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Market Insights

A periodic newsletter from Idaho Trust

Domestically, politics are currently capturing headlines. However, international investors are still watching developments out of Europe and the latest economic information out of China.

Developed Markets

Developed markets continue to be hampered by slow growth and large debt burdens. The European Union continues to be embroiled in their financial crisis with Spain's government getting closer and closer to requiring bailout assistance. Japan's economic future continues to look opaque. Japan is currently saddled with an enormous debt load and efforts to stimulate the economy or lower the yen's international exchange rate, to make the country's exporters more competitive, have consistently failed.

The European Central Bank (ECB) has recently hinted at engaging in another round of bond buying. Last summer, the ECB bought Italian and Spanish bonds in efforts to lower those countries' borrowing costs. The latest ECB's announcement was initially met with speculation. However, ECB President Mario Draghi is structuring this round of bond purchases more strategically. The first difference in the proposed plan is for a country to qualify for the bond buying program they would have to apply to the Euro area's rescue funds, which requires the applicant to conform to strict terms. The second difference is that the bonds eligible for purchase by the ECB would be shorter duration bonds than in the previous bond round purchases, which requires the applicant country to continue to make reforms. Although this program has potential to help the beleaguered euro zone,

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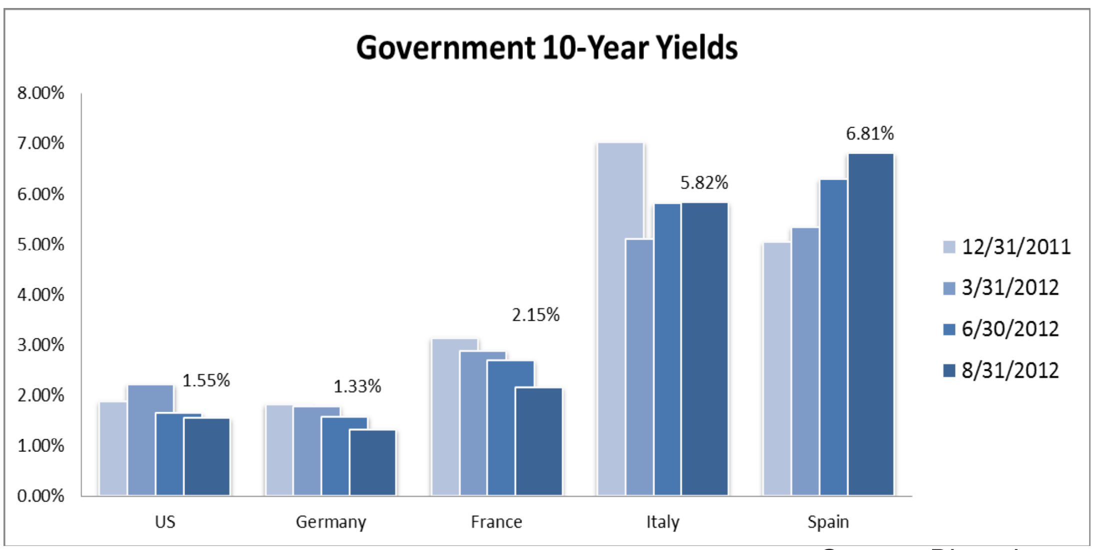
it is far from a done deal. The German constitutional court is scheduled to rule on the legality of the euro area's permanent rescue fund that this bond buying program is linked to, a decision will not even be tendered until September 12th. Mario Draghi, President of the European Central Bank, has also taken steps to stimulate European economies by keeping bank reserve rates low. There is even the possibility that the ECB may follow suit of other European countries, namely Switzerland and Demark, who have sold debt at negative yields or set negative primary interest rates. The ECB themselves have mentioned that this is a possibility. The ECB's key interest rate is currently set at 0%.

The Spanish financial sector received a 100 billion euro bailout in June. This came after the Spanish government made plans to nationalize the country's third largest bank; now, there is talk that Spain will need a bailout for its government. Prime Minister Mariano Rajoy is open to the conversation concerning a government bailout. However, Mr. Rajoy already has a poor track record with the Northern European countries' leadership. In March, Mr. Rajoy surprised markets by changing Spain's budget deficit target only hours after agreeing to a more aggressive target that he had signed with euro region leaders concerning budget coordination. Most recently, Mr. Rajoy has extended unemployment benefits to the unemployed—Spain's unemployment is close to a staggering 20%—which did not demonstrate his commitment to fiscal reforms even as he approaches the idea of asking for a government bailout. As a result, the market has kept Spanish 10-year government debt yields elevated, reaching a peak of 7.62% in July.



Source: Bloomberg

Japan's debt load looks almost insurmountable standing at roughly 200% annual GDP. This coupled with historically slow growth show little sign of positive future findings. Not all the news out of Japan has been bad, the rebuilding effort after last March's earthquake and tsunami tragedy has given some growth in demand for Japan's economy. Currently, the high value of the yen is hindering the Japanese economy. With the yen stuck at such high valuations, Japanese exports appear to be overpriced in the global market. If the Bank of Japan (BOJ), Japan's central bank, could lower the yen's exchange rate then it would take pressure off of Japan's exporters which would positively contribute to growth. Because of the economic woes in Japan, many Japanese leaders are pressuring the BOJ to implement additional stimulus measures. The BOJ's governor, Mr. Shirakawa, has been summoned to testify before their parliament for 26 days so far this year. Two new members of the BOJ's board have also indicated that the central bank should pursue more stimuli to overcome the country's history of deflation.

Global 2012 GDP and Inflation Projections

Country/Region	***GDP***	***Inflation***
Developed Markets	1.3%	1.9%
Emerging Markets	5.3%	4.9%
Euro Area	-0.4%	2.6%
United States	2.3%	2.1%
Japan	2.5%	-0.1%
China	7.9%	2.9%
Greece	-5.8%	1.3%

Source: Barclays Capital

Emerging Markets

China's economic slowdown continues to have rippling effects across emerging markets. China has historically had a great history of economic growth. Recently, China's government lowered their growth target rate to 8%. However, early indications show that 3rd quarter GDP growth may be closer to 7.5% and industrial-output growth recently hit a three year low. The Chinese government has taken action to stimulate their economy. The Chinese Central Bank has cut interest rates in June and July and has lowered the bank reserve ratio three times since last November in order to support growth. These accommodating policies may also eventually contribute to additional inflation in China which may refuel their soaring real estate market, which the government has gone to great lengths to slow.

Brazil's GDP continues to disappoint. Brazil's manufacturing sector's output is still below 2010 levels. This is due, in part, to the economic hard landing of neighboring Argentina. Argentina is a large importer of Brazilian manufactured automobiles. However, as the real, Brazil's currency, has declined it has helped Brazilian commodity exporter's businesses compete with importing firms. Economists are forecasting a reverse in GDP in the third and fourth quarters of this year as stimulus measures take effect.

In a historical context, market valuations appear attractively priced. These attractive valuations are largely due to the number of risks that are present in the international market. However, international investment opportunities persist for willing international investors.

S&P 500 Index

3 Month	7.94%
Year-to-Date	13.50%
1 Year	17.98%
3 Year	13.61%
5 Year	1.28%

Int'l Developed Markets

3 Month	11.13%
Year-to-Date	6.92%
1 Year	-0.04%
3 Year	2.40%
5 Year	-4.80%

Int'l Emerging Markets

3 Month	5.53%
Year-to-Date	5.61%
1 Year	-5.80%
3 Year	6.63%
5 Year	-0.37%

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