

NAVIGATING THE RECOVERY

Identifying Attractive Opportunities Across the Global Landscape



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1 Source: PineBridge Investments proprietary models reflecting our firm's views of various markets developed by the firm's Global Asset Allocation Committee, which includes key members of senior management and our Global Economic Strategist.

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EXECUTIVE SUMMARY

As the global economic recovery gains increasing credibility and momentum in the second half of 2009, the investing environment continues to pose new challenges. And while this changed landscape will require higher levels of insight and due diligence, it also offers unprecedented opportunities, some of which have not been seen in more than 50 years.

This investment overview addresses some of the new possibilities across the major asset classes and examines them in the context of the larger macroeconomic picture.

To maximize the potential of this quickly evolving market, investors will need to weigh the sweeping changes that have occurred over the past several quarters in light of their own portfolios' objectives and constraints. This analysis should be grounded in a consideration of the characteristics, themes and possible outcomes likely to define its next stages.

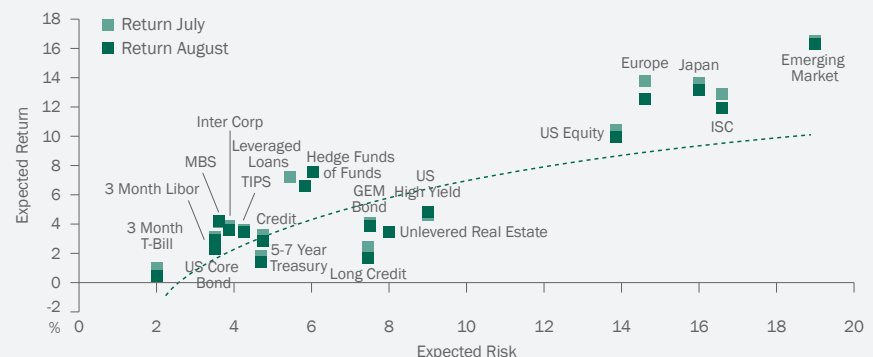
One reflection of the broad array of attractive opportunities is the capital market line, which continues to slope sharply upward, indicating where to best integrate worthwhile risk into existing asset allocations.

In the near- and mid-term, attractive opportunities above the line that merit further consideration range from traditional investments, such as **Emerging Market Equities** and **Leveraged Loans**, to alternative investments, such as **Hedge Funds of Funds (HFOFs)** and **Commodities**.

The following perspectives on each of these four investment strategies provide insight on market dynamics in the context of recent market turbulence and future expectations.

Additionally, these viewpoints offer a potential starting point for capitalizing on new investment ideas that can generate alpha and contribute to overall portfolio returns.

Risk/Return Framework Points To Opportunities Along The Efficient Frontier¹



ECONOMIC OVERVIEW: THE DARKNESS BEFORE THE DAWN

After enduring the deepest, most traumatic recession since the Great Depression of the 1930s, forecasters are looking more closely at the shape the recovery will take. This downturn has evolved very differently from what many economists and investors have become accustomed to, generating concern that the recovery will also be atypical.

One of the differentiators is the fact that this recession has played out in multiple waves, accelerated by widely varying drivers. Initially, in early 2008, the recession was triggered by a macroeconomic response. This took the form of gradually declining aggregate demand and moderate job losses.

In contrast, in September of last year — nine months into the recession — the collapse of Lehman Brothers and the rescue of AIG set off a dramatic liquidity crunch that quickly spread throughout the system. Since then, central banks and governments around the world have aggressively eased both monetary and fiscal policy to counter the demand destruction caused by the credit crunch.

- Reduced economic activity caused energy prices to decline since peaking in July 2008, neutralizing one of the early recession drivers. This helped to stabilize consumer spending after it declined rapidly in the second half of last year.
- This year, the Federal Reserve has flooded the U.S. financial system with newly created reserves through a multitude of liquidity facilities and risk spreads. This has led to a narrowing of the difference in rates between LIBOR, which banks charge each other, and Treasury Bills, the safest and most liquid form of investment, forcing yields to retreat to pre-crisis levels.
- Dealing with the collapse in private credit availability, a key obstacle to a stronger recovery, has proven difficult. The programs enacted by both the Federal Reserve and Treasury Department to stimulate securitization and to take toxic assets off bank balance sheets — both necessary conditions for a sustained recovery — have not yet demonstrated consistent success.
- The response to the crisis by other countries has been even more dramatic. The Bank of England led attempts to fully guarantee bank deposits and bond issues, the European Central Bank relied on massive emergency liquidity provisions, while Switzerland engaged in active market intervention to weaken the Swiss Franc.
- The most significant, and possibly the most successful, intervention actually occurred in China. Authorities there did not just cut interest rates, but the government also implemented a massive fiscal spending program about the same size (relative to GDP) as the one here in the U.S. Even more importantly, China has been able to boost bank lending to record levels during the first half of 2009, when most other economies suffered from a severe credit crunch.

Problems may still lie ahead. Our base case assumes the Federal Reserve will start to reign in its aggressive liquidity support in early 2010 and start to push up policy rates in response to stronger economic growth.

With financial markets awash with central bank reserves and short-term interest rates at record lows, central banks will have to steer a difficult path between leaving rates too low, risking greater inflation, and raising rates too quickly, risking a double-dip recession. These concerns illustrate that it will take awhile for normalcy to return.

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A closer look at four major asset categories — **Emerging Market Equities, Leveraged Loans, Hedge Funds of Funds and Commodities** — offers a timely starting point for an explanation of where attractive opportunities currently exist globally.

Equities

Beyond the initial rebound in listed equities that we have seen since March 2009, there are a number of reasons to remain optimistic about stocks.

First, the global economy continues to rebound, and the combination of inventory replenishment, pent-up consumer demand and the gradual boost to fiscal spending could generate a fairly strong initial growth spurt.

Starting with the near-term outlook, demand is beginning to stabilize in many parts of the world. Exports show tentative signs of life and Purchasing Managers Indices (PMIs) are gradually edging back toward neutral.

Together, these factors point to a fairly strong rebound in corporate profits in the coming quarters, which should warrant higher equity prices.

Emerging Market Equities

Although all countries have seen slower economic growth since the global recession began, emerging market (EM) economies have been impacted less than in the two relatively recent downturns of 1997 and 1998 (**Figure 1**). Throughout that period, emerging markets experienced a much sharper economic decline than developed markets.

In 2001 — and in this most recent downturn — emerging market economies still grew faster than developed markets. This dynamic of realizing faster growth is expected to continue, suggesting that emerging markets are becoming slightly less dependent on developed markets, although they have not been able to “de-couple” entirely.

Generally, emerging market economies continue to maintain current account surpluses (**Figure 1**), as well as solid reserves.

In the past, when emerging market countries held fewer reserves, they were unequipped to fund imports when foreign direct investment suddenly declined. This dynamic would often impair trade and ultimately lead to significant currency devaluations. Because of the reserve positions and current account surpluses that exist in many emerging market countries, the risk of widespread currency devaluations, as well as other risks associated with investing in emerging markets, are somewhat less prevalent than in years past.

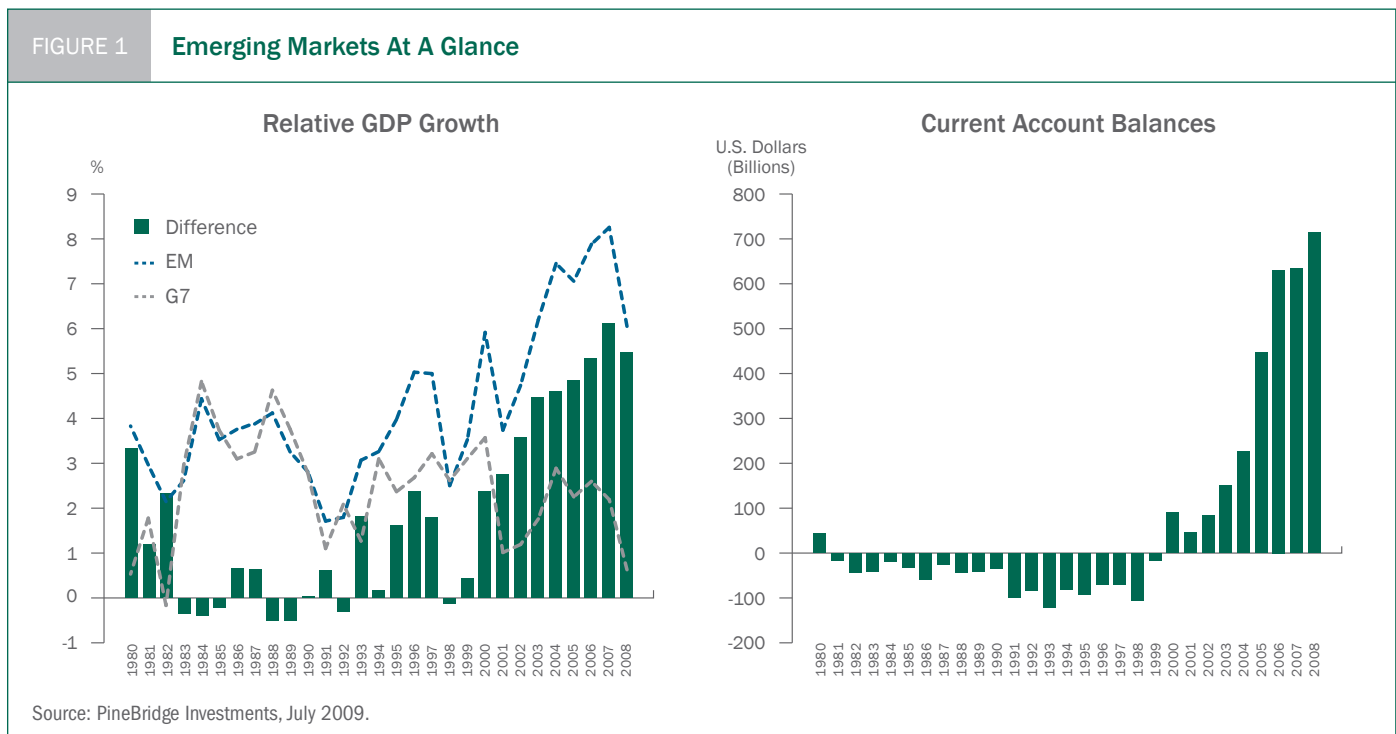
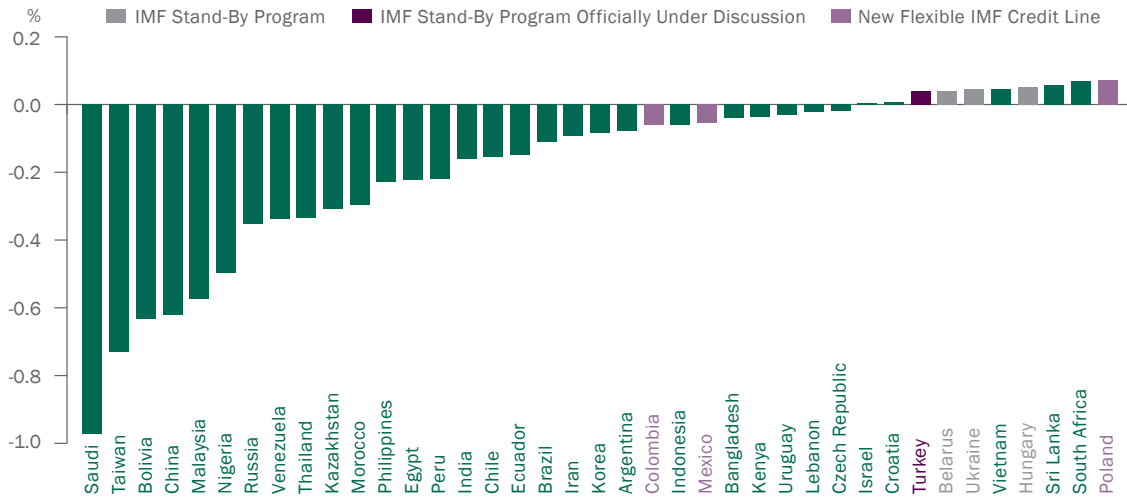


FIGURE 2

Closing Emerging Markets Financing Gaps



Source: PineBridge Investments, July 2009.

The IMF Safety Net

During 2009, the IMF and G20 added US \$250 billion of funding for lending to emerging market countries, in the event that financial difficulties occur, and stand ready to make an additional US \$250 billion available if necessary.² In the past, countries that accessed capital from the IMF were perceived as weak and potentially very risky. During this downturn, that stigma has proved non-existent.

This additional economic support ensures that adequate liquidity is available to all emerging market countries and significantly reduces the likelihood that these economies will face insurmountable difficulties. The IMF's multilateral financing package has dramatically reduced the financing risks for a number of countries, as shown below (Figure 2).

What's Ahead For Emerging Markets?

What changes in emerging market fundamentals (such as economic growth, corporate earnings and fiscal position) are anticipated after the crisis?

Fortunately, the intermediate and long-term story for emerging markets remains intact. Urbanization, infrastructure development and the burgeoning middle class in many of these countries contribute to their upward trajectories, and these dynamics should continue to drive economic and earnings growth that is superior to developed markets.

In emerging markets, commodity prices are also likely to be upwardly biased (even with lower developed market demand), as the major consumers of commodities remain EM economies. Utilizing these inputs for ongoing infrastructure development, this phenomenon is expected to continue.

"...emerging markets could potentially trade in line with – or even at a small premium to – developed markets..."

Additionally, as the dollar weakens, U.S. goods, on a price basis, become more attractive around the globe. Since several emerging market currencies remain managed to the dollar (Thailand, China and Malaysia, for example), U.S. dollar weakness also causes those countries' goods to be more attractive, as their currencies weaken, as well. A weak dollar is generally considered positive for commodities and, therefore, emerging markets.

² Source: Eurodad, 2009.

Emerging Markets Outlook

Global emerging market valuations are not as attractive as they once were, relative to developed markets, before this current rally started in March 2009. Valuations are relatively close to parity with developed markets, which suggests that some caution is warranted.

Over the long term, if emerging market economies continue to be relatively resilient during times of crisis, as they have been recently, it could be argued that emerging markets could potentially trade in line with — or even at a small premium to — developed markets, given the superior economic and earnings-growth potential.

In the short and intermediate term, our outlook for emerging market equities is constructive. Earlier in 2009, we were not as sanguine, as the rally seemed to occur before there were legitimate signs of an economic recovery. At this point, we are seeing evidence of a continuing recovery, and, perhaps more importantly, current consensus earnings growth estimates of 27% for 2010 reflect a rebound. These dynamics should sustain a positive bias for the markets.

Over the long term, our view is very constructive, particularly for continued economic growth in China and Brazil. These two countries merit special mention because they seem to exemplify the trends of industrialization and urbanization, and, therefore, appear to be in the midst of meaningful long-term growth.

Fixed Income

As is well known, the sell-off in corporate credit markets in 2008 was profound. High yield bonds and leveraged loans suffered unprecedented price declines, as the combination of a rapidly weakening world economy and an extremely negative technical environment drove prices down dramatically.

That said, much of the credit market has seen a significant rebound since late December 2008. The high yield bond market garnered a 48.98%³ return in the first nine months of 2009, while the leveraged loan market returned 46.10%⁴. Despite their significant run-up in the first seven months of the year, we believe these two asset classes will remain attractive through the end of 2009.

- Yields for high yield bonds and leveraged loans remain at historically high levels and should more than compensate for expected default losses through the remainder of this cycle.
- The issuers and industries that have been hardest hit by this recession are well known. This allows new investors to benefit from more transparent sector allocations and individual credit selections.
- Underwriting standards have become more conservative, resulting in a marked improvement in new-issue pricing and credit profiles.
- With approximately US \$850 billion of outstanding bonds and US \$567 billion of outstanding loans,⁵ both markets are large and benefit from active secondary markets. The scale and liquidity of both markets allow investors to construct portfolios quickly and efficiently.

The Leveraged Loan Opportunity

The leveraged loan and high yield bond markets often move in tandem, and each still represents an interesting value proposition. However, the loan market is differentiated by certain advantages:

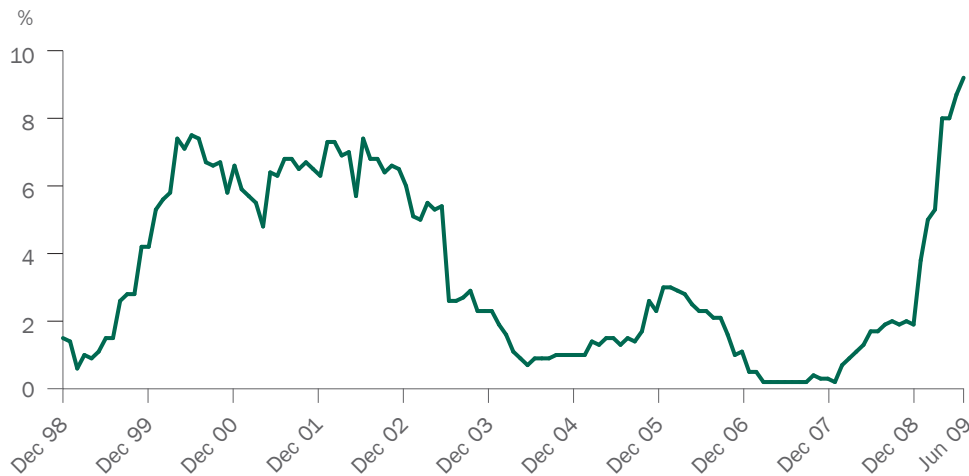
- Recovery rates for leveraged loans continue to be higher than those for high yield bonds. This is due to the greatest advantage of loans: their senior secured position at the top of the capital structure, with a first-priority claim on the majority — if not all — of the issuer's assets.
- Furthermore, with floating interest rates, leveraged loans provide a natural hedge against rising interest rates. The likelihood of inflation, and therefore higher interest rates, has increased with the worldwide surge in spending by both governments and central banks. As a result, leveraged loans are poised to benefit directly as the underlying LIBOR begins to climb from its near-historic lows.
- Because demand for leveraged loans is recovering more slowly than demand for high yield bonds, we believe loans will experience a more extended period of positive returns. The basis for this expectation is that collateralized loan obligation (CLO) issuance, which historically was the largest source of demand for leveraged loans, is likely to remain negligible for some time to come.

³ Source: Barclays Capital US High Yield Corporate Index, as of September 30, 2009.

⁴ Source: S&P/LSTA Leveraged Loan Index, as of September 30, 2009.

⁵ Source: Standard & Poor's, as of July 31, 2009.

FIGURE 3

Leveraged Loan Default Rate**Lagging 12-Months Default Rate By Principal Amount**

Source: Standard and Poor's LCD and S&P/LSTA Leveraged Loan Index.

Note: Default rate is calculated as the default amount over the last 12 months divided by the amount outstanding at the beginning of the 12-month period.

Leveraged Loan Default Outlook

The trailing 12-month default rate reached 9.75% at the end of September, and is widely predicted to continue its ascent during the remainder of 2009 and perhaps into 2010. Already above its previous high of about 7.5% in 2000, some observers have speculated that the default rate could reach as high as 13% — a startling increase by any measure, but particularly from the record low of under 0.5% set in 2007 (**Figure 3**).

“The initial wave of defaults was primarily earnings-related and limited to smaller, less-diversified companies that simply ran out of liquidity.”

Several factors have contributed to the extraordinary increase in the default rate. As in all periods of economic contractions, consumer and corporate spending decreased sharply. The initial wave of defaults was primarily earnings-related and limited to smaller, less-diversified companies that simply ran out of liquidity.

Another factor has been the reversal of huge spikes in commodity prices that caused issuers to fail borrowing-

base tests, a situation that was initially exacerbated by the complete lack of out-of-court rescue financing.

More recently, several larger issuers in basic industries, or industries that are in secular decline have filed for bankruptcy pre-emptively. This strategy has been implemented by issuers seeking to preserve sufficient liquidity to get through the bankruptcy process.

A few mitigating factors that could slow or stave-off defaults have surfaced in recent months. First, the American Recovery and Reinvestment Act of 2009 included a provision that allows companies to defer tax on cancellation of debt income. This provision provided a meaningful benefit to issuers that repurchase or tender for their own debt at market prices, and roughly US \$13 billion of loans were retired this way by their issuers between October 2008 and July 2009, according to Standard & Poor's.

Though reserved for issuers with excess liquidity, this process has allowed some issuers confronting weaker earnings to take advantage of the market dislocation and opportunistically reduce debt at a discount.

Given the improvement in collateral coverage for non-tendered loans, secured lenders could see a higher recovery down the road should a default eventually occur.

Perhaps more importantly, however, larger loan issuers have begun the process of addressing upcoming loan maturities via amendments that extend the maturity for a portion of their loans. In addition to diminishing the risk of default due to an inability to refinance, these amendments typically involve fees, increases in spread and in many cases LIBOR floors, to the benefit of loan investors.

The Outlook For Recoveries

While we see default rates increasing over the next eight to 12 months, we also believe that loans will continue to have recovery rates far in excess of high yield bonds.

“...as senior secured instruments, they (leveraged loans) sit at the top of their issuers’ capital structures, and, consequently, benefit from strong recoveries in the event of bankruptcy.”

Historically, defaulted bonds have recovered approximately 40% of par, while defaulted loans have recovered about 70% of par.⁶ The higher recoveries for first-lien loans stem from their first-priority interest in the majority of a company’s assets. This factor gives loan investors better bargaining power relative to holders of subordinated classes of debt, as well as the highest level of repayment when the defaulting company reorganizes or sells its assets.

As with virtually all asset classes, leveraged loans were not immune to the effects of the credit crisis and experienced unprecedented price volatility in late 2008 and early 2009. However, we believe that leveraged loans remain attractive long-term investments for several key reasons:

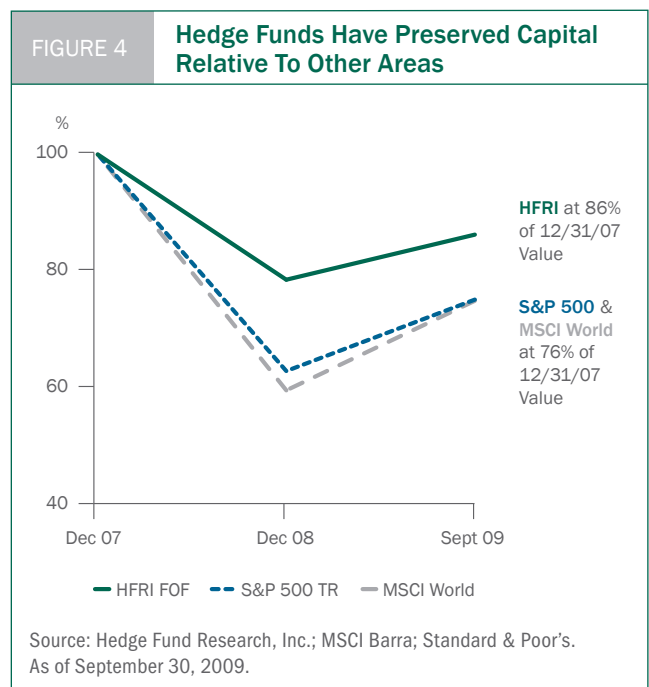
- First, as senior secured instruments, they sit at the top of their issuers’ capital structures, and, consequently, benefit from strong recoveries in the event of bankruptcy.
- Second, financial covenants embedded in the majority of leveraged loans provide investors with opportunities to improve terms or to force early repayments in the event of unforeseen financial difficulties.

- Third, as referenced from the outset, the loan market is large and secondary-market liquidity is very good, affording investors the ability to enter and exit well-diversified portfolios with relative ease.
- Fourth, although loan prices have improved substantially from levels reached at the peak of the credit crisis, they remain at historically low levels, providing an attractive entry point for new investors.

Hedge Funds Of Funds

Despite the recent publicity surrounding hedge funds, Hedge Funds of Funds (HFOFs) continue to merit investor attention based on their demonstrated ability to preserve capital. Investors with the well-diversified hedge fund exposure that funds of funds can provide have fared substantially better during difficult markets than they would have without this key component of their portfolios (Figure 4).

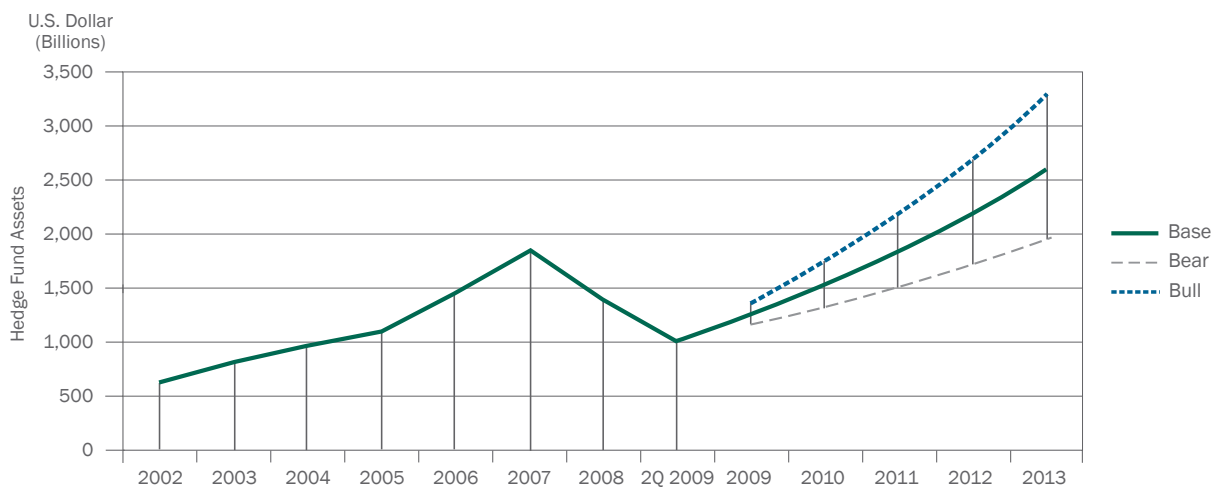
As a result of the long-term benefits, current opportunities and persistent favorable conditions that are expected to continue for some time, many investors intend to increase their allocations to hedge funds over the near to medium term. Of course, attempting to benefit by “timing” one’s hedge fund investments is challenging, if not impossible, as clear signals of market corrections or reversals are most often only evident after opportunities have passed. Accordingly, a stable, long-range commitment to the asset class is most appropriate.



⁶ Sources: Standard & Poor’s and Credit Suisse, historical data.

FIGURE 5 Estimated Future Growth Of Hedge Funds Through 2013

December 2002 Through December 2013



Source: Hedge Fund Research, Inc.; The Bank of New York Mellon and Casey Quirk Analysis 2009.

The criticality of assuming a long-term perspective notwithstanding, there are factors that have the potential to make the current market particularly favorable for investors considering increasing their hedge fund exposure. Importantly, these factors relate not to specific anticipated market movements – although such moves certainly may drive additional opportunities. Rather, there are structural conditions across markets that are proving favorable to hedge funds and their investors.

“...the flight of certain investor segments from even the best-managed hedge funds has freed capacity that was previously scarce...”

For instance, the closure or severe retraction in trading operations by numerous troubled financial institutions has removed a major source of trading competition for hedge funds. In addition, the contraction or closure of some hedge funds has further reduced the capital pursuing similar trades. This leaves greater opportunities available across markets with fewer participants “crowding out” attractive trades and the returns that hedge funds can provide.

For hedge fund investors, the flight of certain investor segments from even the best-managed hedge funds has freed capacity that was previously scarce or impossible to obtain. Of course, due diligence on all managers (established and newer) remains critical.

Accordingly, many investors are best served by accessing this capacity through hedge funds of funds that have been evaluating and/or monitoring many of these managers for years.

As with nearly all asset classes, the market turmoil over the past months has given investors obvious reason to reassess decisions with respect to both how much hedge fund exposure is appropriate and achievable. While they have certainly received their fair share of negative press over this period, now, more than ever, the fundamental benefits of hedge funds remain valid.

An overview of current research presented in *The Hedge Fund of Tomorrow: Building an Enduring Firm* (April 2009) indicates that HFOFs are expected to continue to be the major channel for investors to access hedge funds⁷ in the future, capturing a majority of future flows from both institutions and high-net-worth individuals.

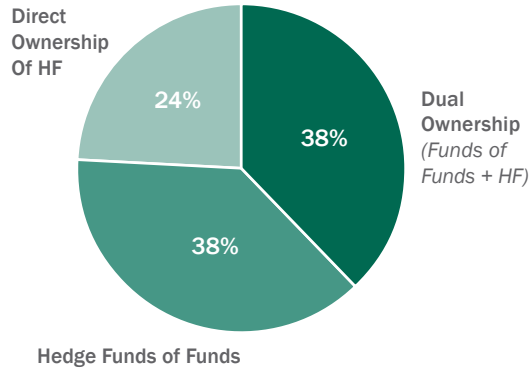
The same report forecasts a growth of the hedge fund industry to US \$2.6 trillion in 2013, with the most aggressive growth between 2010 and 2013. Clearly, there is still significant upside potential seen for capital allocated to this dynamic space (Figure 5).

Notwithstanding the headlines of 2008, for many investors without the resources or asset base to do so independently, HFOFs represent the only viable way of accessing the range of hedge fund strategies. They also bring institutional quality to investing through

⁷ Source: Bank of New York Mellon and Casey Quirk Analysis 2009.

FIGURE 6

Access To Hedge Funds



Includes investor responses.
Source: The Bank of New York Mellon and Casey Quirk Analysis 2009.

a combination of services that most investors would find difficult, costly and inefficient to replicate individually (Figure 6). Superior HFOFs provide the following five services through dedicated teams with specialized skills:

1. Manager sourcing
2. Thorough manager due diligence
3. Ongoing monitoring
4. Appropriate diversification
5. Education and advisory support

Most larger HFOF players with conservative risk profiles, an institutional investor base and little applied leverage survived and have successfully delivered attractive returns in 2009.

Assuming that a qualified investor is comfortable with the widely held understanding that exposure to hedge funds can provide diversification, risk-adjusted returns, downside protection and a specialist strategy, the next step is to decide how to access them.

“...many market-specific conditions are expected to provide hedge funds with ample opportunities in the near and medium term.”

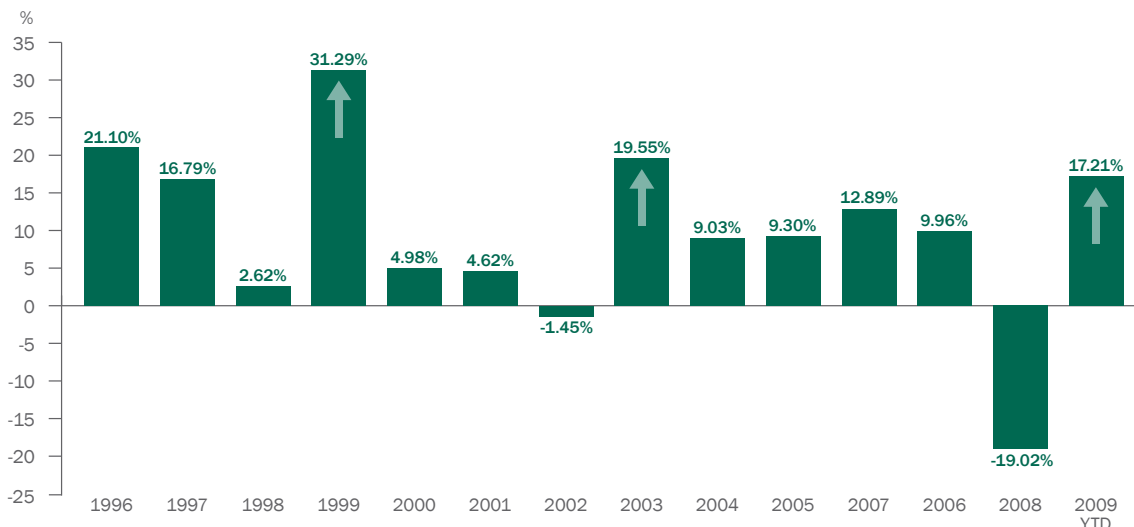
Research has shown that HFOFs are still viewed by many as the most effective way to access hedge funds. The HFOFs that adapt to evolving investor needs around packaging, liquidity, fees and offerings will likely be those that will benefit from much of the future growth in this space.

A key issue for funds of funds is re-instilling confidence in the business model going forward, in order to ease the return of capital to the investment class and structure.

As seen in Figure 7, hedge funds (as represented by the HFRI Fund Weighted Composite Index) have historically often achieved sizable gains in periods

FIGURE 7

HFRI Year-By-Year Returns Show The Potential For Gains



Source: Hedge Fund Research, Inc. As of September 30, 2009.

following those of significant industry-wide weak absolute performance.⁸ We believe these benefits, in addition to the general diversification benefits and alpha delivered over time, continue to make hedge funds a valuable portfolio enhancer.

Today, the Hedge Funds of Funds business is slowly emerging from its crisis period, and we are seeing the first net monthly inflows into HFOFs after Q1 2009's trough in assets under management.

In addition to favorable structural dynamics, many market-specific conditions are expected to provide hedge funds with ample opportunities in the near and medium term. These are discussed further below and span diverse strategies and markets.

- Equity Long-Short Managers are seeing inflows and increasing their market exposure cautiously from a trough in the fourth quarter of 2008.
 - The more liquid of these managers are rebounding in 2009 as they have found favor with investors that seek good risk-adjusted returns. As volatility has dropped to pre-Lehman levels, the managers are increasingly committing capital to the markets and focusing on the business, economic and inventory cycles. As such, they are again starting to see inflows as investors seek to put cash back to work with simpler strategies, such as equity long-short. The lack of activity from proprietary desks and the decrease in hedge assets have proven easy boosts to returns for these managers.
- Event-Driven Funds are focusing more on credit opportunities in high yield, bank loans and convertibles.
 - Credit Funds have profited from the recent tightening in corporate credit across capital structures. The underperformance in the asset class last year, caused by massive global de-leveraging, has provided attractive opportunities that the market has not seen in decades. Over the short and medium term, many funds have captured value through short-dated securities with near-term catalysts (i.e., debt-for-debt and debt-for-equity restructurings).
- Relative Value Funds have reduced leverage drastically and are setting up trades to capitalize on the dislocations we saw in 2008.
 - Convertible arbitrage and volatility arbitrage are interesting again as a result of de-leveraging. High correlation in the equity space is providing good relative value opportunities enacted through bespoke derivative structures because some of these opportunities can be arbitrated. Lack of certainty related to government purchase programs has led to interesting capital structure trades in the mortgage space, which, again, benefit from the lack of interest from bank proprietary desks. Managers with secure capital that can weather this storm will be well-positioned to take advantage of a number of liquidity-related market dislocations.
- Global Macro Funds have seen strong inflows with global uncertainty, and boom/bust investor views are driving trends toward profitability.
 - Longer-term trend followers have been hit by the reversals, while other managers profit from more normal volatility. These funds have seen massive inflows into both discretionary and Commodity Trading Advisor (CTA) vehicles thus far in 2009. Their strong liquidity profile makes them a flexible allocation for investors.
 - The combination of strong market trends and governmental/central bank activity continues to make Global Macro Funds the most obvious choice for investors looking at hedge funds in 2009–2010. As well as fixed income and equities, increased foreign exchange volatility and strong trends in industrial metals, energy and soft commodities (especially sugar and soybeans) have provided good opportunities for managers to make money, and these forces are set to continue.
- Fixed Income/Macro Hedge Funds see opportunities across asset classes as the economic cycle turns.
 - After a few years of low bond volatility, trading opportunities on the global yield curves are now plentiful. Risk aversion anchors the front end, and bond supply, real money demand and sovereign credit worries are causing strong moves in the rest of the curve.

⁸ Past performance is not indicative of future results.

- Hedge funds take advantage of relative value plays, such as inter-country spreads, calendar spreads and on/off-the-run spreads in sovereign space. Increased government bond issuance allows hedge funds to make money through auction-based trades, as bond-price volatility is high around the pricing process. In addition, the reduced activity of bank proprietary desks, which incur less risk in trading, leaves more spread for hedge funds to make money in this area.
- Corporate Credit/Event-Driven/Credit Opportunity Hedge Funds have taken advantage of the revaluation of credit and a surge in issuance this year.
 - Significant upside remains in basis trades going forward. Credit spreads, particularly in bank debt, and convertible bond prices continue to be at very cheap levels as the loss of capital in the space from redemptions in 2008 caused technical selling.
 - Some hedge funds are long distressed/deep-value paper. In 2009, hedge funds are able to pick up this paper with unlevered returns on specific issues of over 50% yield-to-maturity. Hedge funds can then exit these trades by selling on to real-money investors who lack the speed to get in at the trough and often follow the HFs in. This has been most evident in convertible bonds this year.
 - The recent run-up in credit prices has made credit-basis trading in distressed companies highly attractive. The more liquid Credit Default Swaps (CDS) market has tightened on names near bankruptcy, but the cash debt has not increased, as investors stay away from creating an attractive spread. Essentially, it is a cheap default option, as well as offering decent carry, because the distressed loans are trading at very cheap prices. Defaults are picking up, which allows these trades to be monetized.
- Equities - The battle between fundamentals versus sentiment/momentum and sector rotation offers certain trends that managers can take advantage of through both long and short positions.

- Notwithstanding the recent rally, the underlying economic data for most geographies remains weak. Short opportunities are still plentiful, especially with some “junkier” names seeing big rallies lately.
- The opportunities for the broader market lie both on the long and short side. Hedge funds’ ability to capture both is a key to seeking alpha in all seasons.

Commodities

Few experts agree on the intermediate-to-longer term economic and financial outlook, yet commodities have an excellent record of producing healthy returns coming off recessionary bottoms. Every cycle is different, and this one could be a super-cycle for commodities.

With inflation in the air, it is likely that the monetary and fiscal policies of developed economies will continue to err on the side of de-risking the environment — even at the expense of future profitability and growth.

“...commodities have an excellent record of producing healthy returns coming off recessionary bottoms.”

In sharp contrast, many emerging countries appear to be regaining their stride. While the challenge of re-orienting themselves away from an over-reliance on exports is a formidable one, they nonetheless continue to benefit from low costs combined with the latest technology transfers from developed economies (a confluence of factors that is rare in historic terms).

Additionally, their consumer/corporate/government balance sheets are generally in good shape, and so these countries are poised to finance growth, supported by the demographic imperative to do so.

Politically, many countries continue to remove restraints to growth and remain in the infrastructure-focused stage of their economic lifecycles, which is the most commodity-intensive period in terms of long-term development.

The “commodity intensity” of such an EM-led mix of global growth is worthy of further evaluation, especially when combined with the potential for policy-driven inflation elsewhere (Figures 8 and 9).

Demand Versus Supply

While demand in commodities tends to get the most attention, supply issues are often more powerful and predictable. The lingering impact of the financial crisis looks likely to provide a long-lasting benefit with respect to restraining commodity supplies based on several sequential secular issues.

The 1990’s U.S.-centric technology bubble hoarded capital from all over the world into a narrow group of “New Economy” equities. This raised the opportunity cost of investing elsewhere, which contributed to a long period of under-investment in “Old Economy” vehicles, such as commodities and related infrastructures. During the 2003 to 2007 recovery, bottlenecks spiked commodity prices, drawing attention to prior neglect, and required supply build-outs.

Yet the good times did not last long enough to create an enduring impact. In the Energy and Metals sectors, subsequent multiple interlocking supply issues continue to result in a cascading series of bottlenecks. As one commodity-supply bottleneck clears, the next one surfaces. One example is thinking that a certain type of specialized hydraulic pump is needed to access hidden oil deposits, while it is actually the pump in combination

with several other types of equipment and dependencies that are essential for actual drilling to begin.

Historically, it has typically taken more than a decade for many commodities to address supply holistically, from a bigger-picture perspective that encompasses multiple supply-chain factors.

What we do know is that during the 2003 to 2007 upcycle in question, prices never went high enough for a long enough time to address these supply-chain issues. Then, beginning in 2008, courtesy of the financial crisis, needed capital for commodities was once again rationed away from these capital-intensive industries as seen in Figure 10.

Visible supply for many commodities is dwindling:

- The latest rationing of commodity capital lingers as another manifestation of de-leveraging. It has already disrupted the supply process, ensuring that commodity prices will remain high for many years to come. While commodity indices have experienced a nice bounce off the bottom, a strong case can be made that they either need to exceed prior highs or maintain prior levels for a much longer period in order for supply issues to finally resolve themselves.
- The lingering impact of de-leveraging will have differentiated impacts on the investment demand for various alternative asset classes. Clearly, some alternatives had previously benefited for many years from a former growing global savings glut that

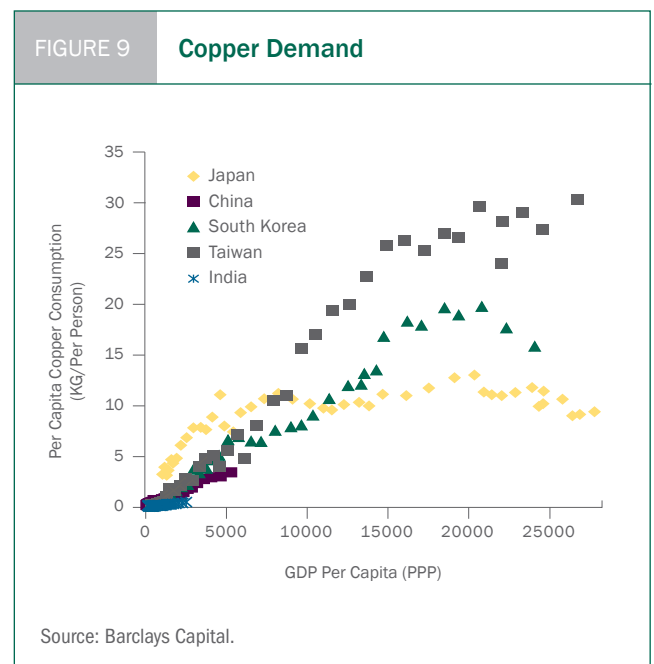
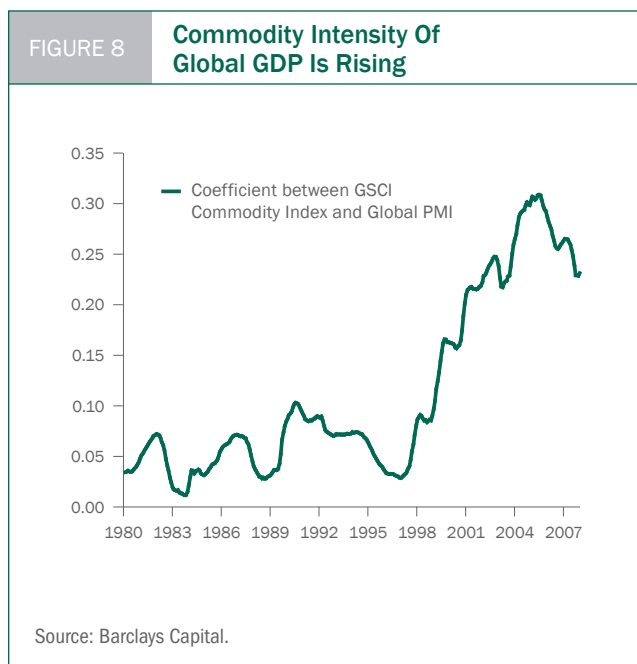
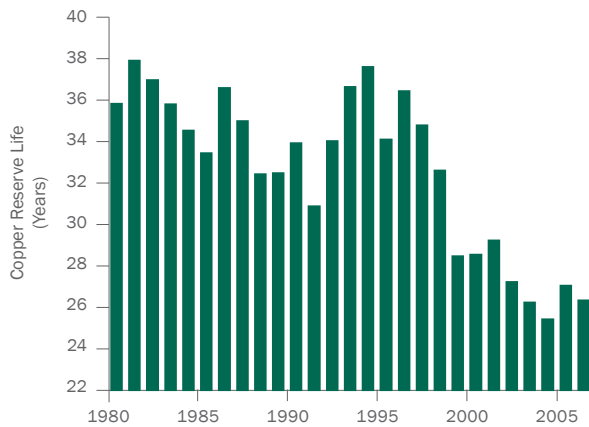


FIGURE 10

Copper Supply

Source: Barclays Capital.

richly rewarded those who were exploiting illiquidity premiums. This had a particularly positive impact on illiquid assets, while the world was happy to lever up.

- Yet contracting leverage shrinks the pool of risk capital, and illiquidity premiums may need to rebuild over a multi-year period. Most alternatives have been more about selecting the right managers than a favorable wind at the asset class' back. Yet, markets are about the marginal dollar, and, in a de-leveraging world, incentives will steer capital toward deep liquid assets that will not be as negatively impacted by de-leveraging as risk capital remains scarce for an upturn.

In an environment where uncertainty beyond the next 12 months is likely to remain unusually high, flexibility is likely to be the new mantra. With the exception of commodity futures, most other deep liquid asset classes that offer such flexibility are highly correlated with each other. If for no other reason, the unwillingness to utilize other uncorrelated alternatives may raise the portfolio-oriented demand for commodities.

In the world we see ahead, our forecasted portfolio returns are higher based on our allocations to commodity futures. As a rule of thumb, we would suggest that layering in allocations up to 5% of commodity futures (either the S&P GSCI or Dow-UBS Index) reduces many portfolio risk levels. Weightings closer to 10% tend to hold risk levels constant. While there is a movement to institute caps on speculators

to be in sync with those on agricultural futures, such proposals should not impact 5% allocations, with the possible exception of the very largest portfolios. Commodities could potentially be an important allocation for investors anticipating the recovery.

A Final Note

Clearly, emerging market economies and corporations have “stood the test” for more than a year and a half, and, therefore, continue to deserve investor attention. Additionally, bank loans represent an attractive opportunity: an asset class that benefits from the exposure to credit, while simultaneously being protected from the risk of a general rise in interest rates.

Considerable opportunities exist in the hedge fund space and we believe that funds-of-fund structures remain an efficient way of accessing this area. Finally, we also think that investors should actively seek protection from the risks of inflation by investing in real assets, and so commodities merit further exploration.

While we have experienced highly turbulent markets — and these may continue for some time — we also see unparalleled investment opportunities occurring throughout the world. With the right guidance, insights and approach to balancing risk and reward, investors can capitalize on favorable conditions and benefit from this historic confluence of events.

BIOGRAPHIES



Hans Danielsson, Senior Managing Director, Chief Investment Officer

Mr. Danielsson joined the firm in 1998 and is Senior Managing Director, Chief Investment Officer. He is a member of the Executive Committee and also responsible for directing the investment approach for all equity investment activities worldwide. Mr. Danielsson has developed the firm's philosophy and process for equity investing globally. In 2002 he was appointed Corporate Vice President, Investments. In 2006 he was appointed Senior Vice President. Previously, Mr. Danielsson worked for five years with SE Banken Fonder (SEB Asset Management) as CIO of International Equities, for eight years with JP Morgan in London and for four years for the Swedish Ministry of Finance. Mr. Danielsson received a BA from Uppsala University in Sweden and an MBA from INSEAD in France.



Markus Schomer, CFA, Managing Director, Global Economic Strategist

Mr. Schomer joined the firm in 1996 and is currently its Global Economic Strategist. He is responsible for providing economic forecasts, analysis and commentary for all groups of the firm. He is a member of various strategy committees and responsible for coordinating interest rate and currency strategies. Mr. Schomer transferred to the U.S. in 2002 from the firm's London office, where between 1996 and 2001 he also managed various fixed income portfolios. Previously, he was a fixed income analyst at Commerzbank in Frankfurt, Germany. Mr. Schomer holds degrees in Economics from the University of Bonn in Germany and the University of East Anglia, in the UK. He also studied at the London School of Economics and is a CFA charterholder.



Harold Singleton III, CFA, Managing Director, Global Equities

Mr. Singleton joined the firm in 2007 as a member of the Global Equity Team. Previously, Mr. Singleton was small-cap value co-manager and senior investment analyst at UBS Global Asset Management. Prior to that, Mr. Singleton was a member of the large-cap investment team and the small-cap value portfolio manager at Metropolitan West Capital Management, LLC. Before that, Mr. Singleton was a small-cap senior investment analyst at Brinson Partners, Inc. Before joining Brinson Partners, Mr. Singleton held investment analyst and portfolio management positions at Fifth Third Bank and Zasko, Sarafa and Associates. Mr. Singleton received a BS in Chemical Engineering from the Illinois Institute of Technology and an MBA in Finance from the University of Chicago. Mr. Singleton is a Chartered Financial Analyst (CFA).



John G. Lapham III, CFA, Managing Director, Co-Head of Leveraged Loan Group

Mr. Lapham's primary responsibility is co-managing the Leveraged Loan Group. Prior to joining the firm in 2001 and SunAmerica Inc. and its affiliates (SunAmerica) in December 1995, Mr. Lapham was a Senior Vice President in the Investment Banking Group of Oppenheimer & Co., Inc., where he was responsible for private placements in the western United States. Previously, he worked at Prudential Insurance Co. for 12 years, primarily in the private placements arena. Mr. Lapham received a Bachelor of Business Administration degree in Finance from the University of Texas at El Paso and an MBA degree in Finance and Accounting from the Graduate School of Management at UCLA. Mr. Lapham holds the Chartered Financial Analyst designation (CFA).



Steven Oh, CFA, Managing Director, Co-Head of Leveraged Loan Group

Mr. Oh's primary responsibility is co-managing the Leveraged Loan Group. Prior to joining the firm in 2001 and SunAmerica in June 2000, Mr. Oh's leveraged finance investment experience included serving as Collateral Manager in High Yield and Special Situation Investments at Citadel Investments, Collateral Manager in High Yield and Bank Debt at Koch Capital, and Vice President in High Yield and Distressed Debt Trading at BancAmerica Securities. Other prior positions include Manager in Ernst & Young's Restructuring and Reorganization and Strategy Consulting Groups. Mr. Oh received a Bachelor of Science degree in Finance and Management from the Wharton School of Business at the University of Pennsylvania and an MBA in Finance from the Kellogg School of Northwestern University. Mr. Oh holds the Chartered Financial Analyst (CFA) designation and has Series 7 and Series 63 licenses.



Julie A. Bothamley, *Managing Director, U.S. and European CLOs*

Ms. Bothamley is a portfolio manager for European and U.S. CLOs. Prior to joining the firm in 2001 and SunAmerica in June 2000, Ms. Bothamley was a Senior Manager in Royal Bank of Canada's Leveraged Finance Group, where she was responsible for business development, including origination, sponsor relationships, and participation in syndicated transactions. Prior thereto, Ms. Bothamley was a Vice President at Creditanstalt Corporate Finance, engaged in middle market leveraged lending, and a Vice President in the Leveraged Finance Group at Credit Lyonnais responsible for loan origination and managing participations in syndicated transactions. Ms. Bothamley began her career in finance at the Bank of New York, where she worked in the credit risk department after completing BNY's credit training program. Ms. Bothamley received a Bachelor's degree from UCLA and an MBA degree from Columbia University Graduate School of Business.



Robert Discolo, *CFA, Managing Director, Head of Hedge Fund Strategies Group*

Mr. Discolo joined the firm in 1999 and is a Managing Director of Alternative Investments and Head of the Hedge Fund Strategies Group. Mr. Discolo, a member of AIG's Hedge Fund Investment and Strategy Allocation Committees, has over 20 years' experience with major financial institutions in various capacities relating to investment products, primarily hedge and private equity funds. Previously, he held positions at PaineWebber Inc., Bank Julius Baer and Merrill Lynch & Co, where his responsibilities included creating portfolios of hedge funds for private and institutional clients, development of hedge fund and private equity products, oversight of business structure and development for hedge funds and hedge funds of funds, and managing the evaluation and selection process of hedge funds for both discretionary and advisory clients. Mr. Discolo also was President of the European Warrant Fund (a NYSE listed closed-end fund) and Julius Baer International Equity Fund. Mr. Discolo received a BS in accounting from St. John's University and an MBA from the Lubin School of Business at Pace University. He holds Series 7 and Series 24 licenses and he is a CFA and CAIA charterholder. Mr. Discolo is also a CPA and a member of the AICPA, CFA Institute, CAIA Association, GARP and NY State Society of Security Analysts.



Michael Kelly, *CFA, Managing Director, Global Head of Asset Allocation & Structured Equities*

Mr. Kelly joined the firm in 1999 as Head of U.S. Equities. He is now Global Head of Client Asset Allocation and Structured Equities responsible for the development and management of structured equity products worldwide. This includes expanding capabilities for institutional pension fund advisory and retail-orientated asset allocation vehicles throughout the firm with respect to approaches to both asset allocation and manager selection. The Asset Allocation group serves as the primary adviser for AIG's worldwide defined benefit and defined contribution plans. The team manages lifestyle and asset allocation strategies, and has developed and manages principal protected strategies and Global Tactical Asset Allocation. The team has provided strategic advice for corporate, trade group and government pension plans and has differentiated approaches to Liability Driven Investment and Total Retirement Outsourcing. Mr. Kelly serves as one of five permanent members of the firm's Global Asset Allocation Committee. Previously, he spent 15 years with JP Morgan Investment Management in various research and portfolio management roles. Prior to JP Morgan he spent several years in research at the economic consulting firm Townsend-Greenspan & Co. His investment experience began in 1980. Mr. Kelly received an MBA from the Wharton Graduate School of Business and is a CFA charterholder.

Endnotes

The information is coming from the GAAC meeting, internal committee held on a monthly basis. (this reflects the Asset Allocation team views); Normal: 5 years out, assuming a normal economic mid cycle, where we believe Prices and key metrics will be; Emerging Market: MSCI EM; US Equity: MSCI US; Europe: MSCI Europe; Japan: MSCI Japan; International Small Cap: SP index EPAC Small Cap; Fixed Income: Barclays live; Unlevered Real Estate: NCREIF; HF: HFRIFOF Index

Disclosure

On 5 September 2009, American International Group, Inc. (AIG) entered into an agreement to sell a portion of its investment advisory and asset management business to Bridge Partners, L.P., an exempted limited partnership owned by the Pacific Century Group, the Asia-based private investment group. This transaction is subject to receipt of regulatory approvals and other consents in various jurisdictions around the world.

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