Regional
Specialists
Review

January 2011

WorldView

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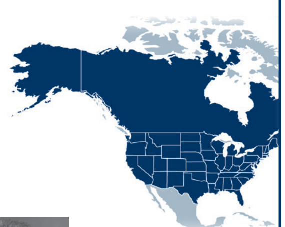
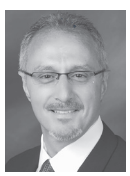
Overview: *The process of cleansing the excesses of the last decade continues around the world. By and large, this means a reversal of the leverage that was built up in many sectors of the economy. However, it also means pulling back in things we could not really afford – be it the early retirement age in France, open-handed unemployment benefits elsewhere in Europe, or generous public-sector wages and pensions across many nations.*

In our view, this will serve to moderate the pace of recovery, not prevent it. Emerging nations also offer another source of support. After the currency and debt crisis of the late '90s, many of them implemented more effective governance, monetary, fiscal and wage policies which now allow them to be a source of demand and capital for the rest of the world.

North America





Tony Caxide, CFA®
Chief Investment Officer

The U.S. economic recovery, after downshifting in the summer, again has pride in its step. Strength in consumer spending has been a surprise to many. Manufacturing slowed from unsustainable double-digit rates and is "passing the baton" of growth to other sectors. Housing could become the next dark-horse contributor to growth, even if it develops gradually.

Inflation, at the core level, has actually slowed to a 0.4% pace, which may constrain increases in Treasury yields. Risks include fiscal deficits, tightening monetary policy throughout many emerging nations and commodity producers, and tighter fiscal policy globally.

Asia

Jeff Wilkins, MBA
Director, Portfolio Mgmt.

Japan has seen only a slight cooling of the Yen's prolonged appreciation, despite material intervention by the government. Even so, the Topix index (Japan's S&P 500) experienced growth of almost 8% in the fourth quarter of 2010. While industrial production and various macroeconomic indicators turned positive in November, it remains unclear whether a sustainable recovery can prevail without additional government stimulus, especially in the face of obstinate deflation. Corporate goods prices offer some hope that deflation will wane, which would be a major development. Employment and consumer activity do appear to be improving.

Europe

Euro-zone growth has slowed and risk of sovereign defaults continue to plague the region. The third-quarter GDP of 1.2% was well below the prior quarter's 4% pace. Retail sales are less robust than in the U.S. (and may be slowing), construction production is 20% off the end-of-2006 peak, and unemployment remains just over 10%. Yet export growth is robust.

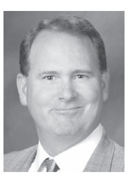
Portugal now occupies the headlines for potentially requiring a rescue package, but it represents a small fraction of the European economy. There is concern Spain could be next. The euro has drifted lower against the U.S. dollar, but there is talk of increasing the €440 billion European Financial Stability Facility to ease investors' concerns.

Eric Shisler, CFA®
VP, Portfolio Management

UK

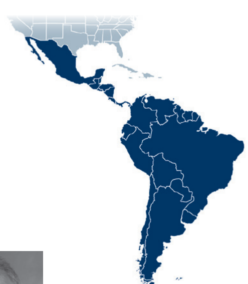
Economic gains continue, as annualized growth in third-quarter GDP of 2.8%, albeit softer than the second-quarter, is nevertheless a solid expansion and typical of the longer-term trend. Household spending is weak, but both manufacturing and capital investment are robust. Looking out to 2011, it appears private-sector activity will be needed to offset a tightening in fiscal policy announced in October.

Much like the U.S., monetary policy in the UK has been accommodative. However, unlike here, inflation running over 3% has been a concern. Thus, we do not expect the Bank of England will embark on a second round of quantitative easing.



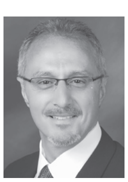
Chris O'Daniel, CTP, CFA®
Director, Portfolio Mgmt.

Latin America



Brazil's political transition went smoothly, as markets hope that Dilma Rousseff (the country's first woman president) will continue the market-friendly policies of the ever-popular Lula, her predecessor. In fact, Brazil has the burden of success – robust growth, rising inflation and interest rates, and a booming currency which threatens future exports.

Brazil's finance minister has voiced concerns that the U.S. Fed's aggressive easing is exporting inflation to his and other countries and even has talked of "currency and trade wars". Most of his counterparts in the emerging world are more measured in their comments, but many increasingly argue that China needs to allow its currency, the yuan, to strengthen or they won't be competitive.



Tony Caxide, CFA®
Chief Investment Officer

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