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MainStay Compass

Economic and Market Highlights – Q4 2013

Equity Markets

- The S&P 500 finished the year on a strong note with a 10.5% return in Q4 alone, outpacing other developed markets (+5.8%). Europe did fairly well (MSCI Europe, +8.1%), as the returns were supported by an upward move in the EUR as well. Emerging Market (MSCI EM) stocks lagged, but still provided positive returns (+1.9%), thus continuing a slow recovery since the second quarter (page 52).
- Sector-wise, cyclical sectors such as industrials, information technology, and consumer discretionary delivered the best performance, but materials and financials also did well. For the second consecutive quarter, telecommunication and utilities were the worst-performing sectors in Q4 (page 35).

Bond Markets

- High-yield bonds continued to recover from the May-June pullback with a return of 3.5% in Q4, while Treasury notes lost 2.5% due to rising bond yields.[1] High-yield spreads tightened roughly 0.8% during the quarter (page 41 and 52) and are now tighter than to the long-term average. Still, the default rate remains below 3%, a relatively low level by historical standards (page 41).
- Municipal bonds[2] returned a moderate 0.3% in Q4, while several European fixed-income markets did better with Euro Area bonds overall returning almost 3%, driven by tighter bond spreads in peripheral countries.

Global Economy

- Signs that the global economy is picking up continued to build through the quarter. U.S. manufacturing indicators (page 11) showed a continued strong inflow of new orders in December, and both Europe and Japan showed continued signs of recovery, but the news out of China was more mixed.
- The European economy is showing signs of recovery, with encouraging signals from business surveys in several countries. Also, European car sales have rebounded quite strongly in recent months with a 13%+ y/y growth rate in December. Spain, Italy, and Greece are showing signs of improvement after several years of tough restructuring and rebalancing. While growth is slowly returning to Europe, many headwinds still remain, and growth is likely to remain relatively low.

The Fed

- At the December meeting, the Fed finally started "tapering" the bond purchase program, reducing the monthly bond purchases from a total of $85 billion to $75 billion. Looking ahead, they continued to emphasize the data-dependency of their policy, pointing out that substantial improvement in the labor market remains a precondition for a move towards a higher Fed Funds rate.
- Inflation has been lower than most forecasts in recent months, and the Fed's preferred inflation measure is now close to 1%--quite a bit below the target of 2% (page 28).

Noteworthy

- The U.S. economy delivered a growth pace that was much stronger than expected during both the second and third quarters of 2013, especially when comparing to what was expected at the beginning of each quarter. The underlying trend in private sector demand was strong enough to counteract headwinds from the federal budget, a relatively weak international economy and a lot of policy uncertainty.
- Even though "tapering" of Fed bond purchases has now begun, the Fed's balance sheet is still growing. In 2013, the monetary base (liquidity proved directly by the Fed) was up by 38%, but this rate of growth is set to decline a lot in 2014. Still, even if the Fed "tapers" off bond purchases towards $0 billion from the current $75 billions/month by the end of 2014, the Fed's balance sheet would still grow by more than 10% in 2014.

1. Barclays U.S Corporate High-Yield Bond Index is composed of fixed-rate, publicly issued, non-investment grade debt.
2. Barclays Municipal Bond Index is an unmanaged index that includes approximately 15,000 municipal bonds, rated Baa or better by Moody's, with a maturity of at least two years.

S&P 500 Index-Widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 focuses on the large cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

MSCI EAFE Index - The MSCI EAFE Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia and the Far East.

MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe. It consists of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

MSCI EM Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Barclays Global Aggregate Bond Index provides a broad-based measure of the global investment grade fixed-rate debt markets. It is comprised of the U.S. Aggregate, Pan-European Aggregate, and the Asian-Pacific Aggregate Indexes. It also includes a wide range of standard and customized subindices by liquidity constraint, sector, quality and maturity.
FOMC is a committee within the Federal Reserve System, is charged under United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities). It is the Federal Reserve committee that makes key decisions about interest rates and the growth of the United States money supply.
It is not possible to invest in an index

Past performance is not a guarantee of future results.

About Risk

High-yield securities (commonly referred to as 'junk bonds') have speculative characteristics and present a greater risk of loss than higher quality debt securities. These securities can also be subject to greater price volatility. High-yield municipal bonds may be subject to increased liquidity risk as compared to other high-yield debt securities.

Equity Securities- Publicly held corporations may raise needed cash by issuing or selling equity securities to investors. When you buy the equity securities of a corporation you become a part owner of the issuing corporation. Equity securities may be bought on stock exchanges, such as the New York Stock Exchange, NASDAQ Stock Market, Inc. ("NASDAQ"), the American Stock Exchange, foreign stock exchanges, or in the over-the-counter market, such as NASDAQ's Over-the- Counter Bulletin Board. Investors buy equity securities to make money through dividend payments and/or selling them for more than they paid. The risks involved with investing in equity securities include (without limitation):

- Changing economic conditions: Equity securities may fluctuate as a result of general economic conditions, including changes in interest rates.
- Industry and company conditions: Certain industries or individual companies may come in and out of favor with investors. In addition, changing technology and competition may make the equity securities of a company or industry more volatile.

Debt Securities- Investors buy debt instruments primarily to profit through interest payments. Governments, banks and companies raise cash by issuing or selling debt securities to investors. Debt securities may be bought directly from those issuers or in the secondary trading markets. Some debt securities pay interest at fixed rates of return, while others pay interest at variable rates. Interest may be paid at different intervals. Some debt securities do not make regular interest payments, but instead are initially sold at a discount to the principal amount that is to be paid at maturity. The risks involved with investing in debt securities include (without limitation):

- Credit risk: The purchaser of a debt security lends money to the issuer of that security. If the issuer does not pay back the loan, the holder of the security may experience a loss on its investment.
- Maturity risk: A debt security with a longer maturity may fluctuate in value more than a debt security with a shorter maturity.
- Market risk: Like other securities, debt securities are subject to the forces of supply and demand. Low demand may negatively impact the price of a debt security.
- Interest rate risk: The value of debt securities usually changes when interest rates change. Generally, when interest rates go up, the value of a debt security goes down and when interest rates go down, the value of a debt security goes up.
- Treasury securities, when held to maturity, are backed by the full faith and credit of the United States government as to timely payment of principal and interest.

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