

# International Market Outlook

It became clear in the fourth quarter of 2008 that global business activity had slowed sharply. We do not expect to see a meaningful economic recovery until 2010. That said, we do believe we will see the projected rate of economic decline start to slow as leading indicators bottom out in early 2009.

We are at least 15 months into a financial crisis that started with problems in the housing market. We have already witnessed a financial recession and we are currently in a corporate recession, which is characterized by rising unemployment, weaker global manufacturing, and falling non-financial corporate profits. The coming year will likely be marked by negative revisions to corporate profits. The big surprise of 2009, however, could be a rise in equity prices. Although we anticipated this economic downturn to be severe, the speed and magnitude of the equity market weakness has surprised even us. Equities normally bottom out about 60% to 80% through a recession. We believe there will be a number of early indicators that equities have indeed bottomed out at some point in the first half of the year.

<sup>1</sup>Source: MSCI Barra

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Equities reached a number of compelling support levels in the fourth quarter of 2008. Equity yields are now higher than the yields provided by government bonds, which has not been the norm over the past 50 years. The Shiller price-to-earnings ratio – a measure of price divided by 10-year average earnings – briefly touched 13 times on the S&P 500 in mid-November. That level indicates future equity returns should be higher than their long-term average.

Investors have been very disappointed by equity markets over the past decade, with U.S. equities offering an annualized total return of -1.67% and U.K. equities offering -1.07% annualized for the 10-year period ended December 31, 2008. World equities did relatively better over this period, with a total return of -0.19%<sup>1</sup>. It is not surprising individuals are putting less of their capital into equities and cash is at a high level. Although the timing of the market bottom is uncertain, investors should be considering an increase in their equity weightings, given current conditions and the solid prospective returns of equities over the coming five to 10 years.