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# Market Comments

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After faltering in June, global equity markets posted robust gains in July of 8.5% and 11.2% respectively in U.S. dollar terms for the MSCI World index and the MSCI Emerging Markets index. That brings total returns for the year to date of 15.4% and 51.3% respectively for the two indexes following last year's sharp declines. Equity markets continued to be supported by positive developments in credit markets amid numerous signs that the global economy was beginning to recover from the sharp credit crunch that was triggered by Lehman's bankruptcy last September.

In the U.S., with about 60% of S&P 500 companies having now reported second quarter earnings, positive surprises have outnumbered negative surprises by 3 to 1, although results for revenues have generally been in line with expectations. European companies have also delivered supportive earnings announcements as well, while economic data on both sides of the Atlantic has continued to support prospects for economic recovery in the second half of 2009. In the U.S., for example, initial unemployment claims have continued to trend down, while retail sales in the U.K. have been better than expected as evidence mounts that housing prices are beginning to trend upward again in response to expansionary monetary policy. Asian economies have also delivered clear signs of economic recovery, with South Korea's economy expanding at an annual rate of nearly 9% in the second quarter, as China and Singapore also reported that growth accelerated in the second quarter.

With the MSCI World index trading at around 14 times expected earnings for the next twelve months, valuations continue to factor in a relatively cautious earnings outlook. That backdrop suggests the potential for further significant gains in global equity markets ahead if the positive news on earnings continues as we expect. A much healthier trend in credit markets also supports a positive view on global economic growth, with the Bloomberg Financial Conditions Index having staged a dramatic V-shaped recovery in recent months, reflecting a welcome return to normalcy in many credit markets that had effectively shut down in the wake of Lehman's collapse. This trend has helped financials and cyclical sectors like materials and consumer discretionary lead global equity markets in July, reinforcing a pattern seen in the internal price action of global equity markets on a year-to-date basis.

When will central banks begin to remove stimulus measures and thereby undermine the equity market rebound? With U.S. unemployment at 9.5% and high levels of excess capacity still evident around the world, the answer is probably no time soon. That said, lending conditions in China have been so lax in recent months that there are now influential voices in China warning of the need for a credit clampdown in order to prevent inflation and to curb rampant speculative forces in asset markets. Because of the increased importance of China to global economic trends, Chinese credit policy will bear close watching in coming months against a monetary policy backdrop in the advanced industrial nations where little seems likely to change any time soon.

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