



Investment Update

Alerus[™]
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Stocks: A Quarter to Forget

Despite strong corporate earnings and reasonable valuations, stocks delivered their worst quarterly returns since this recovery began in March 2009. The Dow Jones Industrial Average fell 12.1% in the third quarter of 2011, the broader Standard and Poor's 500-stock index was down 14.3%, and the Nasdaq Composite index of primarily technology stocks fell 13.6%.

Investors worried that Greece would default on its sovereign debt obligations which would create a banking crisis in Europe that would spread through core countries such as Spain and Italy, and eventually, France and Germany. Additionally, the slowdown in the global economy that began with the earthquake in Japan also spread to the United States, Europe, and Australia; even China appeared to be headed to a hard landing.

European markets fared much worse than their U.S. counterparts. The large German and French banks hold substantial amounts of Greek debt on their balance sheets and their stock prices were pummeled. Both the German and French stock markets lost more than 25% of their value. Despite economic growth and low debt levels, emerging market stocks were not spared. Investors continue to perceive these countries as riskier and sell at the first hint of trouble. The MSCI Emerging Markets stock index fell 23% in the third quarter. The peripheral European countries such as Greece, Hungary, and Cyprus, at the epicenter of the debt crisis, were all down over 40% for the quarter.

Bonds: The Flight to Safety Continues

As the global economy continued to slow and investors feared that the European Union would be unable to contain the spreading debt crisis, they fled to the safety of bonds—particularly to U.S. Treasuries. Ten year Treasury yields dropped from 3.2% to below 2.0% offering investors a return of 23%. Spreads on

corporate bonds widened as investors reduced risk in their portfolios. Spreads on investment-grade bonds, which had fallen below 2%, were again above 2% while spreads on high-yield bonds widened from about 5% to 8%. Problems in the peripheral European countries also helped the bond market as investors sought the safety of U.S. Treasuries. We expect that as long as the soft patch and problems in Europe persist, the U.S. bond market should continue to offer decent returns.

Commodities: As Goes China

Recently, the Chinese government embarked on a path to slow its economy to curb inflation and deflate its property bubble. As growth in China slowed, so did the demand for commodities. The Dow Jones UBS Commodities index fell 11.3% in the third quarter of 2011. Copper, which has become a proxy for Chinese demand and infrastructure spending in emerging markets, fell 26%. Oil prices fell 17% and are down over 32% from their highs of 2011 on reduced global demand. Should the developed economies fall further into recession, the risk is further decline in commodity prices.

Currencies: Dollar is King in Times of Uncertainty

The value of the U.S. dollar offers a window into investor risk appetites. When investors seek risk they sell dollars, when they seek safety they buy dollars. In the third quarter of 2011, the dollar gained against all currencies barring the Japanese yen. The hapless euro, with its survival at stake, fell more than 8%. The Australian dollar tied to exports to China fell 10%. The dollar also surged against emerging market currencies, rising 16% against the Brazilian real and 11% against the Korean won. Since most emerging markets have strong growth and low levels of debt, we believe this is a short-term reversal and presents a buying opportunity for long-term investors.

Outlook: Expect Risk Aversion Near Term

We believe that the global slowdown that began this summer has legs and will be with us for a while. Compounding the problem is the spreading debt crisis in Europe. Investors focused on the next six to twelve months should consider reducing risk in their portfolios by increasing their holding of cash and bonds.

For investors with a long-term horizon, over five years, this sell-off has produced outstanding opportunities in many areas of global equities. We have long favored stocks of large high-quality multinational U.S. companies such as McDonalds, IBM, Oracle, Proctor & Gamble, United Technologies, DuPont, and Boeing. These companies have excellent balance sheets, access to credit markets, growth in emerging markets, and

reasonable valuations. We believe this sell-off has also created outstanding values in emerging market and European stocks. However, there is a good chance that these assets will get cheaper before they rise in value.

The Federal Reserve has said it will hold interest rates at these low levels through 2013. This should provide an anchor for short-term rates. Fixed income should offer value in the near term, but could be a drag on portfolio returns over the long term. As the world emerges from a resolution to the European debt crisis and problems in the U.S. housing market, equities should offer superior returns to bonds. We are not there yet.

Sources: Wall Street Journal, Bank of America Merrill Lynch, Goldman Sachs