Brown Brothers Harriman

Global Financial Markets
Monthly Recap

August 2006

Global Economy - July Highlights

United States

- GDP growth slowed to 2.5% in the second quarter from 5.6% in the first quarter. Less robust consumer spending and weak housing activity had been widely anticipated. Higher interest rates have reduced refinancing opportunities for current homeowners and have raised prospective mortgage payments for new buyers. Consumers are also feeling the squeeze from higher adjustable rate mortgage obligations and higher energy prices.

- Slower consumption growth and steady production gains meant that inventories expanded last quarter, adding 0.4% to the GDP growth. In order to prevent further unwanted accumulation, manufacturing output may slow this quarter, reducing the third-quarter GDP growth rate.

- Responding to a weaker dollar and strengthening economies abroad, exports rose in the second quarter. Higher exports helped to narrow the trade deficit and added 0.3% to GDP growth for the quarter.

- The biggest surprise in the GDP report was the sharp deceleration of capital spending. Cap ex grew just 2.7% in the second quarter compared to 13.7% in the previous quarter. Strong corporate cash flows and large cash balances suggest that access to financing is not limiting capital projects. Capital spending data are notoriously volatile, so we expect to see a reversal of this trend in Q3.

- In contrast to the weaker-than-expected GDP report, the personal consumption expenditures deflator (excluding food and energy) rose sharply, climbing 2.9% at an annualized rate, compared to 2.1% in the first quarter.

- Slower GDP growth confirmed earlier anecdotal reports contained in the Fed's Beige Book that economic growth had decelerated in most of the 12 regional Fed Districts. The accumulating evidence of slower growth should allow the Fed to maintain short-term interest rates at 5.25% when it meets on August 8th.

Asia

- Higher corporate profits in Japan have given way to improved business investment and debt reduction, while private domestic demand has proven resilient. The BoJ hiked overnight interest rates by 25 basis points for the first time in six years on July 14th, citing a sustainable recovery and moderation in deflationary pressures, evidenced in a core CPI rate of +0.6%, an eight-year high. Chinese growth continues at a whirlwind pace, posting an 11.3% year-over-year advance in the second quarter.

Europe

- Growth in the Eurozone remains near trend, with market participants expecting a marginal acceleration in the second quarter. Risks appear balanced, with looming fiscal tightening, high energy prices, and moderating global growth offsetting an improved labor market and manufacturing momentum. In the face of benign core inflation releases, the ECB has maintained a vigilant stance on monetary policy. Overnight rates were raised to 3% in early August, with the ECB citing above-target headline inflation and rising consumer confidence measures as significant concerns.

Fixed Income and Currency Markets

United States

- With the exception of 3-month T-Bills, yields rallied 10-20 basis points across the yield curve, which steepened modestly during the month of July as the spread between 2-year and 10-year Treasury yields finished 3 basis points wider than it began the month. The rally was sparked by Fed Chairman Bernanke's testimony in which he suggested the Fed was looking to halt the tightening cycle, projecting that slowing U.S. economic growth will eventually ease inflation pressures.

- The Merrill Lynch U.S. Treasury Master Index returned 1.22% for the month. The 2-year, 5-year, and 10-year benchmark securities returned 0.74%, 1.24%, and 1.58%, respectively.

- Break-even rates for 10-year TIPS decreased by 3 basis points for the month as inflation expectations were lowered in response to slower domestic growth. Swap spreads decreased 2-4 basis points across the maturity spectrum. The U.S. mortgage, agency, and corporate sectors outperformed similar duration Treasuries by 22, 4, and 9 basis points, respectively, during the month.

Municipal

- Against a backdrop of increased demand and a slowdown in new issue volume, the municipal market performed well in July, as the Merrill Lynch Municipal Master Index returned 1.21%. For the month, long-term issuance totaled $26 billion, a decrease of 25% compared to the same period last year. Overall, year-to-date volume is running 16% behind 2005's record pace.

Asia

- With the exception of nominal steepening at the long-end, the Japanese yield curve ended the month largely unchanged. The Chinese yuan closed the month at 7.97, the strongest level since policy restructuring one year ago. This burst of strength has elevated most Asian currencies, with the exception of the yen, which was virtually unchanged for the month at 114.60.

Europe

- European bonds marked a positive month on prospects that growth in the region may be slowing. The global debt market dependency on the course of U.S. data has pushed bund yields lower on dovish Fed comments and softer U.S. GDP. Gilts rallied as well, through underperforming their European counterparts in all but the extreme long end. The prospect of a Fed pause in August gave a lift to the euro and pound in the latter half of the month.

Equity Markets

United States

- U.S. equity prices were mixed in July amid conflicting data on economic growth, corporate profits, and inflationary pressures. Large-cap stocks edged higher with the S&P 500 index adding 0.6%, while the small-cap Russell 2000 index fell 3.3%.

- The two top-performing major industries in July were tobacco (+8.4%) and oil and gas (+7.0%). Altria led the tobacco sector higher and hit an all-time high on news that the Florida Supreme Court upheld the reversal of a $145 billion class action lawsuit. Oil and gas shares were buoyed by rising energy prices.

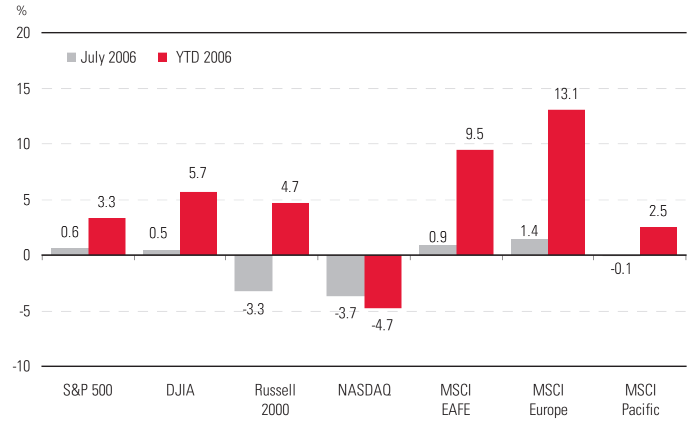
- Internet stocks again led the decliners, falling 14.0% in July following disappointing earnings and guidance from Yahoo!, Amazon, and eBay. Competitive pressures and weak corporate demand for computer hardware also put pressure on the broader technology sector.

International

- International equities generally rose in July with the MSCI EAFE index edging up 0.6% in local currency and 0.9% in U.S. dollars. Asia was the only region that suffered losses in July with Japan down 0.5%, New Zealand off 0.7%, and Australia falling 1.9%.

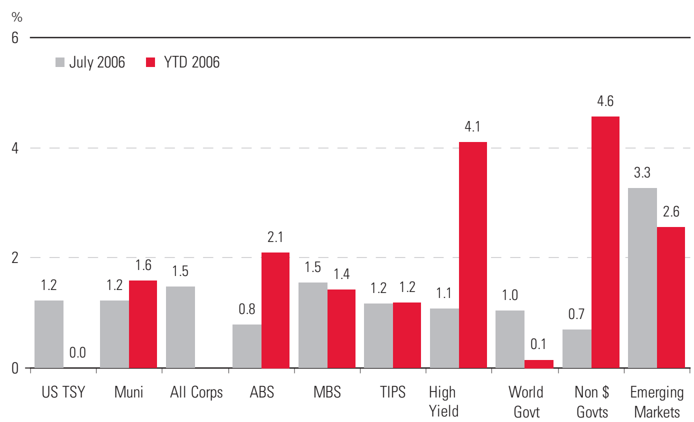
- Year-to-date, the MSCI EAFE index is now up 2.7% in local currency and a healthy 9.5% in U.S. dollars. Europe has led the way this year with gains of 4.3% in local currency and 13.1% in dollars. Asian markets have lagged behind in 2006, down 1.6% in local currency and up 1.4% in dollars.

Global Equity Markets
(Total Return)



Sources: MSCI, Standard & Poor's, Russell Mellon, and BBH Analysis

Global Fixed Income Markets
(Total Return)



Sources: Merrill Lynch and BBH Analysis