



Client Memorandum

The Earthquake and its Aftermath

March 16, 2011

As we watch accounts of the massive devastation and human tragedy in Japan, our thoughts clearly go out to the Japanese people. As expected, the global financial markets are reacting to the possible economic ramifications, escalating fears and creating a wave of selling.

We are reviewing thoughtful commentary and analysis from a variety of research organizations that specialize in global macroeconomics, and though events are rapidly changing, we want to offer a summary of their current views and our thoughts:

- The output loss in Japan's economy could be significant and could trigger a recession in Japan. However, the reconstruction spending will kick in sometime in the second quarter pushing up the growth rate for the Japanese economy.
- Despite the sharp decline in the Japanese stock market, it should be noted that natural disasters rarely change the growth trajectory of an economy. While the infrastructure damage is immense and there are legitimate concerns of radiation contamination, at this point the steep drop in Japanese stocks is at least partially due to panic. The earnings of the corporate sector are unlikely to be significantly affected, and some value seeking investment managers are already planning to gradually increase holdings of Japanese companies.
- The impact on the rest of the world's economy should be small. Japan's contribution to global growth has averaged 2-3% over the last five years, so even if Japan does sink into a recession the impact on the rest of the world should be limited. This probably explains why declines in other stock markets have been muted so far compared to the Japanese Nikkei.
- An important point to keep in mind is that global markets had already begun correcting prior to the earthquake. The disaster has accelerated the speed of a global markets correction and added to investor anxieties over the crisis in the Middle East and renewed worries about the resolution of the European debt crisis. Our sense is that the selling pressures are not over and volatility will continue to be high, but that the global economic expansion will remain intact. From a cyclical standpoint, further declines in equity markets should be viewed as buying opportunities.

In summary, the tragic events in Japan are yet another reminder of the uncertainty of the future, the corresponding need for broad diversification and the importance of focusing on risk management when investing.

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