

Asset Allocation and Global Market Views

FIRST QUARTER 2009

Asset Allocation Views

Given a background of ongoing economic uncertainty, we continue to encourage investors to approach financial markets cautiously. The global recession should progress through at least the first half of 2009, and we expect that credit issues will continue to dominate financial markets. While we are likely in the longest and deepest recession of the post-World War II period, we believe the record fiscal and monetary stimuli are likely to eventually turn the US and global economies around before the deleveraging forces promoting deflation overwhelm the system. Given that background, then, we do expect to see higher-risk assets begin to stage a recovery this year, but the year ahead should continue to be a volatile one for the markets.

Equity Markets

- In general, we suggest a focus on higher-quality companies with relatively strong balance sheets, healthy levels of free cash flow and adequate financing.
- Watch, however, for rallies in lower-quality investments—particularly when those areas of the market become oversold.
- Geographically, we prefer US stocks and continue to have a favorable long-term view toward emerging markets.
- From a sector perspective, we prefer a more defensive stance and see healthcare companies as particularly attractive. We are also finding some value in areas of the technology sector and believe energy companies remain attractively valued.

Fixed Income Markets

- Given the ongoing difficulties in the economy, we continue to advocate a focus on higher-quality investments.
- High-quality securitized assets and selected areas of the credit markets currently look attractive to us.
- We continue to see better relative value in agencies versus Treasuries in light of ongoing strong government support.
- The municipal market also offers attractive value.

Currencies and Commodities

- We expect the weakness of the euro versus the US dollar to persist, and believe that the yen will continue to remain relatively strong.
- Oil prices should recover later in the year as evidence of an economic recovery becomes more clear.

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Economic Trends

- ▶ The sharp and widespread loss in economic momentum that emerged in the aftermath of the Lehman Brothers' bankruptcy filing has since gathered momentum. Around the world, industrial production numbers have deteriorated while inventories have risen. Consumer demand, trade levels and labor markets have all contracted as well. While concentrated initially in the developed economies, the slowdown has also become increasingly evident in the emerging markets, with recent data pointing to a significant reduction in growth levels in China. As if we needed reminding, this backdrop confirms that economic conditions are likely to remain challenging in 2009.
- ▶ In response to escalating economic pressures, key policymakers around the world have become increasingly proactive. Measures aimed at boosting the world economy include dramatic interest rate cuts, with the prevailing deflationary forces sufficient to sway even the most prudent central bankers. The expansion of the Federal Reserve's balance sheet has garnered many headlines, and aggressive fiscal spending by UK and Chinese governments have served as a potential source of stimulus.
- ▶ All of these efforts have started to have an effect on the credit markets, which we expect should help spark an economic recovery over time. The Fed and other central banks have been actively working to combat deflation, and the current state of the credit markets is materially better

Equity Markets

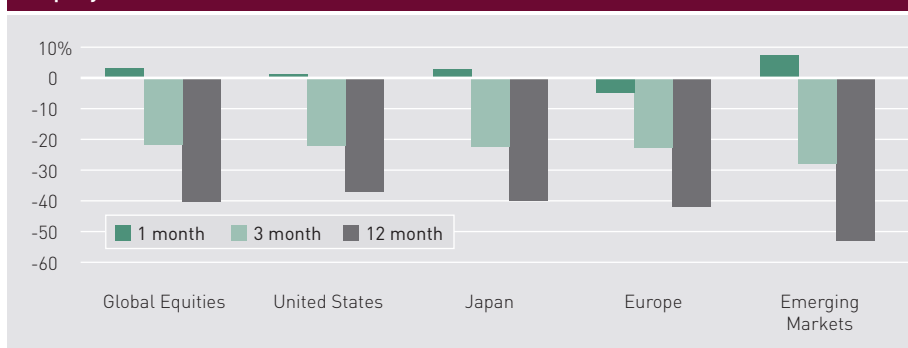
The main driver of market performance has continued to be liquidity and credit problems and the deterioration of the global economy. Non-US stocks started stronger in 2008 than US stocks, but they quickly lost ground as the credit crisis spread globally and the worldwide economy soured. For the year as a whole, and in more recent months, returns varied widely by region and market. In general, US markets outperformed most other developed markets, and most developed markets outperformed emerging markets.

Equity market volatility has continued to be extremely high. Volatility measures began climbing to record levels as the third quarter drew to a close and the fourth quarter began. In early October, as the feverish global market sell-off peaked, the VIX Index (a measure of stock market volatility based on the trading of S&P 500 futures on the Chicago Board Options Exchange) spiked to 80, an unprecedented level. Since that point, the VIX has continued to rise and fall, but has recently decreased to 40—still high by historic standards, but a significant decline when compared to the level reached earlier in the quarter.

Looking ahead, we continue to advocate a focus on higher-quality companies that have relatively strong balance sheets, healthy levels of free cash flow and adequate financing. We would point out, however, that over the past few months we have seen several market rallies, and in each case, lower-quality investments outperformed. To us, this suggests that while our overall bias toward higher quality makes sense at present, investors should be prepared for lower-quality investments to perform well—particularly in times when they become oversold.

From a geographic perspective, we continue to favor overweight positions in US stocks, which tend to have higher earnings predictability and lower volatility compared to most other markets. We also believe that the long-term case for investing in emerging markets remains sound. The recent strong sell-off in these markets has created what we view as attractive relative value.

Equity Returns as of December 2008



Source: Bloomberg. Global Equities: MSCI World Index; US: S&P 500 Index; Japan: MSCI Japan Index; Europe: MSCI Europe Index; Emerging Markets: MSCI Emerging Markets Index. Past performance does not guarantee future results. It is not possible to invest directly in an index.

Bond Markets

The continued “flight-to-quality” theme dominated fixed income markets throughout 2008 and pushed yields of all government maturities lower late in the year as investors factored in the likelihood of continued economic weakness along with growing fears of deflation. Although this theme resulted in higher risk assets underperforming through most of last year, nearly all spread sectors outperformed Treasuries in December as spreads tightened following the massive widening that occurred earlier.

Credit spreads still remain quite wide, however, in nearly every sector of the market, including municipals, investment-grade corporate bonds, mortgage-backed securities and high-yield investments. There is, of course, a reason for the wider spreads and higher yields since investors would be taking on risk by investing in spread sectors of the market. Nevertheless, with judicious security selection, we believe value can be found.

Overall, we continue to advocate a focus on higher-quality investments. As an alternative to US Treasuries, we prefer agency mortgages (Ginnie Mae in particular), which offer attractive yields and represent a good investment opportunity. Select high-quality corporate bonds also look attractive to us, although the high-yield market may not yet have hit a bottom.

Finally, we continue to have a favorable view toward higher-quality municipal bonds. Municipals are supported by a long history as a quality asset class with low relative volatility, consistency in performance and low default rates. As such, we believe munis continue to represent a good long-term investment.

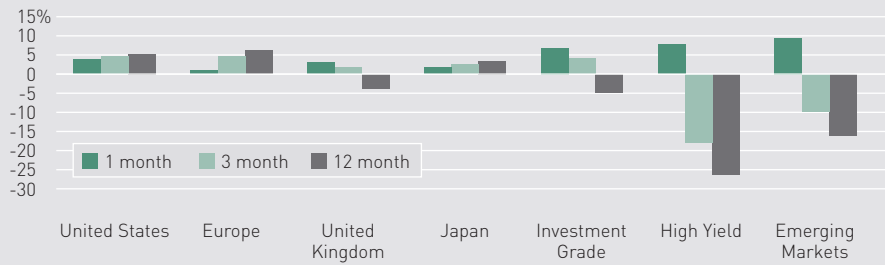
Economic Trends (cont.)

than it was a couple of months ago. Evidence of healing includes the fall in LIBOR, the increase in commercial paper issuance, a rally in the mortgage-backed securities market, lower corporate and municipal bond yields and an increase in actual corporate bond issuance.

► In addition, these efforts mark a drastic change from only a few months ago, when many were concerned about inflationary pressures. At present, it seems clear that debt-induced deflation is more of a concern. In our opinion, the odds are good that inflation will be at or near 0% over the next year or so given the weakness in the economy and the downturn in commodity prices. However, we do not expect to see a significant, long-term deflation problem emerge, although deflation expectations will certainly keep investors on edge.

► Looking ahead, our view is that the fourth quarter of 2008 should be the worst of the current recession, although the next two quarters are likely to see a continuing loss in macro momentum. A trough at some stage in late 2009 or early 2010 is then likely to be followed by a shallow, rather than particularly vigorous, recovery.

Global Fixed Income Returns as of December 2008



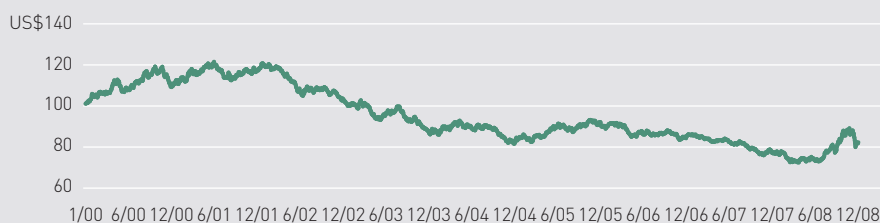
Source: Barclays Capital Indices. US: US Treasury component of the US Government Index; Europe: Treasury component within Pan-European Aggregate Index; UK: Gilts component of the Sterling Aggregate Index; Japan: Japan Government Related component of the Asia Pac Aggregate Index; Investment Grade: Corporate component of the US Credit Index; High Yield: Barclays Capital High Yield Index; EM: Barclays Capital Emerging Markets Index. Past performance does not guarantee future results. It is not possible to invest directly in an index.

Currency Markets

The US dollar rallied strongly against most other currencies through most of the fourth quarter of 2008, but that trend was brutally reversed in December following the Fed's historic rate cut that effectively brought the Fed Funds target rate to zero.

Recent currency moves have changed the valuation background for currencies. On the basis of relative price levels, the dollar and the yen appeared very cheap in the middle of 2008, while the euro in particular was expensive. The dollar and yen now appear closer to fair value given their recent moves. However, the euro still remains expensive, if less so than previously. UK sterling now appears to be the cheapest of the major currencies.

US Dollar Index (DXY) — January 2000 through December 2008



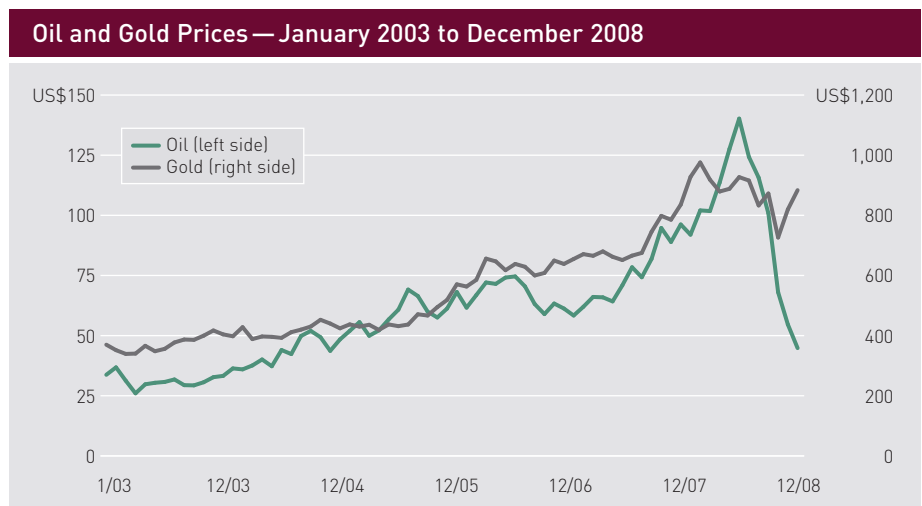
Source: Bloomberg.

Looking ahead, we expect the euro's weakness against the dollar to persist, and regard the yen as potentially the strongest of the major currencies.

Commodities Markets

As oil prices began to unwind in the fall, it became clear that speculative investing, at least to some extent, helped push prices to unrealistically high levels. By year-end, prices had fallen to roughly \$40 a barrel, a level that we believe is similarly unsustainable. Looking ahead, we believe evidence will emerge that the global economy will eventually stabilize. Against this backdrop, we would expect commodity prices to find a bottom and begin to move higher. In particular, we believe oil prices should find some sort of middle ground in the \$60 to \$80 a barrel range, albeit not any time soon.

Gold prices have recovered materially from their November trough near \$700 to well over \$800 as the US dollar weakened. The future direction of gold prices will likely continue to be tied into the fate of the dollar. Among other commodities, industrial metals have been suffering lately, and likely will continue to do so until there is clearer evidence of a global economic recovery.



Source: Bloomberg. Oil prices reflect West Texas Intermediate Crude.

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