



**Parametric™**

Leaders in Structured Portfolio Management

## MARKET COMMENTARY

4th Quarter, 2006



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### Domestic

During the fourth quarter, the inflation-minded Federal Reserve appeared content that the economy was neither too hot nor too cold and left interest rates alone for the third and fourth time in a row. Investors seemed to agree with this "Goldilocks" notion that the economy was just right, as US equities had their best quarter of the year, the S&P 500 Index up 6.7%.

Once again sector rotation reigned, as the third quarter's worst performing economic sectors, materials and energy, were the fourth quarter's best performers, both up over 11%, while health care, a top performing sector in the third quarter, was the worst performer in the fourth quarter, up just 1.4%. Value outperformed growth, as investors gravitated towards cheaper stocks, those with lower prices relative to their trailing earnings and book values. Size was not a factor in driving returns in the last quarter of 2006, as mid-cap and small-cap stocks performed similarly to large-cap.

While the economic environment seemed ideal in the fourth quarter, with low interest rates, low inflation and solid GDP growth, the political environment was anything but "just right", the US electorate giving both houses of Congress and the majority of governorships to the Democrats for the first time in 12 years. Although largely motivated by the war in Iraq, this major political shift could increase volatility in the stock market, but our broadly diversified, sector-neutral Tax Managed Core portfolios will provide a great opportunity to capture the next market leaders, while doing so in a tax efficient manner.

### International

The global indices ended 2006 with impressive double-digit returns, as macro-economic data in Europe and U.S. indicated growth numbers in line with long term-averages, slowing slightly but aided by inflation marginally below expectations. The MSCI EAFE Index, measuring all non-North American developed markets, returned 10.4% for the quarter and 26.3% for the year.

Similarly, the emerging markets measured by the MSCI EMF Index, posted a 17.6% return for the quarter and a solid 32.2% return for 2006. With business confidence in Europe stronger than expected and a Euro survey showing that the manufacturing growth remains well entrenched, most of the European markets performed strongly during the quarter. Some of the top-performing countries in the region were Sweden (+19.9%), Ireland (+17.4%), Denmark (+16.1) and Greece (+15.1%). Germany was up 14.4% as the jobless rate there, declined to 9.8%, the first time it has been below 10% since 1992. The Japanese market was up modestly at 5.0% with the economy growing much more slowly than previously expected. An improvement in economic conditions worldwide together with expectation of a soft landing in the US and Europe has boosted consumer confidence. It remains to be seen if this will translate to sustained high equity returns worldwide in 2007.

### About Parametric

Parametric is the industry-leading provider of structured portfolio management. Founded in 1987 and headquartered in Seattle, Washington, Parametric offers a variety of structured portfolio solutions, including customized core equity portfolios (U.S., Non-U.S., Global Tax-Managed Core™), and overlay portfolio management (OverlayOne™).

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