GLOBAL CURRENTS
INVESTMENT MANAGEMENT

INTERNATIONAL EQUITY COMMENTARY

FIRST QUARTER 2011

International Markets

International equities reflected positive performance during the first quarter of 2011despite multiple shocks in North Africa, the Middle East and Asia. Markets were thrown for a loop by the devastating impact of an earthquake, tsunami and nuclear crisis in Japan, and political turmoil in Egypt, Libya, and Yemen. Despite the staggering impact of world events, investor optimism about better days ahead and the belief in a sustained economic recovery moved many international equity markets higher during the first three months of 2011. Economic growth is gaining strength in most of the world's developed countries with the exception of Japan. Overall, U.S. equities did very well bolstered by supportive central bank policies and signs of economic growth. Non-U.S. equities did well overall, but specific regions and countries struggled during the quarter. Markets appear to be anticipating European monetary policy tightening during the course of the year with most other developed economies expected to be unchanged. In emerging markets, many countries will need to increase policy rates to deal with strong GDP growth and rising inflation. Economic data during the quarter was positive including favorable jobs reports in the U.S – employers added significant jobs and the unemployment rate declined significantly. Also favorable, corporate profits continued to push to new highs and investors consistently added more capital to equity investment allocations. The specter of inflation was exhibited by spikes in oil and food prices and many investors were concerned by increases in input costs resulting from surging commodity prices that could jeopardize the profitability of companies over time. Notably, China has consistently raised interest rates over the past six months in an attempt to fight inflation. Other dark clouds include the U.S. budget deficit, a potential shut down of the U.S. government and the European debt crisis.

The MSCI EAFE index was up 0.99% in local terms and 3.36% in USD terms. Index markets were generally positive in Europe with major indices reporting in local terms: Austria 0.22%; Spain 7.41%; Italy 7.55%; and the United Kingdom 1.36%. In Asia, major country indices reported generally negative performance as reflected by Japan -2.84%, Singapore -2.22%, and Hong Kong -0.35%, respectively. On a relative basis, the U.S. market outperformed international markets as the S&P 500 index returned 5.92% versus 3.36% for the MSCI World Index in USD terms. Additionally, performance in emerging markets was positive as reflected by the MSCI Emerging Markets Index reporting 0.65% in local terms. From an international perspective, all sectors reflected significant positive performance over the quarter with the exception of utilities and information technology as measured by the MSCI indexes.

Outlook and Positioning

Unequivocally, the combined events of an earthquake, tsunami, and nuclear crisis and the horrific human tragedy — dominated the first quarter of 2011. While it is impossible to predict exactly how the Japanese crisis will unfold over the long term, we have focused on our team's disciplined investment process and accordingly, continue to monitor and update our stock screens to evaluate holdings and pursue opportunities. In the past, the Japanese people have responded to adversity with amazing determination and social cohesion – and we are confident that they will lift themselves up once again. Despite the tragedy and other flash points around the world, global stocks performed well during the first quarter. Clearly, the events in Japan have impacted the global supply chain in the short term, with emphasis on technology and automotive manufacturing companies. We believe that these issues will be resolved leaving the main long term impact likely to be on fisheries and some other food items. Current assessments indicate that damage to infrastructure and buildings from the earthquake is limited overall, a testament to Japanese technology given that this was the 4th largest earthquake recorded on earth. Notably, despite the media hype, current radiation levels in Tokyo are less than levels in the city of London or Hong Kong. Although we do not attempt to predict the future, our discipline helps us to filter out fear and overreaction and pursue opportunities to invest in stocks within markets that have been unduly punished by specific events.

Despite the human tragedy, these events have allowed us to identify significant opportunities in newer nuclear technology offered by the French, Chinese and South Koreans. Paradoxically, older technology that had military-based origins in the U.S. has historically suppressed newer technologies – a phenomenon that

is likely to change in the near future. Moreover, the events in Japan are likely to spur increased interest in alternative energy sources – allowing investors to get in on the front end of myriad innovative technologies and solutions.

During the quarter, European banks experienced significant pressure due to the sovereign debt crisis and Basel III capital requirements, ultimately resulting in a rally as once again investors perceived that the worst was over. Austerity programs in Europe advanced and supported the Euro, which rose dramatically fueled by the ECB's hawkish posture toward interest rates and Germany's resistance to unrestricted bailouts. Our view is that the rising Euro, increased interest rates, austerity programs, and decreased government spending will likely serve as a drag on the European economy for the foreseeable future. Moreover, this scenario is also likely to put pressure on the peripheral European countries: Portugal, Ireland, Greece and Spain. In Europe, we believe that the political and social implications of the welfare state are currently underappreciated.

In the United States, there is much confusion and hostility in Congress about the future path and effectiveness of monetary policy as well as a long menu of budget issues that may impact the government for the balance of the year. Also, there is a state and local government spending crisis that will be exacerbated as the Federal government trims its support going forward. On a positive front, economic growth has picked up and job creation has improved. More worrisome is elevated commodity prices and signs that inflation expectations have become untethered.

In Asia, rising interest rates and central bank tightening has allowed these nations to attempt to rein in inflation risk and rising currencies. In China, interest rate tightening has been aimed at curbing excessive spending and real estate speculation, but has led to an underperformance for stocks. The Chinese government is trying to balance an effort to both dampen inflation and keep its economy growing fast enough to generate jobs. Developing countries are combating soaring consumer prices, especially food and fuel. Essentially, loose monetary policy in the U.S. has spurred inflation pressures in China due to soaring commodity prices and a flood of capital that has flowed into emerging economies.

On the earnings front, the comparisons grow more difficult along with rising input costs, rising labor expenses, growing capital expenses, increased competition and rising currencies outside the U.S. This is in contrast to high profit growth expectations for the next two years despite margins already at near record levels. Our team has identified stocks exhibiting margin compression including for example, steel producers and global apparel. We are also cautious regarding mining, mining equipment, and commodities – all reflecting elevated valuations and expectations.

Our perspective can be characterized by our active, contrarian value approach. Accordingly, we are optimistic regarding a number of opportunities including consumer stocks in the United Kingdom, Asia, and specific emerging countries. We are also finding attractive opportunities in the peripheral European countries, specifically Portugal, Ireland, Greece and Spain. Also, despite the tragedy, we believe that Japan offers significant value including specific retailers, capital goods, autos, global consumer, and domestic demand companies. Finally, we continue to identify many high quality global franchises that have suffered rising input costs that remain unaddressed by any adjustment in pricing as well as classic defensive companies in the healthcare, utilities, and telecommunications sectors.

Looking ahead to the rest of 2011, we expect muted but sustained economic growth with substantial variation depending on specific markets and business conditions. We believe that stocks are trading at the higher end of a range bound market given our assessment of valuations and margins and although we believe that the trend will be flat to negative, we see opportunities to identify stocks with room to move up to more normalized valuations. Essentially, the marketplace continues to provide opportunities to invest in stocks with low expectations, low valuations, and solid earnings prospects. We believe that our active management approach is positioned to benefit our clients.

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