



## Citizens Bank & Trust Market Review

September 2010

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## Data suggests a continued modest expansion.

### Recent Economic Indicators

|  |                 |
|--|-----------------|
| Thomson Reuters/Univ. of Michigan Consumer Sentiment | 68.9            |
| Consumer Confidence                                  | 53.5            |
| Existing Home Sales, Monthly Change                  | -27.2%          |
| New Home Sales, SAAR*                                | 276,000         |
| Personal Income, Monthly Change                      | 0.2%            |
| Personal Consumption Expenditures, Monthly Change    | 0.4%            |
| Non-farm Payroll Increase/Decrease                   | -54,000         |
| Unemployment Rate                                    | 9.6%            |
| ISM Non-Manufacturing Index                          | 51.5%           |
| ISM Manufacturing Index (PMI)                        | 56.3%           |
| Durable Good Orders, Monthly Change                  | 0.3%            |
| Industrial Production, Monthly Change                | 1.0%            |
| Capacity Utilization                                 | 74.8%           |
| Retail Sales, Monthly Change                         | 0.4%            |
| CPI, Monthly Change                                  | 0.3%            |
| CPI Core, Monthly Change                             | 0.1%            |
| PPI, Monthly Change                                  | 0.2%            |
| PPI Core, Monthly Change                             | 0.3%            |
| U.S. Trade Deficit                                   | \$-42.8 billion |
| 2Q10 Non-farm Productivity, Quarterly Change, SAAR*  | -1.8%           |
| 2Q10 GDP, Quarterly Change                           | 1.6%            |

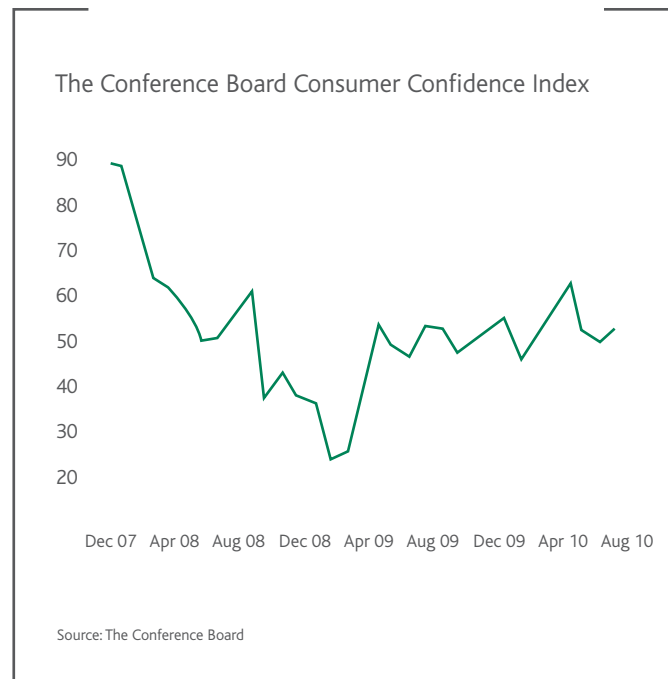
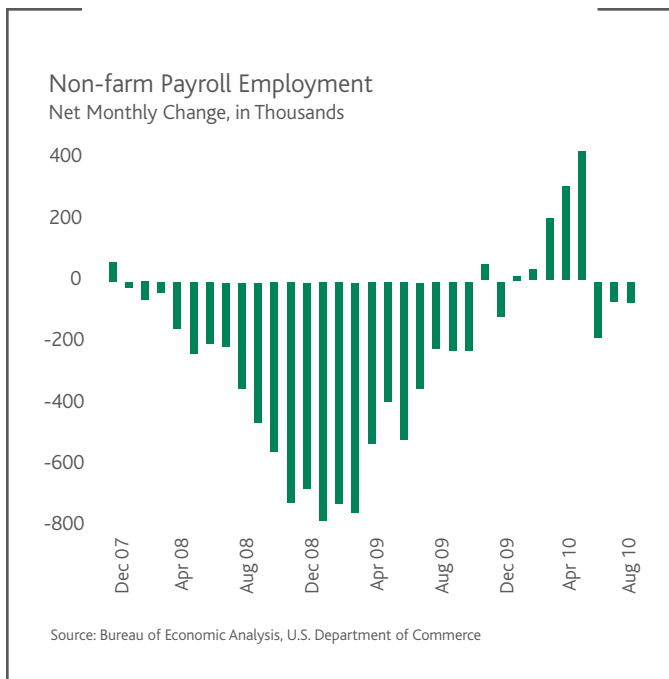
\*Seasonally Adjusted Annual Rate  
Bureau of Economic Analysis of the U.S. Department of Commerce, U.S. Department of Labor, the Federal Reserve, Thomson/Reuters/University of Michigan, Institute for Supply Management, National Association of Realtors, The Conference Board.

### Overview

While the pace of the global economic recovery has moderated, economic data suggests a modest expansion for the remainder of the year. Consumer and business spending continues to increase slightly despite lingering uncertainties about economic conditions. Softening in the U.S. labor market occurred again in August, yet private sector payrolls increased for the third consecutive month. Inflationary expectations remain subdued, with price stability somewhat lower than the Federal Reserve's preferred range to support a healthy economy.

Revised estimates for gross domestic product (GDP), released late August by the U.S. Department of Commerce, showed the economy expanded at an annual rate of 1.6% in the second quarter. Lower than the advance estimate of 2.4%, this follows growth of 3.7% in the first quarter.

Activity in the housing market retreated in July, as shown by the National Association of Realtors. Sales of existing single family homes sank 27.2% for the month to a seasonally adjusted annual rate of 3.83 million, 25.5% lower than July 2009. This represents the lowest level of sales since the series began in 1999. Meanwhile, new home sales edged lower in July. Data released by the Commerce Department reflected a 12.4% decrease in sales from June. The seasonally adjusted annual rate of 276,000 marks a 32.4% decline from the year-ago period. Increased caution among potential home buyers weighed on home builders' morale in August. The National Association of Home Builders/Wells Fargo Housing Market Index, a gauge of builder confidence, declined for the third consecutive month amid ongoing concerns regarding the economic and labor market outlook.



### Employment

U.S. payrolls shrank again in August, losing 54,000 jobs as 114,000 Census 2010 workers completed their temporary work. The U.S. Department of Labor announced that private sector employment has continued to trend higher with 763,000 jobs added since reaching a trough in December 2009. The unemployment rate rose modestly to 9.6%, following a 9.5% rate in both June and July. However, the unemployment rate typically increases following a recession as discouraged workers rejoin the labor force. The average duration of employment fell to 33.6 weeks, down for the second consecutive month from a one-year high in June. Meanwhile, The Conference Board Employment Trends Index signaled that momentum in the labor market may continue to stall in the coming months. Despite the monthly decline in the index, it remains 9.4% higher than in August 2009.

### Consumer Confidence and Spending

Gauges of consumer confidence showed a slight improvement in sentiment during August. The Thomson Reuters/University of Michigan Surveys of Consumers reflected that consumers continue to anticipate soft income and job growth prospects. According to the survey, these expectations have caused people to focus on strengthening their personal financial situations. Surveys of Consumers Chief Economist, Richard Curtin, concluded that the financial crisis taught consumers the importance of paring personal debt as "their best defense against economic adversity." The Conference Board Consumer Confidence Index also edged higher in August, with the gain attributed to a better short-term economic outlook. Of the 5,000 U.S. households surveyed, 17.0% now expect business conditions to improve in the next six months compared with 15.8% in July.

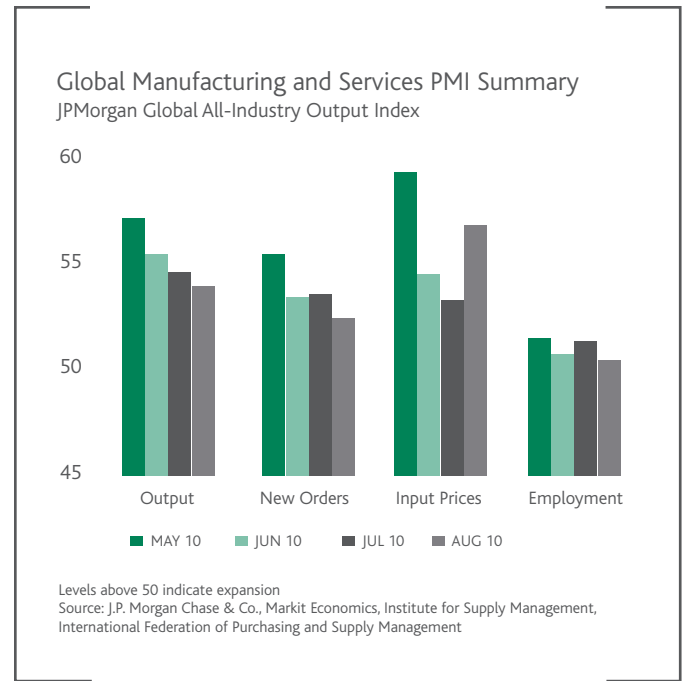
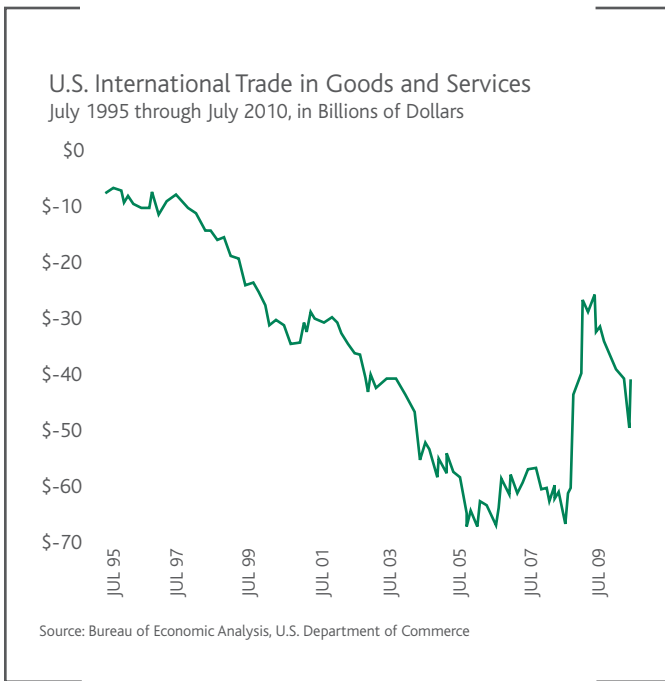
The U.S. Department of Commerce reported that personal income increased 0.2% in July, while personal consumption expenditures (PCE) advanced 0.4%. Personal savings, as a percentage of disposable personal income, decreased from 6.2% in June to a 5.9% rate in July, reflecting a continued focus on deleveraging personal debt.

### Inflation

Recent measures of inflation validate concerns about disinflation, or decreasing rates of inflation. Upward price pressures have remained very subdued within the 12 Federal Reserve districts. Price indexes for PCE, excluding food and energy, released by the U.S. Department of Commerce, posted an annual increase of 1.4% in July. Similarly, the Consumer Price Index (CPI) increased 0.3% in July, up 1.2% in the previous one-year period. Energy prices rose 2.6% from June, while food prices declined 0.1% for the second straight month. Core CPI, which excludes food and energy prices, advanced 0.1% in July, and rose 0.9% on an annual basis for the fourth consecutive month.

### Business Spending

Federal Reserve Chairmen Ben Bernanke presented an economic outlook at the end of August and noted improvements within the business sector. Real investment in equipment and software surged at an annual rate of over 20% during the first two quarters. However, Bernanke acknowledged that some of this resulted from deferred spending from the financial crisis and therefore expects slower, albeit continued, increases in the next year. Indicators of business activity reflected expansion within the manufacturing and non-manufacturing sectors in August. The Institute for Supply Management (ISM) Purchasing Managers Index signaled accelerating growth in the manufacturing sector with 11 of the 18 participating industries reporting expansion for the month. The ISM Non-Manufacturing Index reflected slower growth in the non-manufacturing sector as business activity, production, and new orders all expanded at a decelerating rate. Survey respondents remain "mixed about business conditions and the state of the overall economy."



## Trade

The U.S. international trade deficit narrowed more than economists anticipated in July. The Department of Commerce reported that the deficit declined to \$42.8 billion, following a deficit of \$49.8 billion the previous month. Imports for the month declined \$4.2 billion as demand for consumer goods decreased. The price paid for imported crude oil and the quantity declined slightly in July. Exports, however, increased by \$2.8 billion, largely as a result of higher demand for capital goods.

The second estimate for GDP in the second quarter indicated that export activity decelerated while import activity surged. Exports advanced 9.1% versus an increase of 11.4% in the first quarter. Imports climbed 32.4% April through June after increasing 11.2% in the previous quarter.

Minutes from the Federal Open Market Committee's August meeting reflected better-than-expected growth in the European and Asian economies, which continue to modestly support U.S. export activity. However, the FOMC acknowledged that continued growth in these economies will have to be supported by higher private demand to counteract reduced government stimulus and lower contributions from inventory investment. The European Commission reported that although the European Union (EU) continues to progress toward economic recovery, it expects ongoing weakness in the global economy to place downward pressure on EU export growth. It anticipates private investment and consumption to lead GDP rather than contributions from inventories and net exports.

## World Economy

The global recovery continued to decelerate in August amid slower expansion in the service sector. The JPMorgan Global All-Industry Output Index, produced in association with Markit Economics, reflected that the world economy grew for the 13th straight month, albeit at the slowest pace since February. Although new business activity advanced at the weakest rate in a year, Director of Global Economics Coordination at JPMorgan, David Hensley, dismissed concerns of a significant pullback and noted "sufficient momentum heading forward to maintain the recovery."

The Organization for Economic Cooperation and Development (OECD) announced that the world economic recovery has slowed and consequently lowered its growth forecast for the Group of Seven (G-7). The OECD anticipates the G-7 will expand at an annualized 1.5% rate in the second half of the year, markedly lower than May estimates of 2.5%. It also noted increased uncertainties but concluded "it is unlikely that we are heading into another downturn." The report indicated that consumer spending may likely remain depressed but capital spending seems unlikely to soften further.

In early August, McKinsey & Company conducted an online survey about global economic conditions in which 2,850 executives from around the world and varying industries participated. The survey determined that executives had a more positive view about their countries' economy than negative and 42% now consider weak demand as the greatest economic barrier opposed to credit availability or risk of sovereign default. In a positive sign however, half of the survey participants conveyed expectations for increased demand for their goods or services during the remainder of the year and profits for 2010 to rise. Furthermore, the majority of executives indicated no plans to delay capital investment or the pursuit of mergers and acquisitions; half of respondents that are postponing business spending attributed the decision to more conservative risk behavior.

## Investor appetite for bonds remains strong in August.

| Fixed Income Current Yields | 8/31/10 |
|-----------------------------|---------|
| 3 Month U.S. T-bill         | 0.14%   |
| 2 Year U.S. Treasury        | 0.47%   |
| 5 Year U.S. Treasury        | 1.33%   |
| 10 Year U.S. Treasury       | 2.47%   |
| 30 Year U.S. Treasury       | 3.52%   |

| Total Returns <sup>1</sup>      | 1 Month | 12 Months |
|---------------------------------|---------|-----------|
| Barclays U.S. Aggregate         | 1.29%   | 9.18%     |
| Barclays U.S. Govt./Credit      | 1.86%   | 9.68%     |
| Barclays U.S. Municipal Bond    | 2.29%   | 9.78%     |
| Barclays U.S. Corp. High Yield  | 0.04%   | 21.52%    |
| Barclays U.S. Long Credit A     | 4.04%   | 17.45%    |
| Barclays U.S. Treasury 20+ Year | 8.08%   | 16.87%    |
| Barclays Global Aggregate       | 1.39%   | 5.84%     |
| Barclays Emerging Markets       | 2.01%   | 20.18%    |

<sup>1</sup> Month and 12 month ending 8/31/10  
Source: U.S. Department of the Treasury, Barclays Capital

### Overview

Demand for longer-dated bonds remains especially robust as pension funds, insurers, mortgage companies and other investors attempt to lock in current yields despite several technical indicators suggesting that Treasuries are expensive at current levels. Against this backdrop, strategists are beginning to debate the prospect of a bubble in the fixed income markets. As evidence, they cite mutual fund money flows, which indicate that retail investors continue to rebalance into the bond markets at an alarming rate. Since the start of 2008, bond funds received \$601 billion of cash inflows compared to \$240 billion of stock fund outflows, according to the Investment Company Institute (ICI). However, the bond bulls suggest that demand can remain robust given low inflation expectations along with the likelihood of another round of quantitative easing. Largely attributable to a flight-to-safety trade, most sectors in the broad fixed income markets posted sharply higher returns in August.

Looking ahead, both investment grade and high-yield corporate bonds will likely continue to outperform given historically wide spreads and marked improvements in company balance sheets. A steep yield curve, combined with the expectation of the Fed keeping rates steady for an extended period of time suggests investors should focus on intermediate-term securities, which may run counter-intuitive to many investors. Because many market participants expect rates to rise, they remain reluctant to commit to anything other than short-term securities or cash.

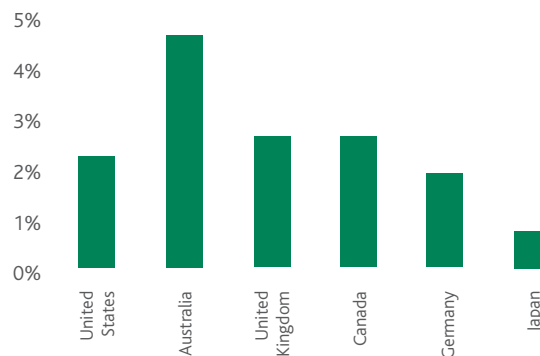
Conservative investors may continue to maintain positions in government linked securities including agency paper and certificates of deposits. These securities provide safety along with good diversification properties with stocks, as their returns are usually negatively correlated.

Investment Grade Corporate Spread  
In Basis Points, through August 2010



Source: Merrill Lynch

10-Year Government Bond Rates  
Latest Yield as of 8/31/10



Source: Bloomberg

### Corporate

The investment grade corporate sector rallied for the third straight in August, gaining 1.98% for the month, bringing year-to-date gains to 10.01%. Corporate debt new issuance remains near historically high levels as companies seek to lock in low borrowing costs. Demand for these bonds has been so strong that the \$100 billion of new issuance over the past six weeks has not led to spread widening, according to a JPMorgan credit strategy report. Indeed, most new issues have been heavily oversubscribed with pricing at the high end of initial indications. This demand, combined with strong credit fundamentals, led JPMorgan to upgrade corporate bonds from Neutral to Overweight.

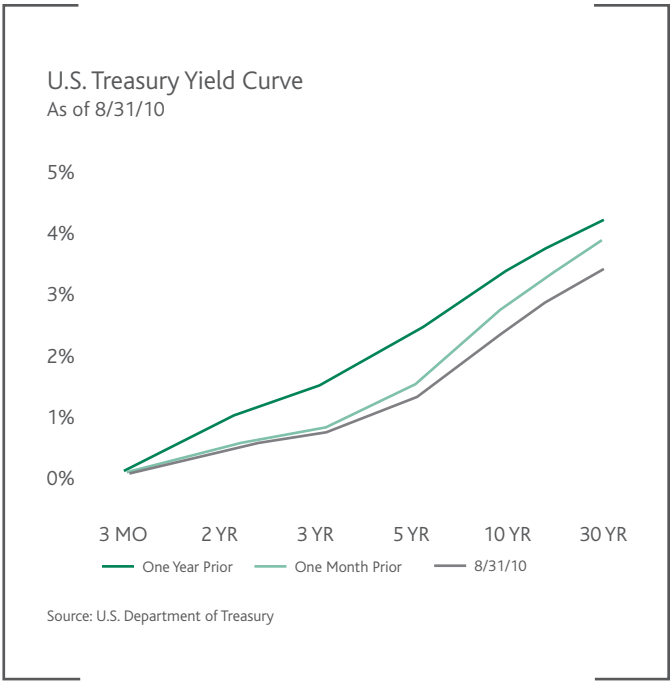
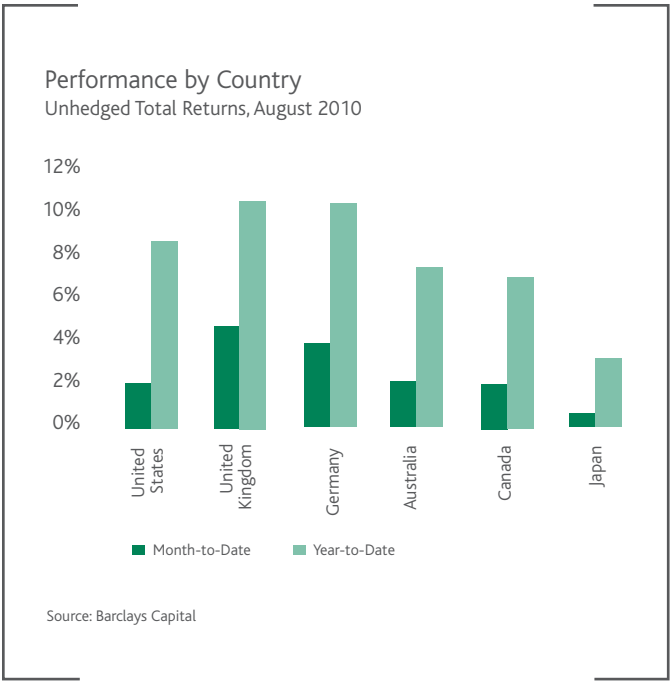
Barclays Capital, consistently ranked the top credit research group by Institutional Investor magazine, analyzed the financial performance of the U.S. banking sector and found unexpectedly strong balance sheets with considerable improvement in asset quality and capitalization levels. Other developments in the sector include a lower risk of ratings downgrades due to a less contentious Financial Regulatory Reform bill, a favorable supply outlook, and stronger-than-expected European bank stress test results. These factors, along with wider spreads than most other areas of the investment grade market, prompted the research team to upgrade their outlook on the banking sector.

High yield bonds ended the month mostly unchanged, gaining 0.04% and bringing year-to-date returns to 8.27%. Historically wide spreads combined with low default rates will likely drive investor demand higher for the junk bond market, according to many strategists. In another sign that corporate balance sheet strength continues to improve, Moody's default rate on speculative-grade bonds recently receded to approximately 2% from a high of 12% one year ago. When default rates last reached current levels in June of 1997, high yield spreads dropped below 3%, suggesting that current spreads near 7% represent very attractive valuation levels.

### Municipals

The long-term rally in the muni market continued once again in August with the Barclays Municipal Bond Index gaining a robust 2.29%, bringing year-to-date gains to 7.00%. This sector has now posted gains in 19 of the last 22 months. Munis rallied along with U.S. government debt as signals mounted that the economic recovery may be slowing. The rally in municipal bonds can be attributed to several factors. In a slow growth environment, investors typically migrate toward safe-haven securities, which include Treasuries and municipality debt. Record low yields for money market funds and longer dated high-grade securities have motivated some investors to focus on higher yielding assets outside of their traditional investment mandates. Finally, the continued strong new issuance of taxable Build America Bonds has reduced the supply of traditional tax-exempt muni debt.

Mutual fund inflows have also had a significant effect on the performance of the market over the past several months. Net inflows into municipal funds recently reached levels considerably higher than historical averages, with overall assets under management totaling \$519 billion in August. Many strategists feel the current pace of inflows is unsustainable, particularly if Treasury yields begin to increase, which ultimately may lead to downward pressure on municipal bond prices. Despite this, the combination of an encouraging supply/demand environment and likely tax increases should contribute to continued market strength, albeit at a much more moderate pace.



**International**

The Barclay's Global Treasury ex-U.S. Index posted positive results, delivering a monthly return of 1.94% on an unhedged basis and gaining 1.88% on a local currency basis, consistent with a slightly weaker U.S. dollar against the euro. Volatility in the European sovereign space dominated headlines once again with the safe-haven markets rallying sharply as investors flocked to the flight-to-safety trade. Strong performers included the United Kingdom (+4.60%), Germany (+3.85%), France (+3.64%), and the Australia (+2.19%). Market participants transitioned away from riskier regions during the month, with the weakest results coming from countries with fiscal troubles including Ireland (-3.50%), Portugal (-0.33%), and Portugal (-0.21%). Although Greece is no longer a member of the index due to its below investment grade rating, the country's debt also heavily underperformed, dropping 5.98% for the month.

Due to concerns that the rising cost of supporting Ireland's struggling banks will balloon its budget deficit, S&P downgraded the country's government debt to AA- from AA and signaled that another cut was possible. In an unusual move, Ireland's National Treasury Management Agency attacked the rating company's assessment: "In terms of the specific analysis by S&P, this is largely predicated upon an extreme estimate of bank recapitalization costs of up to 50 billion Euros." This tactic may have quelled investor concerns as a recent Ireland bill auction drew strong demand, with a 10 to 1 bid to cover for the securities.

Signaling a strong demand environment, new issuance for emerging market debt nearly doubled in August from levels reached one year ago. Continuing improvements in underlying fundamentals have made emerging markets a very attractive place to invest amid 2010 International Monetary Fund growth estimates of 6.8% compared with 2.6% for developed countries. Many strategists feel this growth advantage and attractive yields should continue attracting significant capital inflows to this segment of the market.

**Bond Bubble?**

Concerns that the U.S. is heading toward deflation have been the primary driver of the rally in Treasuries over the past several months. The stampede into bonds has lowered interest rates to historic levels, with the yield on the two-year Treasury note dropping to a record low of 0.5% and the 30-year mortgage rate falling below 4.5%. The bond bears argue this is a sign that such pessimism exists that investors are willing to overpay for fixed income securities. In light of this, some strategists are suggesting we may have entered bubble territory in the fixed income markets. They contend we have reached capitulation with more bets on gains in bond prices than at any other time in this cycle, given expectations for the Federal Reserve to conduct large-scale Treasury purchases in coming months to stimulate the economy. Should stronger economic data reverse these expectations, Treasuries will likely drop sharply in the short-term.

However, the bond bulls suggest that yields are unlikely to rise significantly because the preponderance of recent data reports has been tilted toward a slow growth economy. They argue the market will remain buoyed by low inflation expectations along with the Fed keeping short-term rates low for a sustained period. At the same time, hedge funds and other speculative investors recently turned bullish on the benchmark 10-year Treasury note for the first time in 20 months, according to the Wall Street Journal.

From a conceptual perspective, a bond bubble seems highly improbable. Unlike real estate or technology stocks, bondholders will receive par value at maturity and coupon payments along the way, barring a default. However, bonds do carry interest rate risk and credit risk, with interest rate risk greatest when rates are low.

## Earnings revisions, economic news weigh on stocks in August.

| Price Change <sup>1</sup>    | Month  | 12 Months |
|------------------------------|--------|-----------|
| Russell 2000                 | -7.50% | 5.24%     |
| S&P MidCap 400               | -5.08% | 10.25%    |
| S&P 100                      | -4.96% | 0.21%     |
| S&P 500                      | -4.74% | 2.81%     |
| Wilshire 5000 Equity Index   | -4.90% | 4.23%     |
| Dow Jones Industrial Average | -4.31% | 5.46%     |
| NASDAQ Composite             | -6.24% | 5.22%     |
| MSCI EAFE                    | -3.34% | -4.89%    |
| MSCI EM Emerging Markets     | -2.15% | 15.56%    |
| MSCI EAFE Small Cap          | -3.05% | -0.26%    |

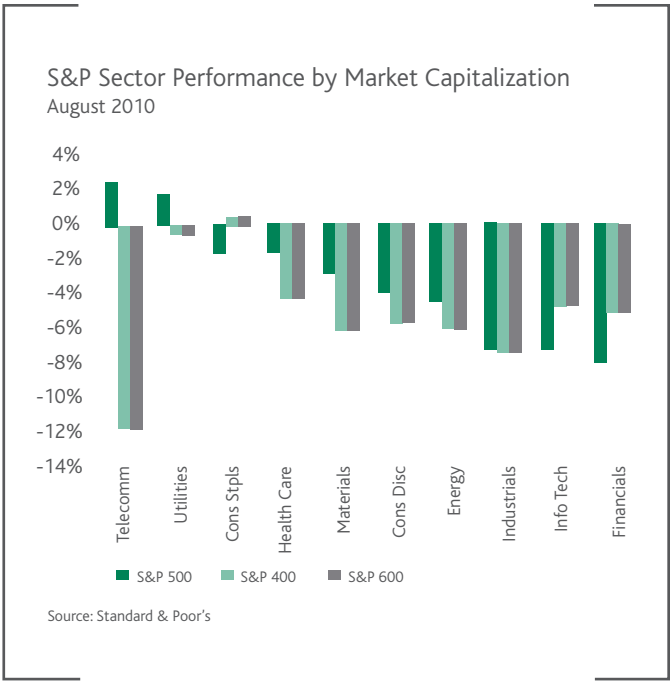
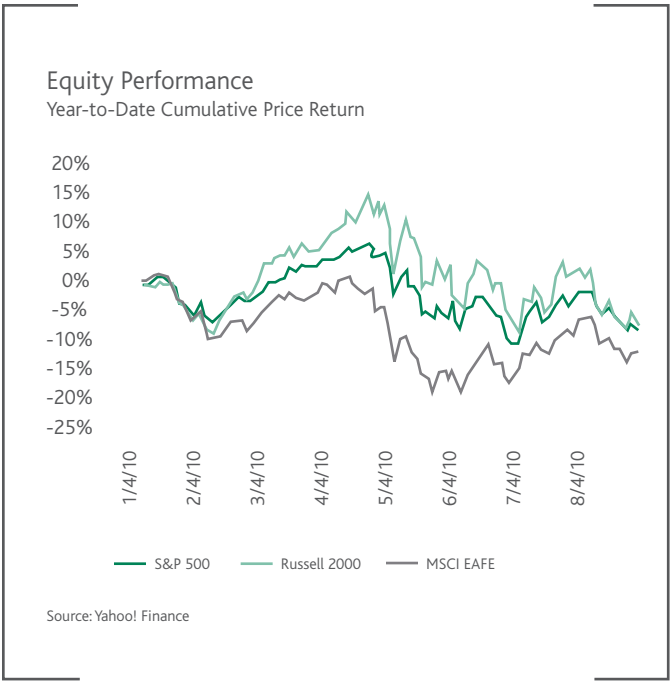
<sup>1</sup>Month and 12 Month ending of 8/31/10  
 Source: Dow Jones Indexes, Morgan Stanley Capital International, Russell Investment Group, Standard & Poor's, NASDAQ, Yahoo! Finance

### Overview

The July rally ended promptly in the first week of August when weak readings on consumer spending, housing, and factory orders caused investors to doubt the strength of the global recovery. Investor pessimism was confirmed mid-month when the Federal Reserve announced that it would begin reinvesting the proceeds from its mortgage bond portfolio, an acknowledgement that the pace of the economic recovery had slowed considerably. Weak corporate earnings from retailers J. Crew (JCG) and Tiffany (TIF) increased pessimism about the economic recovery; a sentiment later enforced by a cautious outlook issued by drugstore Walgreen (WAG) and weak economic data.

The S&P 500 lost nearly 5% in August, but the steepest losses occurred in small cap stocks with the S&P SmallCap 600 Index down 7.54%. The main contributor to the steeper decline in the S&P 600 was the heavy weights in cyclical sectors such as industrials, technology, and consumer discretionary.

Earnings news weighed on technology stocks, sending the technology-heavy NASDAQ Composite down 6.24%. Cisco and Intel (INTC) each reduced their revenue outlooks for the remainder of the year. Both stocks are seen as bellwethers for the economy – Cisco represents corporate spending, while Intel is representative of PC demand. Additionally, Computer giants Dell (DELL) and Hewlett-Packard (HPQ) entered a bidding war for data storage company 3PAR (PAR), sending the stock of the bidders lower while the 3PAR gained over 217% for the month.



#### Domestic Equity

Large cap stocks dropped the least of the domestic equities in August with the S&P 100 losing 4.96%, just slightly more than the 4.74% loss of the S&P 500 and the 4.31% loss of the Dow Jones Industrial Average (DJIA).

News that technology giants Cisco and Intel decreased their revenue forecasts weighed on technology stocks, sending the sector 7.20% lower for the month. Large losses also occurred among financial and industrial stocks, posting monthly losses of 7.91% and 7.33%, respectively. Traditionally defensive sectors outperformed in August with positive returns from telecommunications (2.25%) and utilities (0.89%); consumer staples and health care lost just 1.59% and 1.79%, respectively.

Small and mid cap stocks trailed large cap stocks and international stocks in August as the S&P SmallCap 600 Index and the S&P MidCap 400 Index lost 7.54% and 5.08%, respectively. However, with losses of 3.13% and 0.69% year-to-date, the S&P SmallCap 600 and the S&P MidCap 400, respectively, remain ahead of both large cap and international stocks.

Neither growth nor value stocks took style leadership in August as the large cap Russell 1000 Growth trailed the Russell 1000 Value by 39 basis points. However, the Russell Midcap Growth Index gained 18 basis points on the Russell Midcap Value Index while the small cap Russell 2000 Growth Index gained 23 basis points on the Russell 2000 Value Index.

#### International Equity

While the losses were not as large as those in domestic U.S. equity markets, international stocks sold off in August on concerns that the global economic recovery lost steam. The developed market MSCI EAFE Index lost 3.34% in U.S. dollar terms during the month and is down 9.81% in 2010. However, when measured in local currency terms, the MSCI EAFE lost 2.90% for the month and stands 7.53% lower for 2010 due to declines in the U.S. dollar relative to developed market currencies in aggregate.

Despite a brief respite for Greece in the summer, investors sent shares in the debt-laden nation 9.34% lower in August, as measured in U.S. dollar terms. Year-to-date, Greece shares have lost 40.10%. Additionally, fears of a new banking crisis in Ireland sent the MSCI Ireland Index down 15.42%.

Emerging market stocks remain the best performing global asset class year-to-date, with the MSCI Emerging Market Index losing just 2.15% in August, pulling the index to a 1.96% loss in 2010. The BRIC countries of Brazil, Russia, India, and China are roughly in-line with returns in the U.S. and other developed markets, posting losses of 2.99% in August and a loss of 5.79% year-to-date.

## Alternatives lose momentum in tumultuous month.

| Total Returns <sup>1</sup>  | Month  | 12 Months |
|-----------------------------|--------|-----------|
| Dow Jones                   |        |           |
| UBS Commodity Index         | -2.55% | 3.57%     |
| Crude Oil                   | -8.07% | -11.68%   |
| Copper                      | 1.13%  | 23.80%    |
| Gold                        | 5.62%  | 29.90%    |
| NAREIT- All REITS           | -1.40% | 30.62%    |
| NAREIT-Industrial/Office    | -2.30% | 16.42%    |
| NAREIT- Residential         | -0.38% | 58.08%    |
| S&P Global Property Ex-U.S. | 0.43%  | 6.59%     |
| HFRI Emerging Markets Index | 0.01%  | 12.08%    |
| HFRI Fund Wtd Comp. Index   | 0.38%  | 7.20%     |
| HFRI Equity Market Neutral  | -0.57% | 0.02%     |
| HFRI Event Driven           | -0.07% | 13.03%    |
| HFRI Market Defensive       | 1.42%  | -0.79%    |
| HFRI Merger Arbitrage       | 0.45%  | 5.88%     |
| HFRI Short Bias             | 3.00%  | -13.00%   |

<sup>1</sup>Month and 12 month ending 8/31/10  
 Source: Dow Jones, National Association of Real Estate Investment Trusts, Hedge Fund Research, Standard and Poor's, wsj.com - Market Data Center.

### Overview

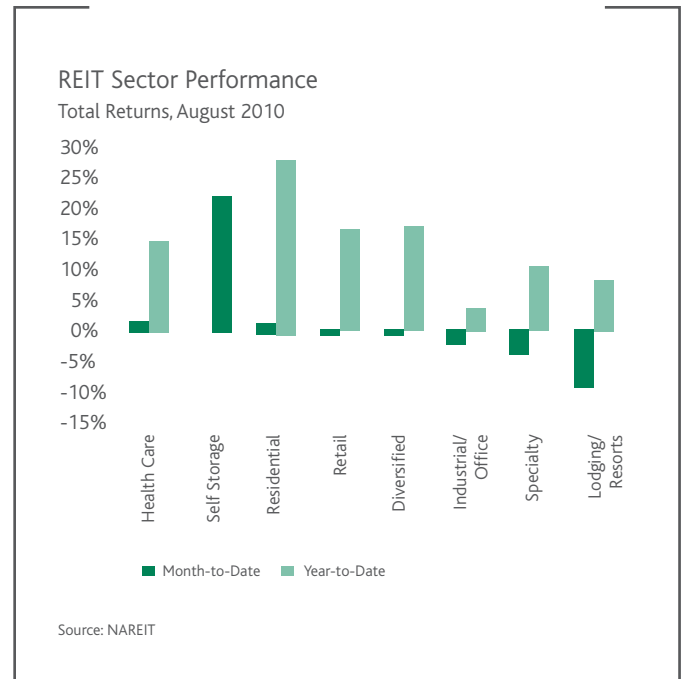
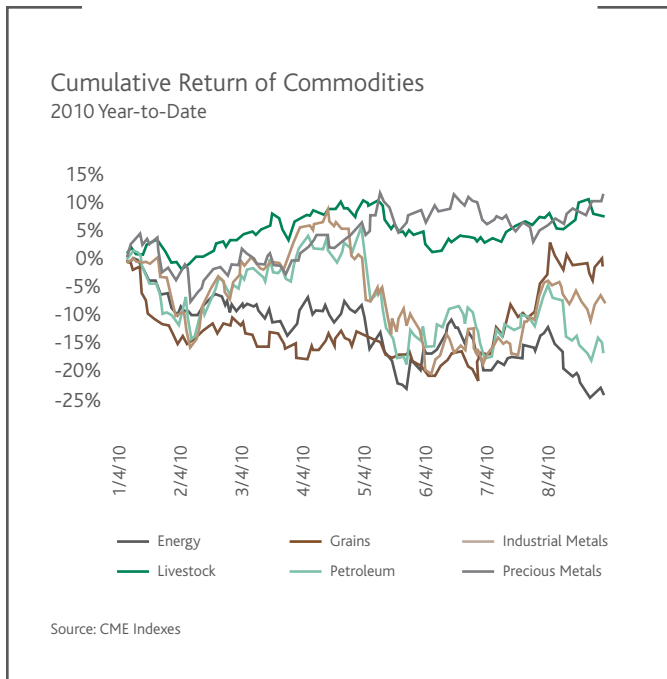
August proved to be a difficult month for alternatives as investors shed risky assets. While broad commodities fell back during August, gold continued to rise as investors demanded safe haven assets. Private equity deal activity remains robust as firms are increasingly looking for trade-exits through secondary market sales or through initial public offerings (IPOs). Hedge funds finished the month flat; meanwhile, industry assets continue to shrink according to Barclay Hedge, a hedge fund data provider.

### Commodities

For the month of August, the Dow Jones-UBS Commodity Index retreated 2.55% as investors avoided more speculative investments and leaped into traditional safe haven assets. The U.S. dollar appreciated 2.61% relative to the euro—typically, commodities react inversely to movements in the U.S. dollar as a higher dollar makes commodities more expensive for foreign buyers. Precious metals rose 6.13%—largely because of gold and silver, which appreciated 5.62% and 7.62%, respectively. In addition to the safe haven appeal of gold, demand widened after China allowed additional banks to import and export the precious metal. The energy sector fell 12.13% and was the largest detractor from broad commodity performance. Crude oil, which continues to trade in lockstep with equities, slipped 8.07% and natural gas plummeted 20.50%. Additionally, data indicates slowing economic growth which continues to constrict energy demand.

As a group, agricultural commodities appreciated 2.33% for the month, prompting many analysts to warn of a new wave of food inflation. In particular, corn futures surged 7.74% as forecasters warned this year's crop yield may be lower than expected. Wheat fell a modest 0.70% after the U.S. and other exporting countries stepped in to fill the void created by the Russian ban on wheat exports. Prices are likely to remain elevated until Russia can assess with greater certainty the status of their 2011 crop.

### Private Equity



In an article published in Businessweek with data provided by Preqin, an alternative investment information resource, private equity firms are still sitting on \$469 billion in capital commitments. Private equity (PE) firms are finding deals, but skepticism has caused many to fall through as investors are cautious not to overpay. Typically, PE firms must invest capital within five years, a deadline quickly approaching for boom-era funds making it difficult to raise fresh capital. Consequently, PE trade-exits are triple the level relative to the same period 12 months ago. The secondary buyout market between PE firms is booming as some buyout firms look to offload assets, consolidate their portfolios, and return money to investors while others look to buy depressed assets and put their cash to work.

Initial public offering (IPO) activity remains robust. According to the New York Times, as of late August, nearly 161 companies seek to raise \$56 billion through IPOs. Through the first eight months of 2010, private-equity backed IPOs raised nearly \$20 billion—eight times 2009 levels and double the activity through the first eight months of 2008. According to Dealogic, nearly 55 PE-backed IPOs are backlogged. Many analysts are questioning if the market is stable enough to absorb the resurgence in activity.

#### Real Estate

Real estate investment trusts (REITs) could not maintain the momentum established in June. During August, the FTSE NAREIT All REIT and the FTSE NAREIT Equity REIT indexes posted total returns of -1.40% and -1.39%, respectively. From a sector perspective, lodging/resorts performed the worst with a loss of 9.46%. Other laggards include specialty, industrial/office, and diversified REITs losing 3.65%, 2.30%, and 0.97% respectively. The only property sector avoiding negative territory was health care, returning 1.28%.

Apartment REITs lost a modest 0.25% for the month but remain

up 28.52% year-to-date. In 2009, apartment vacancy rates swelled to a record high of 7.4%. However, according to commercial real estate firm CB Richard Ellis (CBRE), apartment vacancy rates will fall to 6.8% by the end of 2010 and rental housing will be in high demand for the foreseeable future as American priorities shift and more baby-boomers shift to rental housing.

#### Hedge Funds

As a group, hedge funds concluded August flat, while the broad equity market, as measured by the S&P 500, dipped 4.7%. According to Hedge Fund Research, the HFRI Fund Weighted Composite Index, considered an indicator of the average hedge fund, rose 0.38% for the month. However, equity focused funds lost on average 0.92%. Short-bias funds—a hedging strategy that benefits during falling equity markets—returned 3.00% in August and was one of the top performing strategies, yet remains down 4.76% for the year. HFRI's merger arbitrage strategy posted a total return of 0.45% during August. Merger and acquisition (M&A) activity remains elevated as firms look to put high cash balances to work. Emerging market hedge funds posted strong gains for the month, buoyed by Latin America and Asia ex-Japan.

Despite strong performance during the month of July, investors continued to withdrawal money from hedge funds. According to the most recent flow estimates from Barclay Hedge, investors pulled \$2.9 billion out of hedge funds in July. Industry assets shrank 0.2% and are currently at the lowest level since November.



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