

International Stock Market Outlook Second Quarter, 2007

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Executive Summary

Our outlook for international stocks continues to be quite constructive. International valuations remain very attractive as rapid earnings growth has more than kept pace with sizable price gains. Given our expectation for continued growth and low inflation, the market environment is still positive. Finally, the market internals look healthy, with positive trends, momentum and breadth. The only negative in our opinion is that international stocks have done so well for so long that they appear overextended.

TABLE OF CONTENTS:

International Stock Market Valuation 2

We continue to believe that international stocks are attractively valued on both an absolute and a relative basis. Although the MSCI EAFE (“EAFE”) international stock index has risen sharply from its March 2003 low, it is no more expensive than it was back then due to a significant increase in earnings. International stock valuation measures are even more attractive when adjusted for today’s low inflation, low interest rate, low volatility environment, which arguably could support a higher price-earnings multiple and valuation.

International Stock Market Environment 3

The international stock market environment remains positive. With the exception of Japan, economic growth overseas has been stronger than expected, creating a positive environment for earnings. Inflation is well contained, allowing central banks to adopt a more neutral position. The better than expected economic environment has created a positive environment for earnings. This positive environment should help unlock the value in international stocks.

International Stock Market Trend, Momentum and Breadth Indicators 4

The price action of international stocks remains very constructive. The primary trend of the market is up. The relative momentum of global stocks versus U.S. stocks and global bonds is strong. Market breadth (advancing versus declining issues) is in synch with the market. However, international stocks have been outperforming for such a long period of time that they are looking a bit overbought and have deviated significantly from their long-term trend. Nevertheless, we will side with the bulls until we see a more definitive deterioration in the market internals.

International Stock Market Valuation

We continue to believe that international stocks are attractively valued on both absolute and relative measures.

The price-to-earnings ratio, dividend yield, price-to-book value ratio and cash flow yield on the EAFE remain at attractive levels compared to their five and ten-year averages. Although the EAFE has risen sharply from its March 2003 low, it is no more expensive than it was back then. Earnings, dividends, book values and cash flows have all risen significantly along with price. For example, despite a 158% increase in price, the EAFE's P/E has fallen below 15 times earnings, the lowest level since 1990.

In addition, international stock valuation measures remain even more attractive when adjusted for underlying global inflation, interest rates and volatility. Today's low inflation, low interest rate, low volatility environment arguably should warrant a higher multiple and valuation. Compared to U.S. stocks, the EAFE looks fairly valued. However, we believe both the U.S. and the international stock markets are undervalued.

INTERNATIONAL STOCK MARKET VALUATION MONITOR	
Indicator	Current Bias
<i>EAFE Index Valuations vs. 5&10-yr. MAVs*:</i>	
Price/Earnings	Positive
Dividend Yield	Positive
Price/Book Value	Negative
Price/Cash Flow	Neutral
U.S. Stock Valuation**	Undervalued
<i>EAFE relative to U.S. vs. 5&10-yr. MAVs:</i>	
Price/Earnings vs. 5-yr. MAV	International
Dividend Yield vs. 5-yr. MAV	Neutral
Price/Book Value vs. 5-yr. MAV	U.S.
Price/Cash Flow vs. 5 yr. MAV	U.S.
G-6 vs. U.S. Forward Earning P/E	Neutral
Ned Davis Research (NDR)	
Global Stock/Bond Model	Stocks over bonds
MSCI E/P vs. Bond Yield	Stocks over bonds
MSCI Emerging vs. Developed Valuations	
	Developed

*5 & 10 year moving average

** From Bailard U.S. Stock Market Outlook

Sources: Bailard Research, Ned Davis Research, Yardeni Research, GaveKal Research, Bloomberg

International Stock Market Environment

The international stock market environment remains positive. With the exception of Japan, economic growth overseas has been stronger than expected.

Despite this healthy growth and higher energy costs, foreign inflation remains well contained. While central banks have had a tightening bias, they are currently in a more neutral position. The better than expected economic environment has created a positive environment for earnings. As a result, the international stock markets have focused more on the likelihood of higher earnings growth than on the prospects for further rate

increases. An environment of stable global economic growth, low inflation and interest rates, steady earnings growth, disciplined monetary policy and low volatility should help unlock the value in international stocks.

INTERNATIONAL STOCK MARKET ENVIRONMENT MONITOR	
Indicator	Current Bias
Three-Month Interest Rate Composite	Rising but low
Long-Term Interest Rate Composite	Rising but low
Consumer Price Index	Positive
G-7 OECD Leading Indicator	Positive
Relative Leading Indicators	International
Global Consumer Sentiment Composite	Positive
Global Business Sentiment Composite	Positive
Relative Business Sentiment Indicators	International
CRB Commodity Prices Rate of Change	Positive
Crude Oil Rate of Change	Neutral
Net Earnings Revisions	Neutral
Bailard U.S. Market Outlook	Positive
U.S. Dollar (y-y) and U.S. Bond Yield (y-y)	Neutral

Sources: Bailard Research, Ned Davis Research, Yardeni Research, GaveKal Research, Bloomberg

International Stock Market Trend, Momentum and Breadth Indicators

The price action of international stocks remains very constructive.

The primary trend of the market is up. The relative momentum of global stocks versus U.S. stocks and global bonds is strong. The vast majority of the markets we monitor are above their 10-week and 40-week moving averages, indicating the global nature and strength of this bull market. Market breadth (advancing versus declining issues) is in synch with the market. The main problem with the market internals is that international stocks have been outperforming for such a long period of time that they are

looking a bit overbought and have deviated significantly from their long-term trend. As a result, a correction would not be surprising. However, given the favorable fundamental value and the friendly economic and market environment, we will side with the bulls until we see a more definitive deterioration in the market internals.

INTERNATIONAL STOCK MARKET TREND, MOMENTUM AND BREADTH MONITOR

Indicator	Current Bias
Ned Davis Research (NDR) Trend Composite	Bullish
Trend of 200-day MAV	Bullish
Deviation from Trend	Negative
Global vs. U.S. Relative Strength	Bullish
World Stock vs. Bond Momentum	Bullish
MSCI EAFE Index vs. S&P 500 Index	Bullish
% of markets above 10-wk. MAV	Bullish
% of markets above 40-wk. MAV	Bullish
Combo NDR Price, AD line, New Highs/Lows	Neutral
Overbought vs. Oversold Indicator	Neutral
NDR EAFE Index Composite Model	Bullish
Seasonality International vs. U.S. Stocks	Neutral
Mean Reversion Global Stock vs. Bond	Bonds

Sources: Bailard Research, Ned Davis Research, Yardeni Research, Bloomberg

Market Commentary

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