



## Perspective on the Latest Market Events

### Message from Katherine Ellis Nixon, Northeast Region Chief Investment Officer

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The equity markets continued their ascent this past week, although the path was not as smooth as in the prior week. The Standard & Poor's (S & P) 500 gained 1.7% for the week and has successfully recouped over 15% from the low hit earlier this month. Equally impressive is the continued rally in the financial sector, gaining for the week and up over 40% from the low.

Just as the market glow from the optimistic outlook from Citigroup's CEO was set to fade, enter Ben Bernanke. The Federal Reserve Chairman's announcement that the U.S. central bank would be following in the Bank of England's and the Bank of Japan's footsteps in adopting quantitative easing as an explicit policy tool made it clear: there would be a no-holds-barred assault on the current financial crisis.

This current period of low interest rates will be extended, through maintaining Fed Funds at 0.25%, but also through direct intervention "out on the curve," with the Fed purchasing \$300 billion in U.S. Treasury securities with a two to 10-year maturity. In this way, the Fed is attempting to take control over a part of the yield curve that has been thus far only market-driven, and has reflected and incorporated the forward-looking expectations of the current policy. Clearly frustrated that these market driven rates have not fallen as much as policymakers would like — and in fact had risen — the Fed is taking matters into their own hands.

Additionally, Bernanke announced a doubling of the purchases of mortgage-backed securities and agency debt to \$1.45 trillion, providing further support for the housing market. Clearly there is a renewed and intense focus on improving both the price and the supply of credit in the market, and the Fed is expanding its balance sheet significantly in the process to over \$3 trillion (and most certainly going higher).

Market reaction was immediate. The yield on the 10-year Treasury fell from almost 3% to 2.5% in mere minutes. At the same time, the reflation trade took center stage, with gold and commodities staging their own rallies and the U.S. dollar falling precipitously.

This morning, the U.S. Treasury is set to provide more details about the proposed approach to dealing with the toxic asset problem, including private/public partnerships and expanding the TALF (Term ABS Loan Facility) program to include both newly created and legacy assets. The acceptance of and participation in these programs by the private investor will be driven by more clarification on the "rules of engagement" in the wake of the AIG bonus controversy.



Assessing the potential success of the various programs in place and proposed, we have been carefully considering when and how to implement a more constructive stance on risk-taking for client portfolios. Northern Trust's investment policy committee took an important step this week increasing tactical exposures to emerging markets, commodities and to high yield bonds. We believe that the recent Fed actions and the soon-to-be released TALF details will provide important support to the credit markets, providing a solid foundation upon which real economic recovery can build over time. Many developing markets possess continued strength in terms of foreign currency reserves and likely will be clear and early beneficiaries to the global stimulus under way. Further, credit spreads should narrow in this environment of improved liquidity and transparency, benefiting the high yield bond market. And finally, commodity exposure will be necessary in order to both participate in the global economic recovery as well as to protect portfolios against the reflationary aspects of the current policies.

We are resisting the temptation to add to domestic and developed international equity positions here as earnings estimates continue to fall and as we search for signs of real economic stabilization. Despite the market rally this month, we are wary of continued disappointments in company fundamentals. As noted several times in this commentary, it is not unusual, and in fact is quite standard, to see powerful equity rallies in the midst of a bear market. We remain cautious, but cautiously optimistic at this point.

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

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