

# What Santa Claus Rally?

## Market Summary

December 2007

As equity investors hoped for the famed Santa Claus Rally to end 2007, negativity reigned supreme. The Fed was back in action on December 11<sup>th</sup>, cutting the fed funds and discount rates by 0.25% each. Markets tumbled due to disappointment from investors who were hoping for a larger cut. The abovementioned Fed decision, combined with disappointing holiday sales, record oil prices and political unrest prevented any sort of broad-based rally.

	Dec	QTD	1 Yr	3 Yrs	5 Yrs
<b>Domestic Equities/Fixed</b>					
S&P 500	(0.7)	(3.3)	5.5	8.6	12.8
Russell 2000	(0.1)	(4.6)	(1.6)	6.8	16.2
Russell 1000 Growth	(0.4)	(0.8)	11.8	8.7	12.1
Russell 1000 Value	(1.0)	(5.8)	(0.2)	9.3	14.6
Dow Jones Wilshire REIT	(5.3)	(13.5)	(17.6)	8.5	18.3
Lehman Aggregate Bond	0.3	3.0	7.0	4.6	4.4
TIPs	(0.2)	5.0	11.6	4.9	6.3
<b>International Equities</b>					
MSCI EAFE	(2.3)	(1.8)	11.2	16.8	21.6
S&P/Citigroup EMI-EPAC	(3.1)	(4.8)	6.1	19.1	27.2
MSCI Emerging Markets	0.4	3.6	39.4	35.2	37.0
<b>Alternative Assets</b>					
GS Natural Resources	6.9	34.0	40.5	30.7	30.3
DJ AIG Commodity	4.6	4.7	16.2	12.9	14.3
HFR Fund of Funds	0.1	1.7	9.9	9.3	9.2

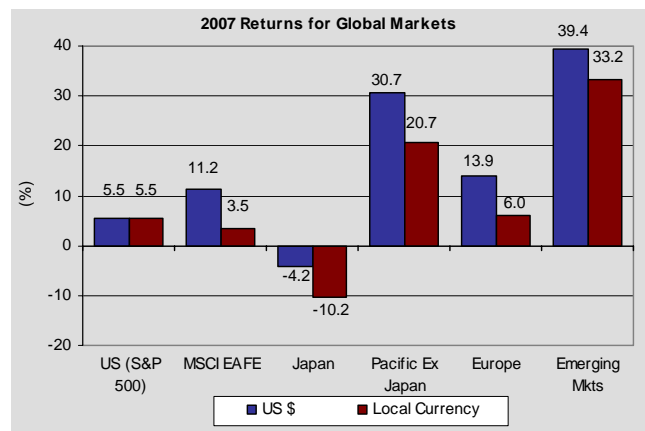
### Domestic Markets

The S&P 500 ended December down 0.7% for the month, but managed a 5.5% return for 2007. The month saw no change to the theme of growth stock out performance. The Russell 1000 Growth Index ended December slightly lower, while finishing the year up 11.8%. This compared to a 0.2% loss for the Russell 1000 Value Index, which ended a long stretch of value outperformance. Small cap stocks finished 2007 lower, with the Russell 2000 down 1.6%, as investors searched for stable returns elsewhere. A slowing economy, combined with difficulty in the housing and credit markets sent REITS down 17.6% for the year, while losing 5.3% in December alone.

Lastly, fixed income securities provided ample returns for the year, with the Lehman Aggregate Bond Index up 7.0% year-to-date. Inflation protected bonds also finished up a strong year, earning 11.6%.

### International Equities

Global growth fears, along with political turbulence took the international equity market lower in December. The MSCI EAFE Index, composed of large cap equities, fell 2.3% for the month, while the S&P / Citigroup EMI-EPAC Index small cap benchmark tumbled 3.1%. December did provide a slight rebound in the dollar, which contributed to international under performance relative to domestic equities for the month. However, the dollar continued its slump in 2007, with the broad-trade weighted dollar falling by 7.5%. International equities have benefited from the weak dollar. For example, in 2007, the MSCI EAFE index trailed the S&P 500 by 190 basis points in local currency terms, but outperformed it by 570 basis points in \$USD terms.



Emerging markets finished December up 0.4%, while finishing the year ahead 39.4%. The positive performance, in an otherwise negative environment, is largely due to a remarkable showing in natural resources, which represents a significant share of the emerging markets index.

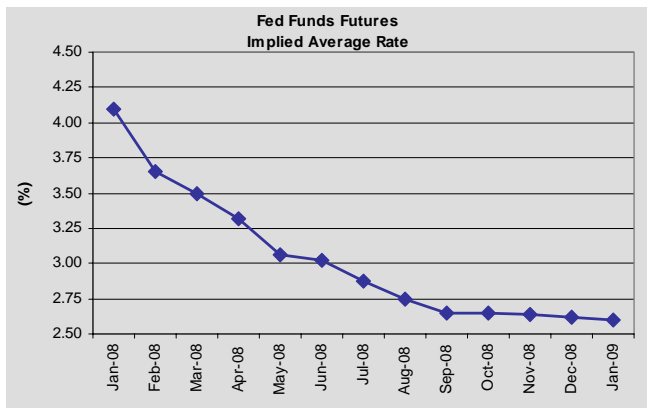
### Alternative Investments

Alternative assets finished 2007 in positive fashion. In particular, the Goldman Sachs Natural Resource Index increased 6.9% for the month of December and 40.5% for the year. Natural resources narrowly bested emerging markets as the best performing major asset class for 2007. These phenomenal returns for the largely energy-based index are attributable to record oil prices, geopolitical concerns, and the threat of world oil

demand growing faster than supply. The DJ-AIG Commodity Index also boasted strong returns for December, gaining 4.6%. For the year, the index earned 16.2%. After a volatile year, the HFR Fund of Funds Index finished with a solid 9.9% return. Hedge funds proved once again in 2007 why they are an integral piece of any well-diversified portfolio.

### **2008 and Beyond**

Although the Fed is doing their best to promote economic growth by cutting rates, more work may be needed. With economic growth estimated to be 2.3% in 2008, unemployment is expected to rise throughout the upcoming year. For these reasons, Fed Funds Futures suggest another 100 basis points may be trimmed off of the current 4.25% federal funds rate by May, and will be below 3% by August. As real estate prices continue to fall and credit markets continue to tighten, downward pressure for 2008 appears evident. With negative factors seeming too numerous to count, we believe that a well-diversified portfolio is essential to reduce risk, while capturing long-term growth.



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