

Global Commentary

Please refer to Appendix – Important Disclosures and Analyst Certification

Now Sovereigns Need Help

Bottom Line:

- U.S. Yields Fall
- Dollar Rallies Gold Gaining Strength
- Global Breadth Deteriorating
- Lessons for the U.S.

The last time around it was the banks that needed to be bailed out – this time it is a sovereign country. Much like the initial round of bank bailouts in the U.S., the approach this time seems haphazard. Questions bubble to the surface. Will they or won't they save Greece? How big of a bailout has been pledged? Is it enough? Who is next?

Left unchecked liquidity crises become insolvency crises, and at this point too many questions seemingly remain unanswered for panic and turmoil to subside. The turning point in late 2008/early 2009 was when the Federal Reserve made an implicitly limitless pledge to support the domestic financial system. A few successful (albeit meager) tests of the veracity of that pledge allowed concerns to crest and a more orderly functioning of the market to return. Absent a clear and expansive answer to the “will they or won't they” question, investors and speculators will likely continue to

shift focus from one sovereign country to the next.

U.S. Yields Fall. As concern about sovereign solvency has evolved, government bonds yields across Europe have soared. The decline in price (the price of a bond declines as the yield rises) of these previously assumed-to-be-safe assets has impacted European banks, which now have to rebuild their balance sheets. With their options narrowing, these banks (and other investors looking for “safe” assets) seem to be turning to debt issued by the U.S. government. The yield on the benchmark 10-year T-Note has dropped 45 basis points over the last month, falling to 3.55%. This comes

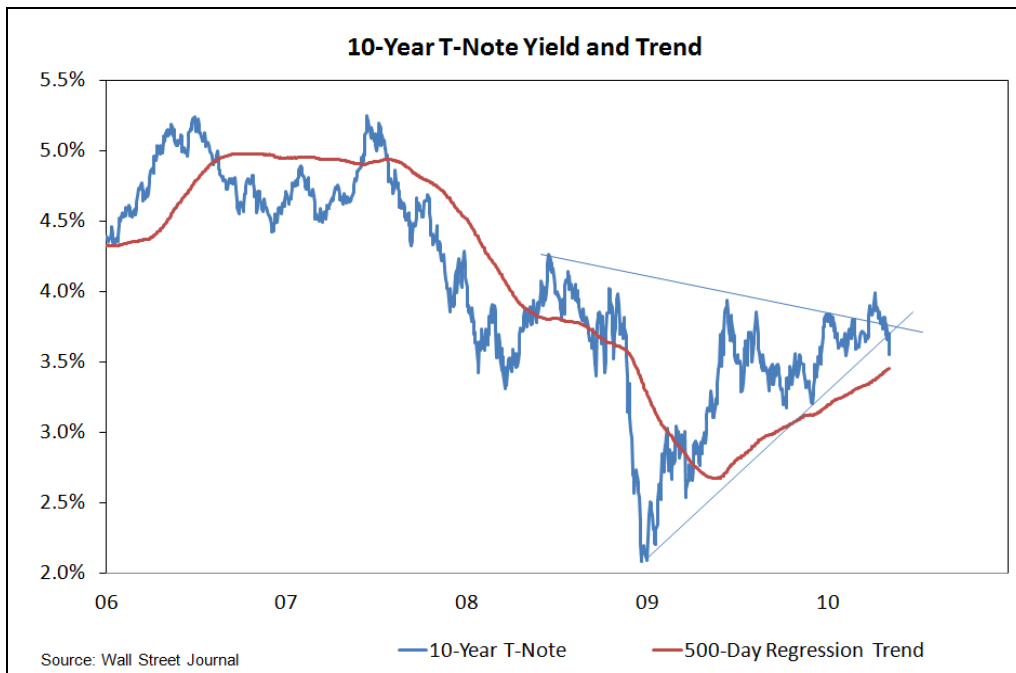
Strategic Outlook Summary

Marketweight Stocks, Underweight Bonds

Global Equities Entering Correction Phase

Sector, Country Allocations Focus on Defensives and Quality

Gold Uptrend Intact



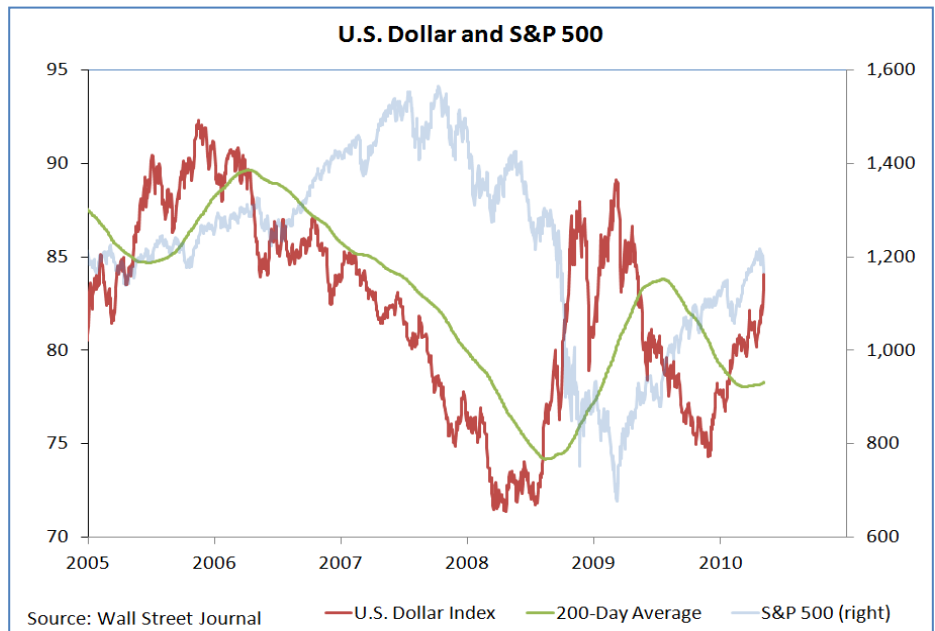
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at a time when the U.S. recovery is said to be hitting its stride, an ample supply of new U.S. government debt is coming to market, and projected fiscal deficits stretch beyond the horizon. While the recent decline in U.S. bond yields is likely largely a reaction to new demand, **the previous equilibrium did not seem to support a view of uninterrupted domestic growth and rising inflation pressures.** Rather, deflation concerns remain elevated, domestically as well as in Europe.

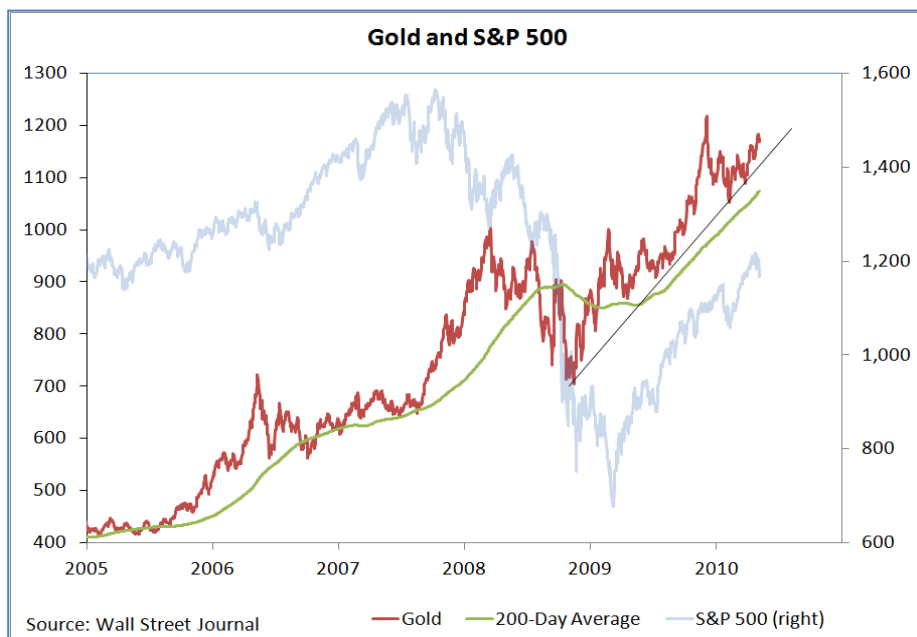
The Pacific-rim countries seem to face a separate set of problems. China is attempting to rein in inflation by raising its reserve requirements and both the Australian and New Zealand central banks are raising interest rates. The yield on Australian 2-year government notes is 400 basis points higher than the U.S. equivalent. **These two countervailing winds (deflation concern and inflation fighting) could add strain to the global economy.**

Dollar Rallies – Gold Gaining Strength. Associated with the shift in preference away from euro-dominated debt and toward dollar-denominated debt has been continued strength in the dollar. The dollar index, which



is largely but not exclusively, impacted by the USD/EUR relationship, is up nearly 5% over the past three weeks and has risen 8% thus far in 2010. This has an impact on overall economic growth and corporate earnings and could help explain the late-stage strength in small-caps relative to large-caps. Net exports subtracted 60 basis points from GDP growth in the first quarter (i.e., without the foreign trade component, growth in the quarter would have been 3.8%, as opposed to the reported 3.2% growth). Going forward, corporate earnings for the large multi-nationals could lose beneficial currency translations, making it that much more difficult to meet elevated earnings expectations.

The initial rally in the dollar this year was accompanied by weakness in the price of gold (denominated in dollars). More recently, however, gold has paced the gains seen in the dollar. The dollar has benefitted on a relative basis by at least appearing to be the strongest of the paper currencies, but **the resurgent up-trend in gold suggests an increased preference away from paper currencies in countries in general with unanswered debt problems.** Non-U.S. dollars (i.e.,



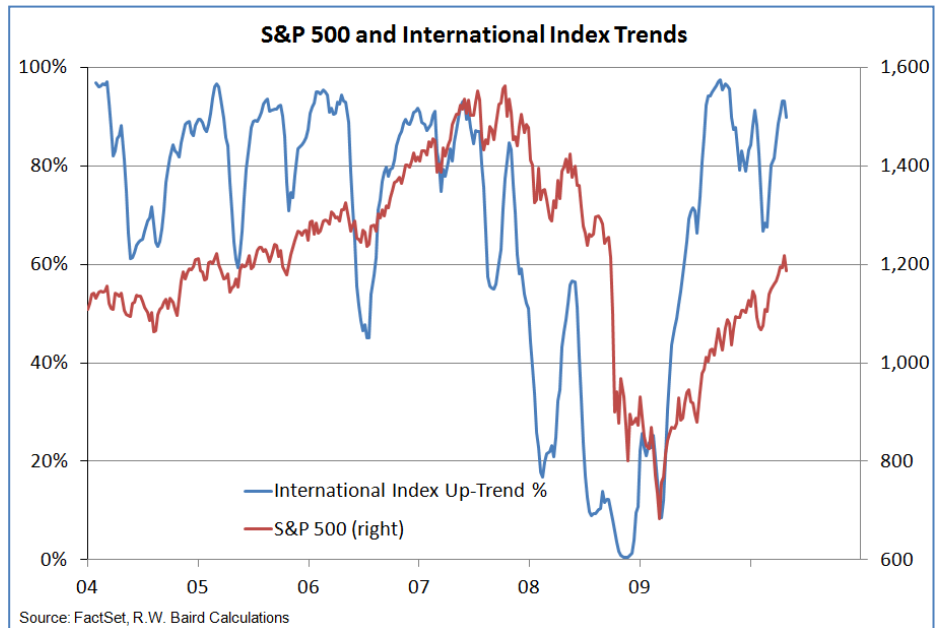
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the Canadian, Australian, and New Zealand currencies) appear relatively strong and are on a more sound fiscal foundation. Gold's strength comes as prices for industrial metals are falling, again suggesting that gold prices are a reflection of currency expectations, not inflation/economic growth expectations.

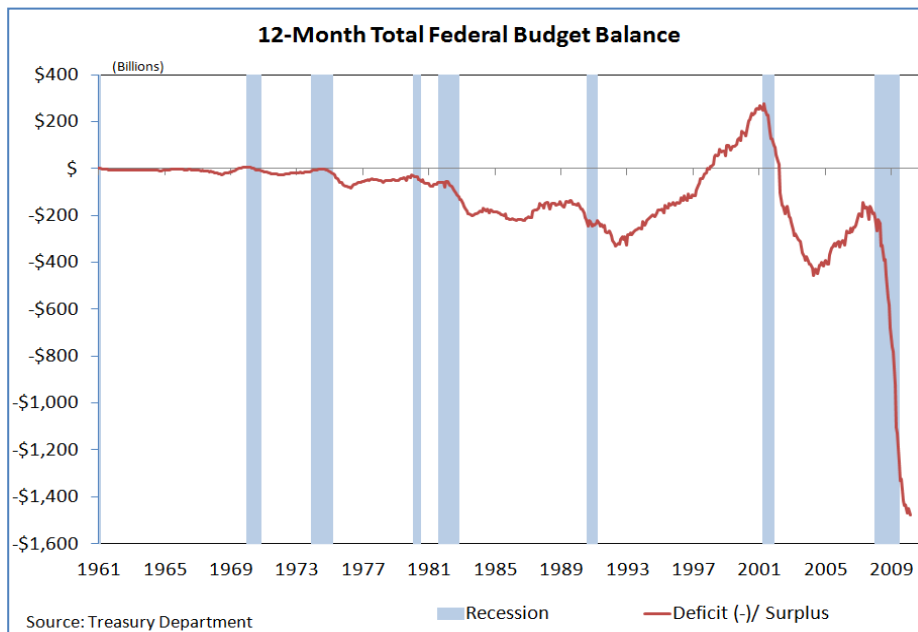
Global Breadth Deteriorating.

While the broad market remains generally supportive of domestic indexes (although the emergence of downside momentum marked by the 10-to-1 down days is concerning), the global breadth indicators argue for more caution. Our international index up-trend indicators are diverging from the S&P 500, and our international relative strength rankings show an improvement in recent weeks in the ranking for the U.S. relative to its international counterparts. **Simply put, the lock-step gains seen domestically and abroad in the early stages of the rally have been replaced by more ragged and inconsistent upside participation.** *Global stock market action over the past week again reminds us that during period of strain, foreign equity exposure tends not to be a reliable diversification tool from a risk management perspective. This is especially true for U.S. investors gaining that exposure through ETFs.*



Lessons for the U.S. While the sovereign debt crisis has had its greatest impact thus far in Europe (in both real and financial terms), its lessons and implications do hit home in the United States. The fear of contagion has hit our financial markets at a time of stretched valuations and looming seasonal weakness. While the U.S. economy is more robust and dynamic than the Greek economy, there are parallels. Both have elevated amounts of debt to GDP and both face significant ongoing budget deficits. This should put renewed emphasis in fiscal stability domestically. Moreover, it brings renewed concerns about spiraling global deflation.

Our concern remains the same. **Nothing has been done to address the problem of excessive debt.** To date, it has been moved around, from corporation to corporation, from corporation to sovereign entities and now from sovereign to sovereign. Even as assets have been destroyed, the debt remains. **The risk is that the assumption of this debt will bring down otherwise-healthy entities and the reluctance to address the debt problem, now and in the past, keeps the global economy fragile and subjects the financial markets to panic.**



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Appendix – Important Disclosures and Analyst Certification

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