Update by Eric Bushell
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Overview and outlook

- The United States and other countries have dealt with most of the symptoms of the credit crisis, with the rescue programs being wound down and new regulations being implemented.
- However, they have yet to deal with the root causes, which include the global current account imbalances. Several nations have been living off the savings of other countries and have developed import cultures that were not self-financing. This is fine until you get a "sudden stop" to capital inflows, which results in falling asset prices, bank failures, and declining wages and currency values.
- Solving these imbalances in an orderly manner depends on the willingness of the funding and borrowing nations – such as China and the U.S., or Germany and Spain – to reach an agreement on the pace of the adjustment. The alternative is a funding crisis, leading to collapsing values for the dollar or the euro.
- An orderly rebalancing is in everyone's best interests and that is why we believe that these risks will diminish, and that these countries will reach what we call a "European solution." This is the most cost-effective way to move forward, and the stock market is beginning to see this way, too. Spain is one of best performing markets so far this year, up 11%.

Our five leading ideas for 2011

- **A synchronized global confidence recovery** – This will unleash a global capital investment and merger and acquisition cycle matched with newfound wealth and confidence in both public and private lenders. This will include a global synchronized corporate spend cycle that is only just recovering after grinding to a halt in 2008. Among the sectors that will benefit are industrials, technology and media.

- **Quantitative Easing 2** – The U.S. government's printing of money to fund most of its Treasury bond issues ignited concerns about the dollar's value and a flight to commodities and other safe-haven assets. This occurred amid high capacity utilization and tight labour markets in virtually all developing countries, creating greater inflationary risk. More aggressive policy tightening in these economies represents one of 2011's biggest growth limiters and risks. However, higher labour costs will encourage more capital spending on energy and labour-saving technologies.

- **Europe holds together** – The continent's recovery is crucial and we are encouraged by the collaborative problem solving as countries take the path of lowest cost and systemic risk to resolve their issues. There are very encouraging signs. Businesses in Germany are investing at the highest rate since preunification because of the confidence and the signals they are getting from their order books.

- **What's the ideal investment today?** – A quality company with low-cost, long-term debt financing and inflation-sensitive revenue sources. With its long-term financing, such a security represents a short against the bond market. Industries that offer these characteristics include railroads, chemicals, miners, energy, infrastructure and property. In these industries, new capacity is very expensive to develop.

- **Real interest rates are likely to rise into 2012** – This is due to our positive outlook on global growth. For example, German two-year bond rates have been rising steadily. We believe European Central Bank president Jean-Claude Trichet, who steps down later this year, will initiate an "exit strategy" from the bank's accommodative policies. This also signals the end of trades into safe havens such as gold.

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