



Insights from Northern Trust

Commentary from Katherine Ellis Nixon, Northeast Region Chief Investment Officer

April 5, 2010

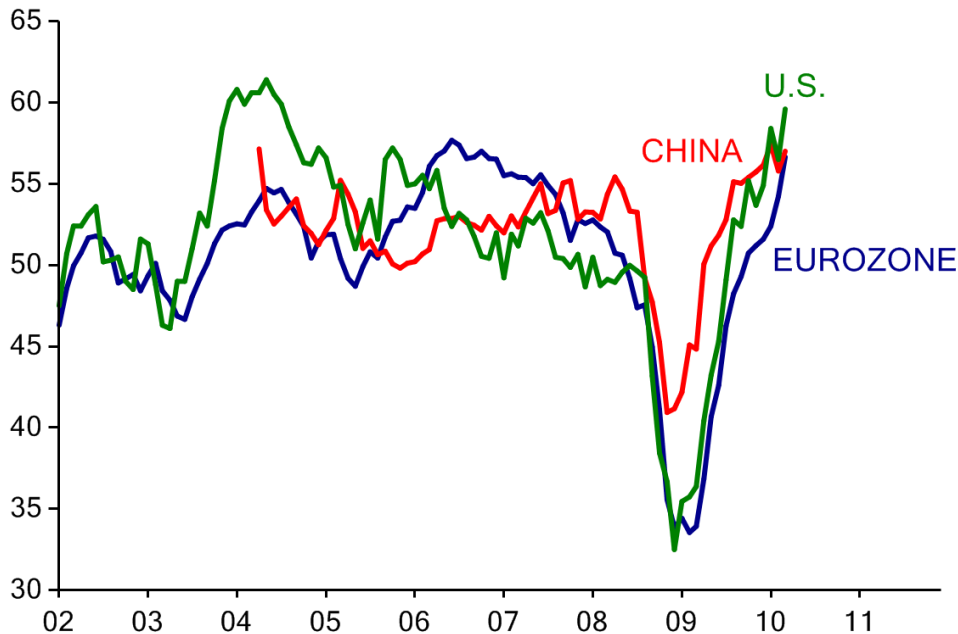
Equity markets around the world shrugged off February's losses and advanced to strong gains in March and broadly positive returns for the first quarter of 2010, reflecting the growing recoveries taking hold globally. For the month, U.S. stocks rose as the Dow gained 5.1% and 4.1% for the quarter. The Standard & Poor's 500 gained 5.9% in March, bringing the quarterly return to 4.9%. This represents the best monthly return since August 2009 and the best quarterly return since the first quarter of 1998. These quarterly results were even better as investors moved down the capitalization scale, with small-cap stocks as reflected by the Russell 2000 posting an advance of almost 9%. Across the Pond the results were consistent: The Europe, Australasia and Far East index gained 6.2% for the month, enabling it to eke out an almost 1% return for the year-to-date period. Even the emerging markets posted more than an 8% return for the month, bringing the quarterly return solidly into the black at 2.45%.

As noted in this month's issue of Northern Trust's *Perspective*, the market performance is a function of robust earnings results driven by cost cutting, of course, but increasingly now being driven by top line growth. Sales have joined the party here as consumers and corporations have begun to spend, and with corporate austerity measures in place, these sales dollars fall quickly to the bottom line. U.S. corporate results are a clear reflection of the broad-based recovery we see taking hold, and it is a recovery that is shaping up much like we had anticipated: cap-ex and export-driven and, unfortunately, characterized by stubbornly high unemployment. These have been two of our major investment themes for 2010, and the strength of these themes was apparent in two important economic releases last week.

We expected manufacturing activity to pick up; indeed, it has. With the rate of depreciation now exceeding capital spending, it was clear there would be necessary spending in that important area. The Purchasing Managers Index (PMI) results released last week showed that U.S. economic activity expanded for the eighth consecutive month, rising 3.1 points to 59.6. A reading above 50 percent indicates that activity is expanding. What we perhaps didn't expect was the strength of that demand, and the fact that this increase in activity was a global phenomenon. The chart below reflects the improvement in activity levels around the world, and the breadth of these synchronous recoveries in manufacturing is apparent across the United States, Europe and Asia. It is also interesting to note that the manufacturing-intensive industrial sector provided among the most robust investment returns for the quarter in local currency within the United States (+12.7), Japan (+11.2%), and Europe (+7.5%).



MFG PMI



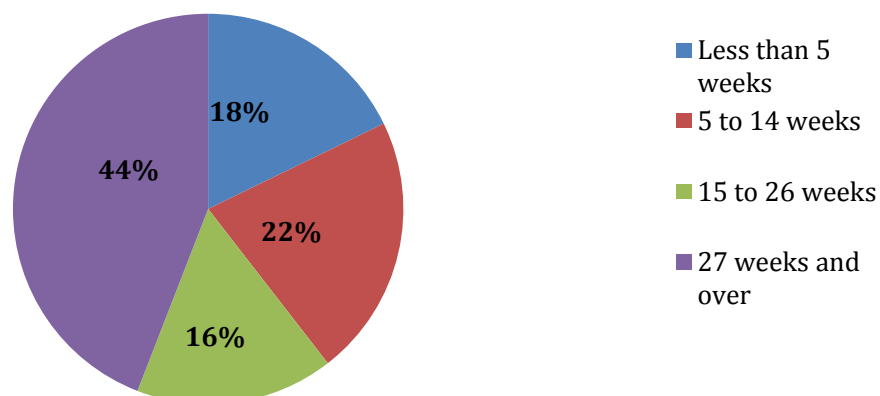
Source: ISI Group

We also had our “jobless recovery” theme reinforced last week with the March nonfarm payroll data showing an increase in jobs of 162,000, but a consistent 9.7% unemployment rate. We continue to believe that this recovery will track the prior two economic recoveries in terms of a sluggish increase in nonfarm payrolls over time. We think this recent data is consistent with the economic recovery theme in that it also reflected solid results from the private sector as well as a 2.1% increase in hours worked. So clearly employers remain cautious about hiring and intent on increasing the productivity of the current lean workforce. The unemployment rate is set to remain high as a result, and also as more discouraged workers potentially re-enter the job hunt, joining the many officially unemployed. As you will see from the chart below, many of the officially unemployed have been so for more than 27 weeks, so the environment for most will be quite challenging. The percentage of those unemployed for over 27 weeks has steadily increased from the year-ago figure of 24%, and the average (mean) duration of unemployment has increased from 20.8 weeks to 31.2 weeks seasonally adjusted.



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U.S. Unemployed Persons Distribution (March 2010)



Source: BLS

We believe that the improving global economic fundamentals, along with our forecasted delay until early 2011 in monetary policy normalization, combine to support our risk-taking stance in client portfolios. As we monitor and analyze the various data points around economic and corporate activity, we look for confirmation of our investment themes and interest rate outlook. So far, that confirmation is apparent. However, we are mindful that things can change, that the Federal Reserve only controls one point of the yield curve, and that there may be potential headwinds in the future in the form of continued currency discussions with China and potential protectionist backlash. There also are growing sovereign debt concerns coming out of Europe and certainly a growing mountain of federal debt necessary to sustain this recovery. We are watching with interest the historical steepness of the U.S. Treasury yield curve, which at 369 basis points as of Friday is near the post-1980 high. We embrace yield curve steepness as a signal of economic activity; however, the current curve may be reflecting a combination of concerns over the growing budget deficit and pending oversupply. As the 10-year Treasury knocks on the door of 4%, and given the close tie between this bond and mortgage rates, it bears careful watching.

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

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