEARS UNDER CONTROL, for now. Month over month, the all-items and core consumer price indices both rose 0.2%. However, the core reading was 2.3% for the past 12 months, the most since a 2.5% increase for the 12 months ended September 2008.

Congress extended the payroll tax cut and unemployment benefits for millions of Americans through the rest of the year. The extension will continue to provide a \$1,000 tax break for the average worker and is designed to help bolster the economy by keeping cash in the pockets of consumers. **THE LACK OF A BILL COULD HAVE SHAVED OFF ABOUT 0.4% OF GROWTH IN U.S. GDP IN 2012.**

After months of haggling, the euro zone agreed on a deal to secure the needed €130 billion bailout and debt-restructuring for Greece. **ALTHOUGH THE AGREEMENT EFFECTIVELY REDUCES THE LIKELIHOOD OF A GREEK DEFAULT IN THE NEAR TERM, CONSIDERABLE DOUBT EXISTS ABOUT GREECE'S SOLVENCY IN THE LONG RUN.**

The stock market continues its relentless rally. The Dow rose 1.3% for the week and nearly 6.5% year-to-date. The S&P rose 1.48% on the week and 8.56% for the year. **MOST INVESTORS BELIEVE THE CURRENT EQUITY RALLY HAS MORE STEAM.**

IN THE FIXED-INCOME MARKET, HIGH-YIELD BONDS AND INVESTMENT-GRADE CORPORATES WERE THE BEST PERFORMERS, EARNING MONTH-TO-DATE EXCESS RETURNS OF 1.69% AND 0.95%, RESPECTIVELY. During the week, Treasury yields rose across the curve by four to six basis points, reflecting positive economic news and progress in Greece.

RATE CHANGES

UST MATURITIES	2/17/12	2/10/12	12/31/11	12/31/10	1Q12 CHG BPS	2011 CHG BPS
3 month	0.08%	0.08%	0.01%	0.13%	+7	-12
2 year	0.29%	0.28%	0.24%	0.60%	+5	-36
5 year	0.86%	0.82%	0.83%	2.01%	+3	-118
10 year	2.00%	1.99%	1.88%	3.30%	+12	-142
30 year	3.15%	3.14%	2.90%	4.34%	+25	-144
2y-30y slope	+286	+287	+265	+374	+21	-109
3 month LIBOR	0.49%	0.51%	0.58%	0.30%	-9	+28
10 yr swap spreads	0.08%	0.09%	0.17%	0.09%	-9	+8

Source: Bloomberg, Conning Analytics

BOND MARKET TOTAL RETURN PERFORMANCE

	FEB '12 EXCESS	FEB '12 NOMINAL	2012 EXCESS	2012 NOMINAL
U.S. Corp HY	+1.69%	+1.12%	+4.29%	+4.19%
Muni (TE)	N/A	+0.11%	N/A	+2.56%
CMBS	+0.58%	+0.17%	+2.22%	+2.22%
U.S. Corp IG	+0.95%	-0.22%	+2.72%	+1.99%
ABS	+0.11%	-0.31%	+0.95%	+0.84%
Aggregate	+0.38%	-0.39%	+0.89%	+0.48%
MBS	+0.38%	+0.03%	+0.51%	+0.44%
Agency	+0.05%	-0.39%	+0.33%	+0.15%
USTs	N/A	-0.96%	N/A	-0.54%

Source: Barclays Capital

EQUITY, CURRENCY AND COMMODITY CHANGES

	2/17/12	2/10/12	12/31/11	WEEKLY CHG	2012 CHG
S&P 600 Small Cap	462	453	415	+1.96%	+11.37%
MSCI EAFE	1,548	1,525	1,413	+1.65%	+9.84%
S&P 500	1,361	1,343	1,258	+1.48%	+8.56%
DJIA	12,950	12,801	12,218	+1.31%	+6.44%
Gold (per troy oz)	\$1,723	\$1,722	\$1,564	+0.1%	+10.2%
WTI Crude Oil (\$/bbl)	\$103.24	\$98.67	\$98.83	+4.6%	+4.5%
Yen per USD	79.55	77.61	76.91	+2.5%	+3.4%
USD per Euro	1.31	1.32	1.30	-0.4%*	+1.4%*

* -% = USD strengthening versus Euro

Source: Bloomberg, Conning Analytics
Equity index returns include dividend reinvestment

SECTOR STRATEGY SUMMARY

ASSET CLASS	BIAS
U.S. Treasuries	Underweight
U.S. Agencies	Underweight
Investment Grade Corporates	Overweight
High Yield Corporates	Overweight
Municipals	Overweight
Commercial MBS	Marketweight
Asset-Backed Securities	Marketweight
Mortgage-Backed Securities	Marketweight
Duration Stance	Short

Source: Conning's February Strategy Meeting

MAJOR U.S. ECONOMIC RELEASES

MONDAY, 2/20

No Releases

TUESDAY, 2/21

No Releases

WEDNESDAY, 2/22

Existing Home Sales (Jan)

THURSDAY, 2/23

Initial Jobless Claims (Weekly)
Continuing Claims (Weekly)
House Price Index (Dec)

FRIDAY, 2/24

U. of Michigan Confidence (Feb)
New Home Sales (Jan)

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