# Global slowdown fears mount amid continued financial fallout

Global financial fallout, resulting in historic regulatory intervention, sent equities sharply lower during the third quarter as global recession fears mounted. As measured by the MSCI World Index, the global equity market finished down -15.1% in dollar terms during the third quarter, weighed by relative non-U.S. weakness; the MSCI EAFE of non-U.S. stocks declined -20.5%. Year-to-date, global stocks are down -23.8%, while non-U.S. equities have moved lower by -28.9%.

All ten sectors depreciated during the third quarter, with commodity-linked areas such as materials, energy and industrials leading the decline. Shares in these sectors finished lower amid falling commodity prices, and as global recession fears resulted in weaker demand expectations for raw materials. Defensive consumer staples and health care stocks marginally depreciated during the quarter but sharply outperformed the broad MSCI World Index, as investors sought safe haven amid a turbulent environment for equities. Through nine months, materials, telecom and financial shares are down more than 30%, while consumer staples and health care stocks have best mitigated losses.

All developed regions declined during the quarter, and only the United States outperformed the broad index. Non-Japan Asia, the United Kingdom and non-U.K. Europe underperformed the MSCI World Index by more than 5%. Year-to-date, the U.S. and Japan have outpaced the broad index, while non-Japan Asia and Continental Europe were the largest underperformers.

During the third quarter, the euro and pound each depreciated by more than 10% relative to the dollar, while the dollar and yen finished mostly in line. Year-to-date, the pound has depreciated sharply relative to the dollar, down more than 10%, while the euro has also depreciated, but by a lesser degree of 3%. The yen, meanwhile, has appreciated by more than 5% relative to the greenback.

World crude oil prices declined sharply during the third quarter to $99 per barrel from $131 a quarter ago, but are still above the year-end level of $90.

## Economy

Annualized GDP growth was flat in the U.K. during the second quarter, as fixed investment, construction and industrial production weakened. The U.K.'s economic slowdown comes at a time when inflation is at its highest level in more than 10 years. Inflation in August rose at a rapid 4.7% year-over-year pace. Despite falling sharply during the third quarter, energy prices are still much higher than year-ago levels. Elevated inflation concerns prevented the Bank of England from cutting short-term interest rates in order to combat the economic slowdown and credit crisis during the third quarter. As such, the central bank kept its key overnight rate at 5%.

In Continental Europe, economic growth contracted at an annualized -0.8% rate during the second quarter. Ongoing weakness in business investment and consumer spending led to the decline, pushing the economy closer to the statistical definition of a recession (two consecutive quarters of negative GDP growth). Consumer prices rose 3.8% year-over-year in August, easing a bit from recent months as commodities such as oil and copper pulled back. Early in the third quarter, growing increasingly worried about the threat that rising inflation might have on the economy, the European Central Bank tightened the money supply by increasing its target rate by 25 bps to 4.25%.

Japan's economy also contracted during the second quarter, slipping -3.0% year-over-year. Consumer spending slowed and the combination of a global slowdown and strengthening yen resulted in weak exports. Consumer prices seem to have curbed earlier deflation threats, rising at an annualized pace of 2.1% in August due to elevated oil prices. The Bank of Japan kept its benchmark lending rate at 0.50%.

Bolstered in part by the stimulus plan, the U.S. economy grew at a 2.8% annualized pace during the second quarter. Despite providing a positive boost, consumer spending was weaker than expected, and business investment and homebuilding were down. The consumer price index was up 5.4% year-over-year in August as food prices continued to rise and oil prices remained above levels a year ago. Core-CPI, which excludes volatile food and energy prices, increased at an annualized rate of 2.5%. At the conclusion of the third quarter, the U.S. Federal Reserve's target overnight lending rate was still at 2%.

| Market Data | 3rd Quarter | Year-to-Date |
|---|---|---|
| MSCI World Index (US Dollar) | (15.1)% | (23.8)% |
| MSCI EAFE Index (US Dollar) | (20.5)% | (28.9)% |
| MSCI World Index (local currency) | (11.3)% | (22.4)% |
| MSCI EAFE Index (local currency) | (12.9)% | (26.3)% |
| Euro (vs. US Dollar) | (10.8)% | (3.4)% |
| British Pound (vs. US Dollar) | (10.7)% | (10.4)% |
| Japanese Yen (vs. US Dollar) | 0.0% | 5.2% |

*Data as of September 30, 2008. Data source: FactSet.*