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Market Comments

March 1, 2010

Global equity markets staged a modest recovery in February after starting off the first few weeks of 2010 with weak performance. The MSCI World index posted a positive total return of 1.4% in February, which left it down 2.8% for the year to date. The MSCI Emerging Markets posted a more lackluster return of 0.4% in February, which left the index down by 5.2% for the year to date. The U.S. dollar index gained nearly 1.6% in February, continuing a trend toward dollar strength which has pushed the dollar index up by nearly 8% since last November.

Equity market jitters this year appear to have been primarily related to investor concerns about three developments: the beginning of monetary tightening in China, intensified fiscal problems in peripheral Europe, and the potential for draconian financial reform policies in the U.S. and Europe. China hiked reserve requirements by 50 basis points in February, surprising market watchers with the second such move this year. Amid surprising reports of growing labor shortages in China, expectations are that the Chinese authorities are likely to begin normalizing interest rates starting in April with the pace of rate hikes likely to depend crucially on upcoming inflation data. There is also increased speculation that the Chinese authorities may find it convenient to engineer a one-step boost in the value of the yuan by mid-year as part of their inflation control efforts.

In Europe, the focus has been on whether Greece could be headed toward default on its government bonds as EU authorities have tried to finesse the situation by suggesting that support for Greece will be forthcoming if the Greek government delivers a credible fiscal adjustment program. Greece's problems have spilled over into concerns that other peripheral European nations like Portugal, Ireland, Italy and Spain face painful adjustments ahead, which could dampen Europe's growth prospects and put prolonged downward pressure on European inflation rates, interest rates and the value of the euro.

In both the U.S. and Europe, extremely severe winter weather has contributed to some weak economic data releases in recent weeks. But most economists believe that the global economic recovery remains intact, with J.P. Morgan estimating that global growth in the fourth quarter of 2009 reached 4.2% on a seasonally adjusted annualized basis. U.S. growth came in at 5.9% annualized for the fourth quarter, suggesting solid momentum that is unlikely to be seriously dented by transitory weather factors. The Bloomberg Financial Conditions Index continues to depict a broad-based normalization of financial conditions from a year earlier,

which augurs well for a sustainable economic recovery in coming quarters. Although the Fed continues to suggest that interest rates will remain low for an extended period, we continue to believe that a significant post-winter recovery in job growth will set the stage for the Fed to begin to normalize interest rates in the second half of the year.