

This Month in the Markets

April 2010



EQUITY COMMENTARY

Choppy Seas

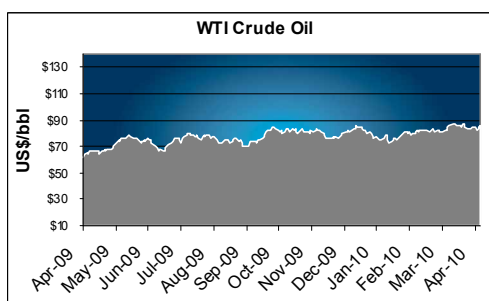
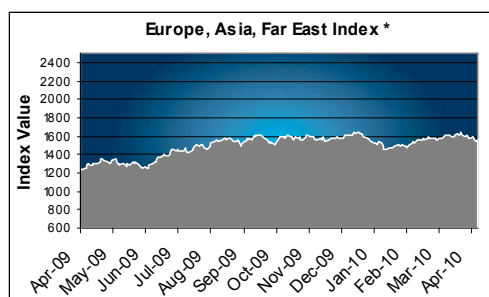
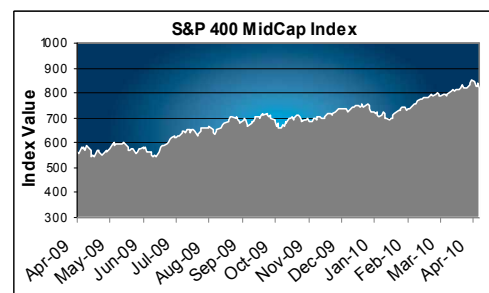
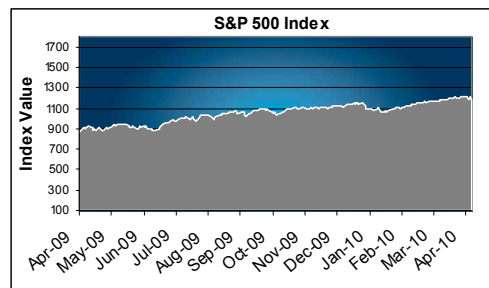
Despite some volatile trading, equities ended the month relatively flat. Strong earnings from the bulk of companies and improving economic data was offset by further concern over debt in Greece, a fraud investigation of Goldman Sachs and the explosion of a deepwater drilling rig off the coast of Louisiana. The Morgan Stanley World Composite Index (MSCI) closed the month down 0.15 percent. Consumer discretionary shares continued to lead the charge higher returning over 3 percent. Healthcare and telecom companies were the biggest drag on the global index, down 3.7 and 2.6 percent respectively.

Although the general investment arena is quite favorable at the moment, there have been some landmines. On March 16, Goldman Sachs and one of their investment banking employees were charged by the SEC with fraud for allegedly failing to disclose that a hedge fund that had influenced the composition of a complex mortgage-debt transaction was also shorting it. Goldman's boss and six other current and former Goldman investment bankers testified before the Senate Permanent Subcommittee on Investigations. The assault, which lasted more than ten hours, was as hostile as any hearing of Wall Street executives. Goldman continues to vigorously deny any wrongdoing. They have offered the "caveat emperor" defense and suggest the investors were offered all the information required to make an informed decision. Goldman shares ended the month down 21 percent from their March 15 highs.

The other major landmine that is front and center in the news is the sinking of the Deepwater Horizon in the Gulf of Mexico and the resulting oil spill. The Deepwater Horizon was drilling in 5,000 feet of water when there was an explosion causing the rig to sink and oil to begin to leak into the water at an estimated 5,000 barrels per day. The catastrophic event has caused an oil slick the size of New Jersey that is threatening the gulf states. The operator of the rig, BP, is financially liable for the cleanup and environmental damage. The oil company is working diligently to stop the leak and to impede oil from hitting the shore. At 5,000 barrels per day the spill would become the largest spill in US history if the flow was not contained by mid-June. Political reaction to the spill has been significant with the Obama administration taking a step back on their proclamation of opening some new areas on the east coast to new drilling. At this point we believe that this event is being viewed as a one-off event and should not effect current drilling in the Gulf but will lead to more scrutiny of the industry.

Earnings have once again been relatively strong. Of the 340 companies who have reported earnings in the S&P 500 index, 265 or 78 percent of them were better than analyst estimates. On a market cap weighted basis earnings are up 53.5 percent from the depressed earnings reported in the first quarter of 2009. On a trailing 12 month basis, earnings for the S&P 500 index of \$67.86 imply a P/E ratio for the index of 17.8. On a forward basis estimated earnings for the S&P 500 index are about \$80 which implies a P/E ratio for the index of about 15 which is close to the long term average of 14.5. Bulls will argue that earnings estimates are too low and the index could earn over \$100 in 2011 which would make the market extremely cheap at 12x earnings. Bears argue that strong earnings over the past few quarters have been largely driven by cost savings and stimulus spending that will soon be expiring. While we are not yet convinced that the optimistic growth rates are attainable, we are encouraged with the reporting season and do not view the market as expensive.

Going forward we believe that economic growth will lag rates achieved in the last two decades as households, corporations and governments de-lever their respective balance sheets. As such our focus will continue to be on buying higher-quality, stable-growth names with low earnings risk, strong franchise values, resilient free cash flow generation, dividend sanctity and solid balance sheets. We see material upside on many quality companies and remain excited about the prospects for the future.



*MSCI EAFE Index

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FIXED INCOME COMMENTARY

All Eyes on Europe

The sovereign debt crisis in Europe has escalated. Short-dated Greek bonds yields increased to as high as 18 percent, after one of the rating agencies downgraded the obligations to junk status. Portugal and Spain were also downgraded by Standard & Poor's. The euro has remained under pressure since the budget deficit of the euro area widened to more than double the three percent limit. In addition, the debt to GDP ratio rose to 73.6 percent, breaching the region's 60 percent limit. The focus has clearly shifted from the U.S. fiscal deficit to Europe's growing problems.

U.S. Fixed Income Strategy

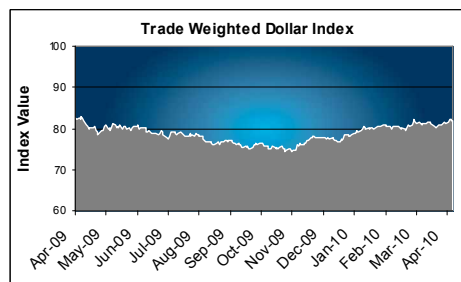
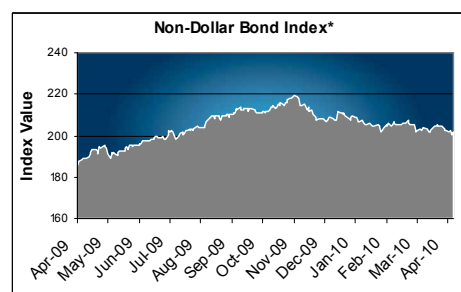
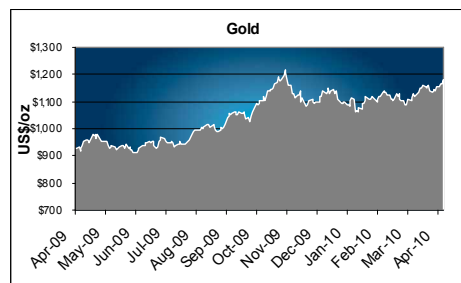
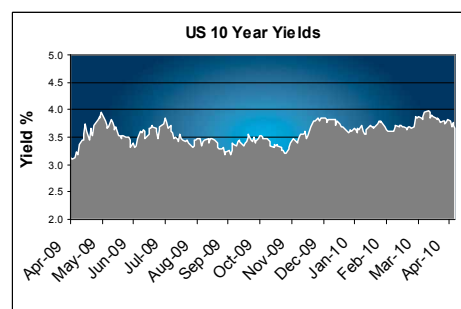
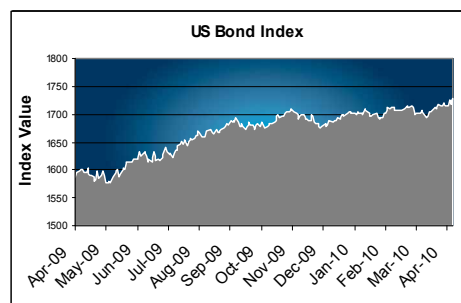
Despite rising default risk and lower growth prospects in Europe, the International Monetary Fund (IMF) upgraded its world economic growth outlook from 3.9 to 4.2 percent for this year and left its 2011 forecast unchanged at 4.3 percent. Global growth will be led by emerging and developing countries. Within the developed world, Canada and the U.S. got high grades from the IMF. Both economies are expected to grow by 3.1 percent this year and hence will outperform most economies in their peer-group. Indeed, economic data released in April bodes well for the recovery in the U.S. The ISM business surveys for the manufacturing and service sectors have risen to their highest levels of the last five years and point to growth rates of about four percent. Even more impressive was the release of the U.S. leading indicators, which posted another strong increase and points to an annual growth rate beyond four percent.

Growth upgrades, rising economic indicators and supply risk pushed the ten-year U.S. government security over the four percent mark at the beginning of April. This is the same level Treasuries yielded before the financial crisis hit the international markets. The four percent mark could not be held for long however. Once renewed concerns about Greece and other Mediterranean countries emerged, flight to safety dominated the bond markets and pushed the yield of U.S. Treasuries down again. In addition, the Federal Reserve reiterated its outlook for "exceptionally low levels" of interest rates and left its outlook for inflation unchanged. The Anchor managers have been overweight corporate versus government bonds for some time. Recent developments warrant a continuation of this stance. The earnings season has surprised to the upside (78 percent of the companies in the S&P 500 index have beaten their estimates) and global default rates have continued to drop. Moody's forecasts the rate to drop to 2.8 percent by year-end.

International Fixed Income Strategy

The central banks of Australia and Norway have been the only two of the G10 economies who have raised interest rates this year. Recent upbeat economic data in Canada has changed the Bank of Canada's outlook for its interest rate cycle. The Canadians appear to be the next ones who will increase the benchmark rate from the current record low level. Prospects for higher bond yields have made the Canadian dollar the star performer of the developed market currencies this year, reaching parity with the U.S. dollar. New Zealand might join the monetary tightening cycle soon as well, after business survey reports have risen to its highest level in 11 years and prices for commodity exports have soared.

The euro has been the big laggard this year and lost another two percent versus the U.S. dollar in April. The sovereign debt crisis in Greece has spread primarily to Portugal and Spain. There has been more talk about the failure of the European Monetary System and calls for Greece to leave the euro. This negative sentiment has put a lot of pressure on the common currency. The European Union and the IMF have agreed to a rescue package for Greece but the duration of its implementation is concerning. In addition, it will require the Hellenic Republic to take big spending cuts which in turn will restrict growth. S&P estimates that it will take Greece seven more years before they will reach the nominal GDP output level of 2008 with such restrictive measures in place. Less dramatic but similar is the situation in Portugal and Spain while growth in other European nations will be subdued as well due to proposed tight fiscal policies. Thus, Europe is expected to grow by just one percent this year (Bloomberg's consensus estimate) and hence underperform most of its G10 peers. The Anchor managers prefer the peripheral European currencies of Norway and Sweden. We also see value in the British pound as one of the most undervalued currencies. The General Elections on May 6 are the next big event to watch for the pound.



*Merrill Lynch Non-US Dollar Bond Index