

**MARKET REPORT
THIRD QUARTER 2011**

If you haven't read the book Moneyball by Michael Lewis, you might consider putting it on your reading list. Or, if the big screen is more to your liking you can now go see the movie. It is a timely reminder that investors, like baseball team managers, need to remain focused on the stats that matter in order to achieve long term success. Distractions of any sort can be hazardous when it comes to making good investment decisions rooted in fundamental analysis.

In the third quarter investors were forced back on to the roller coaster ride of volatile, and negative, equity returns. There is no shortage of headlines fueling investors' anxiety such as Europe's sovereign debt crisis, emerging economies' growth slowing (China), and the risk of recession in the U.S.

In this market report we will review the performance of equities, fixed income, and touch on what is happening in commodities. We also will revisit some familiar topics that support our generally more bullish outlook. Increased volatility, higher levels of insider buying, and corporate stock buybacks are often indicators of better days ahead.

Market Performance

By now you've likely seen the headlines proclaiming this quarter to be the worst in returns since 2009. This was true with the S&P 500 off 13.9%, including dividends. The weakness was led by small-cap stocks down 21.9% (per the Russell 2000 index). This brought the year-to-date returns also into negative territory with the S&P 500 off 8.7%, including dividends. International markets, by and large, fared worse with equity indexes in Europe and Asia posting losses greater than 20%.

Our focus these past couple of years has been on large-cap stocks as we believe they have presented very compelling valuations, on average. While this remains true, that valuation discount compared to small-cap stocks has narrowed a bit with the third quarter results. Still, we believe that high quality, multi-national, large-cap stocks present a compelling risk/return opportunity in what continues to be uncertain economic times. We addressed this in greater depth in our December 2010 Market Commentary which can be accessed via our website (www.ebs-asset.com/library.aspx) or call our office and we will be glad to provide you a copy.

On the fixed-income front, corporate bonds, as measured by the BofA ML 1-10 Yr index, returned 0.4% and 3.7% for the quarter and YTD, respectively. Treasuries and Agencies, as measured by a similar index, returned 3.4% and 5.6% for the quarter and YTD, respectively.

Total Return as of September 30, 2011						
	QTD	YTD	1 Yr	Annualized		
				3 Yr	5 Yr	10 Yr
S & P 500	-13.9%	-8.7%	1.1%	1.2%	-1.2%	2.8%
NASDAQ	-12.7%	-8.3%	3.0%	6.0%	2.3%	5.7%
<i>Russell 3000</i>						
Index	-15.3%	-9.9%	0.6%	1.5%	-0.9%	3.5%
Value	-16.6%	-11.9%	-2.2%	-1.6%	-3.5%	3.6%
Growth	-13.9%	-7.9%	3.4%	4.5%	1.6%	3.2%
<i>Russell Mid Cap</i>						
Index	-18.9%	-12.3%	-0.9%	4.0%	0.6%	7.5%
Value	-18.5%	-13.0%	-2.4%	2.0%	-0.8%	7.5%
Growth	-19.3%	-11.6%	0.8%	5.9%	1.6%	6.7%
<i>Russell 2000 (Small Cap)</i>						
Index	-21.9%	-17.0%	-3.5%	-0.4%	-1.0%	6.1%
Value	-21.5%	-18.5%	-6.0%	-2.8%	-3.1%	6.5%
Growth	-22.3%	-15.6%	-1.1%	2.1%	1.0%	5.5%

The remarkable story in bonds is that despite the notable credit rating downgrade of U.S. debt by Standard & Poor's, investors were buying up Treasuries at a break-neck pace pushing yields to historic lows. The 10-year Treasury yield is less than the S&P 500's dividend yield and the 30-year has fallen below 3%.

On the commodity front, the retrenchment that began in the second quarter continued in the third, and was likely due to worries of an economic global growth slow-down or just plain fear. Copper futures fell 26% and crude oil futures fell 17%. Many agricultural commodities were also down in the quarter. Most notable was corn, which was 25% off its all time high of June 10th. Even though everyone's favorite yellow metal (yes, gold) ended the quarter in positive territory, it was not without significant shifts, falling 12% in just one week during September.

Regardless of the reason for the retrenchment, lower commodity prices are generally good, as a break from the increases should help consumers and corporations alike.

Insider Buying & Corporate Buybacks

Another bullish indicator is the level of insider buying and corporations buying back their own shares. According to *Vickers Weekly Insider* (cited as one of the more widely watched insider buying newsletters on Wall Street), purchases by company insiders (corporate executives purchasing their own company's stock) relative to sales hit the highest levels since 1998. For a variety of reasons it is rare for purchases to outnumber sales, **but in mid-August insider purchases were at least double insider sales.**

Corporations are also announcing share repurchase programs at significant levels. This is logical given the large and growing cash hoards possessed by many companies, and the seemingly compelling valuations ascribed to many of them. Dividend increases may continue to rise too, and special dividends may become more commonplace.

Volatility

There were 18 days where the Dow Jones Industrial Average (DJIA) moved more than 200 points for the day (intraday moves would have been even larger). There were four consecutive days in August where the DJIA moved more than 400 points (a record).

In September 2008 we wrote about stock price volatility in our Research Perspective (again, available on our website or we would be happy to send you a copy). At that time we were experiencing high levels of volatility that crept even higher by November 2008 and stayed elevated into early 2009.

Breaking down the numbers and bringing them up to date: recent volatility, while not at the extreme levels witnessed at the end of 2008, is double or triple the historical norms. What are the implications? Increased volatility is often associated with stock market bottoms. Investors' fear can lead to a more frenzied level of activity which may cause prices to fluctuate quite a bit, overall resulting in negative pricing pressure. These can provide the best buying opportunities. And for those who don't have cash on the sidelines to go out and buy newly undervalued stocks, bear in mind that a decision to hold a stock can be construed as a decision to buy that stock (less the transaction costs, of course).

Looking Ahead

There are still many unresolved economic and political issues and uncertainties here and abroad. This is nearly always the case, to some extent, and will likely continue for many months to come. Declining markets and the volatility that often accompanies them can present additional challenges for investors in their effort to remain focused on the longer-term. This is particularly true today. **We intend to remain focused on the "stats" that matter** (the fundamentals like price-to cash flow or price-to earnings) and hope to take advantage of discounted stocks to improve the outcome for our investors and us.

Past performance is not indicative of future results. Market and economic data has been provided by third party services. This data, while believed to be reliable, has not been independently verified by EBS.