Highlights of October 2008

- Financial markets have continued to be driven more by emotions than fundamentals
- Policymakers globally are pulling out all the stops to stabilize the financial system
- Commodity prices have collapsed as fears of weak demand have swamped constraints on supply
- The U.S. economy continued to struggle in October 2008
- Short-term bank borrowing rates fell from historic highs, potentially signaling an easing in the credit markets

Financial markets have continued to be driven more by emotions than fundamentals

- **Global Market Performance:** The U.S. equity market, as measured by the S&P 500 index, dropped by 16.79% in October. This was the largest monthly drop in 20 years. Emerging market stocks lost the most during the month, 27.35%, followed by developed foreign equity markets which lost 20.17%. For the 12 months ending October 2008, emerging markets lost a shocking 56.22%. Refer to Table 1 and Chart 1 for trailing returns across all markets.

- **U.S. Equity Market Decline:** The S&P 500 index has declined approximately 47% from its October 2007 peak. This is similar to the level of decline seen in previous major recessions, such as 1972-1974. In terms of length of declines, market declines in deep recessions have lasted 18 to 24 months. This decline is now 13 months old.

- **Value vs. Growth:** Value continues to have a winning streak over growth in this down market. Both large and small-cap value performed better than their respective growth counterparts with large-cap value leading the pack.

- **Bond Markets Feel Equity Market’s Pain:** Parts of the fixed income market fell as much as equities in October. The Lehman U.S. High Yield Index lost 15.91% compared to the 16.79% drop in S&P 500 index.

### Table 1 - Index Performance for Periods Ending October 31, 2008

<table>
<thead>
<tr>
<th>Index</th>
<th>1 Month</th>
<th>3 Months</th>
<th>YTD</th>
<th>1 Year (annualized)</th>
<th>3 Year (annualized)</th>
<th>5 Year (annualized)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Large Cap (S&amp;P 500)</td>
<td>-16.79</td>
<td>-23.11</td>
<td>-32.84</td>
<td>-36.10</td>
<td>-5.21</td>
<td>0.26</td>
</tr>
<tr>
<td>Foreign Developed Markets (MSCI EAFE)</td>
<td>-20.17</td>
<td>-34.44</td>
<td>-43.25</td>
<td>-46.34</td>
<td>-4.83</td>
<td>4.04</td>
</tr>
<tr>
<td>Foreign Emerging Markets (MS EM)</td>
<td>-27.35</td>
<td>-44.83</td>
<td>-53.05</td>
<td>-56.22</td>
<td>-0.07</td>
<td>9.87</td>
</tr>
<tr>
<td>U.S. Mid Cap (Russell Mid Cap)</td>
<td>-22.35</td>
<td>-30.61</td>
<td>-37.50</td>
<td>-40.67</td>
<td>-7.06</td>
<td>1.76</td>
</tr>
<tr>
<td>U.S. Small Cap (Russell 2000)</td>
<td>-20.80</td>
<td>-24.48</td>
<td>-29.02</td>
<td>-34.16</td>
<td>-4.79</td>
<td>1.57</td>
</tr>
<tr>
<td>U.S. Large Cap Growth (Russell 1000 Growth)</td>
<td>-17.61</td>
<td>-26.36</td>
<td>-34.31</td>
<td>-36.95</td>
<td>-5.90</td>
<td>-1.29</td>
</tr>
<tr>
<td>U.S. Large Cap Value (Russell 1000 Value)</td>
<td>-17.31</td>
<td>-22.08</td>
<td>-32.90</td>
<td>-36.80</td>
<td>-5.24</td>
<td>1.90</td>
</tr>
<tr>
<td>U.S. Bonds (Lehman Aggregate)</td>
<td>-2.36</td>
<td>-2.76</td>
<td>-1.74</td>
<td>0.30</td>
<td>3.60</td>
<td>3.48</td>
</tr>
<tr>
<td>U.S. HY Bonds (Lehman High Yield)</td>
<td>-15.91</td>
<td>-22.35</td>
<td>-24.38</td>
<td>-25.81</td>
<td>-4.40</td>
<td>0.43</td>
</tr>
</tbody>
</table>

Source: SunAmerica and Wilshire Compass

Indices are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
Policymakers globally are pulling out all the stops to stabilize the financial system

- **Global Central Banks Coordinated Effort:** In an unprecedented move, the U.S. Federal Reserve Board, the European Central Bank, the Bank of England, and central banks of Sweden, Canada, and Switzerland cut interest rates in a coordinated effort to ease the global economic slowdown. The Federal Open Market Committee (FOMC) made a second rate cut in October, reducing the Fed Funds target to 1.0% on October 29.

- **Short-Term Financing Facilities:** The U.S. Federal Reserve took significant steps to allow foreign countries to continue to have access to foreign exchange currencies such as the dollar. In addition, the International Monetary Fund pledged a total of $188.2 billion for 16 emerging market countries and countries like Iceland that are experiencing financial difficulties.

- **Capital Injection for Financial Institutions:** The U.S. government will inject $250 billion into domestic financial institutions, including nine of the nation's largest banks, in exchange for equity stakes in those firms. Many other foreign governments are also directly and indirectly supporting the capital structure of their financial companies.

Commodity prices have collapsed as fears of weak demand have swamped constraints on supply

- **Commodity Prices During the Downturn:** During an economic slowdown, lower demand has always led to a sharp reduction in production and inventory requirements. This reduces the need for all types of energy and industrial materials, and usually leads to sharply lower commodity prices.

- **Commodity Prices Drop at Record Pace:** This downturn is no exception. Over the past few months, commodity prices have dropped faster and farther than ever before. From their peak in July 2008, commodity price indices have tumbled about 25% on average.

- **Oil Prices Take a Nosedive:** Oil prices fell by about one-third during October to end below $65/barrel. This represents less than half of July’s peak level of $147/barrel.

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**Chart 1 - Global Market Performance**

**Chart 2 - Short-term Borrowing Costs of Banks, Relative to Treasuries**

Source: SunAmerica and Wilshire Compass Website

Source: SunAmerica and Bloomberg website
The U.S. economy continued to struggle in October 2008

- **GDP in Negative Territory:** The economy contracted at 0.3% annualized rate in the third quarter. Consumer spending declined 3.1% in real terms, the largest drop since second quarter of 1980.

- **Labor Market:** September 2008 recorded the ninth consecutive monthly decline in payroll employment, and represented the largest one-month drop this year with 159,000 job losses. Unemployment continues to accelerate.

- **New Home Sales vs. Lower House Prices:** New home sales increased by 1.1% in September as lower house prices brought out more buyers. House prices were reported to be 16.6% lower in August 2008 compared to August 2007. The stock of unsold homes is declining, a necessary condition to stabilize home prices. However, it will be some time before home inventories are back to normal levels.

Short-term bank borrowing rates fell from historic highs, potentially signaling an easing in the credit markets

- **Normalcy in Short-Term Lending:** As credit conditions seized up earlier in the year, the rate that banks charge each other for overnight loans reached as high as 6.88%. Recently this rate has dropped below 1% again as central banks around the world have been actively injecting money into the system and cutting interest rates. This indicates a gradual restoration of normalcy in short-term lending.

- **Medium-Term Bank Borrowing has also Fallen:** The more closely watched three-month bank borrowing rate, the London Interbank Offered Rate (LIBOR), had recently climbed from under 3% to close to 5%. The three-month LIBOR has recently retreated back to around the 3% level. This is another sign that we are beginning to see some normalization in bank lending. A very important indicator of a healthy banking system is how high banks’ borrowing costs are relative to the U.S. Treasury. This level, known as the TED spread, has also shown signs of increasing confidence in our banking system. Refer to Chart 2 for trends in TED spread over trailing one year.