

# Equity Markets Overview & Outlook

September 30, 2011



## Q: How did stocks perform during the quarter?

**A:** Stocks sold off sharply during the third quarter, as investors reacted to an assortment of troubling news. Weak economic data, including a first-half GDP<sup>1</sup> growth rate of only 0.8%, an unemployment rate stuck at 9.1%, and a still-depressed housing market, combined with rising inflation led to renewed fears of a double-dip recession. In addition, sovereign-debt problems in the United States and Europe contributed to the negative sentiment. In the United States, a late-July Congressional battle over raising the nation's debt ceiling culminated in Standard & Poor's (S&P) stripping the United States of its stellar credit rating. This early-August move marked S&P's first-ever downgrade of the U.S.'s "AAA" credit rating since the credit-ratings firm awarded it in 1917. Investors reacted to the news somewhat ironically—they fled stocks and other "risk" assets in favor of the relative safety of U.S. Treasury securities. At the same time, mounting sovereign-debt problems in Greece and other European nations led to concerns about the health of the entire European Union banking system, which contributed to the widespread risk aversion and global selloff in stocks.

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## Q: Where did investors find the best opportunities?

**A:** In general, market sectors with the least sensitivity to economic conditions performed the best during the quarter. Within the S&P 500 Index, the defensive utilities sector was the only one of the index's 10 sectors to post a positive return for the three-month period, gaining 1.55%. The consumer staples sector, also a traditionally defensive market segment, followed with a return of -4.19%. In terms of equity styles, large-cap stocks generally outperformed mid- and small-cap stocks. Growth stocks outperformed value stocks in the large-cap universe but underperformed in the mid- and small-cap areas.

## Q: What were the key challenges in this environment?

**A:** Stocks generally correlated to economic growth, including those in the materials, industrials, financials and energy sectors, were among the weakest market performers during the quarter, with declines of more than 20%. Concerns about the overall health of the global economy weighed on these economically sensitive sectors. In addition, fears of a sovereign-debt default in Greece and its impact on European banks sent shockwaves rippling through the global financial sector. Furthermore, while oil prices remained

## Keys to Watch

- Economic growth data
- Unemployment rate
- Europe's debt crisis

relatively high during the quarter, they continued to fall from recent highs, which caused additional problems for the energy sector.

## Q: What is your outlook for stocks?

**A:** There is a long list of reasons to be pessimistic regarding the economic growth and financial market outlooks. Nevertheless, valuations in the stock have returned to levels that provide investors some downside protection. Unlike the beginning of the year, when a continuous stream of good economic news was necessary to sustain stretched valuations, the markets now appear primed to rise from any improvement in financial results, potential policy surprises out of Washington, D.C., on entitlement reform or pro-growth deficit reduction, or solutions from European policymakers on solving Europe's sovereign debt problems.

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<sup>1</sup> The Gross Domestic Product (GDP) is the measure of the market value of the goods and services produced by labor and property in the United States.

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