

# Global Perspectives

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30 April 2007

Last year, we witnessed a period of risk aversion when investors became anxious that inflation was heading up and central banks were going to turn the screws. But, when it became evident that policymakers weren't going to become proactive about stomping on inflation, risk appetite increased and stock markets were off to the races. From August of last year to the present we have had only brief periods of risk aversion.

The lads at the central banks have been very reluctant to turn off the liquidity tap. Pretty much all of them have been playing the same game of moving forward, one tentative baby-step at a time. As for the Fed, its desire to lower interest rates is being hampered by inflation concerns.

Even the hawks are prone to talk tough, but to act in a dovish manner. Witness Jean-Claude Trichet, the president of the European Central Bank. He has repeatedly warned investors about complacency regarding risk. However, the ECB is not notably more aggressive than the other central banks in conducting monetary policy. Although in Trichet's defence, we should note that the euro's rise has effectively tightened monetary conditions in the Eurozone.

Well, inflation isn't a big problem yet but it is, nevertheless, edging up almost everywhere. The exception is Japan, where there is slight deflation. So the issue of what to do about inflation is back on the agenda. Not that it ever really went away. It was simply ignored as being unproblematic.

Normally, GDP growth has to be brought back below trend to cool the economy and reduce inflationary pressures.

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And, currently, the global economy is still growing at a fast pace, even though there are signs of a slowdown. There is still too much liquidity in the global economy, driving growth and risk appetite.

Credit spreads remain very tight, historically. This is true for junk bonds, as well as emerging market debt. Meanwhile, private equity deals and mergers-and-acquisitions activity continues on both sides of the Atlantic, shoring up the stock markets. When cash-flow yields of targeted companies are attractive relative to junk-bond yields, there are deals to be made.

The Bank of Japan's notoriously expansionary monetary policy has been a source of liquidity for the global economy for a number of years. It has resulted in imbalances that would need to be adjusted at some point in time. The low-interest-rate religion in Japan is probably hurting rather than helping domestic recovery. We no longer buy the story that modest increases in interest rates will sink the economy. The pressure to keep interest rates low has more to do with politics than sound economics. And the BoJ's actual independence on this issue isn't clear-cut.

First-quarter GDP growth in China surprised on the upside. The consensus view is that the economy was even stronger than the reported numbers seem to indicate. This caused a degree of anxiety among many observers because it does not appear that economic activity is responding to policy measures to cool things down.

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But, the fact of the matter is that the authorities haven't been trying hard enough. Monetary tightening has been just as tentative as elsewhere. China's policymakers want to keep growth rising at a fast pace to absorb the increase in the labour force and to allow backward sectors of the economy to participate in the rapid transformation of economic structures. But in their reluctance to rein in the pace of growth they risk overheating and a burnout.

Earlier hopes of an economic slowdown aren't supported by the data. The OECD's leading indicator for China is still gaining momentum, which points to continued strong growth. Meanwhile, industrial production has picked up again.

Capital spending isn't slowing down as much as expected. Urban fixed-asset investments perked up in March, growing at a substantial 25.3%, year-on-year. The composition of demand may be gradually shifting towards consumption, but total demand isn't flagging.

Purchasing managers' indices for new orders and order backlogs have both risen. At the same time, indicators of consumer and business confidence are also trending higher. In addition, the profits of industrial enterprises are rising rapidly.

More recently, headline inflation has accelerated. But this isn't as alarming as it looks because food prices have been a major contributor to the increase in overall CPI. The ex-food index is rising more modestly. There are also some indications that China's export prices may be edging up. If so, this is a worrying factor for inflation in importing countries. Over the past few years, falling Chinese export prices has been an important ingredient in the high-growth low-inflation environment enjoyed in many countries.

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China's policy of only allowing very slow appreciation of the renminbi is offsetting efforts to slow down the economy. It results in huge increases in foreign exchange reserves and makes it difficult to run a tight monetary policy.

Meanwhile, those Americans who are clamouring for rapid currency revaluation should realise what that means in terms of a higher inflation rate in the United States.

Overheating of the Chinese economy and the possibility of a hard landing should be a source of concern to all policymakers. It is possible that the authorities are hoping that the expected slowdown in the US will do part of the job for them, via a weaker export sector.

All in all, global liquidity is still too plentiful and inflation is becoming more troublesome. So the central banks are going to be forced into further action. As a result, it would not be surprising to see more instances of market volatility ahead.

Investors have been cheered by the first-quarter earnings picture in the United States. At the beginning of the season, expectations had been lowered so much that it was a relief to see them beaten when the results came out. Investment banks and technology companies have shored up the average. And sentiment is still very positive about the equity market.

Slow earnings growth and a moderate slowdown in the economy won't clobber the stock market. Some of that is already priced in. What would really hurt would be a combination of high inflation and a tight monetary policy.

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# Market Snapshot

30 April, 2007

LOM Fund	As of	Price	Yield	1 Month	YTD	1 Year	3 Years	5 Years
LOM Global Equity Fund	4/20/2007	\$11.11		3.63%	6.16%	15.00%	53.35%	65.09%
LOM Global Equity Fund (Ex-US)	4/20/2007	13.38		1.81%	4.26%	6.30%	N/A	N/A
LOM Fixed Income Fund	4/20/2007	\$11.81		0.23%	1.39%	4.64%	7.37%	16.50%
LOM Balanced Fund	4/20/2007	\$10.84		2.21%	4.33%	11.22%	29.09%	35.39%
LOM Money Market Fund-USD Retail (AAA rated)	4/27/2007	\$13.27	4.58%	0.38%	1.47%	4.73%	9.33%	10.90%
LOM Money Market Fund-USD Institutional (AAA rated)	4/27/2007	\$116.30	4.87%	0.41%	1.57%	5.09%	10.40%	12.59%
LOM Money Market Fund -CAD	4/27/2007	\$13.21	3.53%	0.29%	1.16%	3.67%	7.93%	12.61%
LOM Money Market Fund -EUR	4/27/2007	11.88	3.66%	0.31%	1.14%	2.87%	5.91%	10.34%
LOM Sterling Reserve -GBP	4/30/2007	£1.00	5.62%	0.47%	1.49%	4.96%	14.77%	23.21%

  

EXCHANGE	As of	Close	1 Week	1 Month	YTD	1 Year	3 Years	5 Years
BERMUDA STOCK EXCHANGE	27-Apr-07	5,129.03	-0.41%	1.00%	6.49%	17.05%	56.76%	93.73%
DOW JONES INDUS. AVG	30-Apr-07	13,120.94	1.25%	5.97%	5.99%	15.16%	25.07%	33.03%
S&P 500 INDEX	30-Apr-07	1,494.07	0.68%	4.71%	5.93%	13.58%	30.54%	39.13%
NASDAQ COMPOSITE INDEX	30-Apr-07	2,557.21	1.23%	4.97%	6.09%	9.56%	23.98%	52.40%
S&P/TSX COMPOSITE INDEX	30-Apr-07	13,632.01	-0.14%	3.41%	6.42%	9.66%	55.72%	76.94%
DJ STOXX 50 = PR	30-Apr-07	3,850.56	-0.96%	4.40%	5.43%	9.11%	38.17%	10.58%
FTSE 100 INDEX	30-Apr-07	6,418.70	-0.95%	2.29%	4.70%	7.07%	41.06%	25.13%
CAC 40 INDEX	30-Apr-07	5,930.77	-0.01%	6.29%	7.18%	14.87%	57.44%	34.53%
DAX INDEX	30-Apr-07	7,378.12	0.49%	7.58%	11.84%	23.28%	79.57%	47.94%
IBEX 35 INDEX	30-Apr-07	14,403.60	-4.49%	-0.67%	2.76%	20.87%	71.89%	76.46%
S&P/MIB INDEX	30-Apr-07	43,642.00	0.61%	6.00%	5.75%	15.84%	53.26%	34.45%
AMSTERDAM EXCHANGES INDX	30-Apr-07	530.49	-0.55%	5.27%	8.15%	13.08%	49.71%	5.03%
OMX STOCKHOLM 30 INDEX	30-Apr-07	1,264.61	-0.60%	6.31%	12.67%	22.85%	77.88%	79.31%
SWISS MARKET INDEX	30-Apr-07	9,419.90	0.72%	6.18%	8.97%	17.16%	60.31%	43.57%
NIKKEI 225	27-Apr-07	17,400.41	-0.30%	0.20%	1.50%	2.92%	43.56%	50.77%
HANG SENG INDEX	30-Apr-07	20,526.50	-1.10%	2.79%	2.50%	21.95%	67.47%	78.84%
S&P/ASX 200 INDEX	30-Apr-07	6,151.60	-0.69%	2.91%	10.45%	16.11%	78.70%	83.91%

  

Currency Cross	As of	Close	06-Apr-07	16-Mar-07	31-Dec-06	14-Apr-06	12-Apr-04	12-Apr-02
British Pound - Euro	27-Apr-2007	1.46	1.47	1.47	1.48	1.45	1.51	1.62
British Pound - Japanese Yen	27-Apr-2007	238.97	237.40	231.88	233.21	207.81	193.02	186.45
British Pound - United States Dollar	27-Apr-2007	2.00	2.00	1.97	1.96	1.83	1.77	1.46
Euro - Japanese Yen	27-Apr-2007	163.29	161.09	157.36	157.13	143.78	129.04	115.29
Euro - Swiss Franc	27-Apr-2007	1.65	1.64	1.62	1.61	1.56	1.56	1.46
Euro - United States Dollar	27-Apr-2007	1.37	1.36	1.34	1.32	1.26	1.18	0.90
United States Dollar - Bahamas & Bermuda Dollar	27-Apr-2007	1.00	1.00	1.00	1.00	1.00	1.00	1.00
United States Dollar - Cayman Islands Dollar	27-Apr-2007	0.82	0.82	0.85	0.85	0.85	0.83	0.82
United States Dollar - Canadian Dollar	27-Apr-2007	1.12	1.12	1.15	1.17	1.12	1.36	1.56
United States Dollar - Japanese Yen	27-Apr-2007	119.61	118.65	117.83	119.07	113.83	108.97	127.86

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