



Perspective on the Latest Market Events

Message from Katherine Ellis Nixon, Northeast Region Chief Investment Officer

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To borrow a phrase, “it’s *déjà vu* all over again,” with economic realities crushing already reduced expectations. We continue to live in an economic and financial climate characterized by superlatives. At -8.6%, the return on the Standard and Poor’s (S&P) 500 last month proved to be the worst January in history. Global equity market indexes also finished the month in solidly negative territory, largely reflecting the fact that the global economic picture is weakening at an accelerated pace.

The -3.8% U.S. Gross Domestic Product report for the fourth quarter 2008 actually masked even greater weakness in the broader economy. From the kitchen table to the boardroom, spending activity and sentiment remain extremely weak across the globe. Further, the employment picture continues to worsen, with U.S. initial weekly jobless claims hitting a 26-year high. The evidence is overwhelming that this slowdown is global, with the developed and emerging markets showing dramatic reductions in growth.

The inauguration of President Barack Obama seems to have ushered in a renewed focus on taking decisive action to deal with the most significant near-term issues – the continued lack of credit availability and the deepening recession in housing. The potential one-two punch of segregating the toxic assets that currently reside on banks’ balance sheets into an “aggregator bank” and structuring a quasi-guarantee against the assets that will remain (let’s call them the pre-toxic assets) could provide both price discovery as well as a floor valuation. This should enable resumption in prudent risk taking and credit provision by these entities. That would be an important development. Further, direct intervention in the housing market through loan modifications and mortgage purchases should, over time, stabilize the housing market. In all cases, the challenge will be in the details, and there are enormous complexities around structuring and implementing such programs.

Indeed, Washington has been a busy place during the past 10 days. The controversial, nearly \$900 billion stimulus bill now is in the hands of the Senate, and the Federal Reserve has signaled its intent to buy longer-dated Treasuries to help rates stabilize at low levels. But the market response to the lack of a definitive timetable around Treasury purchases was swift, and interest rates have risen across the yield curve, with the 10-year Treasury yield rising more than 50 basis points since the inauguration. Market participants have grown weary of the doubling back and flip-flopping around policies and programs and are firmly in “show-me” mode. The use of “quantitative easing” — flooding the markets with liquidity — is not without risk; however, there is ample slack in the economy to soak up this excess. It is clear that the Fed is more worried about persistent deflation than inflation at this point, and we believe rightfully so.



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Global economic recovery will not be quick or painless, and it likely will be accompanied by some unintended consequences. In the midst of this crisis, we are hearing a rising chorus urging caution. At the recent annual World Economic Forum in Davos, Switzerland, the issue of capital protectionism is front of mind, as financial leaders from around the world worry about the downside of controlling the free hand of global capital allocation.

We continue to monitor conditions as they evolve, and we have seen nascent signs of a decrease in risk aversion, as evidenced by the narrowing of credit spreads as one example. We worry, however, about the near-term reality of deepening economic woes. The volatility in both financial markets and expectations strongly suggests that our belief in maintaining conservative postures in portfolios remains the correct strategy.

Katherine Ellis Nixon holds designations as a Chartered Financial Analyst and Certified Investment Management Analyst.

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