Regional
Specialists
Review

September 2011

WorldView

Overview: *Economies fall – or recessions occur – typically when they're pushed. Usually the culprits are rising inflation and interest rates and a contraction in the booming, "leveraged" sectors of the economy, like housing and inventories.*

Political confrontation and seemingly intractable fiscal deficits in the U.S., Europe and Japan, rising interest rates in emerging markets, and an unemployment problem the developed world over certainly make for stomach ulcers. But, although risks of contraction have increased, the usual triggers for recession appear contained in the U.S. Further, a fairly low U.S. dollar and falling commodity prices may be the needed prescription for continued, if mild, growth.

Tony Caxide, CFA®
Chief Investment Officer

North America

The U.S. continues to see a dichotomy – record second-quarter profits teamed with tepid economic growth. Although this partially reflects a positive (America's gains in exporting and sourcing sales abroad are boosting profits), it's nevertheless unsettling thanks to weak gains in employment and other sectors.

We feel that, ultimately, success in the U.S. financial markets will be a function of public policy and attractive valuation. The Federal Reserve appears to be one of the few adults in the room, and should work with its foreign counterparts to try to bring about growth. The rest of the government remains a disappointment. But, although the confrontation to date does not foster hope, in the end we feel they will do the right thing, if only to avoid losing elections.

Jeff Wilkins, MBA
Director, Portfolio Mgmt.

Asia

After a significant natural and nuclear disaster, the speed of recovery in many of Japan's economic fundamentals is clear evidence of the country's resilience and determination. Exports have been growing despite a strong yen, and recent consumer measures have also increased. The risk of deflation may have passed as some degree of inflation appears to have taken hold and may be sustained.

Whether or not this recovery will translate to sustained growth and stronger corporate profits is not yet clear. Despite many headwinds, including political instability and declining population, it remains possible that the rebuilding effort's "spark" may ignite sustained growth in consumption and GDP.

Europe

Eric Shisler, CFA®
VP, Portfolio Management

The likelihood of a Greek default continues to be a pall over Europe and its banks. To avoid the ripple effect from such an event, European leaders may need to bring about an orderly default or restructuring to prevent a spread to other countries (particularly Italy and Spain) and/or a breakup of the Euro. These policies could also serve to lay the groundwork for greater fiscal responsibility by each Eurozone-member country.

We believe these financial stresses and a slowing global economy are resulting in weaker economic releases, and negative growth in Europe is increasingly likely – perhaps as soon as the fourth quarter. The buck now stops with policy makers' ability to bring about the needed fiscal solutions and avoid contagion.

UK

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

As the third quarter draws to a close, challenges to growth are emerging. The UK economy has slowed as manufacturing has declined. Consumer incomes are stressed, owing to high inflation and a lackluster labor market. The Eurozone and the U.S. – key sources for exports – appear to be softening. To avoid contraction, the UK's services sector (75% of output) will need to continue to expand.

Despite languid growth, the coalition government is sticking with its restrictive fiscal policy. The objective is to lower the nation's structural budget deficit. Over the course of the next five years, government spending (about 47% of GDP) is to be brought closer to revenue (37%). To do so, public-sector employment and services are being curtailed. This is likely to be a drag on the UK's growth.

Emerging Nations

Tony Caxide, CFA®
Chief Investment Officer

Emerging nations appear to be suddenly downshifting from a boom (rapid growth, excessive inflation, sharply rising wages, currencies and interest rates) to a slower pace of growth. This is the result of their own efforts to slow unsustainable growth as well as global financial stresses.

This "late stage" of the economic cycle is usually unfriendly to local stocks and bonds. Sure enough, many emerging stock markets have underperformed the U.S.' Sentiment has been aggravated by fears that their business model – invest and export aggressively to the developed world – may be leading to bubbles (as in real estate) and is vulnerable to slow growth and financial pressures in importing economies like Europe and the U.S.

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Hamilton Capital Management, Inc.
5025 Arlington Centre Blvd., Suite 300
Columbus, Ohio 43220

614/273-1000 • 614/273-1001 (fax)
888/833-5951 (toll free)

www.hamiltoncapital.com