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Shares rise on monetary stimulus

Share prices vaulted to fresh all-time highs last quarter amid a wave of monetary easing from the world's central banks. Policymakers in more than 20 countries slashed borrowing costs in an effort to spur growth and fight weak—and in some cases negative—inflation.

Measured in local currencies, the MSCI All Country World Index jumped 5.0%, the largest rally in more than a year. But for US-based investors, the benefit of stock appreciation was countered by a strengthening US dollar. The trade-weighted value of the greenback soared 8.1% during the quarter. Outside of the final three months of 2008—when a flight to quality drove a 10.8% spike in the dollar—this marked the biggest gain in more than 40 years.

Market Performance (% Change)	1Q15	YTD
S&P 500 Index (USD)	1.0	1.0
Dow Jones Industrial Average (USD)	0.3	0.3
NASDAQ Composite (USD)	3.8	3.8
Russell 1000 Growth Index (USD)	3.8	3.8
Russell 1000 Value Index (USD)	-0.7	-0.7
Russell Midcap Index (USD)	4.0	4.0
Russell 2000 Index (USD)	4.3	4.3
Russell Microcap Index (USD)	3.1	3.1
Barclays US Aggregate Bond Index (USD)	1.6	1.6
BofA ML US High Yield Bond Index (USD)	2.5	2.5
Bloomberg Commodity Index (USD)	-5.9	-5.9
MSCI EAFE Index (USD)	5.0	5.0
MSCI EAFE Index (local)	11.0	11.0
MSCI Emerging Markets Index (USD)	2.3	2.3
MSCI Emerging Markets Index (local)	4.9	4.9
MSCI All Country World Index (USD)	2.4	2.4
MSCI All Country World Index (local)	5.0	5.0
British Pound per USD	5.0	5.0
Euro per USD	12.7	12.7
Japanese Yen per USD	0.0	0.0

Source: FactSet as of 3/31/15.

Dampened by the dollar rally and ongoing concerns about supply/demand imbalances, commodity prices continued to retrench. The Reuters CRB Index tumbled 5.3%—its fourth consecutive loss and longest downtrend since 1998. The price of West Texas Intermediate crude oil fell 10.6% and briefly touched \$43/barrel, the lowest level since March 2009.

Fresh highs for US markets

Wall Street investors applauded a relatively healthy US economic backdrop and a potentially delayed Federal Reserve (Fed) rate-hike cycle. The S&P 500 Index staggered into uncharted territory with a 1.0% gain, its ninth in a row and its longest winning streak since 1998. The Nasdaq Composite advanced 3.8%, approaching peaks last seen during the dot-com era. Pressured by asset inflows from abroad, the yield on 10-year Treasuries closed the quarter at 1.93%, a decline from 2.19% on December 31, 2014.

US stocks are near all-time highs



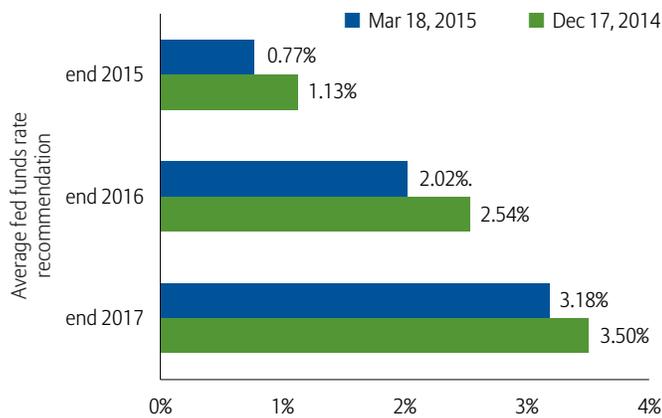
Source: FactSet as of 3/31/15.

Economic reports were mostly positive. Bolstered by the biggest gain in real consumer spending since 2006, fourth-quarter 2014 gross domestic product (GDP) expanded at a 2.2% annualized pace. According to the International Monetary Fund, growth may accelerate above 3% in 2015—which, if realized, would mark the best year for the economy since 2003. But unforeseen obstacles have been a recurring theme throughout the post-crisis era, and last quarter was no exception: Growth was likely dulled by the West Coast port strike and another unseasonably nasty winter in the Northeast.

While areas of slack frequently get headlines, the US labor market continues to improve. Employers added 295,000 jobs in February, raising the six-month total above the 1.75 million mark for the first time in 15 years. Meanwhile, overall unemployment dipped to 5.5%—the lowest level since June 2008.

At the March 17-18 Federal Open Market Committee meeting, central bankers weighed the balance of economic risks against the likely course of monetary policy. They removed the word “patience” from their official statement—a sign that, if incoming data are sufficiently strong, rate hikes could begin by June. But policymakers also indicated that conditions had changed since their December assessment, reducing their forecasts for GDP, inflation and long-run unemployment. Together this means the Fed is not on a pre-set course and is increasingly data-dependent. While policy tightening could happen this summer, the odds appear to be falling.

Fed policymakers have trimmed their recommendations for benchmark interest rates



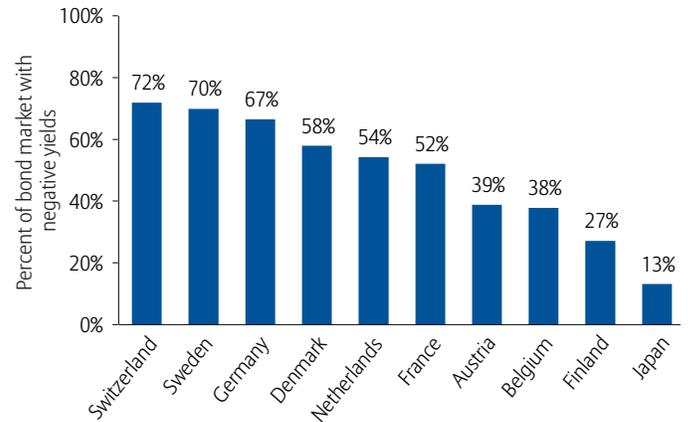
Source: Federal Reserve as of 3/18/15.

The ECB opens the taps

Europe’s bourses rocketed to unprecedented heights as the European Central Bank (ECB) launched a massive, unconventional stimulus program. Measured in local terms, the MSCI All Country Europe Index posted an 11.5% gain, with every country advancing except Greece and Turkey. The MSCI Denmark Index led the charge with a 31.9% spike, the biggest since 1983. The MSCI Germany Index rallied 22.1%, its best quarter in almost 12 years.

Bond yields crumpled beneath the weight of the ECB’s new €60 billion per month asset-purchase program. The rate on 10-year German bunds fell to 0.15%—easily the lowest level on records dating back to 1972. Rates on shorter-term debt sank into negative territory—not just in Germany, but across a big chunk of the currency union. It is hoped that through the ECB program—which officially began March 6 and is expected to continue for at least 18 months—the euro zone will shake free from the specters of deflation, high unemployment and middling economic growth.

Negative sovereign yields are spreading across Europe



Source: Allianz Global Investors as of 3/25/15.

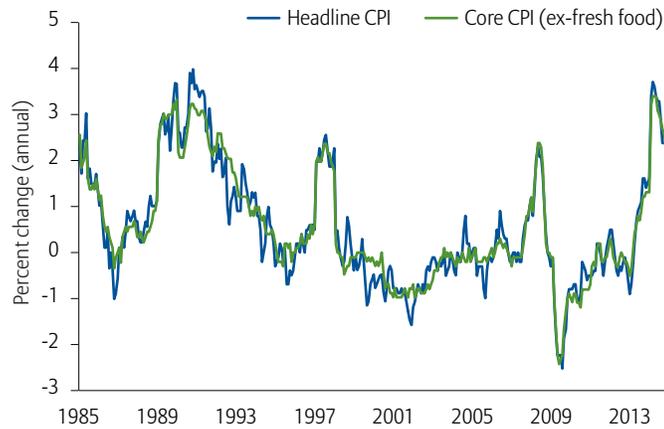
The challenges are significant. Euro-zone GDP grew at a meager 1.3% annualized pace during the fourth quarter of 2014, and is still almost 2% below its mid-2008 peak. At 11.4%, euro-zone unemployment is more than double the US rate. Headline prices in the euro zone fell 0.6% in January, matching the weakest inflation print since the launch of the euro.

Asian equities accelerate

The MSCI All Country Asia Index popped 7.7%—its best quarter since late 2012—as policymakers from Australia, China, India, Indonesia, South Korea and Thailand cut benchmark lending rates.

Led by a more than 23% surge in health-care stocks, the MSCI Japan Index logged a 10.4% advance. Reports on Japan’s economy were mixed. Labor conditions continued to strengthen, with job openings hitting an eight-year high and unemployment falling to 3.4%, the lowest level since 1997. But while hiring has improved, consumer spending remains tepid. Retail sales in February were down 1.8% compared with the same time last year.

Despite rising import prices, inflation in Japan is falling



Source: Japan Ministry of Internal Affairs and Communications as of 2/28/15.

Meanwhile the benefits of a weaker yen—which touched an 8-year low versus the US dollar last quarter—appear to be fading. Japan’s exports rose 2.5% in February (year-over-year), the weakest showing since last August. Inflation, which has been lifted by rising import prices and the April 2014 sales tax hike, eased to 2.2% in February. That is down from a 3.4% annual pace as recently as July. Stripping out the impact of the tax hike, prices are flat and in danger of tipping back into negative territory. Some investors are betting that this may prompt the Bank of Japan to further expand its quantitative-easing program at some point this year.

The global market outlook

Global macro data are consistent with moderate economic expansion holding near or slightly above potential in the coming quarters. Momentum remains stronger in the developed world than in emerging markets, with the US providing key support for the world economy.

While we expect the Fed to begin raising interest rates in mid-2015, monetary policy should remain stimulative for some time—not just in the US, but abroad as well.

From an investment standpoint, at the end of March we favored equities over bonds and were neutral on commodities.

It is notable that the ECB’s planned asset purchases this year exceed the scheduled net new issuance of euro-zone government bonds. As such, we expect more yield-curve flattening and more negative yields, and we are monitoring prospective liquidity challenges in the broader government bond market.

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