Weekly Market Update – Week Ending January 27, 2012

Sacrificing Purchasing Power

Federal Reserve chairman Ben Bernanke delivered a blunt message to investors who seek safety and liquidity: be patient when waiting for returns. Mr. Bernanke announced that the central bank will likely keep short-term interest rates low for the foreseeable future, possibly until 2014. This policy means that a portfolio of very high-quality, short-term, fixed-income investments, such as U.S. Treasury Bills, might lose money if inflation persists. When inflation-adjusted U.S. Treasury rates turn negative, as they are now, investors are sacrificing purchasing power for the privilege of owning these investments. The Federal Reserve has kept interest rates near zero to support the economy since the credit crisis broke in late 2007. The central bank hopes that low interest rates will encourage businesses and individuals to spend and invest.

Key Economic Release

The economy grew 2.8% during the fourth quarter; 1.9% of the gain came from inventory building.

On Friday, the Commerce Department released a relatively weak report of economic growth for the fourth quarter 2011. The economy grew at an annualized rate of 2.8%, the first time economic growth has exceeded 2.0% since the second quarter 2010.[1] However, despite the surge in fourth quarter growth, GDP fell short of economists' expectations and the long-term historical growth rate of 3%. The report revealed significant weakness because much of the growth was driven by two presumably temporary factors. Roughly 60% of the growth stemmed from inventory building while much of the remainder was an increase in consumer spending largely on autos (likely due to pent up demand). Moving forward, the absence of these temporary factors might slow GDP growth as companies struggle to clear goods from their shelves. For the full year of 2011, GDP growth posted a meager 1.7%, coming in far lower than 2010's 3.0% rate.

The weak economic report re-enforced the prospect for continued low short-term interest rates because it validated the Federal Reserve's premise of weak growth. The Federal Reserve projected growth ranging from 2.3% to 2.6%; this range falls below the historical trend of 3%. The Federal Reserve stated that short-term interest rates might stay close to zero if slow economic growth persists. Mr. Bernanke and the Fed took a historic step last week for the first time setting a target for inflation of 2% but acknowledged that the Federal Reserve might tolerate higher inflation: "If there is a need to let inflation return a little bit more slowly to target to get a better result on unemployment then that is something that we would be willing to do."

The Federal Reserve's near zero interest rate policy since 2008 has subjected U.S. Treasury Bills to losses after inflation. Investors have historically considered U.S. Treasury Bills among the safest investments based on the perceived credit strength of the U.S. Federal Government and short maturity (under one year). Since 2007, 90-day US Treasury Bills have sustained a cumulative inflation-adjusted loss of 5%. As noted above, the central bank has signaled that near-zero rates might persist with inflation close to 2%. This scenario would mean continued inflation-adjusted losses for U.S. Treasury Bills. The prospect of persistent losses for such a defensive investment illustrates the extraordinary challenge that investors face.

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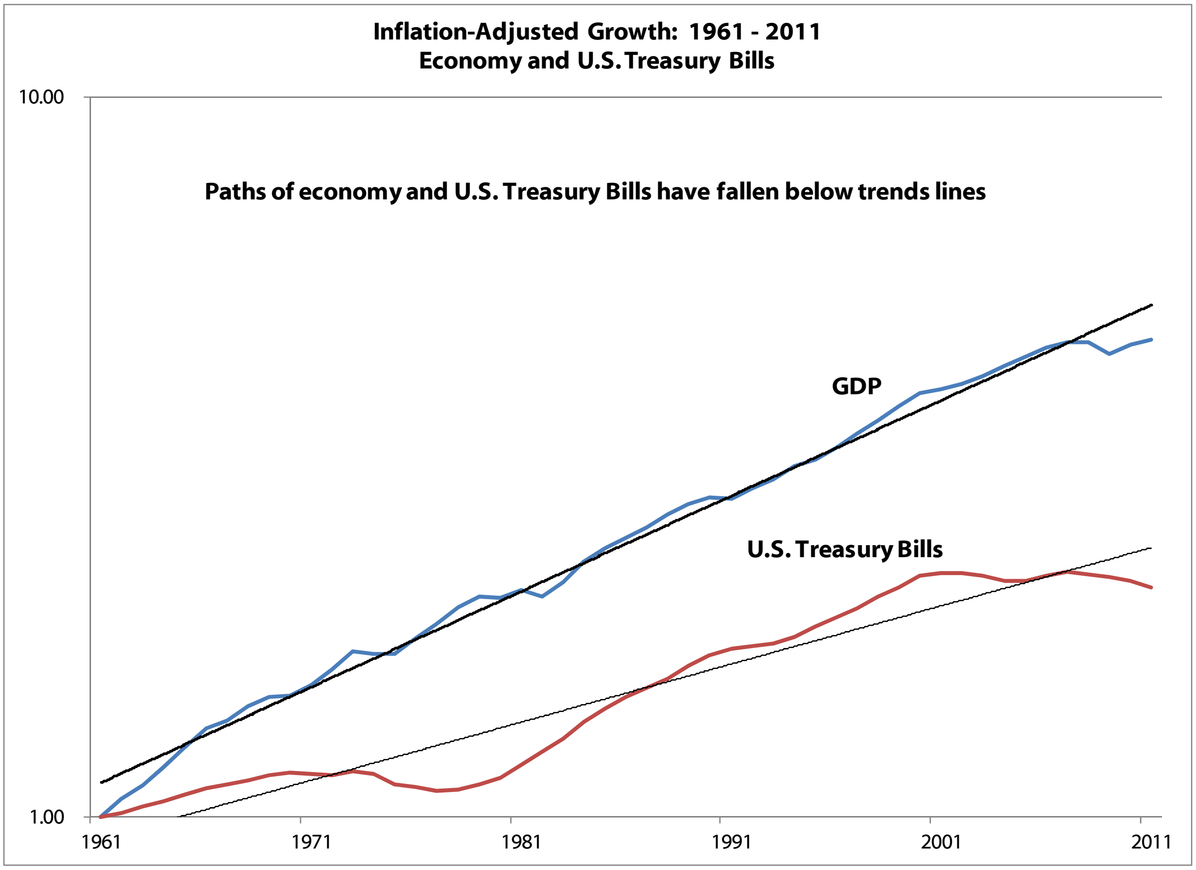
[1] *http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm*

The following chart shows the long-term performance of the economy and U.S. Treasury Bills.



Periods as of January 27, 2012	Week	Month to Date	Quarter to Date	Year to Date
MSCI All Country World Index	1.04%	6.15%	6.15%	6.15%
S&P 500 Index	0.09%	4.79%	4.79%	4.79%
Russell 2000 Index	1.83%	7.87%	7.87%	7.87%
MSCI EAFE Index	1.63%	5.96%	5.96%	5.96%
Barclays Capital Aggregate Index	0.61%	0.51%	0.51%	0.51%
MSCI REIT Index	3.26%	6.83%	6.83%	6.83%
DJ-UBS Commodity Index	3.81%	4.23%	4.23%	4.23%
Index Sources: Standard & Poor's, Russell, MSCI Barra, Barclays Capital, Dow Jones, UBS				

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