

# Capital Markets Commentary

## 3rd Quarter 2009



HEFFERNAN FINANCIAL SERVICES

A DIVISION OF HEFFERNAN INSURANCE BROKERS

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The third quarter of 2009 for the U.S. stock market was marked by dramatic gains in an across-the-board rally. Continuing to recover from deeply oversold conditions seen in March, investors sought bargains amidst the carnage of late 2008 and early 2009. During a time when many Americans went camping, fishing, or pursued other vacation-related activities, the capital markets worked overtime to post solid gains in every major asset class. Still, despite robust short-term Q3 performance, most major U.S. equity indices are still “underwater” on a trailing one-year basis, even though they are in positive territory through the first three quarters of 2009.

The S&P 500 Index gained 15.6% in the third quarter, on par with the NASDAQ Composite Index's gain of 15.9% and in line with the return for the Dow Jones Industrial Average, which gained 15.8% in Q3. This marks the second consecutive quarterly gain of more than 15% for the S&P 500 Index. Of course, that comes after a lengthy series of quarterly declines in the S&P 500 Index. Small cap stocks, as measured by the Russell 2000 Index, sprinted ahead by 19.3% in the third quarter, nearly matching the Russell Midcap Index's return of 20.6%.

While American investors waved goodbye to summer, they also sent a fond farewell to recently “departed” citizens Farrah Fawcett, Michael Jackson, and Edward Kennedy. Too, many of these very investors are hopeful that they have also said their goodbyes to “The Bear Market of 2008-2009.”

As the chart to the right shows, the S&P 500 Index and the NASDAQ Composite Index have shown similar price behavior patterns in the last three months. Each of these indexes was up 20% for the quarter in mid-September, but investors decided to do some early Autumn profit-taking before the end of the quarter.



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Source: Bigcharts.com

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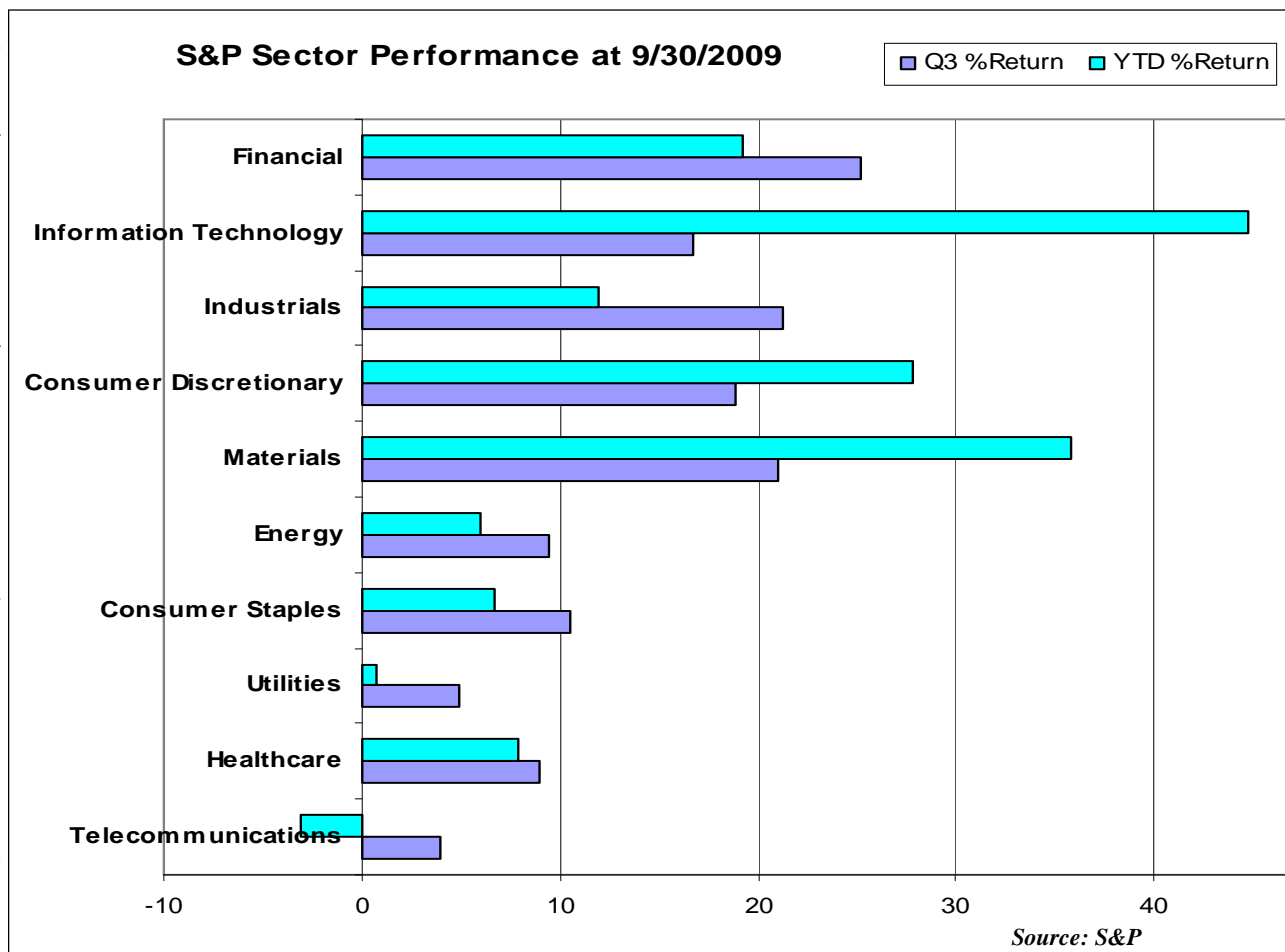
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**Stock Market Sector Performance**

From a stock market sector performance standpoint, all ten of the S&P stock market sectors exhibited gains in the third quarter, repeating this same feat for the second consecutive quarter. Financial, Industrials, and Materials were the three strongest sectors in the third quarter, each gaining more than 20%. The bottom three performing sectors during the third quarter were Telecommunications, up 3.9%, Utilities, up 5.0%, and Health Care, which gained 8.9%. Since these sectors are largely considered to be more conservative sectors, this is an indication that investors' general appetite for risk has increased, after investment risk was completely eschewed in late 2008 and early 2009.

On a year-to-date basis through September 30, 2009, the strongest performing stock market sector was Information Technology, up more than 44% in the first nine months. The worst performing sector, and the only one in the red, was Telecommunications, which has declined by 3.1% in the nine months ending 9/30/09.

According to Standard & Poor's Senior Index Analyst Howard Silverblatt, market volatility diminished during the third quarter, which ended without any 3% market moves, an event not observed since Q4-2007. Furthermore, September 2009 witnessed the fewest number of market trading days with a move in either direction of at least 1% since May 2008.



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### Domestic Economy and Unemployment

Unemployment continued to climb in the third quarter, with the September nonfarm payroll employment monthly job report showing 263,000 jobs lost. Since the start of the recession in December 2007, according to the U.S. Dept. of Labor, the number of unemployed persons has increased by 7.6 million to 15.1 million, and the unemployment rate has doubled to 9.8%. However, there are signs that the rate of increase in unemployment may be showing signs of abating, as September's loss of 263,000 is much less than the approximately 700,000 jobs eliminated each month in early 2009.

It is interesting to note that the rate of unemployment for adult men exceeds that of adult women rather dramatically, 10.3% versus 7.8% respectively. Looking at unemployment within each state in the Union, the worst employment conditions were in Michigan, with 15.2% unemployed, Nevada at 13.2%, and Rhode Island at 12.8%. The three states with the lowest level of unemployment were North Dakota, South Dakota and Nebraska, each with no more than 5% unemployment.

The Car Allowance Rebate System, aka the "Cash for Clunkers" program, accelerated demand for major durable goods purchases in the form of automobiles. According to an article published by the Federal Reserve Bank,

*As of October 1, the "Cash for Clunkers" program has processed 670,557 reimbursements totaling \$2.8 billion dollars. The program has received rave reviews in the media for its short-term success, but the open question is whether short-term successes facilitate long-term growth. Will the program jump start the restructured auto industry or will it result in mere transitory demand shifts, "stealing" from future consumption?*

Of course, the answer to this question remains to be seen. In the meantime, consumer sentiment remains bruised. Since the consumer typically comprises about two-thirds of economic activity, the economic recovery is not likely to be consumer-led. Rather, it is very likely that government spending will be the primary driver for economic growth in the second half of 2009 and into 2010. In a statement from the National Retail Federation, the average consumer will spend \$56.31 on Halloween merchandise this year, down from \$66.54 in 2008. That probably excludes subsequent dental expenses.

### U.S. Fixed Income Markets

Returns in the domestic fixed income markets were positive in the third quarter, as interest rates declined across the U.S. Treasury yield curve. The long end of the yield curve experienced the greatest appreciation, as the Barclay's U.S. Treasury Long Index gained 4.5%, but was still down 8.0% on a year-to-date basis. On the short end of the yield curve, T-bill investors continued to experience minuscule returns, as the 3-month T-bill Index returned 0.04% in the quarter, and 0.14% on a year-to-date basis. The U.S. high yield market continued its very strong performance in the third quarter, sprinting ahead 14.8%, and bringing its total return for the first nine months of the year to a stellar 48.5%, which is by far the best performing domestic asset class over that timeframe. The Federal Reserve again voted to keep the Fed Funds Rate at 0% - 1/4% and will likely keep rates low for a prolonged period.

### Russell Index Performance

In the third quarter, Value outperformed Growth in Large, Mid, and Small cap segments. The greatest outperformance of Value vs. Growth was in the Small Cap area, as the Russell 2000 Value outperformed its growth counterpart by 675 basis points. The Russell Midcap Index had the best quarterly return, up more than 23%. The laggard was the Russell 1000 Growth Index, up 14% in the quarter.

(source: Russell Investments)

#### **Q3 Russell U.S. Equity Returns (%)**

	Value	Blend	Growth
Large Cap	18.2	16.1	14.0
Mid Cap	23.6	20.6	17.6
Small Cap	22.7	19.3	15.9

### International Stock Markets

The rally in equities in the third quarter was experienced in international equities as well as domestically. The MSCI EAFE Index jumped by 19.5% in the third quarter. U.S. dollar-based investors reaped the benefit of a generally weaker U.S. dollar vs. major global currencies. The strongest performance in U.S. dollar terms among developed markets was experienced in Greece, Australia, and The Netherlands, each gaining more than 30% in the third quarter. The weakest performing country was Japan, posting a gain of 5.8% for the quarter.

The MSCI Emerging Markets Index gained 21.0% in the third quarter, and has gained an impressive 64.9% year-to-date. The top three performing markets in U.S. dollar terms were Peru, Hungary and Indonesia each gaining more than 36% in Q3. The bottom performing markets were Morocco, down 7.1%, Chile, up 5.5%, and China, which posted a return of 7.3% in the third quarter of 2009.

### Residential Real Estate

The U.S. real estate market has begun to show signs of recovery, as the S&P/Case-Shiller Index of home prices gained 1.2% in July, as reported at the end of September. The 20-city index indicated that home prices increased in 17 of the 20 major metropolitan areas in their most recent report.

On a seasonally adjusted basis, recently reported home price gains were strongest in Minneapolis, up 3.1%, San Francisco, up 2.9%, and San Diego, up 2%. The weakest markets were Las Vegas, down 1.9%, Detroit, down 0.4%, and Seattle, down 0.3%.

It is important to note that the \$8,000 first-time home buyer tax credit, part of the stimulus package passed by Congress in the first quarter of 2009, is scheduled to expire at the end of November 2009. If it is not renewed, demand from first time home buyers may wane.

### Commodity Prices

The price of gold took the spotlight in the third quarter, as one troy ounce of the yellow precious metal fetched over \$1,000 at the end of September. As recently as 2002, gold was valued at less than \$300 per ounce. The chart to the right shows the behavior of the SPDR Gold ETF during the third quarter. (Source: Bigcharts.com) Silver also posted gains in the quarter, rising from just above \$13 to nearly \$18 per ounce.

The price of crude oil was relatively flat for the third quarter, as a barrel of oil began the quarter at \$68.59 and finished at the end of September at \$67.69. Although higher than its five year average price, oil is still less than half the price levels seen last summer.



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## Index Returns Since 2000, Sorted From Best to Worst

INDEX	ASSET CLASS
Russell 1000 Value	Large Value
Russell 1000	Large Blend
Russell 1000 Growth	Large Growth
Russell Midcap Value	Mid Value
Russell Midcap	Mid Blend
Russell Midcap Growth	Mid Growth
Russell 2000 Value	Small Value
Russell 2000	Small Blend
Russell 2000 Growth	Small Growth
MSCI World Index	Global Equity
MSCI EAFE Index	Int'l Equity
Barclays Aggregate Bond Index	Intermed. Bond
Merrill Lynch High Yield Index	High Yield Bond
Balanced (60/40)-Rebal. Annually	Balanced
Citigroup 3-month T-bill	Cash Equiv.

2000	2001	2002	2003	2004	2005	2006	2007	2008	YTD
22.8%	14.0%	10.3%	48.5%	23.7%	14.0%	26.9%	11.8%	5.2%	48.5%
19.2%	8.4%	1.7%	47.3%	22.3%	12.7%	23.5%	11.6%	1.8%	37.1%
11.6%	4.5%	-1.9%	46.0%	20.7%	12.7%	22.3%	11.4%	-20.7%	32.6%
8.3%	4.1%	-9.2%	42.7%	20.2%	12.1%	20.7%	9.6%	-26.2%	29.6%
7.0%	2.5%	-9.6%	40.1%	18.3%	10.0%	20.2%	7.1%	-28.9%	29.1%
6.0%	2.3%	-11.4%	39.2%	16.5%	7.1%	18.4%	7.0%	-33.8%	27.6%
-1.2%	-3.7%	-15.5%	38.1%	15.5%	6.3%	15.5%	6.1%	-36.9%	27.1%
-3.0%	-5.6%	-15.7%	33.8%	15.3%	5.3%	15.3%	5.8%	-37.6%	25.5%
-5.1%	-5.6%	-16.2%	30.0%	14.3%	4.7%	13.4%	5.6%	-38.4%	22.4%
-7.8%	-9.2%	-19.5%	29.9%	11.4%	4.5%	11.8%	4.7%	-38.4%	21.1%
-11.8%	-12.5%	-20.5%	29.8%	10.9%	4.2%	11.2%	2.2%	-38.5%	16.4%
-12.9%	-16.5%	-21.7%	28.2%	8.3%	3.9%	10.7%	-0.2%	-40.3%	15.2%
-14.0%	-20.2%	-27.4%	19.3%	6.3%	3.0%	9.1%	-1.4%	-41.5%	14.8%
-22.4%	-20.4%	-27.9%	4.1%	4.3%	2.7%	4.8%	-1.6%	-43.1%	5.7%
-22.4%	-21.2%	-30.3%	1.1%	1.2%	2.4%	4.3%	-9.8%	-44.3%	0.1%

Returns assume reinvestment of dividends and income. This material is for informational purposes only. Not for public distribution. YTD (Year-To-Date) data as of 9/30/2009. Data source: Zephyr Associates. NRP Financial makes no guarantee as to the accuracy of third party information.

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