



# Investment Update

**Alerus**<sup>™</sup>  
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## Stocks Take a Breather as Global Economy Slows:

A confluence of factors hit the global economy from March through May of this year causing a “slow patch” in the recovery. Worried about rising inflation, central bankers in China, India and other emerging economies began reversing their easy money policies. An earthquake and tsunami hit Japan in March which pushed the world’s third largest economy into a recession and disrupted the global auto and technology supply chains. Finally, oil prices hit a high of \$113/barrel causing a pull-back in consumer confidence and spending. Stocks, reacting to this slowdown, ended the quarter flat-to-slightly-lower from where they began.

The Dow Jones Industrial Average rose 0.8% in the second quarter of 2011, the broader Standard and Poor’s 500-stock index fell 0.4%, and the Russell 2000-index of small company stocks fell 1.9%. This “risk-off trade” was reflected in sector performance as strong defensive sectors such as health-care, consumer staples and utilities outperformed, while energy, technology, and financials were the laggards. Within the Dow, investors favored Johnson and Johnson, Kraft Foods and McDonalds and sold Hewlett Packard, J.P. Morgan-Chase and Bank of America.

International markets faced a slowdown similar to that in the U.S. and performed about the same. The Dow Jones World (excl. U.S.) index fell 0.5% in the second quarter. Within international markets, the German DAX rose 4.8% as German companies benefited from strong exports and a robust local economy. Greece, facing a potential debt default and austerity programs as part of an IMF bailout, was the worst performing market—down 18% for the quarter. In emerging markets, where central bankers were reversing easy money policies to combat inflation, the global slowdown made matters worse. Brazil’s stock market leveraged to commodity demand and prices fell 9%. The Shanghai Composite fell 5.7%, Hang Seng index dropped 4.8% and India’s Sensex lost 3.1%.

## Bonds: Helped by Flight to Safety

As the global economy slowed, investors fled to the safety of bonds and, particularly, U.S. Treasuries, which rose 2.8% during the second quarter. Investment-grade corporate bonds also did well, up 2.6%, while high-yield or “junk”

bond performance was more reflective of the stock market—relatively flat for the quarter. Problems in the peripheral European countries also helped the bond market as investors sought the safety of U.S. Treasuries. We expect that as long as the soft patch and problems in Europe persist, the U.S. bond market should continue to offer decent returns.


## Commodities: Hit by a Perfect Storm

Of all the risk assets, commodities fared the worst in the second quarter. The Dow Jones-UBS Commodities Index fell 6.7%. The global slowdown, reversal of easy monetary policies in many emerging markets and the decision by Western governments to release strategic oil reserves to help consumers, combined to cause commodity prices to fall. Oil prices fell 11%, wheat was down 23%, while corn plunged 20%. Only gold prices held their value—up 4.4% for the second quarter.

## 2011 Outlook: Overweight U.S. Stocks

As Japan rebuilds the damage caused by the earthquake and tsunami, its economy should emerge from recession and provide a boost to global growth. The disruption caused to global supply chains should also be mitigated, thus normalizing auto and technology production. Finally, the end of the Fed’s quantitative easing program in June should strengthen the dollar and weaken commodity prices, particularly oil prices. This should be supportive of consumer spending in the West. We believe that the “soft patch” will be temporary and global growth should resume in the third quarter at more normal levels.

We expect stocks to be the best performing asset class in the second half of 2011. Within stocks, we particularly like U.S. equities. In most emerging markets governments are raising interest rates and using other measures to tighten monetary policy, while in the U.S. the Federal Reserve is expected to continue to provide ample liquidity to support housing and labor markets. Many European countries face sovereign debt issues, while the U.S. still has a few years to repair its balance sheet. Within equities, the economically sensitive sectors such as technology, energy, and financials should outperform. We also favor stocks of large high-quality multinational U.S. companies such as McDonalds, IBM, Oracle, Proctor & Gamble, United Technologies, DuPont, and Boeing. These



companies have excellent balance sheets, access to credit markets, growth in emerging markets, and reasonable valuations. We expect these companies to outperform most other financial assets over the next five to seven years.

We believe that the Federal Reserve will hold interest rates at these low levels until the second half of 2012. This should provide an anchor for short-term rates. However, as economic growth begins to accelerate in the second half of 2011, long-

term rates should drift higher. We expect the 10-year note to yield between 3.5% and 4.0% by the end of the year. This drift to higher rates should limit fixed-income returns. Within the fixed income categories we would be overweight in riskier sectors such as high-yield and asset-backed securities and underweight in government debt.

Sources: *Wall Street Journal, Bank of America Merrill Lynch, Goldman Sachs*