MURRAY
INVESTMENT MANAGEMENT

3rd Quarter 2012 Update

Economic Review

The U.S. economy continued to grow at a modest level during the quarter. 2nd quarter GDP was revised down to 1.3% with the expectation for similar growth during the 3rd quarter. Consumer spending continues to be the biggest concern as joblessness weighs on consumer confidence.

The U.S. unemployment rate fell to 8.1% during the quarter, but the improvement was largely attributed to workers leaving the workforce. Job growth during 2012 has averaged 139,000 per month but has been weakening and is not currently strong enough to make a meaningful dent in the unemployment rate.

The most significant events during the quarter related to central bank action with the U.S. Federal Reserve announcing additional stimulus ("QE3") and the head of the European Central Bank ("ECB") announcing his intention to do "whatever it takes" to preserve the Euro." QE3 includes bond purchases and keeping interest rates low through mid 2015 while the ECB support somewhat calmed the fears of a more serious European crisis.

Equity Market Performance

	3 Months	YTD
S&P 500	6.35%	16.44%
MSCI EAFE (International index net return)	6.92%	10.08%

Led by the Energy sector, broad U.S. equity markets had a strong rally in the 3rd quarter and have posted very strong performance for the year. With all of the surrounding noise (slow global economy, European concerns, fiscal cliff, etc.), some are referring to this as a "stealth" rally given that it does not feel like we are up over 16% for the year. Either way, equity markets have been very good in 2012. Broad International equities were also strong for the quarter but have lagged U.S. markets for the year.

The third quarter could be characterized as "bad news is good news" given that the market rally was largely driven by the expectation that weak conditions would lead to further easing by the U.S. Fed and the ECB. The ECB action was particularly well received and drove strong performance for European equities.

Bond Market Performance

	3 Months	YTD
BarCap US Aggregate Bond (Broad Bond Market)	1.58%	3.99%
BarCap Municipal	2.32%	6.06%
BarCap US Treasury Long	0.20%	4.36%
BarCap US Corporate	3.83%	8.66%
BarCap US Corporate High Yield	4.53%	12.13%

The 10 year Treasury was little changed during the quarter but has fallen year to date while continuing to serve as a safe haven during times of stress. The corporate bond market has followed the equity market with very strong performance during the quarter and year to date. High yield corporates have been particularly strong this year.

Economic Outlook

Expectations for economic growth in the near term are modest. Economic data continues to be mixed with some data pointing to improving fundamentals while other data reveals continued weakness.

Low interest rates and several years of light building are helping fuel an improving housing market. This is favorable for both consumer confidence (wealth effect) and the employment situation (construction related jobs). In addition, the strong stock market is good for consumer confidence as higher valuations improve consumer balance sheets and may stimulate consumer spending. The corporate sector also remains a bright spot with generally strong balance sheets and solid earnings.

The employment situation, however, continues to be the biggest hindrance to better GDP growth as businesses are reluctant to hire. Business confidence remains weak due to the impending fiscal cliff (higher taxes, lower spending and reduced benefits) and a lack of clarity on tax policy and regulations. If not addressed, the fiscal cliff mandates would likely send the U.S. into a recession, but Congress doing nothing on these issues is highly unlikely. The expectation is that the issues will be temporarily resolved by extending a decision on the cuts and tax increases until 2013.

Taken all together, the net result should be an economy that continues to muddle along at below trend growth until some of the above mentioned issues are resolved.

Source: standardandpoors.com, bls.gov, Morningstar, bea.gov, cnbc.com, wsj.com, federalreserve.gov and treasury.gov
The performance data shown represents past performance, which is not a guarantee of future results.
Return data is as of 09/30/2012. Except as noted, index returns are Total Returns.

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Market Outlook

Equity markets may be volatile in the 4th quarter as mixed economic data and the fiscal cliff discussion weigh on investor confidence. In addition, with the economy showing signs of strain, there is concern that corporate earnings will roll over and put pressure on the stock market. With this volatility, it would not be surprising to see the equity market pull back as we approach year end.

On a more positive note, domestic equity valuations are still reasonable even with the rally that we have experienced. In addition, by engineering extremely low interest rates, the U.S. Fed is attempting to force investors out of cash and bonds and into riskier equity assets. Investors may eventually move low yielding cash and bond investments into equity markets which is exactly what the Fed wants to see and which may drive equity markets higher.

The fixed income space remains somewhat of a mixed bag with a general consensus that long U.S. Treasuries are overvalued. This view is balanced against the Fed's stated intent to keep interest rates low through mid 2015. While some shorter term and less interest rate sensitive fixed income securities make sense in the context of a diversified portfolio, the equity market generally looks more attractive than the fixed income market at this time.

Murray Investment Management

If you would like help with establishing an investment plan or would like to schedule a portfolio review, please give us a call. Also, please pass along our name to anyone that may be in need of investment advice.

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