HELPING INVESTORS

Consider this

Russell experts discuss timely topics around the world and give perspective on how they're likely to impact the markets and you.

FEBRUARY 2012

THIS QUARTER:

Mike Smith, consulting director, on

keeping Europe, the world economy and a globally diversified portfolio in perspective

Will Europe bring down the global economy?

For investors, 2012 is off to a good start. As of February 13, 2012, year-to-date stock returns are strong across the globe: In the U.S. the Russell 3000® Index is up 8.53%. Internationally, developed markets also rose with the Russell Developed ex-U.S. Large Cap Index up 9.1%. And leading the pack is emerging markets, with the Russell Emerging Markets Index up 15.1%.

Yet even with these positive early results, clouds of uncertainty remain.[1] Europe is still on many investors' minds, leaving us to wonder when their debt crisis might rear its ugly head again. Unresolved issues in the Eurozone have led many investors to question the long-held belief that a globally diversified portfolio is the foundation of long-term investment success.

It can be difficult to stick to your guns during times of stress, but as we have seen so often in the past, emotions and sentiment tend to betray us as investors. Sound, rational perspective should guide our investment decisions, not fear-charged perceptions. So let's consider this…

These days it's common to hear market pundits raging on TV, things like "Europe is going to crater and take the rest of the world down with it!" Will something like this actually happen? Probably not. But this kind of hype provides great ratings—and fodder—for the networks.

Getting past the theatrics, Russell believes there is a high likelihood that Europe could enter a recession in 2012, if it hasn't already. Does that mean it will be a recession of biblical proportions that takes the rest of the world with it? No, it doesn't. Even though the global economy is becoming more tightly connected, trade between nations is becoming more diversified.[2] And just as it is with your portfolio, we believe global diversification is a good thing.

[1] Greek Economy Stuck in Deep Recession, Associated Press 2/13/12
http://www.nytimes.com/aponline/2012/02/13/world/europe/AP-EU-Greece-Financial-Crisis.html;

Portugal's Debt Efforts May Be a Warning for Greece, NYTimes, 2/14/12
http://www.nytimes.com/2012/02/15/business/global/portugals-debt-efforts-may-be-a-warning-for-greece.html?hpw

[2] IMF World Economic Outlook, Sept. 2011, http://www.imf.org/external/pubs/ft/weo/2011/02/pdf/text.pdf

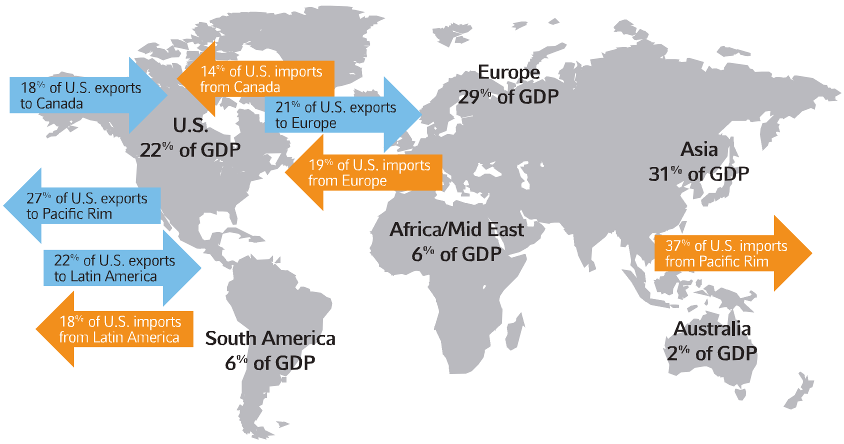
Understanding our place in the world.

The U.S. trades and invests more with Europe, Asia, South America and Canada than ever in the past, and these nations all have trading relationships with each other. If, or when, Europe goes through a recession, it will likely impact everyone to some extent, making the intertwined global economy a little less appealing for a while.

There is a flipside, though. No single economy is completely dependent on Europe—not even Europe's own nations. This leads us to believe the impact of a recession in Europe can be absorbed within the overall growth of the global economy.

The accompanying chart gives you an idea of the United States' global trading partnerships. You see that the U.S. trades a significant amount with Europe, but not more than we trade with Asia, South America or Canada. So if Europe should enter a deep recession, the U.S. will feel some pain, but it's not likely to be severe enough to send our economy into a recession. Russell expects any European recession to be moderate, allowing continued growth and recovery for the U.S. and the global economy.

U.S. trade partnerships and global GDP



Sources: Global Equity from Russell Global Equity Index, GDP from IMF World Economic Outlook Sept 2011, Trade Data from U.S. Census Bureau Foreign Trade Report

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Understanding the world's place in your portfolio.

Many investors see evidence of a gradual U.S. improvement in recent reports on corporate earnings, employment, housing, lending, etc.[3] And this may make people more comfortable putting money to work in U.S. stocks. Unfortunately, it's not as easy to see improvements beyond our shores right now, especially with all the downbeat news coming out of the Eurozone. It's this uncertainty that gives investors pause.

At Russell, we think it's unwise to abandon global markets. While we acknowledge that the global economy may grow in fits and starts, it is not going away. What's more, the U.S. will likely continue to become a smaller player in the world as global economies as a whole grow faster than the U.S.[4] Russell believes forward-looking investors will want to position their portfolios to participate in that global growth potential.

[3] U.S. Bureau of Labor Statistics News Release, 2/3/12; Payroll employment rises 243,000 in January; unemployment rate decreases to 8.3% http://www.bls.gov/news.release/empsit.nr0.htm;

Bloomberg, 2/2/12, Mortgage Rates for 30-Year Fixed U.S. Loans Decline to Record-Low 3.87%, http://www.bloomberg.com/news/2012-02-02/mortgage-rates-for-30-year-fixed-u-s-loans-decline-to-record-low-3-87-.html

[4] IMF World Economic Outlook, Sept. 2011, http://www.imf.org/external/pubs/ft/weo/2011/02/pdf/text.pdf

For those that want more information, here are five reasons to consider global diversification should your risk tolerance allow:

1. It's a great big world out there and the U.S. equity market now makes up less than 46% of the global market opportunity. Why limit yourself?
2. Some of the biggest brands in the world are domiciled outside our borders. Nestle, Royal Dutch Shell, Samsung and Honda* make great products you probably know. Great products can create growing revenues which often translate to great investments.
3. Compared to historical averages (2002–2011), non-U.S. stocks are cheap relative to U.S. stocks by many measures (price to earnings, price to book value, price to cash flow as of December 31, 2011). People often shop for bargains in many aspects of life, so why not things like stocks from other countries?
4. Non-U.S. economies are projected to grow at a faster rate than the U.S. economy over the next ten years. This doesn't guarantee anything, but higher growth can open up new opportunities.
5. Non-U.S. stocks are even more attractive now than they were five years ago when investors were asking for more of them in their portfolios (after an impressive stretch of performance).** Successful investing does not equate to purchasing what worked last year. It is predicated on making informed decisions on what should work in the future.

* The information contained in this piece should not be considered investment advice to buy/sell any securities referenced.

** Russell 3000 Index and Russell Developed Large Cap ex U.S. Index

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Seeing beyond Europe's trouble spots.

As we turn our sights back to Europe, we find the majority of negative headlines swirling around peripheral countries like Portugal, Ireland, Italy, Greece and Spain, commonly referred to as the "PIIGS." These nations have outspent their revenues for years, essentially living beyond their means.[5] The one saving grace is that the PIIGS make up a small portion of the overall European equity market.

For instance, Europe represents 45.5% of the global equity structure outside the United States (according to the Russell Global ex-U.S. Index as of 12/31/2011). For U.S. investors, the PIIGS market breaks out this way: Portugal, 0.15%, Ireland, 0.64%, Italy, 1.52%, Greece, 0.10% and Spain, 2.05%.

Of course, European uncertainties go beyond the borders of the PIIGs, with much of the focus squarely on the European banking community and their exposure to bad loans. We've witnessed some progress in this area that we believe helps mitigates some of the uncertainty going forward:

- The European Central Bank's Long Term Refinancing Operation has provided a significant liquidity cushion for European banks[6]

[5] Fiscal Union Cannot Save the Euro, The Atlantic 11/28/11
http://www.theatlantic.com/business/archive/2011/11/fiscal-union-cannot-save-the-euro/249093/

[6] WSJ.com, "ECBs Massive LTRO Gives Risk Assets Wings", 12/21/2011
http://online.wsj.com/article/BT-CO-20111221-703943.html

- The next ECB offering is expected to receive even greater participation than the first, rumored to be approaching $1 trillion[7]
- Markets are responding positively to this news (based on Russell 3000 Index & the Russell Developed Large Cap excluding-U.S. Index performance as of 2/17/2012)

The structural issues facing much of Europe—as well as ambiguous growth prospects—are real concerns that remain on the table. However, avoiding this area means you're intentionally avoiding a group of globally diversified, multi-national companies that include Nestle, Royal Dutch Shell, GlaxoSmith Kline and others.* These companies are global leaders in their industries and they derive the majority of their profits outside of the Eurozone. In the absence of a crystal ball, we believe diversification should be a primary component of everyone's investment portfolios.

Markets are impossible to predict. That's why we believe investors are best served to have a diverse mix of domestic and global exposure in their portfolios. And, yes, that may include Europe.

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[7] Financialtimes.com, "Banks Set to Double Crisis Loans for ECB", 1/30/2012 http://www.ft.com/intl/cms/s/0/09ab9542-4b6d-11e1-b980-00144feabdc0.html#axzz1n3dPo6sL