

Listed Equity Allocation Notes

November 2011

The PineBridge Investments' Listed Equity Allocation Committee (LEA) establishes equity views for the firm's comprehensive array of allocation products. The LEA meets monthly with key equity professionals to review developments in the four equity regions — North America, Europe, Japan, Emerging Markets — based on various criteria, including:

Valuations: Determine if the stocks in the region are over-, under- or properly valued.

Revisions: Evaluate current guidance by the companies and their impact.

Fundamental Progress: Review of what the fundamentals are likely to look like going forward.

Equity View - Driving Themes

- We are on the cusp of a global easing cycle, which is normally very bullish. There are exceptions, however, when the global economy weakens faster than liquidity rises. The world's largest economy, the US, continues to surprise with steady strengthening from this summer's stalled pace to almost trend-like growth today. Growth in China is decelerating, from 10%+ to a "mere" 8%. Policy measures intended to slow growth and allow for cooling inflation appear to be working. Now that inflation seems to have peaked, we believe authorities will switch back to easing mode with little fanfare. This shift from deceleration to stable growth may be quite bullish, as the market's fear of a hard landing for the world's second largest economy dissipates.
- Only Europe can spoil the party with a sudden shock to the global financial system. We do not think that

TABLE 1 Allocation Weightings As of 10 November 2011

'X' indicates our current stance on allocation. (-) indicates our intended relative allocations over the medium-term.

	Unfavorable	Cautious	Neutral	Constructive	High Conviction
North America			X		
Europe	X				
Japan			X		
Emerging Markets					X

merely seeping into recession will be enough to cause reverberations in the rest of the world. Lehman's effect on freezing markets had much to do with that episode's element of surprise. In a "too big to fail" era, they suddenly shocked the system by being allowed to fail. In this sense, today is very different from 2008. Back then, counterparties had taken very limited safety precautions. Europe is an entirely different matter. Today, the majority of counterparties (within Europe and to European financial institutions) have been pessimistic about prospects and have been disentangling exposures to Europe for close to a year now. This pace accelerated dramatically after the summer. European headlines have led to relatively sharp drops in the stock market on a very regular basis. But follow through is difficult to maintain and markets have tended to come right back. Why has this been the case? It has become difficult for Europe to negatively surprise normally optimistic equity people. For more dour fixed income investors, it's now even more difficult for this group to be negatively shocked by developments in Europe. That said, rising spreads in France seem to illustrate a skepticism over their

ability to maintain an AAA rating in an election year backdrop.

- Only emerging markets ("EM") have been attempting to restrain growth. Still, their decelerating economies continued to outpace the rest of the world economically, although their markets have feared hard landings and have underperformed. Now with inflation topping and policy reversing, we believe that these markets can once again begin to lead.

UNITED STATES

Valuations: All risk assets are inexpensive, barring economic relapse. Yet, within risk assets, US Equity is fairly valued after substantial relative performance in the past 12 months.

Revisions: Productivity jumped in the third quarter, enabling earnings to keep pace even as the economy did temporarily stall. Estimates have kept nudging down even as the economy has reaccelerated.

Fundamental Progress: A slow economy has continued to be enough to produce stellar earnings growth. Now the economy seems to be accelerating. The US economy and earnings picture have proven to be amazingly resilient to

natural disasters, populist uprisings, and a disappointing political backdrop.

United States Equity View: Fundamentals keep surprising to the upside. We had been overweight most of the last year, yet with meaningful outperformance now built in, we have stepped aside to neutral. This is mainly based on valuation, which we view as fair, whereas most EM valuations are superb.

EUROPE

Valuations: Europe is still not attractive versus other equity markets, even after significant underperformance. Clearly, most banks will experience some sort of forced recapitalization. Financials are the largest sector in Europe. Either dilution or balance sheet shrinkage (and thus earnings shrinkage) lies ahead through June 2012. Europe can get cheaper.

Revisions: These continue to be the poorest of all the regions, with no end in sight.

Fundamental Progress: A vicious cycle is setting in. Premature austerity has brought back recessionary conditions. The bank recapitalization program is allowing too much time for banks to act. While regulators are acting with confidence that they will be able to get banks to raise equity, the banks themselves are planning on reducing their balance sheets. Without very vigorous easing by the European Central Bank (ECB) (which is difficult to imagine), a credit crunch lies ahead, which will contribute to the vicious cycle of austerity, weakness, bank balance sheet shrinkage, more weakness, and more austerity.

Europe Equity View: Europe remains a maximum underweight for us, as it has been for some time. After a brief

rally in response to the release of the European Grand Plan, we're much more comfortable being maximum underweight again. For non-euro investors, they should also expect to lose money on a falling Euro, as well as on falling earnings and local currency-based stock prices.

EMERGING MARKETS

Emerging Europe, Emerging Asia, Latin America, Africa and The Middle East

Valuations: Valuations are very favorable. After a year and a half hiatus, we reinstated our prior almost chronic constructive view on the "region."

Revisions: EM revisions are neither stellar (like the US), nor disappointing (like Europe). Cost pressures have clashed with macro prudential policies, and outright price controls dampening profits for companies in otherwise relatively strong economies. Yet, falling commodity prices now offer some relief.

Fundamental Progress: Fundamentals continue to decelerate. However, earnings in EM remain relatively healthy; fast enough to support world growth but with slower momentum recently, we have seen inflation pressures easing and policy measures reversing after a year and a half of restraint. Brazil's inflation has rolled over the fastest and they are now set up for their third easing. China's inflation just rolled and they too will soon be in the easing game.

Emerging Markets Equity View:

Emerging markets have significantly underperformed in the past year. After downshifting growth recently, we believe that they will outpace the developed markets very significantly in the next 12-24 months. Despite structural upgrading of their growth outlook, EM

valuations relative to developed markets have approached an extreme low. In any scenario except a hard global landing, we see significant EM outperformance immediately ahead, led by a new global cycle of central bank easing.

JAPAN

Valuations: Valuations are relatively fair but unattractive versus emerging markets.

Revisions: The recovery-related earnings bounce is over and the outlook from here is increasingly disappointing.

Fundamental Progress: The floods in Thailand are causing yet another instance of supply chain disruptions within the year. Korea's supply chain is much less impacted, and this is an unfortunate event for Japan's market share in automotive and PC related products.

Japan Equity View: With share loss, earnings beginning to decelerate, and a surging currency, we are no longer optimistic for this export-oriented economy. ■

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