



## **Third Quarter 2009 Investment Commentary**

Financial markets continued to advance during the third quarter as economic activity started to stabilize. Consumer-centric government programs, such as Cash for Clunkers and the \$8,000 tax credit for first time homebuyers, were enough to induce some consumers to spend. Nearly 700,000 vehicles were traded for new, more energy efficient models, driving the auto sales index up 11.9% for the month of August.<sup>1</sup> Although the median sales price of existing homes is down 12.5% versus a year ago, new and existing home sales appear to have stabilized, spurred by low interest rates, builder incentives, falling prices and the tax credit.<sup>2</sup> While housing (and autos to a much lesser extent) shows signs of stabilizing, it remains an open question to what extent the economy can sustain this improvement without government support. The overriding issue in the U.S., along with much of the rest of the developed world, remains the de-leveraging of balance sheets, including the government, corporations and individuals. While a higher savings rate means that consumers and companies are repairing their respective balance sheets, more cautious and conservative consumption, which comprises about two-thirds of the U.S. economy, translates to sluggish GDP growth. In contrast, developing countries, fueled by rising raw material prices (which helps exporters of energy such as Russia and Brazil) and favorable trade balances (China), are in a better position to consume. These realities are likely to cause a shift in global consumption patterns away from the U.S., Europe and Japan and to emerging economies.

From a global perspective, the U.S. has been a bellwether country that either could lead the world into prosperity or drag the world into recession. In the last decade, however, emerging countries in Asia and Latin America have grown from 6% of global GDP in 1999 to over 19% at the end of 2008 while the U.S. has declined from 47% to 36%. This shift in fortunes comes with a silver lining: global economic growth is less dependent on the American consumer spending to support emerging countries export markets. According to the International Monetary Fund October 2009 economic outlook, “Emerging and developing economies are further ahead on the road to recovery, led by a resurgence in Asia—in general, emerging economies have withstood the financial turmoil much better than expected based on past experience, which reflects improved policy frameworks.”<sup>3</sup> In summary, global GDP will be more balanced and hopefully will prove beneficial, especially to U.S. exporters and multinational corporations, helping to sustain the U.S. economic recovery.

### **UMFNE Socially Responsible Stock Pool\***

The third quarter of 2009 was in many ways a repeat of the second quarter: stocks continued to advance as investors’ appetite for risk grew and economic data suggested that the worst of the Great Recession was behind us. The S&P 500 Index rose 15.6%, only slightly less than the 15.9% of the second quarter and interest rates remained low. Buoyed by more robust economic growth and smaller debt burdens, the biggest gainers of the quarter were the international markets. Emerging markets returns were especially impressive with 21.0% gain for the third quarter and 64.9% return year to date. The developed market international MSCI EAFE Index was up 19.5% for the quarter and 29.6% year to date through the end of September. Returns on non-U.S. equities have been aided by the weakness of the U.S. dollar. After peaking in early March, the dollar declined over 15% versus the euro and over 9% versus the yen as liquidity and stability returned to the capital markets<sup>4</sup>.

The UMFNE Socially Responsible Stock Pool\* is comprised of two portfolios designed to optimally track the performance of both domestic and international stocks as represented by the Russell 3000 Index

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<sup>1</sup> Source: Baseline

<sup>2</sup> Hanley Wood Market Intelligence report dated October 2, 2009

<sup>3</sup> World Economic Outlook, October 2009, Sustaining the Recovery, page x of foreword, <http://www.imf.org/external/pubs/ft/weo/2009/02/pdf/text.pdf>

<sup>4</sup> Source: Thomson One

(target: 75% of the pool) and MSCI EAFE (Europe Australia Far East) Index (target: 20% of the pool) and MSCI Emerging Markets (target: 5% of the pool). Currently, our Stock Pool consists of over 1170 holdings with an asset allocation of 52% large-cap, 17% mid-cap, 6% small-cap, and 25% international companies with 6% in Emerging Markets.

<b>Time Weighted Return</b>	<b>Quarter Ended 09/30/09</b>	<b>Year to Date 09/30/09</b>	<b>12 Months Ended 09/30/09</b>	<b>3 Years Ended 09/30/09</b>	<b>5 Years Ended 09/30/09</b>
UMFNE Stock Pool*	16.86%	24.76%	-2.78%	-3.65%	2.48%
Russell 3000 Index	16.31	21.19	-6.42	-5.06	1.56
S & P 500	15.61	19.26	-6.91	-5.43	1.02
Domini Social Index <sup>5</sup>	16.21	22.58	-3.69	-4.20	1.10
MSCI EAFE Index	19.47	28.97	3.23	-3.60	6.57

### **UMFNE Socially Responsible Bond Pool\***

For the third quarter, the UMFNE Socially Responsible Bond Pool\* posted a return of 2.77%, lagging behind the Barclays (formerly Lehman) Intermediate Government Credit Index which had a return of 3.25%. On a year to date basis, our Bond Pool was up 2.87%, versus the 4.92% for the Index. Our focus on quality and the conservative structure of the portfolio (particularly its underweight to BBB-rated bonds and our underweight to corporate bonds relative to the benchmark), was additive to our performance for all of 2008 but has lagged the benchmarks as credit markets recovered and investors' appetite for risk has increased. Investors have rotated out of treasury and agency debt and into corporate credit. We view the bond portfolio as (ideally) a stable source of income for investors and look to our equity investments for appreciation over time.

### **Market Outlook**

Our economic scenario for the U.S. remains intact: short-term improvement fading into very slow growth in 2010. Meanwhile, 2010 earnings estimates are rising, with expectations for a 27% jump, according to Thomson Financial. If our economic view is correct, this leap in earnings seems unlikely to be realized. At the same time, slow growth/low inflation/low interest rate environments historically have been hospitable for liquidity driven rallies: since 1900, there have been 38 years in which real GDP growth ranged between 0 – 2%. Stocks rose in 21 of those 38 years, and by more than 20% in 13 of them. We do not expect anything that robust for 2009, but it does argue against the inevitability of a meaningful market decline from here. This leaves us concluding that there is neither a strong case for a big rise or fall from current equity market levels. It is an environment in which a global perspective is essential and in which high quality equities and long/short strategies should excel. We appreciate your loyalty to our firm and we welcome your feedback on our correspondence.

Kimberly D. Gluck CFA  
UMFNE Investment Committee  
October 20, 2009

\* The actual performance of individual customer accounts will be impacted by fees, deposits, withdrawals and timing of investments, and may not reflect the performance described in UMFNE's Pools.

<sup>5</sup> <http://www.kld.com/indexes/ds400index/performance.html>