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Market Comments

October 1, 2009

Global equity markets have posted gains during five of the past six months, with the MSCI World Index gaining 4% in September and 17% for the quarter. The World Index has posted a two-quarter advance of 42%, which is the biggest two-quarter advance since the inception of the World Index in 1974. Even with that recovery, the index remains roughly 33% below its peak level in October 2007 after having plunged nearly 60% during the global financial crisis.

Economic news released in recent weeks has made it increasingly clear that a synchronized global economic recovery is underway. Although Europe has experienced a slower-than-expected recovery, global industrial output rose at an annual pace of nearly 8 percent in the three months through July. Together with strong readings in August on purchasing managers' surveys in major nations like the U.S. and China, it appears increasingly likely that the growth in global industrial output in the second half of 2009 will outpace that of any comparable period in the past two decades. Asia in particular appears to be experiencing a truly V-shaped business cycle with production in the July quarter having grown at a 40% annual pace following two quarters of decline at a violent 35% pace. And even though the output recovery in Europe has lagged that of other regions, the delayed recovery appears to reflect an exceptionally deep cutback in inventories that should set the stage for a strong recovery later this year.

Improved financial conditions continue to be very supportive of further economic gains. The Bloomberg Financial Conditions Index, which we track very closely, posted a gain of more than 1 standard deviation in the September quarter and has now had a massive recovery of 11 standard deviations from its low of October 10, 2008. In a business cycle that has been driven by massive changes in financial conditions, the Bloomberg Index gave advance warning of a wave of downward revisions to global growth forecasts last fall. In contrast, this year it has consistently pointed – and continues to point – to economic growth rates in coming quarters that may exceed consensus forecasts by a wide margin. Accordingly, we remain constructive on the outlook for both real GDP growth and corporate profit growth over the next twelve

months and continue to focus on companies that should benefit from a continuation of the business cycle expansion that is now underway.

In response to the normalization of economies and financial market conditions, policy makers are understandably beginning to carefully consider their exit strategies. But for the time being, unemployment and slack resources remain so high that authorities in major industrial nations seem likely to continue with highly accommodative monetary policies for at least the next two quarters. That suggests a continued “sweet spot” for global equity markets as growth expectations continue to firm while central banks refrain from stepping on the brakes. The exception may be some emerging markets like Brazil, where interest rates are now expected to move up early next year.