

GLOBAL EQUITY COMMENTARY

FOURTH QUARTER 2009

Global Markets

Equity markets generated solid gains during the fourth quarter, cementing the rally since March that has rebuilt markets after one of the most harrowing periods since the Great Depression. Both U.S. and global equity markets moved up during the quarter and emerging markets continued to do well. Thanks to unprecedented stimulus by governments around the world, the quarter capped a year that saw financial markets rally significantly across varied capitalization, style and geography. Investors embraced some of the most volatile and higher risk stocks and bonds during the quarter and the year – racking up sizable gains. Global markets and economies continued to be supported by the benefits of stimulus – both fiscal and monetary - and central bank pledges to keep interest rates low in many countries. Overall, a global economic recovery seemed to be in place, however, many strategists were concerned about how markets would fare going forward as the impact of stimulus wanes.

The MSCI World index was up 4.50% in local terms and 4.07% in USD terms. Index markets were generally mixed with major indices in Europe reporting in local terms: Austria -8.12%; Spain 3.19%; Italy -0.84%; and the United Kingdom 5.94%. In Asia, major country indices reported generally positive performance as reflected by Japan 1.10%, Singapore 9.36%, and Hong Kong 3.63%, respectively. On a relative basis, the U.S. market outperformed global markets as the S&P 500 index returned 6.04% versus 4.07% for the MSCI World Index in USD terms. Additionally, performance in emerging markets was solid, with the MSCI Emerging Markets Index reporting 7.17% in local terms. From a global perspective, most sectors reflected significant positive performance over the quarter with the exception of Utilities and Financials. From a style perspective, growth outperformed value on a relative basis, as measured by the MSCI World indices.

Outlook and Positioning

During the quarter, earnings and cash flows generally came in better than expected with analysts significantly raising estimates. Margins are currently expected to be at high levels in 2010, with expectations of record highs by 2011. Investors started to care about actual earnings during the quarter. We believe that one key going forward is the sustainability of earnings versus what appear to be unrealistic expectations currently. Mergers and acquisition activity began to pick up despite the rally in stock prices since March as managements began to search for growth. History shows that most of this activity will benefit sellers and the bankers only. The U.S. dollar rallied during the quarter, especially against the Yen as the short dollar trade became overcrowded. Investors employing this strategy have painted themselves into a corner, where stronger growth in the US raises rates and drains excess liquidity – while weaker growth means more debt and deficits and declining commodity prices as the deleveraging cycle and defaults begin anew. The implication: stronger growth is a negative for commodities, bonds and emerging markets. Given massive incentives, record low short rates, money printing and trillions of stimulus spending – more signs of stabilization and recovery emerged, albeit weak and tentative in many areas. Income growth and consumer debt levels continued to contract at post war records and tax receipts – both sales, income and employment – all continued to fall, especially in the US, despite official statistics showing strong growth. Inflationary signs emerged as energy, food and industrial commodity prices rose.

Regarding equities, large capitalization stocks recovered in the fourth quarter and outperformed, especially in the three large developed markets – U.S., United Kingdom, and Japan. The Dow Jones Industrial Average generated double the performance of its smaller capitalization brethren, the Russell 2000 Index. Investors poured massive amounts of money into fixed income investments at the same time borrowers fed demand via issuance in the junk bond market – setting a new record for the quarter. Sector performance in the fourth quarter generally followed the post-March recovery script – leaders were Basic Materials, Mining, Metals and Technology. But signs of a rotation away from the most volatile and lowest quality stocks emerged with outperformance by defensive food, beverage, tobacco, utility and healthcare providers. With earnings expectations currently high and valuation support largely dependent on rosy estimates, the



rotation in leadership to higher quality areas of the market is significant and is aligned with our portfolio positioning. Financials were the worst performing sector during the quarter.

Asia experienced a strong recovery based on a boom in housing and construction, bank lending, infrastructure spending, rebounding consumer spending on durables and a resurgence in technology demand. China, the marginal provider of growth and liquidity currently, wrestled with the desire to sustain positive growth but keep inflation and speculation in check. The faith in the great 'centrally planned nation' is probably misplaced – the country is balanced on a razor's edge. We anticipate that the supply of excess liquidity will have a diminishing effect. Japan jumped nearly 13% in December alone as measured by the Nikkei 225 Index, led by financials and exporters. The Yen weakened and earnings came in better than expected and banks bolstered their capital positions, which could lead them to making new loans. The relative outperformance of this distressed and cheap market is likely to continue and the investment team is seeking to capture opportunities currently. The default in Greece increased the focus on sovereign debt risks. As a result, rates have begun to rise and the yield curve steepened. We anticipate that Japan, the US and the United Kingdom will be challenged by this event.

Emerging markets posted solid gains for the quarter, capping off a spectacular year. As with all markets, gains were strongest in the places that were down the most through March and reflected high risk opportunities, led by a 130% rise in Russia. Emerging markets benefited from the combination of excess liquidity, cheap money, the risk-asset trade, rising commodity prices and relatively strong economic growth. Emerging Asia tended to lag in the fourth quarter (ex China) as the non-dollar denominated countries suffered a competitive disadvantage economically as their currencies rose; namely, India and South Korea. Vietnam decided to devalue the currency. The increase in trade tensions is likely to be an important factor in 2010. Australia and New Zealand began to raise rates, which hurt their currencies and led to underperformance in stocks. The PIGS (Portugal, Ireland, Italy, Greece, and Spain) led underperformance of the Euro zone in the fourth quarter. A weak Euro also significantly reduced dollar based returns as well.

Going forward, we anticipate that the positive momentum of economic recovery will bode well for many stocks. However, we also expect headwinds and challenges that reaffirm the importance we place on building a margin of safety into our portfolio construction process. Our investment approach is centered on a bottom up, active investment process using a combination of quantitative, qualitative and fundamental analysis. We believe we are likely to see range-bound markets over the foreseeable future. Finding stocks that outperform in such markets is a challenging endeavor and favors an active equity approach. Range bound markets are payback periods where earnings and the economy grow, but valuations and multiples contract on average. We believe that by purchasing high-quality stocks we can generate a total return comprised of price appreciation, share repurchases, dividends and dividend growth over time. Looking ahead to 2010, we are satisfied that we have positioned the portfolio to take advantage of opportunities and we believe that investors who stay the course may benefit going forward.

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Performance returns and other data are current as of December 31, 2009.

