Financial Markets: Is "after the crisis" just "ahead of the crisis"?

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Outline

- About BNY Mellon / Mellon Capital
- Financial Markets, current conditions and outlook
  - Equities
  - Bonds
  - Commodities
- Conclusion

Additional information in Disclosure Statements at the end of this presentation
About BNY Mellon/Mellon Capital

Bank of New York Mellon
- Headquartered in New York
- 47,700 employees (Oct 2010)
- 10th largest financial institution in the U.S. by market cap (11/08/2010)
- Custodial services: >$20t under custody (Oct. 2010)
- Asset Management
  - $>1t under management (Oct. 2010)
  - Distributed over a dozen boutique asset management companies

Mellon Capital Management
- Founded in 1983
- Headquarters in San Francisco
- $196b under management (Oct. 2010)
- Mostly institutional clients
- Variety of active and passive strategies
- Founded by innovators in indexing

Additional information in Disclosure Statements at the end of this presentation
Here we go again: the S&P500® has recovered 84% of its drawdown

Nov 5, 2010: -21.7% from peak, -16.0% with dividends

March 9, 2009: -56.8% from peak

Source: Datastream

Additional information in Disclosure Statements at the end of this presentation
Hedge funds and emerging market stocks/bonds fared even better!

S&P 500 vs. Hedge Funds, EM equities, EM bonds

Index level (09/30/2007=100)

- S&P500 total return
- HFRI Composite Index
- MSCI Emerging Market Equities
- BofA Emerging Market Sovereign Plus

Source: Datastream and Mellon Capital Management

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TED Spread: back to pre-crisis levels, hardly moved in mid 2010 crisis

3M LIBOR over T-bill spread
(20d rolling average)

Source: Datastream and Mellon Capital Management
Relative to earnings, the S&P500® is still properly valued, by historical comparison.
Earnings vs. S&P500® index: 1990-current

S&P seemed properly valued at the peak

Oct 2010:
<10% below previous earnings peak
>20% below index peak

15 times earnings

Source: Datastream and Mellon Capital Management
Bonds: the next bubble?

- Bonds yields are at or close to record-low levels
- Large deficits, especially in developed economies
- Inflation risk
5 year yields at all time low, 10 year yields close to 2008 lows

5Y and 10Y Treasury yields vs. S&P 500 dividend yield

TIPS implied inflation expectations
Over 10 years: 2.12% as of Nov 8, 2010

Source: Datastream and Mellon Capital Management
Severity of recession vs. U.S. budget deficit

Deficit = cumulative deficit during recession + eight quarters of recovery as % of annual GDP

GDP drop during recession

Source: Datastream, Bureau of Economic Analysis, Mellon Capital Management

Additional information in Disclosure Statements at the end of this presentation
Chasing yields: risky bonds yields are at or close to all-time lows

Source: Datastream, Barclays and Bank of America

Additional information in Disclosure Statements at the end of this presentation
Commodities may hedge against inflation

GSCI average annual return in different inflation environments
(by calendar year 1970-2009)


Additional information in Disclosure Statements at the end of this presentation
Caveat: since 2009 actual commodity returns lagged spot returns

+78% since Feb 2009
+14% YTD

+38% since Feb 2009
+4% YTD

Source: Datastream and Mellon Capital Management

Additional information in Disclosure Statements at the end of this presentation
Why commodity total returns have underperformed spot returns in 2009/10

Example: Commodity fund/ETF

- Hold December 2010 WTI crude oil contract:
  - Investor never wants to take delivery of oil, thus before Dec 1:
    - has to sell December contract
    - buys January 2011 (or later) contract
- Nov 9, 2010 futures prices are in contango (from Bloomberg)
  - $86.77 for December 2010 contract
  - $87.36 for January 2011 contract (0.7% premium over Dec)
  - $87.85 for February 2011 contract (1.2% premium over Dec)
  - $88.37 for March contract (1.8% premium over Dec)
- => Sell cheaper contract, buy expensive contract
- Negative “roll yield” reduces returns by about 0.6-0.7% per month!
Conclusion

- Unlike rest of the economy, financial markets are in full swing again
- Equities seem adequately valued
- Bonds seem expensive
- Commodities bound to continue their rally, but beware of negative roll yields
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