

market commentary for january 2011

The United States economy's recovery appeared to be gathering steam in December and January. U.S. Gross Domestic Product (GDP) grew by 3.2 percent in the fourth quarter of 2010 according to the Bureau of Economic Analysis' advance estimate. This figure is below the consensus estimate of 3.6 percent growth but well above the third quarter's 2.6 percent growth. GDP grew by 2.9 percent for all of 2010, the largest increase since 2005. Fourth quarter growth was led primarily by both domestic consumption and exports, which suggests that the consumer is supporting the recovery instead of government spending. Moody's predicts that growth will be approximately 4.0 percent in 2011, which may be enough to finally bring down the high unemployment rate.

Although growth appears to be accelerating, unemployment remains stubbornly high. Payrolls in January increased by just 36,000. Severe weather likely played a large role in the disappointing numbers. In the Bureau of Labor Statistics' survey an unusually high number of respondents claimed weather prevented them from working. The official unemployment rate actually decreased to 9.0 percent, but that is mostly due to declining participation in the workforce. On the bright side, manufacturing showed a gain of 49,000 jobs, however financial services witnessed declines as did the construction, leisure/hospitality, and government sectors. It is still thought that unemployment will decrease as 2011 presses on.

Leading business indicators were mostly positive in the preceding two months. New orders for manufactured goods increased by 0.2 percent in December, and core capital goods order climbed 1.9 percent in the same month. The Institute for Supply Management's manufacturing index, which measures the overall health of the manufacturing sector, rose from 58.5 to 60.8 in January, which is evidence that the sector's recovery continues. The index's fourth quarter average was 57.3, the highest since 2004. Retail sales produced strong gains in December, rising by 0.6 percent, making for six consecutive months of increases. Year-over-year, retail sales are up by 7.9 percent.

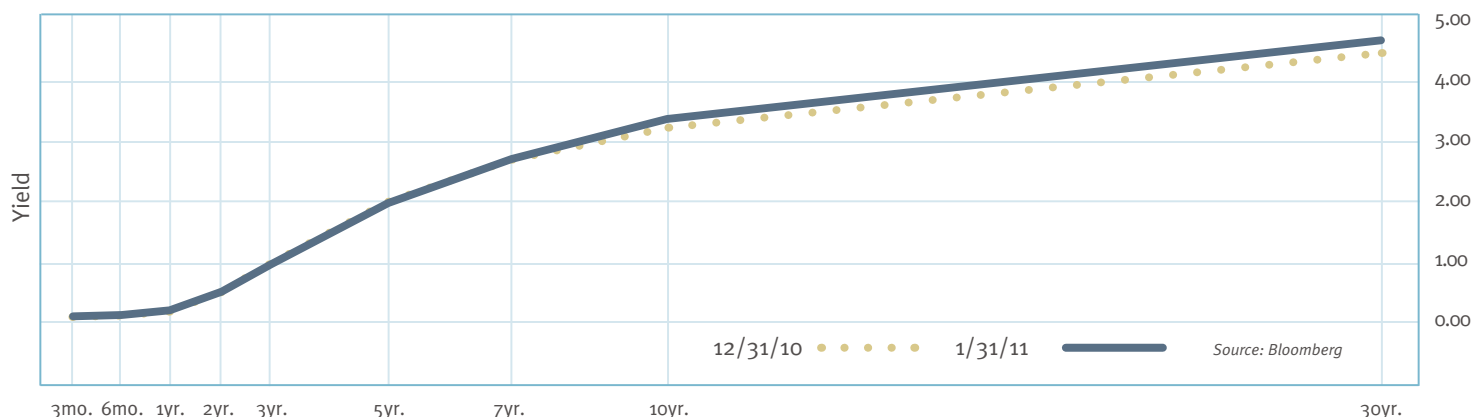
Consumer indicators also bolstered the notion that the recovery is gaining momentum. Consumer spending grew by 0.7 percent in December, while personal income growth came in at 0.4 percent in

the same period. The savings rate fell slightly to 5.3 percent from 5.5 percent in November. Prices grew 0.3 percent, but the core personal consumption expenditures (PCE) deflator, which is the Fed's preferred measure of inflation and excludes food and energy prices, remained unchanged, suggesting that inflation remains in check. Consumer confidence is also on the rise. The Conference Board index of consumer confidence rose to 60.6 in January from 53.3 in December (revised upwardly from 52.5). Both the expectations and present conditions components of the index saw gains. The index has increased for five consecutive months, which may indicate that consumers are beginning to believe the economic recovery is real. However, it should be noted that the index is still historically low. As GDP continues to grow in 2011 and as unemployment declines, consumer sentiment will rise into more normal territory.

The housing market also showed positive numbers in December. Sales for existing homes increased 12.3 percent in December to 5.28 million units annualized, and the months of supply on the market fell to 8.1 months. The median existing house price was down 1.0 percent year-over-year. New home sales were also up by an impressive 17.5 percent in December, which is the strongest single month gain in over 10 years. Although sales are historically low, the housing market has been steadily improving for the last six months. It is expected that the market will continue to recover in 2011 but will likely lag behind other sectors of the economy.

The Federal Open Market Committee (FOMC) met in late January and did not change monetary policy, keeping the fed funds target rate between zero and 0.25 percent. The minutes from the meeting focused more on the Fed's continued policy of quantitative easing. It read, in part, "To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee decided today to continue expanding its holdings of securities as announced in November. In particular, the Committee is maintaining its existing policy of reinvesting principal payments from its securities holdings and intends to purchase \$600 billion of longer-term Treasury securities by the end of the second quarter of 2011."

HISTORICAL YIELD CURVE



KEY ECONOMIC INDICATORS

	For the Period	Date of Release	Expected	Actual	Prior
Unemployment Rate	January	02/04	9.5%	9.0%	9.4%
Consumer Price Index	December	01/14	1.3%	1.5	1.1%
– Less Food and Energy	December	01/14	0.7%	0.8%	0.8%
Consumer Conf. (CB)	January	01/25	54.0	60.6	52.5
FOMC Rate Decision		01/26	0%–0.25%	0%–0.25%	0%–0.25%
Gross Domestic Product	4QA	01/28	3.5%	3.2%	2.6%

market summary for january 2011

WEEK-ENDING RATES AND YIELDS

	01/07	01/14	01/21	01/28	1 st QTR AVG
Overnight Rates					
Effective Fed Funds	0.17	0.16	0.17	0.17	0.17
Repurchase Agreements	0.09	0.09	0.10	0.09	0.09
Discount Rates					
1 Month Treasury Bill	0.13	0.13	0.14	0.12	0.13
1 Month Agency Disc.	0.12	0.14	0.14	0.14	0.14
1 Month Com'l Paper	0.21	0.20	0.21	0.20	0.21
3 Month Treasury Bill	0.14	0.14	0.15	0.14	0.14
3 Month Agency Disc.	0.14	0.17	0.17	0.18	0.17
3 Month Com'l Paper	0.29	0.27	0.28	0.26	0.28
6 Month Treasury Bill	0.16	0.16	0.17	0.15	0.16
6 Month Agency Disc.	0.17	0.19	0.19	0.19	0.19
6 Month Com'l Paper	0.38	0.36	0.37	0.33	0.36
Yields					
1 Year Treasury	0.29	0.27	0.27	0.24	0.27
1 Year Agency	0.40	0.36	0.37	0.34	0.37
2 Year Treasury	0.60	0.57	0.61	0.54	0.58
2 Year Agency	0.76	0.74	0.79	0.69	0.75
5 Year Treasury	1.96	1.92	2.01	1.92	1.95
5 Year Agency	2.32	2.28	2.37	2.26	2.31

sector review

U.S. Treasuries: Treasuries rallied slightly in the front end of the curve for the first month of the year as rates declined a few basis points compared to the end of 2010. The U.S. Treasury Department announced it would reduce their Supplementary Financing Program (SFP) outstandings from \$200 billion to \$5 billion beginning in February due to concerns of the federal debt limit. Even though this announcement was widely anticipated, short dated Treasury Bills rallied on the news. However, further out on the curve, rates continued to sell off, accentuating an already steep yield curve. The 30-year note widened 24 basis points to a 4.57 percent yield and the 10-year note finished the month at a 3.37 percent yield, seven basis points wider. (Rates and prices maintain an inverse relationship. Prices decrease as yields increase.)

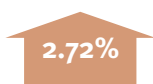
Commercial Paper: Available supply in the commercial paper market continues to lag investor demand helping keeping spreads compressed. Asset-backed commercial paper (ABCP) outstandings have risen ever so slightly, in large part due to the only new ABCP program of 2010. This program came to market in mid December and has been exceptionally well-received by investors, growing steadily each week. One-month and three-month top-tier, higher quality ABCP and bank names continue to trade in the 0.24 percent and 0.27 percent context respectively.

U.S. Government Agencies: Agency spreads remain tight due to the effective guarantee provided by ongoing Treasury capital support. Although Treasury's

recommendations for restructuring the Government Sponsored Enterprises (GSEs) are to be released soon, it is believed to be some time before real changes are put into law, probably well after the 2012 presidential election. The most likely area of contention will be government involvement, where the Treasury may call for some explicit government participation, but members of the House of Representatives will most likely counter with proposals for total privatization. Agency yields at month-end on three-month paper yielded 0.18 percent, six-month paper yielded 0.22 percent, and 12-month paper yielded 0.29 percent.

Strategy: The FOMC kept policy unchanged at the January meeting, with only minor changes to their outlook and left its asset purchase program unchanged. As opposed to the previous two statements regarding their uneasiness of unemployment, the Fed further clarified their concerns about the lack of "significant improvement" in "labor market conditions." Fed officials also said longer-term inflation expectations are stable and measures of underlying inflation have been trending downward while acknowledging higher commodity prices. Until the FOMC sees the unemployment rate fall and core inflation pick up, members will do what they can to promote economic growth. Most investors continue to barbell their portfolios with one-month to three-month fixed rate paper combined with six-month to one-year floating rate paper due to more restrictive maturities rules implemented last year.

DIJA

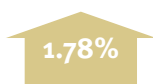


Month



Year-to-Date

NASDAQ

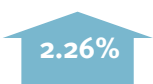


Month

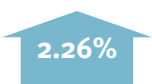


Year-to-Date

S&P 500



Month



Year-to-Date

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