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# Market Comments

August 1, 2008

Global equity markets suffered additional losses in the month of July, contributing to their double digit losses for the year. In U.S. dollar terms, the MSCI World Index fell 2.4% during the month, which left the index down 12.8% for the year. Emerging market equities also lagged during the month of July, with the MSCI Emerging Markets Index posting a loss of 3.8% in U.S. dollar terms. That brought the year-to-date return for emerging markets to an even weaker -15.1%.

Evidence continued to mount in July that the global economy had entered a synchronized slowdown due to the combined impact of the global credit crisis and energy price shock. The English-speaking nations have tended to lead the slowdown based on common factors such as home price declines and high levels of household debt. In the U.S., jobless claims hit a 5-year high of 448,000 suggesting that recessionary dynamics have intensified. In the U.K., consumer confidence fell to the lowest level since 1974 while housing prices were down by 8 percent from a year ago. In Canada, GDP has fallen three months out of four, while in Australia retail sales have softened markedly since the beginning of the year.

Outside of the English-speaking nations, signs of economic weakness also have multiplied. Business confidence surveys across Europe took a hit in July with Germany's closely watched IFO survey having posted a notably sharp decline. In Japan, manufacturing has now declined for two consecutive quarters while consumer confidence has also hit a six-year low. And while most emerging market nations continue to post robust growth, policy tightening to fight inflation suggests that growth will slow in coming quarters. Given that more than 50 emerging market nations have recently reported inflation rates above 10%, monetary tightening in those nations has become an urgent priority. The central banks of Brazil and India surprised markets with decisive monetary tightening measures in July and many other emerging market central banks appear likely to follow their example.

Concerns about intensifying recession dynamics around the world helped contribute to sharp declines in some commodity prices in July, with oil falling notably from a peak of \$147 per barrel in mid July to \$123 per barrel by the end of the month. Financial stocks rallied sharply in the second half of July as oil prices declined and U.S. lawmakers passed a bill to help the housing sector. The bill included targeted measures to shore up the finances of beleaguered mortgage giants Fannie Mae and Freddie Mac, whose troubles had spurred significant financial sector volatility in recent weeks. With the developed global equity markets now trading at 11 times forward earnings, financial markets appear

to have fully priced in global recession. From this point on, the severity of the global recession is likely to depend critically on whether a decline in energy and other commodity prices can help dampen the evident inflation pressures that have worried investors. With unit labor costs well under control in the major industrial nations, there is a good chance that July will represent peak inflation for this cycle, setting the stage for equity market recoveries and better growth in 2009.

In our diversified global equity portfolios, we currently have approximately 48% exposure to North America, 28% to Europe, 12% to Japan, 7% to the emerging markets, and 5% 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 away from the materials, industrial, consumer staples, financial, and energy sectors.

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