

During the 3rd quarter of 2009 world equity markets reacted positively to the ending of the U.S. and global recessions, the deepest since the 1930s. So far this year all major world equity markets have recorded double-digit percentage gains in both local currency and U.S. dollar terms. Although equity prices remain 25% to 30% below the September 2007 highs, it is estimated that the six-month global equity rally has added some \$17.0 trillion to the value of stocks worldwide.

Stocks are no longer inexpensive however, given their strong rebound and the uncertainties surrounding the economic outlook and the sustainability of the recovery. Stock market valuations have priced in robust earnings growth for 2010. Disappointments on that score cannot be ruled out.

Going forward we feel that companies with weak fundamentals will cease to outpace quality companies with strong financials. A “flight to quality” will replace the “dash for trash” investment style and thus allow for more valid assessments of investment performance.

At this stage, the global economy has yet to feel the full stimulative impact of the massive government led spending programs of the last 12 months. Accordingly, the IMF (International Monetary Fund) is raising its forecast for 2010 global growth from 2.5% to 3.0% - a welcome development.

We are also gratified by the G-20s focus on stricter regulations of the financial markets, and of the activities of banks considered “too big to fail”. A return to pre – Glass-Steagall separation of traditional commercial banking activities from trading and investment banking activities is impossible, but strict risk management standards are under active consideration thanks to the leadership of Paul Volcker, the former Federal Reserve Chairman.

U.S. equity prices were up 16.0% this quarter. Leading economic indicators rose in August for the fifth straight time, a strong indication that the U.S. economic recovery is gaining strength. Eleven of the twelve regional banks of The Federal Reserve reported signs of stable to improving economy in July and August. Recent economic data, however, continues to send mixed signals. Consumer confidence fell in September as unemployment is expected to reach 10.0% this year. Since December of 2007, job losses have reached 6.9 million – the worst record in 60 years. Consumer spending remains weak, and quite selective (cash-for-clunkers) program. Home values are declining at a slower rate and the pace of job losses is slowing. So far, capital spending has been the

main driver of the recovery as indicated by the Institute for Supply Management index (ISM), which increased from 48.9 in July to 52.7 in August. GDP growth, which was down 6.4% in the first quarter and 1.2% in the second, is expected to fluctuate between 2% and 3% in the next 12 months depending on the strength of the consumer and industrial sectors. U.S. equity prices should consolidate at current levels until it becomes clearer that rising consumer income and spending can support higher corporate earnings. At this time, we feel that large-cap, blue chip growth companies offer the best values given their reasonable price to earnings ratio (PER) compared to value and small-cap stocks.

Stock prices in Europe rose 20.8% during the third quarter, in euro terms and 25.3% in U.S. dollar terms. The euro is not expected to advance much further from the current 1.46 level but should remain strong. As confidence in the global economy improves, the demand for “safe haven” instruments such as the U.S. Treasuries, diminishes particularly when the U.S. dollar offers record low interest rates. Furthermore, the re-election of Mrs. Merkel with a coalition government of Christian Democrats and Free Democrats favoring tax cuts and pro-business programs, confirms the steady shift to the center right of the governments of France, Italy, and Germany.

The IMF is now projecting a 4.2% decline in GDP for 2009 and a 0.3% increase for 2010. France and Germany returned to economic growth during the second quarter. While manufacturing and services industries were up in both August and September, support from fiscal and monetary policy will have to remain in place until labor markets stabilize. The European unemployment rate could top at 11.7% next year. Despite the uneven pace of the recovery, overall conditions in Europe are improving and should enable a rebound in corporate profits. European stock P/E ratios and dividend yields remain among the most competitive in our universe. Our overweight exposure in portfolios will be maintained for the foreseeable future.

In Japan, we do not believe that the recent Democratic Party of Japan’s (DPJ) landslide victory over the Liberal Democratic Party (LDP) will revive the necessary economic reforms championed by Mr. Koizumi, who led Japan from 2001 to 2006. The DPJ’s program of guaranteed minimum pensions, child subsidies, and other welfare spending will prove insufficient to pull Japan out of its deflationary slump. Just last month, Japan’s CPI dropped 2.4% from a year earlier – the most in 30 years. For the last 14 months, price declines have led to more wage declines. The latest Tankan Survey indicates that large firms plan to cut capital spending by 9.0%. The government announced a partial cutback of the \$164 billion economic stimulus package. The strengthening yen undermines exports, which have been Japan’s main economic driver and account for 12.0% of the economy. According to an April survey, Japanese exporters estimate that they can remain profitable at a 97.3 yen per dollar. The current rate is 87.7 – the highest level since 1995. We feel no urgency, at this time, to increase our Japanese exposure in portfolios.