



Perspective on the Latest Market Events

Commentary from Katherine Ellis Nixon, Northeast Region Chief Investment Officer

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Economic statistics and the global financial markets continue to send mixed messages about the state of recovery. While second derivative (or change in the rate of change) analysis suggests that the pace of economic deterioration has moderated, important indicators such as employment and housing continue to reflect dismal actual results. In the United States, initial jobless claims fell by 21,000 to 601,000 in the week ending June 6, 2009 – fewer than forecasted and an improvement from prior weeks. Yet 600,000 still is a staggeringly high number of claims. In the U.S. housing market, contracts for existing home sales increased 6.7% in April, the third consecutive monthly increase and, as noted in a recent commentary by Paul Kasriel, Northern Trust's chief economist, housing affordability is the highest in 40 years. At the same time, we continue to see rising foreclosure rates. Developed Europe is showing similar trends of improvement in the second derivative: industrial production in the Eurozone fell 1.9% month over month in April, the eighth consecutive decline, however the pace of decline appears to be slowing.

Simultaneously, we continued to have a global rally in risky assets – everything from equities to corporate credit and commodities. Global market indices are breaching new 2009 highs, and oil has surpassed the \$70 level. European markets are selling at the richest price to earnings valuations in four years, the Dow Jones Industrial Average broke into the black for the first time this year, and the Shanghai market is up over 50% year-to-date. “The worst may be over,” appears to be the mantra of most economists, and belief in the success of the various fiscal and monetary stimulus packages appears to be the norm.

Over the weekend, the G8 finance ministers met in Italy to heave a collective sigh of relief, making note of signs of stabilization. At the meeting, the finance ministers also touched on a topic of intense interest: if global central banks have indeed stabilized the system, when should they reduce the stimulus to avoid a rise in inflation?

We are seeing a sharply steepening yield curve both here in the United States as well as abroad, indicating that investors also believe the recovery is real, and that inflation likely will be an outcome of the stimulative policies now in place.

This belief also has taken its toll on the U.S. dollar, and has renewed discussions among the emerging market economies in particular to reconsider the dollar's role as the global reserve currency. While the calls for a new global reserve currency appear mainly to be just talk at this stage, they are creating volatility and uncertainty. The discussion also shines a spotlight on the longer-term effects of our massive stimulus programs combined with our growing budget deficit.



Taking away the punch bowl can be a tricky business, however, and must be done carefully. According to Newton's Law, a body in motion tends to stay in motion. Hence, the first move – when it comes – will send a strong signal to the market and likely will result in an immediate overreaction. However, no move to end the stimulus will be possible until we see more sustained signs not just of stability, but of actual recovery.

The global challenges of excessive leverage and a financial and economic meltdown have eased substantially in the face of global fiscal and monetary stimulus policies and targeted governmental programs aimed at housing and credit. The continued, albeit weaker, effects of these problems, coupled with the emergence of higher oil and gas prices and the prospect of higher taxes have created an economic headwind. When coupled with the stimulus-created tailwinds, we find ourselves in a crosswind, which is the most difficult to navigate successfully. At the Investment Policy Committee (IPC) level, we will continue our surgical approach to the tactical asset allocation process, assessing the various risks as they evolve and any potential opportunities that are uncovered in the process.

Katherine Ellis Nixon holds designations as a Chartered Financial Analyst and Certified Investment Management Analyst.

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