June 13, 2012

Global Focus

Europe and emerging markets in the spotlight

The World Bank just issued an update to its *Global Growth Outlook*. The outlook sees slower growth this year, but expects growth to pick up again in 2013 and 2014. Implicit in that forecast is an assumption that European tensions are resolved. The bottom line for the report was that most of the world economy (except Europe) will skirt by recession this year and 2013-2014 will begin a period of accelerating growth led by developing economies — especially Asia (see table).

World Bank Global Growth Estimates

Region	2012	2013	2014	Avg. '12-14
Euro Area	-0.3%	0.7%	1.4%	0.6%
Developing	5.3%	5.9%	6.0%	5.7%
East Asia	7.6%	8.1%	7.9%	7.9%
Latin America & Caribbean	3.5%	4.1%	4.0%	3.9%
Middle East & North Africa	0.6%	2.2%	3.4%	2.1%
South Asia	6.4%	6.5%	6.7%	6.5%
World	**2.5%**	**3.0%**	**3.3%**	**2.9%**

Source: *World Bank*

As you might expect, the report acknowledged the potential for a sharp deterioration in conditions but confessed that the nature of this scenario was "unknowable" in advance. If an acute crisis in Europe were to unfold, the emerging markets, central Asia, and continental Europe would be among the most significantly effected by such an outcome. The ripple effect on the global economy could emanate from Europe and spread through commodity prices, remittances, tourism, trade, and finance.

The other potential outcome cited by the report is that central banks and policymakers are implementing expansionary policies too late. In such a scenario, the risk arises that some combination of monetary and fiscal policy could "kick in" with a delay and create unwanted stimulus once the economy is already on the mend. In other words, if the current troubles in Europe turn out to be only temporary, and if aggressive policy actions are taken in response, the outcome could be unwanted inflation.

From the World Bank's point of view, the baseline scenario remains one of growth that favors developing markets. The Bank offers two "tail risk" scenarios to watch for — a sharply worsening Euro zone (which ultimately favors bonds) and a reacceleration of inflation risks (which favors commodities and stocks).

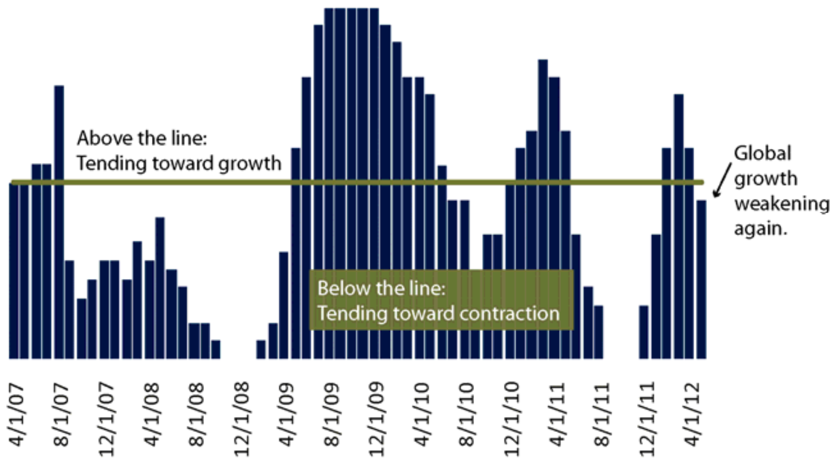
Kevin Caron
Portfolio Manager
(973) 549-4051

Chad Morganlander
Portfolio Manager
(973) 549-4052

Matthew Battipaglia
Analyst
(973) 549-4047

Fundamental conditions outside the United States have weakened over the past two months, based on data through May. While the weakness may prove to be temporary, a sustained reading below 50 may suggest a need to reevaluate non-U.S. fundamentals.

Europe's Troubles Contribute to Uneven Recovery Overseas
Recent Foreign Purchasing Managers' Reports Reveal Another Dip in Growth



Data: Markit (Underlying Data) / Washington Crossing Advisors (Further Calculations)

The graph above is a "diffusion style" index that is intended to measure the general direction of a variety of different data related to foreign manufacturing and services activity. The index combines ten different purchasing managers' indices from countries including China, Brazil, Germany, France, and the United Kingdom.

WCA Foreign Conditions Index™ (Above)

All along, we have believed that monitoring foreign conditions should play a significant role in forming an opinion about overall fundamental conditions. We always incorporate a wide variety of indicators on foreign markets, trade, and production into our assessment of conditions. Recently, we adopted a series of purchasing manager indices (PMI) that incorporate surveys of "front line" purchasing managers from a variety of countries into our analysis of foreign conditions. The data is made available on a timely basis once a month. The PMI surveys are replacing our earlier series of inputs, because the PMI data has now been available for a sufficient period of time and, in our judgment, is an unbiased and forward-looking measure of activity in both manufacturing and services. The countries and regions covered include China, Brazil, Germany, the United Kingdom, and France.

As the graph above shows, fundamental conditions outside the United States have weakened over the past two months, based on data through May. While the weakness may prove to be temporary, a sustained reading below 50 may suggest a need to reevaluate non-U.S. fundamentals.

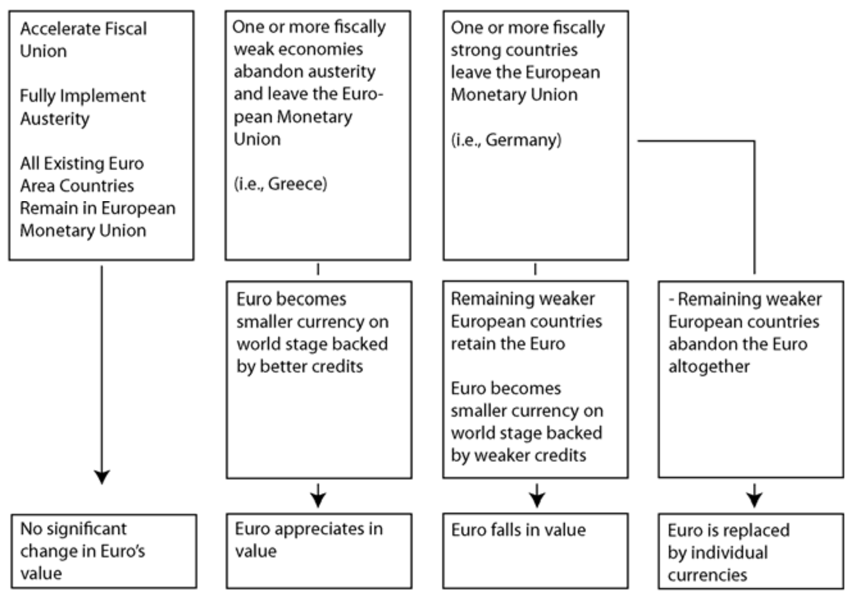
Decisions made in the weeks ahead will be important ones to watch, particularly as recent evidence suggests Europe's troubles may be impacting growth.

Europe

As we approach the June 17 Greek elections, we continue to believe that Europe will move toward a solution that sustains the Euro. Our rationale for this view stems from our conviction that departure from the Euro by Greece or others will impose significant near-term pain on both the exiting country and those countries that remain. In other words, a fragmentation of the Euro zone is a lose-lose proposition in the short run (a period of time that is most important to politicians and policymakers).

In order to avoid the near-term cost of a disorderly breakup, we believe Europe will most likely seek to maintain the status quo (left column in the diagram below). We believe that this path will not be easy and ultimately involves compromise. It is important to note that politics and policy response remain wild cards (Greece heads to the polls this weekend, the Federal Reserve meets June 19-20, and the European Central Bank meets on July 6).

Possible Euro Roadmap



What are markets looking for in European negotiations?

1. Shared responsibility for debts
2. Increased subordination of sovereign fiscal policies relative to the goals of the Euro zone at large
3. Adoption of a pact for area-wide coordinated growth

Time Will Tell

The World Bank expects Europe's tensions to be relieved in the months ahead and for growth to pick up as a result. Only time will tell if the World Bank's forecasts are correct, but the decisions made in the weeks ahead will be important ones to watch, particularly as recent evidence suggest Europe's troubles may be starting to impact growth.

Index Definitions

Barclays U.S. Government Inflation-Linked Bond Index measures the performance of the U.S. Treasury Inflation-Protected Securities ("TIPS") market. Used as a proxy for "inflation-protected bonds."

Bloomberg/EFFAS Bond Indices U.S. Government 1-3 Year Total Return Index is a transparent benchmark for government bond markets. Indices are grouped by country and maturity sectors. Bloomberg computes daily returns and index characteristics for each sector. Used as a proxy for "short-term Treasuries."

Bloomberg/EFFAS Bond U.S. Government 10+Year Total Return Index is a transparent benchmark for the total return of the 10+ year U.S. Government bond market. Used as a proxy for "long-term Treasuries."

FINRA-Bloomberg Active Investment Grade U.S. Corporate Bond Index and FINRA-Bloomberg Active High Yield U.S. Corporate Bond Index are comprised of the most frequently traded investment-grade and high yield U.S. corporate fixed coupon bonds represented by the Financial Industry Regulatory Authority (FINRA) transaction reporting facility. Used as proxy for "high-yield bonds."

FTSE NAREIT Equity REIT Total Return Index is a total return performance index of all equity REITs tracked by NARIET. Used as a proxy for REITs.

MSCI EAFE International Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets excluding the U.S. and Canada. As of June 2007, the MSCI EAFE Index consisted of 21 developed market country indices. Used as a proxy for "developed foreign."

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. Used as a proxy for "emerging markets."

Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 index. The Russell 3000 Index measures the performance of the 3,000 largest US Companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. Used as proxy for domestic "large cap stocks."

Russell 2000 Index measures the performance of the 2,000 smallest companies in the broader Russell 3000 index. Used as proxy for "small cap domestic stocks."

Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. Used as proxy for "domestic growth stocks."

Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios. Used as proxy for "domestic value stocks."

The information contained herein has been prepared from sources believed to be reliable but is not guaranteed by us and is not a complete summary or statement of all available data, nor is it considered an offer to buy or sell any securities referred to herein. Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation, or needs of individual investors. There is no guarantee that the figures or opinions forecasted in this report will be realized or achieved. Employees of Stifel, Nicolaus & Company, Incorporated or its affiliates may, at times, release written or oral commentary, technical analysis, or trading strategies that differ from the opinions expressed within. Past performance is no guarantee of future results. Indices are unmanaged, and you cannot invest directly in an index.

Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. High-yield bonds have greater credit risk than higher quality bonds. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains.