

## MARKET UPDATE

## Financial Market Review

**GLOBAL EQUITIES (+11.3%) SURGED** in the first quarter, marking the best quarterly gain since 2009. Markets shrugged off lingering uncertainty over eurozone sovereign debt, focusing instead on improving economic data. Strong corporate earnings news and the US Federal Reserve's pledge to keep interest rates "exceptionally low" until at least late 2014 buoyed investors' appetites for risk assets. The Greek debt restructuring deal added to investors' optimism, helping to offset heightened geopolitical risks, a rise in oil prices, and fears of a slowdown in China. Emerging markets (+10.8%) trailed their developed market (+11.3%) counterparts for the sixth consecutive quarter. US equities (+12.6%) outperformed non-US equities (+10.3%) for the seventh quarter in a row.

Yields rose in most high-quality government bond markets and fixed income spreads tightened in response to the risk-on tone. Most currencies — including those of emerging markets, which had a particularly rough 2011 — appreciated versus the US dollar based on the pick-up in global growth momentum and exceptionally loose fiscal and monetary policy. While the Fed relied primarily on forward rate guidance and enhanced communication to anchor policy rate expectations, the European Central Bank (ECB) and the Bank of Japan (BoJ) expanded their balance sheets considerably to ease monetary policy.

In commodities (+5.9%), all four sectors rose, bolstered by signs of economic recovery and continued upward pressure on production costs.

### Equities

#### United States

US equities (+12.6%) soared in the first quarter as the S&P 500 rose to its highest level since May 2008.

Better-than-expected corporate earnings, generally improving economic data, and growing consumer confidence helped to counter a persistent slump in housing. Early in the quarter, a strong employment report and robust manufacturing activity provided a tailwind for stocks. The rally continued in February as the unemployment rate fell to 8.3%, its lowest level since February 2009, and fourth-quarter GDP was revised upward to a 3.0% annual rate. Consumer confidence climbed to a one-year high as solid job growth and rising stock prices helped to keep Americans optimistic even as they were faced with surging gasoline prices. Stocks rose again in March, albeit at a slightly slower pace, as the services sector grew at the fastest rate in a year and the US leading economic indicators rose by the most in 11 months, a sign that the world's largest economy is gaining momentum.

US equity market gains were widespread — nine of the 10 sectors in the S&P 500 Index (+12.6%) generated positive returns for the quarter. Financials (+22.0%) were the best-performing sector. The Greek

debt restructuring deal and the favorable results of the US bank stress tests helped to ease investors' concerns about European sovereign debt. Information technology (+21.5%) outperformed on the heels of strong earnings reports from several large-cap leaders. Improving outlooks for employment and consumer spending trends boosted consumer discretionary stocks (+16.0%). The traditionally defensive utilities (-1.6%), telecommunication services (+2.1%), and consumer staples (+5.5%) sectors lagged the broader market.

### Europe

European equity markets (+7.7%) moved higher during the first quarter. Eurozone GDP contracted less than expected in the fourth quarter as stronger growth in France partially offset weakness in the periphery. However, fiscal austerity, soft employment numbers, and decelerating economic activity continued to take their toll on the region. Spain (-5.5%) was the worst-performing European country as unemployment swelled to 22.9% and the economy edged into its second recession since the end of 2009. Portugal (-0.9%) also underperformed after Standard & Poor's downgraded the country's sovereign debt rating to junk status. In Germany (+18.0%), Europe's largest economy, unemployment fell to the lowest level in more than two decades and German business confidence rose more than economists forecast to a seven-month peak. French equities (+9.5%) moved higher on news that France's economy unexpectedly expanded in the fourth quarter.

### Pacific Basin

The export-driven economies of the Pacific Basin (+15.5%) advanced during the quarter. Japan (+19.1%) led the region higher, fueled by the BoJ's surprise move to ease monetary policy. Japan's retail sales surged and overall household spending surpassed expectations, signaling that the economy is poised for a rebound. In Singapore (+15.7%), exports unexpectedly rose due to a surge in pharmaceutical shipments, which more than offset a decline in sales of electronic products. In Hong Kong (+13.4%), the unemployment rate slid to its lowest level since 1998 amid strong domestic consumption and spending by tourists. Australia (+7.9%) underperformed on news that fourth-quarter GDP grew by 0.4%, lower than the 0.8% expected.

### Emerging Markets

Emerging market equities (+10.8%) rose during the quarter as all three regions — Europe, the Middle East, and Africa (EMEA, +8.9%); Latin America (+10.3%); and Asia (+11.5%) — posted gains. Within EMEA, Egypt (+41.3%) soared as signs

of political stabilization, including peaceful protests marking the anniversary of the end of Mubarak's reign and failed attempts for a nationwide strike, renewed investors' confidence in the country. Within Latin America, Brazil (+11.4%) helped push the index higher as the central bank cut interest rates more than expected with inflationary pressures receding. Within Asia, India (+15.2%) advanced on strong corporate earnings reports, a reduction in the required cash reserve ratio for banks, and speculation of further interest rate cuts to stimulate growth as inflation appears to be under control.

### Fixed Income

The Fed maintained its accommodative stance throughout the quarter and reiterated that it would keep the fed funds rate exceptionally low until at least late 2014. By March, Fed policymakers had upgraded their assessment of the US economy based on improving employment data and diminishing strains in the global financial markets. Interest rates rose sharply in response to the Fed's statements, as market participants scaled back expectations of a third round of quantitative easing. At the end of the quarter, however, weak data for manufacturing in Europe and further signs of a slowdown in China led to a pullback in yields on safe-haven government debt. After protracted negotiations, eurozone officials finally approved a second rescue package for Greece amounting to €130 billion. Greece used collective-action clauses to force recalcitrant private creditors into approving the debt restructuring, thereby avoiding a disorderly default but triggering payouts on credit default swaps. The ECB also injected another round of liquidity into markets via its Long-Term Refinancing Operation (LTRO), further reducing interbank funding pressures. Meanwhile, the BoJ initiated aggressive policy easing while signaling that 1% inflation is now a serious policy goal.

Global investment-grade corporate bonds ended the first quarter with a 3.2% total return on a US dollar-hedged basis. Extremely loose global monetary conditions, progress toward containing the European sovereign debt crisis, and an improving global macroeconomic climate supported the asset class. Corporate bonds outperformed duration-equivalent government bonds by 3.9% for the three-month period as spreads tightened 68 basis points (bps) to a level of 194 bps. The US high-yield sector posted solid results in the first quarter, returning 5.3% and outpacing duration-equivalent Treasuries by 5.9% on the heels of similarly stellar outperformance in the final three months of 2011. Technicals were strong, with retail inflows of US\$20.8 billion. New

issuance totaled US\$98.1 billion, the highest single-quarter sum in the history of the high-yield market. Commercial mortgage-backed securities (+3.5%), agency mortgage-backed securities (+0.6%), and asset-backed securities (+0.8%) all generated positive returns. US dollar- and local-currency-denominated emerging market debt posted gains of 4.2% and 8.3%, respectively.

## Currencies

The main influences on currency markets during the quarter were improved growth expectations and supportive policy conditions. Relative to the US dollar, most major currencies strengthened as better-than-expected data resulted in upward revisions to forecasts. Emerging market currencies in particular saw a healthy rally after a challenging 2011. High-yielding and commodity currencies, such as the New Zealand dollar (+5.3%), Norwegian krone (+4.9%), South African rand (+5.4%), and Mexican peso (+8.8%), appreciated versus the US dollar. A notable exception was the Japanese yen (-7.0%), which weakened considerably versus the US dollar following very dovish BoJ rhetoric about aggressively easing monetary policy so as to raise inflation and weaken the currency.

## Commodities

All four commodities sectors increased during the quarter. Precious metals (+7.7%), energy (+7.3%), and industrial metals (+6.3%) notched the highest returns, while agriculture & livestock (+0.3%) was up only marginally. Gains in precious metals were due primarily to a spike in silver (+16.2%) prices. Silver's use in industrial applications provided a tailwind as economic data surprised to the upside. Gold (+6.4%) also rose but more modestly, benefiting from US dollar weakness. Energy commodities extended their fourth-quarter climb, paced by continued strength in crude oil (+7.3%). Falling spare capacity and concerns that tensions with Iran could lead to a supply disruption supported prices. Strong shale production and tepid demand related to a very warm start to the winter continued to pressure US natural gas (-37.2%) prices, which ended at their lowest level in over a decade. A firming economic picture was supportive of industrial metals. Copper (+11.1%) performed best as imports into China picked up, despite signs that Chinese inventories are rising. Within agriculture & livestock, soybeans (+15.4%) gained as it became apparent acreage was shifting toward higher-priced corn (-1.1%), potentially reducing future soybean supplies.

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## Market Performance Total Returns

	Periods Ended 31 Mar 2012			
	3 Mos	6 Mos	1 Yr	4Q11
<b>Equities</b>				
MSCI All Country World (USD)	12.0%	20.2%	-0.2%	7.3%
MSCI All Country World (Local)	11.3	19.6	1.3	7.5
MSCI World (USD)	11.7	20.3	1.1	7.7
MSCI World (Local)	11.3	20.2	2.0	7.9
S&P 500	12.6	25.9	8.5	11.8
Russell 1000 Growth	14.7	26.9	11.0	10.6
Russell 1000 Value	11.1	25.7	4.8	13.1
S&P MidCap 400	13.5	28.2	2.0	13.0
Russell 2000	12.4	29.8	-0.2	15.5
MSCI EAFE (USD)	11.0	14.7	-5.3	3.4
MSCI EAFE (Local)	10.3	14.9	-3.7	4.1
MSCI Europe (USD)	10.8	16.8	-6.9	5.5
MSCI Europe (Local)	7.7	15.9	-3.9	7.5
MSCI Japan (USD)	11.3	7.1	0.4	-3.8
MSCI Japan (Local)	19.1	14.3	-0.3	-4.0
MSCI Pacific Basin ex Japan (USD)	11.3	18.0	-5.4	6.0
MSCI Pacific Basin ex Japan (Local)	10.0	12.5	-5.9	2.2
MSCI Emerging Markets (USD)	14.1	19.2	-8.5	4.4
MSCI Emerging Markets (Local)	10.8	16.1	-3.7	4.9
<b>Fixed Income</b>				
Citigroup Wld Govt (Unhedged)	-0.5	-0.6	5.1	-0.1
Citigroup Wld Govt Non-US (Unhedged)	-0.2	-0.7	3.9	-0.5
Barclays Capital Global Aggregate	0.9	1.1	5.3	0.2
Barclays Capital US Aggregate	0.3	1.4	7.7	1.1
Barclays Capital US Treasury	-1.3	-0.4	8.6	0.9
Barclays Capital US MBS	0.6	1.5	6.2	0.9
Barclays Capital US CMBS	3.5	6.7	7.6	3.1
Barclays Capital US ABS	0.8	1.1	5.3	0.2
Barclays Capital US Corporate	2.1	4.0	9.5	1.9
Barclays Capital US Corporate High Yield	5.3	12.1	6.5	6.5
JPM Emerg Mkt Bond Global Diversified	4.2	9.1	10.9	4.7
<b>Currencies (% Return vs US Dollar)</b>				
Australian dollar	1.0	6.2	0.2	5.2
British pound	2.7	2.5	-0.3	-0.2
Canadian dollar	1.8	4.1	-2.7	2.3
Euro	2.5	-0.8	-6.6	-3.4
Japanese yen	-7.0	-6.8	0.7	0.2
Swiss franc	3.3	0.5	1.2	-3.0
Brazilian real	2.2	1.7	-12.1	-0.5
Chinese renminbi	-0.1	1.4	3.8	1.4
Indian rupee	4.1	-4.0	-14.2	-8.4
Russian ruble	8.3	8.7	-3.6	0.4
<b>Commodities</b>				
S&P/Goldman Sachs Commodity Index	5.9	15.4	-6.2	9.0
S&P/GSCI Energy	7.3	21.7	-2.5	13.4
S&P/GSCI Industrial Metals	6.3	8.2	-18.5	1.7
S&P/GSCI Precious Metals	7.7	3.3	10.0	-4.1
S&P/GSCI Agriculture & Livestock	0.3	-0.2	-16.5	-0.5



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