

**STATE STREET**

**INVESTOR  
CONFIDENCE  
INDEX<sup>®</sup>  
SUMMARY**

## MEASURING INVESTOR CONFIDENCE ON A QUANTITATIVE BASIS

The State Street Investor Confidence Index® (the index) provides an objective, quantitative measure of global risk tolerance of the world's sophisticated investors. Regional components measure separately the risk appetites of institutional investors in North America, Europe and The Asia-Pacific region.

The index is published at 10:00 local time in Boston, USA on the last Tuesday of each month.

## THE PREMISE

Confidence in the economy and the capital markets is a critical driver of economic and financial fluctuations and of the business cycle. When confidence increases, consumers and investors want to buy consumer goods, durables and invest at prevailing prices. When confidence decreases, spending and risk-taking tend to fall.

Investors are said to be confident when the news about the future is good and stock prices are rising. However, rising prices are related both to good fundamentals, such as growth in industrial production and productivity, as well as to the underlying sentiment or mood of investors. A good confidence measure should indicate whether, for a given set of fundamentals, investors have an increased or decreased appetite for risk.

Quantitatively measuring shifts in investor sentiment presents a unique set of problems to researchers. Investor surveys are often outdated by the time they are released. On the institutional side, accuracy can be compromised as decision makers are often too busy to fill out surveys. In all cases, survey responses, like prices, tend to obscure the effects of fundamentals and investor sentiment.

## THE APPROACH

State Street's approach measures confidence directly and quantitatively by assessing the changes in investor holdings of risky assets, implementing a research model developed by Harvard Professor Ken Froot and Managing Director Paul O'Connell of State Street Global Markets' research partnership – State Street Associates.

The idea is simple: the more of their portfolios that sophisticated investors are willing to devote to riskier as opposed to safer investments, the greater their risk appetite or confidence. When risk appetite increases, investors move to increase, in the same proportion, their holdings of each risky investment. This process may occur when there is good news and prices are up, but could also happen over a period of bad news and falling prices. As a result, the risk appetite of institutional investors is a separate and distinct measure from the behavior of prices. Actual investor holdings and recent purchases provide a solid foundation on which to base a measure of investor confidence.

## INFORMATION BASE

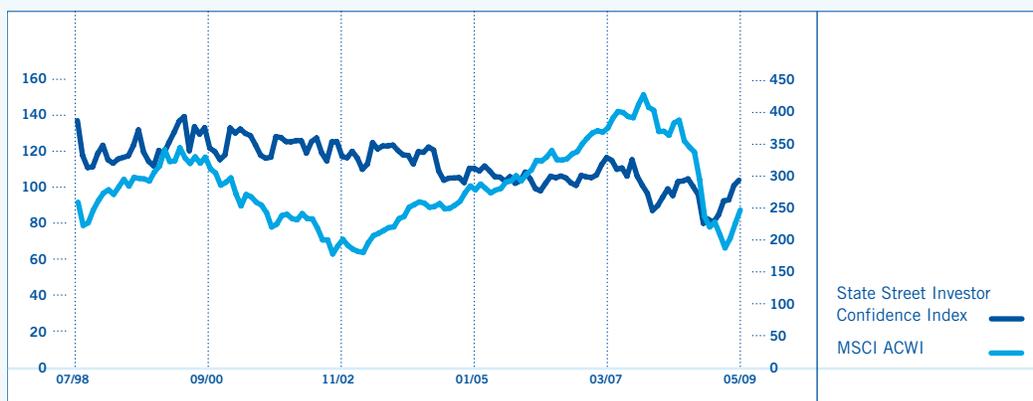
The index uses the aggregated portfolios of the world's most sophisticated investors, representing approximately 15 percent of the world's investable securities, together with the model of Froot and O'Connell to create the State Street measure of investor confidence. The index shows the risk appetite of these sophisticated investors by aggregating the common buying patterns of risky investments, and how these allocations evolve over time.

State Street Global Markets' investor behavior research into the flows, holdings and borrowings of the world's sophisticated investors models activity across more than 45 countries and across asset classes, represented in more than 22 million security transactions annually. This research provides insight on the behavior of institutional investors over time providing a complete portfolio perspective of equity, fixed income, currency and securities lending markets and the correlation of activity into and between asset classes, geographies and sectors.

## COMPARISON WITH GLOBAL EQUITY PERFORMANCE

- > During much of 2008 the index moved up and down in line with markets. The spring and early summer saw optimism that emerging markets could decouple and drive global growth. The index rose above 100 in March and this was followed by a 6% rally in the MSCI World index in April and May. Confidence started to wane and markets fall in the late summer as concerns about the impact of the credit crunch on the real economy began to mount.
- > The collapse of Lehman Brothers in late September 2008 precipitated a sharp fall in investor confidence to a new record low. There was a flight away from all risky assets into safe-havens such as the dollar, Swiss francs and government bonds. Monthly flows into sovereign bonds hit a new record in the second week of October. The MSCI World index fell by more than a third in six weeks of unprecedented volatility.
- > The previous record low in confidence occurred in August 1998, when Russia defaulted on its external debt and Long Term Capital Management failed.
- > Confidence improved sharply ahead of the market lows in March 2009. The confidence reading in March was the highest since the Lehman bankruptcy. This foreshadowed a sharp 40% rally in the MSCI World index between March and the end of May.

**FIGURE 1 (TO MAY, '09)**



<sup>1</sup> MSCI is a registered trademark of Morgan Stanley Capital International, Inc. The Conference Board is a registered trademark of The Conference Board, Inc. Neither Morgan Stanley Capital International, Inc. nor The Conference Board, Inc. endorse or have any involvement whatsoever with the State Street Investor Confidence Index®

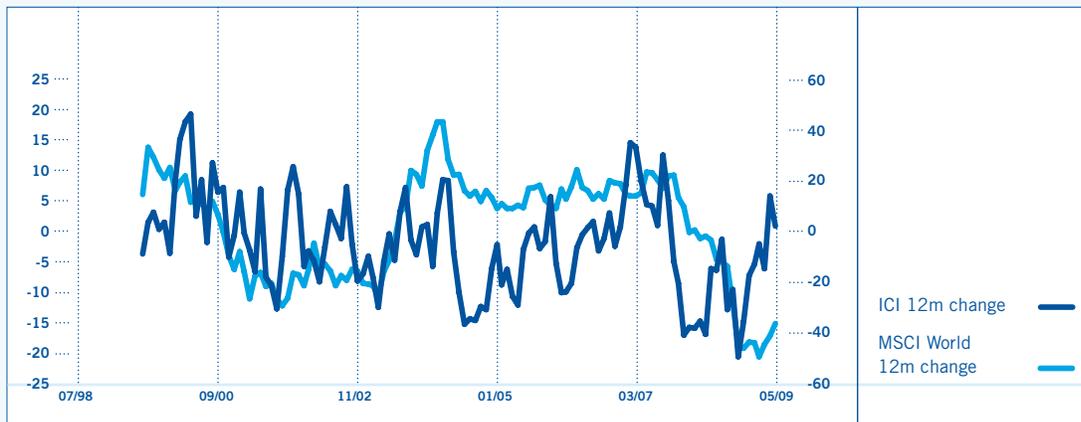
## REGIONAL INVESTOR CONFIDENCE

From January 2005, State Street began tracking three regional components of Investor Confidence; North America, Europe, and The Asia-Pacific Region. Each regional component analyzes the actual and changing levels of risk contained in investment portfolios domiciled in each of these regions, providing a regional perspective on investor confidence. The North American component captures the confidence of U.S. and Canadian investors as it is reflected in their purchases of assets all around the world. Similarly, Europe consists of institutional investors in continental Europe, the UK and Ireland and Asia-Pacific includes Asia, Australia and New Zealand.

The three regional components are calculated from January 2005, and are based so that, together, they average to the global index in that month. The percentage of the global index that each region represents varies over time, since it depends on the activities of each regional group of investors. Some investors, for example those domiciled in South America, who are included in the index are not represented in the regional components.

- > Following the collapse of Lehman Brothers in September 2008, confidence among North American investors fell far more sharply than in the other regions. A fall of 24 points in a month in the North American index was unprecedented both for the global and regional series. However, while investors in North America started to gain in confidence around the end of the year, perhaps in recognition that a systemic financial crisis had been averted, European confidence continued to fall into 2009. Investors seemingly reacted favourably to the aggressive monetary and fiscal policies of the US authorities compared to the more cautious stance of the European Central Bank.

**FIGURE 2 (TO MAY, '09)**



# THIS IS STATE STREET

## INVESTMENT RESEARCH AND TRADING

State Street Global Markets provides specialized investment research and trading in foreign exchange, equities, fixed income, derivatives, and money market products. Our goal is to enhance and preserve portfolio values for asset managers and asset owners with original flow-based research, innovative portfolio strategies, trade process optimization, and global connectivity across multiple assets classes and markets.

## INVESTMENT MANAGEMENT

State Street Global Advisors, one of the world's leading managers of institutional assets, provides disciplined, systematic investment strategies for clients of every size and investment objective. Our active, enhanced and passive strategies capitalize on technological and intellectual innovation. We also offer integrated solutions and trading services to customers who wish to outsource aspects of their investment programs.

## INVESTMENT SERVICING

As the world's leading investment service provider, State Street provides an array of customized investment solutions to asset managers, pension funds, hedge funds, insurance companies, collective funds, mutual funds and nonprofits. We offer fund accounting, fund administration, custody, securities lending, investment operations outsourcing, recordkeeping, performance and analytics and transfer agency services that are highly scalable and truly global. With our expertise and local knowledge, we help our customers control costs, develop and launch competitive new investment products, and expand globally.

### Legal Disclaimer

This report is intended to provide generic background information about investments generally and does not take into account the individual needs and circumstances of the recipients. Nothing in this report should be construed as a solicitation, offer, recommendation or advice on the merits of acquiring or disposing of any investment or of engaging in any other transaction or as investment, legal or tax advice. This report does not provide any assessment of the value or prospects of any particular investment or issuer of investments. The recipients should make their own assessments and evaluations of the report in the light of their individual needs and circumstances. The recipients may only use and copy the report for internal purposes and may not forward, amend or distribute the report without prior written consent. The report is not intended for distribution to, and may not be relied upon by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to applicable law or regulation.

None of the foregoing entities, or any of their respective affiliated companies, directors and employees, makes any representation that the information and opinions contained in the report are accurate, complete or up to date and accepts no liability for any losses, liabilities, damages, expenses or costs arising from or connected with the use of this report.

State Street Global Markets is a registered trademark of State Street Corporation.

**FOR MORE INFORMATION  
ABOUT STATE STREET  
INVESTOR CONFIDENCE  
INDEX® PLEASE CONTACT:**

**STATE STREET CORPORATION  
WORLD HEADQUARTERS  
BOSTON, MASSACHUSETTS 02111  
+1 617 786 3000**

**FOR MORE INFORMATION: WWW.  
STATESTREET.COM**



**STATE STREET®**