



# Market Comments

May 3, 2010

Global equity markets offered decidedly mixed performance in April as attention centered on whether Greece was headed toward a default on its sovereign debt. Fears of contagion effects from a possible Greek default created downdrafts for other European equity markets like France, Portugal, and Spain. But outside Europe, many other major markets fared relatively well, with the U.S. market posting a 1.6% gain for the month. Overall, the MSCI World Index was unchanged while the MSCI Emerging Markets Index rose 1.2% in U.S. dollar terms last month.

The situation in Greece led to a noticeable worsening of overall financial indicators during April, despite otherwise favorable economic reports from around the world. For example, the Bloomberg Financial Conditions Index fell from a positive reading of 0.65 as of mid-month to a reading of only 0.21 at the end of the month, reflecting spikes in volatility, junk bond spreads, and the Libor-OIS spread. The worsening of financial conditions may also reflect increased scrutiny of major investment banks over their securities underwriting practices, as reflected in fraud charges leveled against Goldman Sachs in April along with indications that Federal investigators are considering launching a full criminal probe into the bank's mortgage-backed securities business.

We suspect that the recent downdraft in financial conditions will be readily reversed in coming weeks as European authorities and the International Monetary Fund provide sufficient credit to prevent Greece from having to access global capital markets for the next several years. That said, the fiscal problems of peripheral Europe seem likely to remain a significant drag on European growth for several years to come as nations like Portugal, Ireland, Italy, Greece, and Spain are forced to implement politically unpopular austerity measures without being able to use currency devaluation as a tool for restoring their international competitiveness.

Despite the crisis in Greece, which accounts for only 2% of European output, there is now ample evidence of a broad-based global recovery which has gained both breadth and momentum in recent weeks. Preliminary reads on the U.S. and Emerging Asia have been quite strong, with J.P. Morgan's economics team now estimating that global GDP rose at an annual rate of nearly 4% in the first quarter of 2010. Moreover, numerous business sentiment surveys rose impressively in April and are now well above the first quarter averages, suggesting that global growth will accelerate further in coming months. The International Monetary Fund now projects global GDP growth of 4.25% for both 2010 and 2011, with its April forecast emphasizing the multi-speed nature of the expansion as emerging markets (which got off to a strong start in 2009) remain in the lead in 2010 and 2011.

The multi-speed nature of the expansion clearly sets the stage for central bank exit strategies to proceed at multiple speeds as well. Central banks in leading emerging market nations like Brazil and India have already begun to tighten monetary policy and China is widely expected to begin its rate hike cycle this

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quarter while also allowing its currency to appreciate. In contrast, the Fed will be in no hurry to tighten policy until it has seen several months of robust growth in employment, while deflationary pressures in peripheral Europe and in Japan argue for continued monetary accommodation. With developed global equity markets trading at a reasonable 13 times the next twelve month's estimated earnings, and with earnings projected to advance by 25% this year and nearly 20% next year, equities continue to look attractive relative to fixed income.

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