



**TRILOGY
GLOBAL**
ADVISORS

Market Comments

July 1, 2008

The positive April-May returns of global equity markets were more than unwound in the month of June, with the MSCI World Index finishing the quarter down 1.7% in U.S. dollar terms and dropping the year-to-date return to -10.6%. Emerging market equities also declined during the quarter, falling a slight 0.9% and bringing the return of the MSCI Emerging Markets Index to -11.8% for the year in U.S. dollars.

Economic news flow in June was generally downbeat. Oil prices rose to above \$142 a barrel over the month, creating crisis conditions in auto, airline and related industries. Consumer confidence in the U.S. plummeted to new lows, in response to the energy shock, continued home price declines, and tightening credit conditions. News from Europe and Japan was also disturbing, with Germany's closely watched IFO survey of business confidence sharply lower while consumer confidence in Japan fell to a six-year low. Inflation fears continue to mount, with more than 50 developing nations reporting annual inflation greater than 10%. On the geopolitical front, current tensions between Israel and Iran have also roiled energy markets and added to the gloom.

Economic policymakers have signaled higher levels of concern about inflation, with ECB officials indicating their intention to raise interest rates soon while the Fed has made clear that further easing is off the table for now and rate hikes will be forthcoming if inflation expectations worsen. In the meantime, many developing nations have been raising interest rates and, in some cases, reducing energy subsidies that have contributed to excess demand and worsening fiscal deficits. Such measures, along with the need for more stringent tightening ahead, increase the odds of growth recessions in many developing nations in 2009.

In short, a key concern of many market participants is that layering an oil shock on top of the global credit crisis will be enough to tip the U.S. and other key nations into prolonged recessions. Although a muddle-through scenario is still possible, it will require an easing of energy and other commodity prices sooner rather than later. Otherwise, risks of a broad-based global slowdown scenario in 2009 may begin to dominate market perceptions. With developed market global equities now trading at an estimated 11.9 times 12-month forward earnings, a substantial degree of bad news already appears to be discounted in current equity prices. But, near-term risks to the outlook for corporate earnings remain daunting.

In our diversified global equity portfolios, we currently have approximately 49% exposure to North America, 28% to Europe, 13% to Japan, 6% 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, health care and consumer discretionary sectors and are tilted away from the financial, energy, materials, consumer staples, and telecommunication services sectors.