

Asset Allocation Views

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- Slowly, the market's focus is shifting from the financial crisis to the rapid deceleration in global economic activity, which is increasingly looking like a recession.
- This is not to say that the financial crisis is over — several key markets are still not functioning properly. But the markets are no longer waiting for coordinated action on the part of the G-7 to address the crisis. It will take time, however, for the policy actions to work.
- Our view is that the provision of massive amounts of liquidity and the injection of capital into major banks in the United States and Europe in October has averted a meltdown in the global financial system. Individual institutions are likely to continue to incur losses, however, and a process of consolidation is underway.
- Weak retail sales, industrial production and housing starts point to a contraction in real GDP this quarter in the United States. The U.S. economy is likely to remain weak before recovering toward mid-year 2009, in our view.
- Purchasing managers indices and employment are declining in the eurozone, indicating that real GDP is likely to decline in 4Q for the third quarter in a row.
- The Reuters Tankan index of business sentiment in Japan plunged in October, suggesting that Japan's economy will shrink in 4Q for the third quarter in a row.
- The almost hysterical selling that gripped the markets in the eight days ending October 10 produced an oversold market, in our view.
- It is not unusual for the stock market to bounce back after sentiment has become exceptionally pessimistic. On October 14 we departed from our neutral position in all asset classes to overweight large-cap U.S. stocks modestly, financed by a modest underweighting of fixed income. We will be watching economic and market developments closely to determine whether any bounce that occurs is merely a bear market rally (which is our base case), in which case we will exit the overweight equities position.

Current Positions			
	Benchmark (%)	Recommended Allocation (%)	Change from Last Move
Stocks	65.0	70.0 Overweight	Raised
Bonds	35.0	30.0 Underweight	Reduced
Cash	0.0	0.0 Neutral	Unchanged
Allocation among stocks			
Domestic stocks			
Large-cap core stocks	18.0	23.0 Overweight	Raised
Large-cap growth stocks	13.5	13.5 Neutral	Unchanged
Large-cap value stocks	13.5	13.5 Neutral	Unchanged
Mid-cap stocks	4.0	4.0 Neutral	Unchanged
Small-cap stocks	6.0	6.0 Neutral	Unchanged
International Stocks			
EAFE stocks	10.0	10.0 Neutral	Unchanged
Total stocks	65.0	70.0	