



## North American Management

David H. M. Baker, CFA  
Chief Investment Officer  
Ten Post Office Square, Suite 1200  
Boston, MA 02109 [www.namcorp.com](http://www.namcorp.com)

Telephone: 617.695.2100  
Fax: 617.695.2121

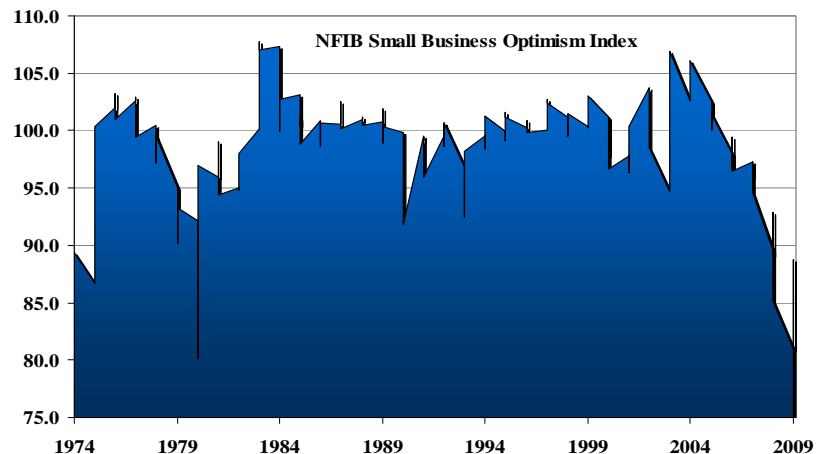
### Sovereign Stress and Seismic Shifts February 2010

The inflationary concerns of some investors that appeared towards the second half of 2009 seem to have given way to deflationary fears in early 2010. This is a direct result of the debt funded international economic stimulus programs causing a sharp increase in outstanding global liabilities. Rising debt is often inflationary as it requires an ever-increasing amount of currency to carry or to finance, but large debt overhangs are ultimately deflationary, as the retirement of debt crowds out consumption. We continue to believe that tension between these forces will dominate the macroeconomic outlook this year. As a result, we expect to see periods of sharply elevated market volatility.

It will be very interesting to see how the European Union deals with the serious debt issues within the over leveraged nations of Greece, Spain, Portugal, Italy and Ireland. Hopefully these governments will be forced to make necessary cuts before receiving aid - to do otherwise would only serve to delay the inevitable. In our view, the moral hazard to enable these nations is high. Their debt burden is simply too great, well above the euro-area limit of 3% of GDP. For example, Portugal's 2009 budget deficit was 9.3%; Ireland's was 11.7%, and Spain's was 11.4%\*. Among them, Ireland has taken the initiative, cutting 6% from its budget. It is a step in the right direction that others need to follow. The equity market may be sending a message to the region, as many of these markets are down twice the S&P 500, and the Euro has fallen nearly 5% year to date\*\*.

We believe a more engaged populist base will reduce the political viability of ongoing bailouts as the default policy tool to "save" failed or failing institutions. The default of a sovereign nation and a stream of defaults by weaker corporate credits unable to restructure their debt in less forgiving capital markets seem likely.

Given these pressures, the developed world could endure a prolonged period of structurally higher unemployment and lower growth rates. This is highlighted by the recent National Federation of Small Business Optimism Index (NFIB) showing a rebound from March lows, yet languishing at historically low levels. These businesses drive employment growth and a significant improvement in the index will need to occur before we can expect to see inflation loom as a serious economic concern.



In this environment, the quality of your investments is absolutely critical. As a result, we seek to identify and own companies that possess dominant market share, pricing leadership, rising cash flow, consistently higher revenues and strong, liquid balance sheets. Where appropriate, we will utilize external managers with specific focus and internally maintain a bias toward assets that have lower correlation with the broader market in order to limit downside.

Our portfolios remain more conservatively positioned than in more "normal" markets, allowing us to take advantage of the volatility we foresee emerging over the next several quarters. When opportunities arise, we will seek to deploy cash or liquidate some of our fixed income positions with embedded capital gains.



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From time to time, we are asked whether or not we are taking on new clients at North American Management. We believe that we are well positioned to provide services to additional investors in 2010 and beyond. In these times of economic uncertainty, we can provide independent, objective reviews of portfolios and have the ability to evaluate all of the investment choices available. If you, or anyone you know, would like to discuss our capabilities in more detail, or would like to schedule a meeting, please don't hesitate to contact us.

*\*Source: Wall Street Journal*

*\*\* Source: Bloomberg*

*The information in this discussion is taken from sources that North American Management believes to be reliable. Notwithstanding, North American Management does not guarantee the accuracy of the data.*