



## Insights from Northern Trust

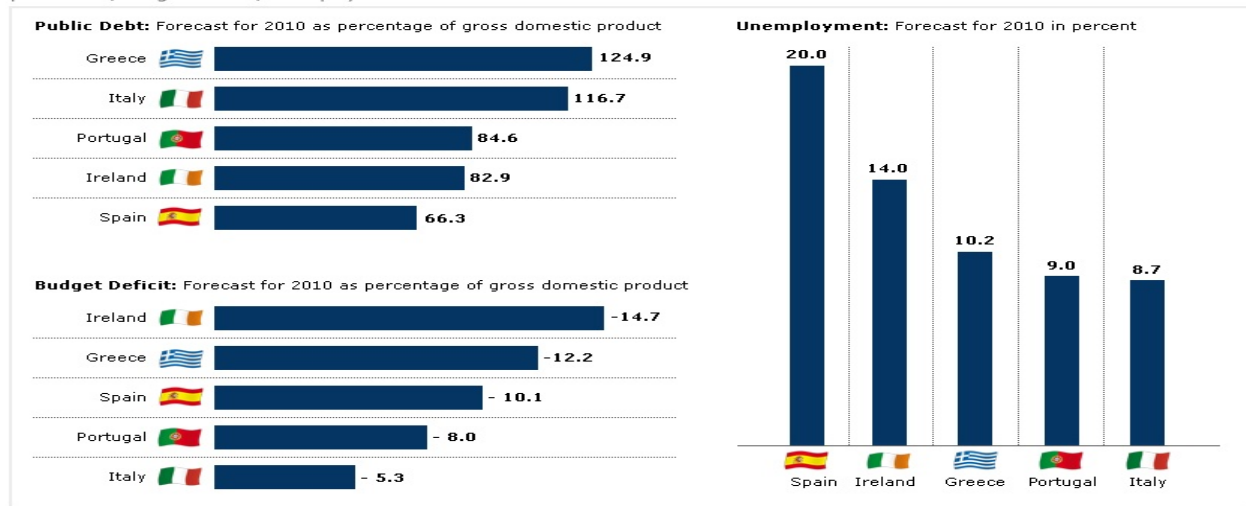
### Commentary from Joseph Fedacsek, Manager, PFS Investment Group

May 17, 2010

The \$1 trillion “shock-and-awe” package announced by the European Union (EU) caused short-term euphoria as markets rallied last Monday. As the awe subsided, markets wondered how a debt-fueled aid package could possibly triage a solvency issue caused by debt. At the end of the week, most equity markets remained higher – notably the Standard & Poor’s (S&P) 500 was up 2.2%.

#### The Euro Zone’s Problem Children

public debt, budget deficits, unemployment



Source: European Commission

Greece has been the focus of investor attention due to its short-term funding needs as it faces maturing debt that needs to be refinanced. However, many EU countries have deficits exceeding the 3% of gross domestic product cap stipulated in the Maastricht treaty. Strains in the European Union are appearing as fiscally conservative German voters oppose any bailout and remain very concerned for potential inflation. Acknowledging these strains, Jean-Claude Trichet, the European Central Bank president, recently called for a “quantum leap” in governance of the eurozone.

Policy actions by worldwide governments likely will continue making investors anxious. Spain, Greece, Portugal, France and the United Kingdom are all attempting to announce *and* enact some planned “austerity” budget. Even the Australians jumped on board, planning a 40% tax on mining “super” profits. Not wanting to be left out, the United States broadened its financial probe and scuttled Visa and MasterCard shares with a new scheme for debit card fees. Perhaps it may be wise not to attract attention with super profits; mere “really good” may be preferable for the near term.



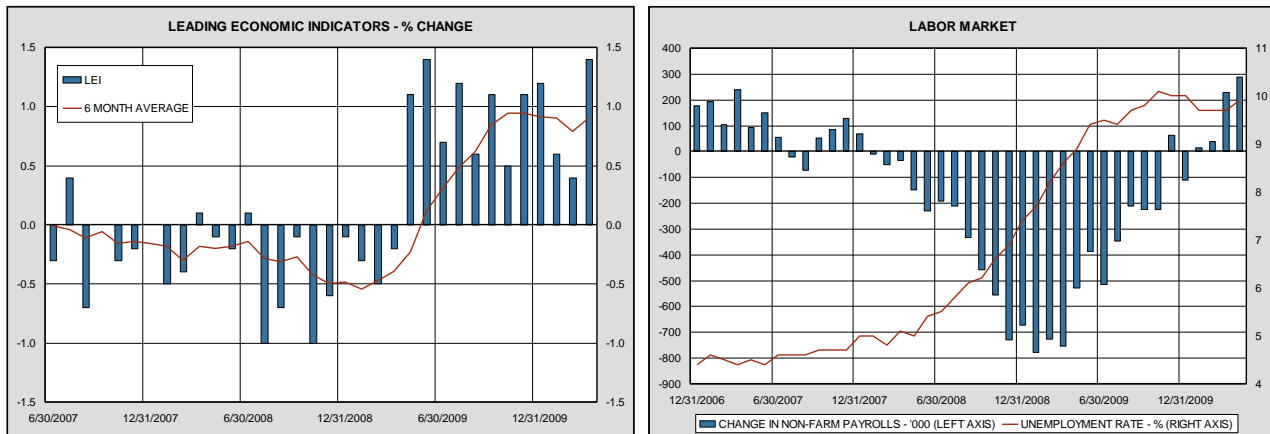
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The profitability of companies in the S&P 500 continues to surprise. After the corporate cost-cutting in 2008 and 2009, the rebounding economy has translated the improving revenues into much higher profitability. Current estimates for 2010 aggregate earnings nearly match the previous profit milestones set in 2007.

	S&P 500 EPS				
	2007	2008	2009	2010	2011
<b>Q1</b>	22.39	16.62	10.11	19.12e	21.76e
<b>Q2</b>	24.06	17.02	13.81	19.65e	23.10e
<b>Q3</b>	20.87	15.96	15.78	20.67e	24.22e
<b>Q4</b>	15.22	-0.09	17.16	21.89e	25.44e
<b>YEAR</b>	82.54	49.51	56.86	81.33e	94.52e
<b>% YOY</b>		-40%	15%	43%	16%

Source: Bloomberg

The economic picture in the United States continues to improve, with both leading economic indicators and employment figures improving. We think the unemployment rate likely will remain stubbornly high as the improving job market entices people to look for work and re-enter the workforce.



Source: Bloomberg; Northern Trust Economic Research

One of the surprises has been the recovery in the U.S. real estate market. While there is still a high rate of residential foreclosures, the feared debacle in commercial real estate has not reached the levels forecast. A recent article in *Barron's* noted that "bubble level pricing has returned to parts of the commercial and retail markets." The upside of the eurozone crisis has been that U.S. treasuries have rallied, lowering mortgage rates back below 5%. Over the weekend, an article in *The New York Times* also commented on the residential building activity in Las Vegas. The stigma of a heavily foreclosed neighborhood and heavy discounting of new homes has spurred new construction in the area.

With the events transpiring in Europe, we believe the Federal Reserve likely will have a bigger window to consider removing the domestic stimulus. This artificial support, both domestically and in Europe, lengthens the adjustment period as asset values reflect investor contemplation of increased sovereign risk and budgetary imbalances. The irony is that the corporate landscape has improved vastly from two years ago, when the largest companies were criticized for being too fiscally conservative and underleveraged.

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