

Ben Bernanke, Year 1

Market Summary

January 2007

The end of the month meant the end of the first full year of Ben Bernanke's tenure as Chairman of the Federal Reserve.

He is generally given high marks for establishing himself in the position following eighteen years of Alan Greenspan at the helm. Fourth quarter GDP data couldn't have hurt. The GDP figures out in January showed the economy grew 3.5% during the fourth quarter and 3.4% for all of 2006, above the 20 year average growth rate of 3.1%. This strong growth number came despite a sharp 19.2% *decline* in residential fixed investment. This decline shaved 1.2% off the fourth quarter growth number.

REIT's fell to only 3.4% and the premium to long-term TIPS is now only to 1.1%, not much of a risk premium for holding an asset that is significantly more risky than TIPS. Also, REIT's are now trading at about a 10% premium to their NAV. While a premium to NAV is expected, since REIT's offer liquidity that direct real estate holdings do not, the average premium since 1993 is only 6.7%.

Domestic equity markets were positive as well. The S&P 500 index rose 1.5% in January. Value stocks, measured by the Russell 1000 Value index rose 1.3% and growth stocks, measured by the Russell 1000 Growth index rose 2.6%. While one month does not a trend make, we have been anticipating that growth stocks will outperform value stocks over the next few

	2006	Contribution	4Q	Contribution
	Growth (%)	to 2006	Growth (%)	to 4Q
		Growth (%)		Growth (%)
Personal Consumption Expenditures	3.2	2.3	4.4	3.1
Residential Fixed Investment	(4.2)	(0.3)	(19.2)	(1.2)
Non-Residential Fixed Investment	7.4	0.8	(0.4)	(0.1)
Government Consumption	2.1	0.4	3.7	0.7
Change in Inventories	-	0.3	-	(0.7)
Trade Balance	-	(0.0)	-	1.6
GDP Growth		3.4		3.5

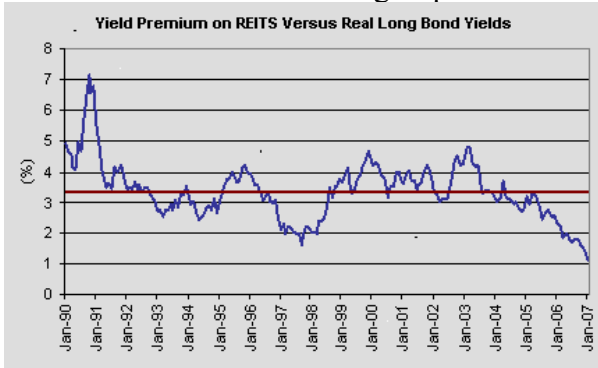
Residential fixed investment was the only component of the 2006 GDP number that came in negative. For the year it declined 4.2% and led to a 0.3% reduction in the overall GDP estimate. Non-residential fixed investment was strong for the year, although negative for the fourth quarter.

The decline in the residential investment number certainly did not dampen returns for all real estate investors. The Wilshire REIT index continued its warp speed appreciation, gaining 8.9% in January and 37.3% over the last twelve months. The dividend yield on

years. This is based on the belief that relative to their historical relationship where growth stocks have traded at a premium (as measured by price-to-book or price-to-sales, for example) this premium is currently well below historic levels. For premiums to get back on line with expectations, growth stocks need to outperform value stocks. This has been a focus of our 3rd and 4th quarter Quarterly Research Report's (QIR's).

International equity markets were mixed in January. The developed market indices were positive: MSCI EAFE increased 0.7% for the

month and the S&P/Citigroup index of



international small cap increased 1.2%. Emerging market stocks, on the other hand, had a negative return. The MSCI emerging markets index fell -1.1% (in US\$ terms) in January. Although international equities underperformed their domestic counterparts in January, they still lead performance for the one, three and five year periods. Fund's that have been more heavily invested in international markets than their peers have done well as a result.

Alternative asset returns were mixed as well. The HFR Fund of Funds index was positive, gaining 1.2% for the month, as was the Dow Jones AIG Commodity index. It gained 0.2%, although commodity markets remain in contango with future prices above spot prices. The gap that needs to be overcome to break even remains substantial as discussed in our third quarter QIR. The GS Natural Resource index fell in January by 0.5 percent. A contributing factor was a decline in oil prices which fell to \$58.14 per barrel at the end of January

Fixed income markets were little changed in January. The Fed Funds rate remained at 5.25% while the yield on the 10 year Treasury rose slightly from 4.7% at the end of December to 4.81% at the end of January. The rise in the yield on the 30 year Treasury

was similar. It rose from 4.81% to 4.91%. The option adjusted spread on the Lehman High Yield Index fell from 2.75% to 2.58%. Investors continue to either ignore risk or believe that it is no longer what it once was. We believe that they are ignoring risk and that they do so at their peril.

The yield on 10 year TIPS fell from 2.41% to 2.39%. This indicates that the market does not anticipate an increase in inflation, although TIPS are a form of protection against *unexpected* inflation. Mr. Bernanke seems to have done a good job in his first year convincing markets he is up to the job and if he can keep actual inflation in line with expectations he may well put to rest the ghost of his predecessor.

	Jan	1 Yr	3 Yrs	5 Yrs
Domestic Equities/Fixed				
S&P 500	1.5	14.5	10.3	6.8
Russell 2000	1.7	10.4	12.6	12.0
Dow Jones Wilshire REIT Idx	8.9	37.3	29.2	26.0
Lehman Aggregate	0.0	4.3	3.4	4.9
International Equities				
MSCI EAFE	0.7	19.8	19.6	16.4
S&P/Citigroup EMI-EPAC	1.2	22.9	25.9	24.6
MSCI Emerging Markets	-1.1	17.6	28.6	25.5
Alternative Assets				
HFR Fund of Funds Idx	1.2	8.6	8.1	7.6
GS Natural Resources Idx	-0.5	1.8	26.4	18.7
Dow Jones/AIG Commodity	0.2	0.4	10.0	16.3

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