

From: US GIO <[REDACTED]>

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## Eye on the Market, January 18, 2011

Topics: Market update; Brazil and related opportunities in Private Equity

**Market update.** Developments in early January show a continuation of the 3 regional trends highlighted in our 2011 Market and Portfolio Outlook. In the US, manufacturing and service sector surveys point to expansion (strongest service sector activity in 4 years), consumer spending is solid, federal and state tax receipts are improving, and banks may reinstate dividends and stock repurchases in the second quarter. In the emerging world, rising currencies, higher interest rates and increased bank reserve requirements (particularly in China) are being used to stave off inflation. Food prices have risen sharply, which has a lot to do with it; more on that and the world's strange weather patterns next week. In Europe, even as Germany posts another round of positive economic data, financing costs for sovereigns and banks in the periphery are reaching new highs. As shown in the second chart, several European countries are growing well below the cost of financing their government debt, which is not a sustainable equilibrium. The largest concentration of 2011 European bank debt maturities lay in April; Europe may need a more comprehensive solution well before then. Recent events reinforce the rationale behind the US being the largest regional equity allocation in our portfolios.

### World food prices

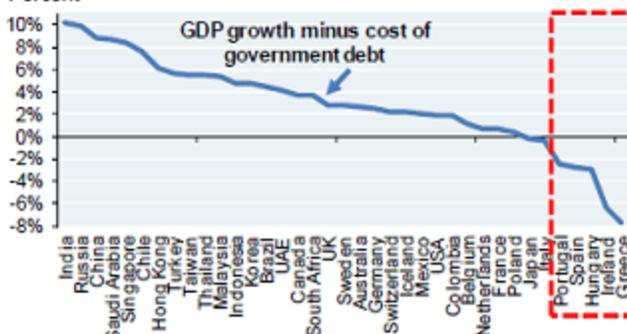
United Nations Food and Agriculture world food price index



Source: Food and Agriculture Organization of the United Nations.

### Peripheral Europe: an unsustainable dynamic

Percent



Source: International Monetary Fund, Bloomberg, Gavekal.

**O futuro é agora.** In the emerging world, equity markets tend to be dominated by manufacturing, financial, energy and utility stocks. This persists despite the growth of thousands of companies servicing a new class of emerging markets consumers. In China, consumer stocks servicing its middle class (now estimated at 300 million people) represent less than 10% of the market cap of the Shanghai Composite Index. Providing growth equity capital to such companies (typically at levels well below public market P/E multiples) has been one of our investment objectives.

Like China, Brazil also migrated away from its 1970's centrally-planned economic model (before a pit-stop at inflation-financed growth in the 1980s). **Brazil's success over the last decade has resulted in the emergence of 50 million new consumers, and the companies that service them.** This week, we look at Brazil's transformation, its ongoing challenges, and the opportunity in private equity. While Brazil still grapples with legacies of its fiscal and monetary history, by the end of this decade, it will likely overtake Britain and France to become the world's 5th largest economy. For the first time in decades, the future is now (*o futuro é agora*), which is the topic of this week's Eye on the Market investment review (attached).

Michael Cembalest  
Chief Investment Officer

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