Bellwether Consulting

*Your Quarterly Update on the Financial Markets*

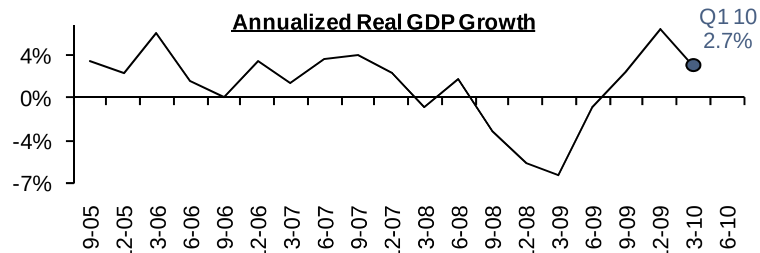
*June 30 2010*

**2nd Quarter**

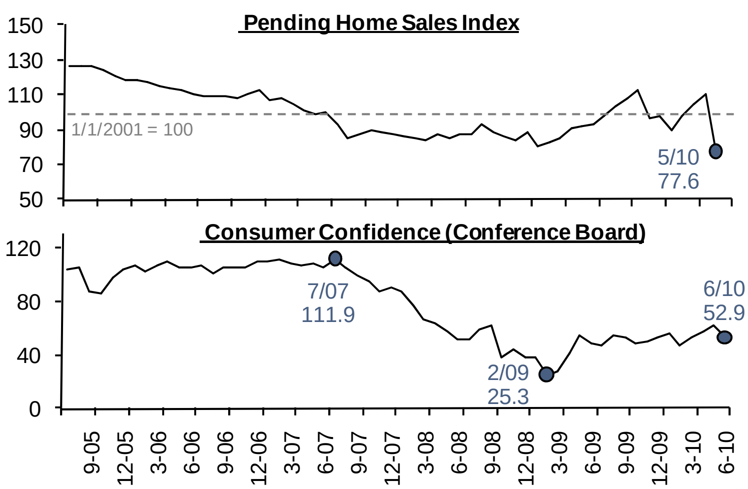
# MARKET Recap

## The Economy: *"Revenge of the Money Pit"*

Growth moderated in the first quarter to a 2.7% annualized pace, down from the post-recession 5.6% rate experienced in Q4 2009. The deceleration primarily reflected slowing private inventory investment and exports, a downturn in residential and nonresidential fixed investment, and slower state and local government spending. Real personal consumption expenditures increased 3% in the first quarter, and real federal government spending rose 1.2%.

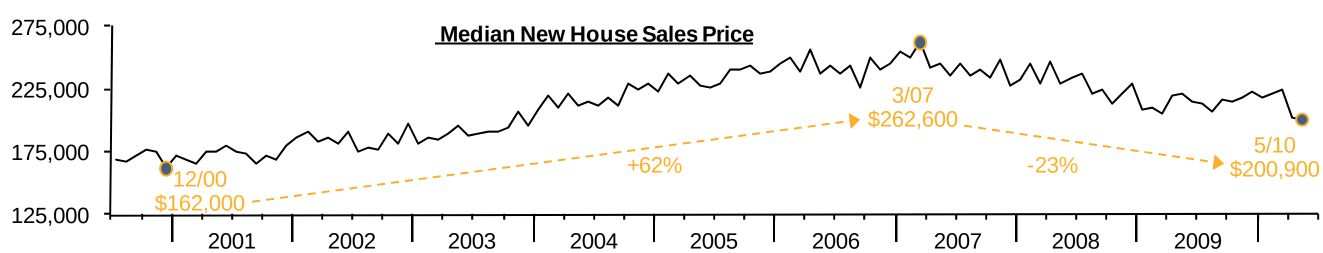



Money remained loose with the Federal Reserve holding short-term rates near the zero-level due primarily, as discussed in last quarter's *Market Recap*, to the US housing market. Pending home sales fell sharply in May upon expiration of the homebuyer's tax credit; the 30% drop was more than twice the median forecast. Unfortunately, programs that pay people to buy things, like this tax credit and the "Cash for Clunkers" program, tend to shift future purchases into the present; eventually the future arrives, with even softer demand. Home prices resumed a gradual downward trajectory as well. Although in the greater scheme of things prices have not really declined that much (-23% from the 2007 peak), extreme leverage associated with so many purchases turn small declines into solvency problems.



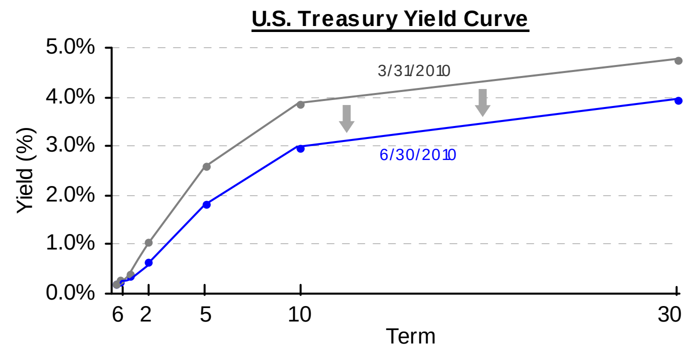

Manufacturing activity slowed in May, with new orders declining 1.4% after eight consecutive monthly increases. Inventory continued to rise, although our sense is that producers are beginning to curtail activity at current levels in anticipation of weak consumer demand. Capacity utilization stood at 74.1% in May, off peak levels of 80-85%, but also off a bottom of 65-70%. If we are correct, new orders should continue softening as slower demand is transmitted back through the production cycle. This trend is modestly negative for employment, as is ongoing weak consumer sentiment which affects service-sector demand.

Note carefully that each new point of economic data carries with it a hefty amount of measurement error. While we have little choice but to process the data, it is perhaps too easy to react dramatically. Witness the sharp selloff in international stocks following a revision in a series of leading indicators for China barely six months old. Similarly, bits of bad news precipitated downturns in US stocks and credit bonds, sectors we have argued were inflated. While we believe it is best in the long run when bubbles are popped early and often, weak data has also likely cemented the Fed's loose policy bias for the foreseeable future. How long until money market funds start "breaking the buck" is anyone's guess.



# The US Bond Market

It was a tale of two quarters for treasuries. Early in the quarter yields rose in anticipation of inflation and an eventual rate increase from the Federal Reserve. However, the quarter ended in disappointment for investors who expected that deficits and rising inflation would force rates higher. On the contrary, in June yields hit their low point for the year as markets responded to increased volatility at home and abroad. A domestic stock market correction, weakness in the Eurozone, slowing growth in China and tensions on the Korean peninsula were significant contributors to the quarter's "flight-to-quality." At its June 23 FOMC meeting, the Fed announced that it had decided to keep short-term rates near zero for "an extended period," citing challenges to economic growth including the effect of new financial troubles abroad.



Source: Bloomberg LP

Treasury yields ended the quarter flat on the short end of the curve, but down more than 80 basis points on the very long end after a relatively flat first quarter. Yields fell across the curve with the most significant drop in the 10 year, down 90 basis points. At quarter-end the spread between the 2-year and 10-year note was 233 bps, narrowing nearly 50 bps. The narrowing spread indicates bond investors' outlook for slower growth.

Corporate bonds underperformed their like-maturity government peers; both investment-grade and high-yield corporate bond spreads widened over the course of the quarter. Early on, buoyed by the market rally, investors were moving back into riskier debt, narrowing spreads in late April on high-yield bonds to 542 bps, while corporate investment-grade debt reached 151 bps, according to Bank of America Merrill Lynch Global Research. These spreads were the lowest since November 2007. However, as fear re-emerged, spreads widened to 727 bps on high-yield bonds and 213 bps on investment-grade corporates, the widest levels since early December.

| Q2 Index Total Returns | |
|---|---|
| BarCap Aggregate | 3.49% |
| BarCap Interm. Gov't | 3.26% |
| BarCap Long Gov't | 11.83% |
| BarCap Interm. Credit | 2.41% |
| BarCap Long Credit | 5.93% |
| BarCap High Yield | -0.11% |

The quarter saw commercial mortgage-backed spreads widen to 394 basis points despite increased issuance. Since the beginning of June, there have been eight issues of CMBS, amounting to an estimated $5 billion in loans. As much as $10 billion in CMBS deals are expected to be completed by the end of the year, according to Wells Fargo. While the majority of the deals have been single-borrower issuances, a $716 million origination by J.P. Morgan Chase was backed by 36 loans. The Royal Bank of Scotland issued a $310 million offering in April comprising six loans on a total of 81 properties, the first multiple-borrower bond of its kind since 2008. Of course this is nowhere near the 2007 peak of $230 billion in MBS securities. However, demand for most of the commercial mortgage-backed issues appears to be exceeding supply. Some lenders praised the government's Term Asset-Backed Securities Loan Facility program, or TALF, which helped bolster the securities markets by providing equity and debt capital to lenders. The program ended in June but has been credited with helping the balance sheets of lenders and investors.

# The US Stock Market

Just as in the bond market, US stock markets saw the best of times along with the worst of times. While April was a continuation of the strong first quarter, May 6 brought a 1,000-point plunge in the Dow that reminded investors of the crash of 1987 and the more recent volatility of 2008/2009. The largest intra-day decline on record took just 16 minutes, its speed and scale feeding fears that the Greek crisis had gone global. But the market began to turn around almost as quickly as it had dropped, with the Dow ultimately closing the day down just 3.2%, while the S&P and NASDAQ were down 3.2% and 3.4% for the day, respectively.

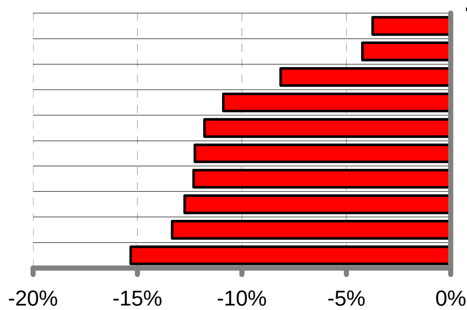
| Q2 Index Total Returns | | | |
|---|---|---|---|
| **Largecap Stocks** | | **Midcap Stocks** | |
| S&P 500 | -11.43% | S&P Midcap 400 | -9.59% |
| Russell 1000 | -11.44% | Russell Midcap | -9.88% |
| Growth | -11.75% | Growth | -10.20% |
| Value | -11.15% | Value | -9.57% |
| **Broad Markets** | | **Smallcap Stocks** | |
| NASDAQ Comp. | -11.84% | S&P Smallcap 600 | -8.73% |
| DJ Wilshire 5000 | -11.45% | Russell 2000 | -9.92% |
| | | Growth | -9.22% |
| | | Value | -10.60% |

However, while the day managed a bit of a recovery, the quarter did not fare so well. By the end of the quarter all major indices closed down, most in negative double-digit territory. In a quarter that marked a sharp reversal to the risk rally that began in March of 2009, the Dow closed at 9,774, down 10% from the start of the quarter and down almost 13% from its 2010 high on April 26. The NASDAQ Composite and S&P 500 also ended the quarter down, at 2,109 and 1,030, respectively.

The second quarter slide was enough to move returns on all major indices into negative territory on a year-to-date basis, causing many analysts to wonder if the deepening correction would move to a full-blown bear market. With investors faced with a laundry list of worries (the fragile US economy, the financial crisis in Europe, a potentially cooling Chinese economy, battles over financial regulation in Washington, the oil spill in the Gulf of Mexico, May's "flash crash," to name a few), an official bear market (i.e., a decline of 20%) does not seem out of the realm of possibility for 2010. With all the doom and gloom in the market, at least one analyst cautioned that realism about the challenges we currently face may be inflating into a "pessimism bubble," as happened in the last two American economic crises – the late 1970's stagflation and early 1980's post-cold war recession.

As always in uncertain times, investors flocked to safe havens. Gold rose 12% over the quarter to $1,245 per troy ounce. The utilities sector, traditionally a defensive play, finished the quarter in negative territory, but still as the relative winner within the S&P 500. Financials ended the quarter near the bottom, plagued by the impending legislation that would initiate the biggest regulatory changes to the banking and brokerage industries since the Glass-Steagall Act. While the Dodd-Frank bill is predicted to have a significant negative impact on financial sector earnings through reduced fees, higher costs, restrictions, and capital tie-ups, the passage of the bill (now estimated for mid-July) will at least remove uncertainty that has been weighing on the sector.

**S&P 500 Economic Group Components - Total Return**




| Sector | 2Q2010 |
|---|---|
| Utilities | -3.74% |
| Telecom | -4.24% |
| Consumer Staples | -8.14% |
| Consumer Disc. | -10.89% |
| Health Care | -11.79% |
| Info Tech | -12.25% |
| Industrials | -12.31% |
| Energy | -12.75% |
| Financials | -13.34% |
| Materials | -15.32% |

*Source: Standard & Poor's*

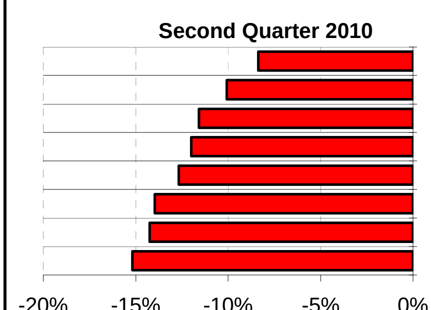
Not surprisingly, early reports forecast a cool-down in earnings for the second quarter. Thomson Reuters data puts average earnings from companies in the S&P 500 at $19.65 per share, up 27% from the year-ago period. However, this represents a slowdown from 1Q 2010 when earnings in the S&P 500 reached an average of $19.68 per share or up 55% from that quarter's year-ago period.

One relative bright spot for the quarter was the IPO market – specifically venture-backed, which saw its highest issuance since 4Q 2007 with 17 offerings worth $1.3 billion coming to market. According to Thomson Reuters, there were also 92 M&A transactions completed in the quarter, demonstrating continued strength of venture-backed acquisitions as an exit alternative. Of the venture-backed M&A deals reported, 22 had an aggregate deal value of $2.9 billion. The 2Q volume marks a decline from the record-breaking first quarter of 2010, but a 42% increase in the number of deals compared to second quarter 2009.

# Overseas Markets

Increased market volatility hurt performance in every sector as Eurozone debt concerns, a "flash crash" in the US, and slowing growth in China drove equity investors into the perceived safety of government bonds in the US and Japan. European markets were hit hardest as continued sovereign debt problems, high deficits, and sluggish growth made it the world's regional laggard. Even emerging markets, which had held up fairly well over the last year, took a hit.

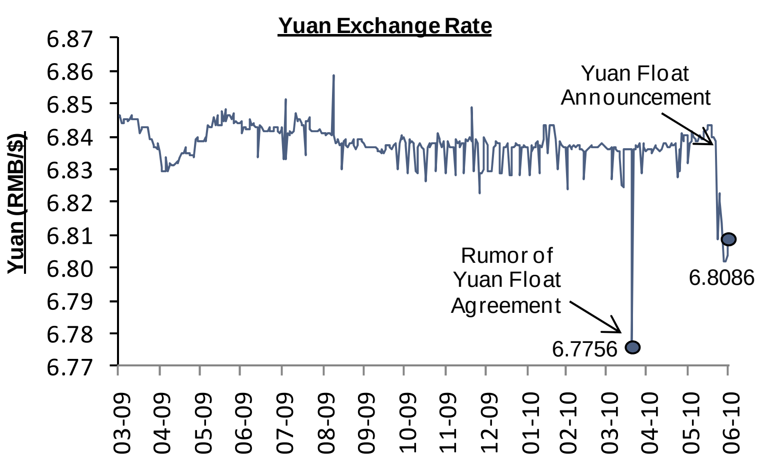
**Net Total Return of Selected MSCI Regional Indices**




| Region | 2Q10 |
|---|---|
| Emerging Markets | -8.37% |
| Japan | -10.07% |
| North America | -11.57% |
| Latin America | -12.00% |
| World Index | -12.67% |
| EAFE | -13.97% |
| Pacific ex Japan | -14.25% |
| Europe | -15.19% |

News out of the Eurozone was not good. Issues that surfaced during the first quarter concerning sovereign debt seemed likely to create a domino effect, spurring calls for economic austerity measures from solid (Germany) and struggling (Greece, Ireland, Portugal, etc.) economies alike. Sovereign downgrades fed market fears. In April S&P cut Greece's credit rating from BBB+ (investment grade) to BB+ (junk) prompting a bailout intended to stave off similar predicaments in Spain, Portugal and Italy. Spain's sovereign rating was downgraded by Fitch to AA+ from AAA reflecting ongoing concerns over slow growth and budget deficits. Corporate bond sales in Europe had shown signs of growth early in the quarter as interest-rate swap spreads narrowed buoyed by the Greek bailout and increasing investor confidence that Europe's debt crisis would be contained. Two-year swap spreads, an indicator of investor fear, fell to 33.93 basis points from 52.25. However, this phenomenon was short-lived as investors were ultimately unconvinced that the debt crisis was moderating. Against this backdrop, the spread on Spanish credit default swaps rose 49 bps to 212. Portuguese CDS spread rose 82 bps to 366, while the Irish CDS spread rose 36 bps to 225, and Italy's was up 16 bps to 158. Political turmoil within the zone also did not help with Germany demanding that all Eurozone nations adopt its stringent budget laws and France threatening to leave the alliance unless all countries agreed to aid Greece. In a complete reversal from the first quarter, and in concert with the €110 billion EU-IMF aid package, the ECB announced that it would accept Greek bonds as collateral for loans to Eurozone banks even if they had been downgraded to junk. This amounted to acknowledgement of wider systemic issues, and put pressure on the beleaguered euro which fell to $1.1944 on June 8 (a 4-year low). Rumors spread that China and Kuwait were reevaluating their euro positions, potentially undermining the euro as a reserve currency. While the rumors proved groundless, the damage was done as European bank solvency concerns and additional sovereign downgrades kept the euro depressed. Unemployment across the zone rose to 10.1% in April, slightly higher than the 10% consensus expectations. However, unemployment in Germany dipped to 7% in May from 7.1%, while France's jobless rate was unchanged at 9.9%. Italy held steady at 8.7%. Double-digit stock market losses were the norm for the quarter with the MSCI Germany Index down 12.8%, the MSCI France Index down 18.8%, and the MSCI Spain and Greece indexes down 20.8% and 40.5%, respectively.

In April, Japan's central bank voted unanimously to keep its policy interest rate and special monetary stimulus programs unchanged. Its statement hinted that it was looking into other ways to support private financial institutions. In May, core CPI was down 0.9% year-over-year, slightly better than in March when it was down 1.2% for the year, but continuing to fuel concerns about deflation. However, household spending and wages climbed, adding to hopes for an economic recovery. The rise in wages was the first in 22 months, and it was hoped that it would spur a boost in domestic demand, considered key to Japan's recovery. The Ministry of Internal Affairs and Communications reported that average monthly consumption expenditures per household rose 3% in nominal terms compared to the same period last year and 4.4% in real terms from a year ago. Average monthly income per household stood at ¥439,410, up 0.4% in real terms from the same month last year, though it was down 0.9% in nominal terms, according to government data. Voters elected a new Prime Minister, Kan Naoto, who instantly vowed to strengthen the country's economy. To that end, in mid-June, the Bank of Japan said it would offer financial institutions up to ¥3 trillion ($32.8 billion) in new lending, while also leaving its key policy rate unchanged at 0.1%. According to the BOJ the new lending facility will be temporary, with funds possibly available by the end of August. Counterparties will be allowed to borrow up to ¥150 billion on a one-year basis and will be able to roll the loans up to three times. "Through this measure, the bank expects that the efforts of firms and financial institutions to support Japan's economic growth will be further stimulated," according to a statement by the BOJ. The bank also said the economy "shows further signs of a moderate recovery, induced by improvement in overseas economic conditions." Despite improving conditions, the bank expects to remain accommodative given the global financial environment.




As the US and some of China's other Asian trading partners continued to push for the yuan to free-float, China felt obligated to tell the world that it would not be changing its policy of keeping the yuan in a narrow band around the dollar. At the same time, other issues confront China. In response to a growing real estate bubble, down-payment requirements were raised and lending rates increased on some types of mortgages after official data showed property prices in its major cities increasing at the fastest pace in nearly five years. The required down-payment on purchases of second homes will rise to 50% from 40%, down-payment requirements on homes of more than 90 square meters will rise to 30% from 20%, and the minimum mortgage rate on second-home purchases will be 110% of the benchmark lending rate. In April bank lending rose nearly 30% faster than expected with Chinese banks extending 774 billion yuan worth of new local-currency loans, according to central bank data. Chinese banks extended nearly half of their annual lending quota for 2010 in just four months, adding to the risks that credit could significantly exceed the government's 7.5 trillion yuan target, indicating the need for a rate hike.

China's inflation rate accelerated in April and May, exceeding consensus expectations. China's consumer prices were 2.8% higher in April than a year earlier and 3.1% higher in May, according to the National Bureau of Statistics. Monetary data may also be showing a threat from inflation. Money supply as measured by M1 rose 29.9%, down from April's 31.3%, while M2 (a broader measure) was up 21%, easing slightly from 21.5% in April. The money supply data indicated cash was moving from longer-term deposits to shorter-duration investments, increasing inflationary pressure. In addition, China's 1Q GDP growth of 11.9% was another indicator that tighter monetary policy may be needed. Finally, factory workers have been striking for wage increases due to the spiraling cost of living, clearly a sign that inflation is not in check. The quarter ended with two surprises – first an announcement by China that it will allow the yuan to be more fairly valued versus a basket of currencies. Second, the announcement of a "calculation error" in a leading economic indicator calculated by the Conference Board which, when recalculated, showed sharply lower growth than previously indicated. The announcement sent stocks and commodities prices lower across the globe. It remains to be seen if China will actually allow its currency to be more fairly priced in the markets. All eyes will remain focused on the juggernaut which China has become. The MSCI China Index was down -4.6%.

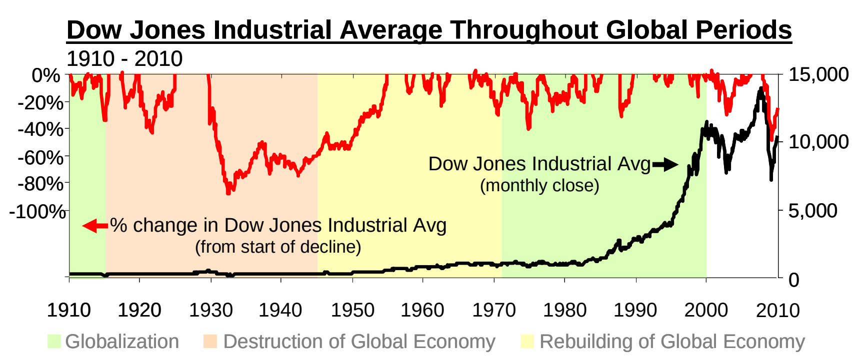
In emerging markets, Brazil posted the strongest employment growth, ahead of China and India. Rebounding activity may be signaling inflationary pressure as first quarter input costs rose to their highest levels in the last 18-months. In early May Brazil's central bank raised interest rates by 0.75%, the first increase since September 2008. Prior to the hike, Brazil's overnight rate was at a record low of 8.75%. The move is an attempt to use monetary policy to manage the money supply and slow inflation, which climbed to 5.2% in April against a 4.5% target for 2010. According to IMF estimates Brazil's economy is expected to grow by 5.5% this year. April saw retail sales fall by a record 3% from the previous month. The decline was more than the median forecast of a 1.6% decrease by a Bloomberg analyst survey, and may be a sign that the expansion is moderating naturally. The MSCI Brazil Index was down -15.3%. In Argentina, consumer prices rose at the fastest annual pace in almost four years in May according to Argentina's national statistics institute. Prices rose 10.7% from a year earlier, the biggest increase since August 2006. Inflation was seen in home appliances, clothing, and food prices. In addition, a government spending increase of 34.3% in April (year-over-year) has fueled price increases in South America's second-biggest economy. In response to rising prices labor unions are pressing for wage increases of as much as 48% during negotiations that are currently underway. The MSCI Argentina Index was down -5.8%.

# Focus On: *Globalization and the "New Normal"*

There's nothing new about the term the "New Normal." It has been applied for the better part of a decade to describe everything from purported evidence of climate change to developments in the field of project management. But since the credit meltdown of 2008 and ensuing global recession, the term has become a financial buzzword, flooding headlines and news reports attempting to describe and define the post-recession reality. But just how new is our "New Normal"?

## Globalization Once and Again

Throughout the 1990's the world economy became increasingly integrated and interdependent with freer flows of goods, services, and capital. The term "globalization" was used to describe this new world order. However, a look back through economic history reveals at least one other period of significant capital markets integration and rapid growth in world trade. The "Gilded Age" of the late nineteenth century saw a boom in North America and Europe as per capita income and wages rose and developing technologies (most notably, electricity and steam engines) dramatically increased the speed of communications and significantly decreased transportation costs bringing the world closer together. Lower tariffs combined with the technological advances resulted in a major net reduction in trade barriers and a rapid integration of world capital markets. Real wages and standards of living rose throughout the world, albeit at much faster rates in industrialized countries, as pointed out by IMF deputy-director Anne Krueger in her 2006 remarks on "The World Economy at the Start of the 21st Century." Economies experienced structural changes, with a shift from primary production (i.e., agriculture, mining, etc.) to manufacturing and industry. Unfortunately, the First World War led to an abrupt reversal in globalization, which was further entrenched by the Great Depression, subsequent wars, and declines in trade as a result of both disruption in transportation and increased tariffs.



Source: Dow Jones Averages

It was not until the late 20th century that the productive structure of the world economy again experienced rapid change. By 1970, the service sector was the primary source of added value, making up 52% of world production. (United Nations Industrial Development Organization 2009) This figure increased to 68% by 2005. The remaining sectors, agriculture and industry, experienced drops over the same period, going from 10% to 4% and 38% to 29%, respectively. The move from agriculture to manufacturing to services has long been considered a natural economic progression by many economists and can usually be explained by decreasing relative prices of goods that require no further production for use (or "consumptive goods") along with a simultaneous growth in demand for superior (or luxury) goods and services. Further, the latter half of the 20th century saw a blurring of the distinction between manufactured goods and services as the interaction between manufacturing and services, especially business services, became more complex. Many service activities began supporting manufacturing, and manufacturing, in turn, began producing technology-intensive goods that supported services. This latter period of globalization was also marked by technological advances and policy changes that led to geographical and functional splits in consumption and production and their reintegration through trade. As a result, trade in intermediate goods grew faster than trade in final goods as the effects of international divisions in manufacturing processes played out. All of this increased interdependence among world economies as well as gave them greater exposure to external shocks, as evidenced in the recent global crisis. (UNIDO 2009)

## Reversal of Fortune

But recently, it appears that global financial markets and economies have entered a period of fundamental structural change. A 2009 UNIDO working paper shows a slowdown between 2005 and 2008 in world production by the service sector relative to production in agriculture and industry. This decline is partly due to a rise in the relative prices for agriculture and mineral products (generally categorized as mining and utilities) which is, in and of itself, an inversion of the phenomenon generally attributed with driving traditional economic progression. Perhaps not surprisingly, the decline in service production and the associated growth in agriculture and mining occurred in regions typically thought of as developing or emerging markets, that is Asia, Latin America, and Africa. The decline in the service sector has been concentrated in “other activities” which include financial intermediation, real estate, and education as well as personal and business services. The 2009 UNIDO Industrial Development Report identified diversification and sophistication of production as the main driver of competitiveness for middle and low-income countries. This ability to focus on segments of production breaks with the traditional view of a linear progression in economic development (i.e., agriculture to industry to service), but takes advantage of (and possibly drives) the trend to disaggregate then reintegrate production.

On a region-by-region basis, the 2005 – 2008 time period shows a fundamental shift in production growth for 4 out of the 6 areas of the world. For instance, from 1970 through 2000 the Asian economy was characterized by a progression from a strong specialization in agriculture and industry to a focus on service as that sector’s share of added value in the Asian economy grew from 40% to 59%. However, over the past decade, the Asian economy has been marked by an increase in industry from 34% to 38% as well as a slight rise in agriculture (6% to 7%). In Oceania (i.e., Australia, New Zealand, etc.), traditional economic development peaked in 2000 with the service sector representing about 70% of value added. In this decade, it began a modest decline with industry – particularly mining and utilities as well as construction, taking up share. Latin America and Africa have seen directionally similar trends but at more significant rates, with mining and utilities in Africa experiencing a rise from 35% to 41% of value added by the region since 2000 and the associated decline in service production going from 49% to 43% over the same time period. Europe and North America are the notable exceptions to the declining trend in service production. Both regions have maintained an emphasis on the service sector as a source of added value. In 2008, the service sector was still responsible for 70% of value added in the European region and for 76% of value added in the North American region.

## Charting the New Normal

The concept of systemically important countries (SICs) is well-developed in global economics. SICs are countries whose economic performance and policies affect the performance of the global economy and the stability of the global financial system. Certainly the G-20 nations are all SICs. However, it is likely that the list of SICs is only expanding. Further, the idea of systemic importance is probably also issue-dependent. For instance, Switzerland may be quite significant when it comes to the global financial system but may have much less influence on the global economy, as suggested by Edwin Truman, Senior Fellow at the Institute for International Economics in his 2006 paper “Implications of Structural Changes in the Global Economy for its Management.”

The last decade has seen the rise of structural factors that have changed the drivers of key global economic and financial relationships. In his 2008 book When Markets Collide, Mohamed El-Erian points to a fundamental realignment of global economic power and influence as a factor that has impacted and will continue to change key global economic and financial relationships. Countries that were the stable core of the world economy and financial markets and countries that were considered developing or emerging economies and part of the periphery have started to change roles. For instance, in the most recent financial crisis, China, long considered an emerging economy with greater potential for systemic disruption, became a key stabilizing factor. China’s assumption of this role was just one example of what many economists considered to be a puzzling phenomenon: the flow of capital from developing countries to industrial countries – or as characterized by El-Erian, from the poor to the rich, sometimes referred to as the Lucas paradox. Examining the average annual growth in reserves of some of the G-20 nations from 2000 to 2005 shows us how this could occur. The weighted average of the average annual growth in reserves for countries considered to be developing was twice that of

**Avg. Ann. Reserve Growth**
2000 - 2005

| | |
|---|---|
| Russia | 48.6% |
| China | 37.7% |
| India | 28.6% |
| South Africa | 25.8% |
| Australia | 19.5% |
| Japan | 19.0% |
| Turkey | 17.7% |
| South Korea | 17.0% |
| Mexico | 15.7% |
| Brazil | 10.5% |
| Saudi Arabia | 5.9% |
| United States | 3.9% |
| Indonesia | 3.0% |
| Canada | 1.1% |
| Italy | 1.0% |
| United Kingdom | 0.8% |
| Argentina | -1.4% |
| Germany | -4.3% |
| France | -5.7% |

G-20 Developing Country
Source: World Bank

countries considered to be developed (or industrial). Looking at specific countries shows China growing its reserves by an average of 37.7% from 2000 to 2005 while the US managed an average growth rate of only 3.9% during this period. Out of the group of developed countries in the G-20, only Japan and Australia had reserve growth that compared to that of the developing countries group.

Of course it is much easier to look back to understand what happened than it is to look forward and predict what will happen. But to navigate what is increasingly being seen as a major redefining of the global economic and financial system, we need to consider what may become the future drivers of systemic importance. Much attention has been paid to various economic indicators like gross domestic product, current account balances, and trade surpluses and deficits, as well as financial statistics like the level of investment or public debt, and discount and lending rates. An examination of these factors would take more space than our recap format allows. And since additional indicators may be found outside the world of economics and finance, in human capital, for instance, we will propose two non-financial/non–economic factors for consideration.

**Life Expectancy**
in Years

| | |
|---|---|
| Japan | 82.2 |
| Australia | 81.7 |
| Canada | 81.3 |
| France | 81.1 |
| Italy | 80.3 |
| Germany | 79.4 |
| United Kingdom | 79.2 |
| South Korea | 78.8 |
| United States | 78.2 |
| Argentina | 76.8 |
| Saudi Arabia | 76.5 |
| Mexico | 76.3 |
| China | 74.5 |
| Brazil | 72.3 |
| Turkey | 72.2 |
| Indonesia | 71.1 |
| India | 66.5 |
| Russia | 66.2 |
| South Africa | 49.2 |

G-20 Developing Country
Source: CIA Word Factbook, 6/4/2010 data

*Population Aging*: Accepted as a benefit of industrialization and economic development, life expectancy is one factor that could impact the influence a nation has in the global arena. On the positive side, a longer life expectancy allows for the cultivation of experience and wisdom and their integration into all aspects of society. On the negative side, increasing life expectancy puts pressure on pension systems, both public and private, as we are quite familiar with in the US This can be exacerbated by any diminishment in the workforce as there are less workers to support more retirees. An aging population also puts pressure on healthcare, educational, and infrastructure systems (at least in the US), although for different reasons.

*Education:* Quality education enables people to take advantage of increased opportunities that growth brings. Studies have shown that education contributes to economic growth by influencing labor productivity and expanding the rate of technological change. Comparison of a nation's spending on education, especially in proportion with other expenditures, may be an indicator of its focus for the future

**Expenditures**
% of GDP

| | Education | Military |
|---|---|---|
| Saudi Arabia | 6.8 | 10.0 |
| France | 5.7 | 2.6 |
| United Kingdom | 5.6 | 2.4 |
| Mexico | 5.5 | 0.5 |
| South Africa | 5.4 | 1.7 |
| United States | 5.3 | 4.1 |
| Canada | 5.2 | 1.1 |
| Germany | 4.6 | 1.5 |
| South Korea | 4.6 | 2.7 |
| Australia | 4.5 | 3.0 |
| Italy | 4.5 | 1.8 |
| Brazil | 4.0 | 1.7 |
| Turkey | 4.0 | 5.3 |
| Argentina | 3.8 | 0.8 |
| Russia | 3.8 | 3.9 |
| Indonesia | 3.6 | 3.0 |
| Japan | 3.5 | 0.8 |
| India | 3.2 | 2.5 |
| China | 1.9 | 4.3 |

G-20 Developing Country
Source: CIA Word Factbook, 6/4/2010 data

## Brave New World

With the turn of the century we have entered a period of fundamental structural change. While globalization and its benefits have been experienced before, the traditional models of economic growth and financial markets have already seen alterations that are signaling a major redefinition of global systems. For investors this means a good amount of skepticism must be applied to the conventional wisdom that guided past asset allocation and investment decisions. Perhaps total disregard is actually more in order. For instance the old notion that developed markets are "safe" while emerging markets are "risky" is suspect, at least, and potentially devastating if applied indiscriminately, as it appears the journey to the "New Normal" will be a bumpy ride. In When Markets Collide, El-Erian notes our current period has already been characterized by "institutional excesses, market overshoots, and institutional debacles" and predicts periodic market breakdowns. Settling on a long-term, profitable investment strategy may seem impossible in this environment. However, relinquishing old ideas and developing new, global strategies seems to be a good start. In the words of H.G. Wells, "Adapt or perish, now as ever, is nature's inexorable imperative."

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