



Market Comments

January 1, 2008

During the fourth quarter, the MSCI World Index sagged 2.4% in U.S. dollar terms, dropping the return of the MSCI World Index to +9.0% for the year. Emerging market equities had a positive quarter, gaining 3.6% and bringing the strong return of the MSCI Emerging Markets Index to +39.4% for the year in U.S. dollars. For non-U.S. investors, however, the investment returns from global equity markets in 2007 were much less favorable due to the weakness of the U.S. dollar versus other global currencies. For example, in Canadian Dollar terms, the MSCI World Index finished down 7.5% for the year and the MSCI Emerging Markets Index finished the year up a relatively disappointing 18.2%.

Fears of a U.S. recession mounted in the fourth quarter, despite the release of third-quarter data which showed the U.S. economy growing at an annual rate of nearly 5%. As the mortgage crisis deepened, financial stocks have been pummeled as write-offs of bad debt continued apace. Despite concerns about a widespread credit crunch, central banks have worked hard to maintain banking system liquidity, with foreign central banks like the Bank of Canada and Bank of England having also joined the Fed in easing monetary policy. With the Fed having already slashed the Fed funds rate by 1 percentage point since September, and with potential rate cuts of an additional half point to full point yet to go in 2008, we believe the odds of the U.S. economy entering into recession are lower than commonly perceived and that a modest reacceleration of U.S. growth is likely in the second half of 2008.

Outside of the U.S., leading indicators of economic activity have also lost ground in many of the other major developed economies, reflecting previous monetary tightening as well as the negative impact of U.S. dollar weakness on export-oriented firms. In contrast, leading indicators for major emerging market economies have generally soared in recent months. Since emerging markets now represent more than 30% of world GDP -- or 50% in real purchasing power parity terms -- the global expansion seems set to continue even if economic activity in major developed markets is sluggish for several quarters. That said, rising inflation in emerging market nations like China has begun to prompt monetary tightening measures that should begin to generate slower growth in coming quarters.

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In our global equity portfolios, we currently have approximately 49% exposure to North America, 29% to Europe, 13% to Japan, 5% to the emerging markets, and 4% to the developed markets of Asia-Pacific excluding Japan. In terms of sector exposures, we currently are tilted toward the information technology, consumer discretionary and health care sectors and are tilted away from the financial, consumer staples, utility, telecommunications, and materials sectors.

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