

Listed Equity Allocation Notes

JUNE 2010

The PineBridge Investments' Listed Equity Allocation Committee 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 being issued by companies, and their impact.
- **Fundamental Progress:** Review of what fundamentals are likely to look like going forward.

Allocation Views (As of June 3, 2010)

X indicates our current view on allocation.

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

Targets based on PineBridge Investments' view of the equity markets as of the date shown and are subject to change. Actual allocation may be different.

Driving Themes

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

Allison Emmert, *Vice President, Global Economic Strategy*

- We lowered our previous overweight in Japan and initiated an overweight in emerging markets (EM).
- Japan had been a differentiated liquidity play. Yet, with Japan halting Quantitative Easing (QE) measures while all other central banks are delaying either the pace or the onset of their exit strategies, Japan's relative liquidity situation now looks just like everyone else's.
- EM began underperforming when China started talking about taking actions to restrain their economy back in October. However, Europe has become China's largest export market, and the prospect of a second Western-induced slowdown will, in our view, lead China to take its foot off of the brake soon.

- Asia, which is the largest segment within EM, is where the global economy's current strength lies. EM is inexpensive and should resume market leadership as its policy moves back towards neutral, as it has in other regions.
- Usually, in a "V-shaped" recovery, once economies pass the initial sweet spot, where most news is good news, anxieties about double-dips become commonplace. However, actual double-dips are extremely rare.
- We disagree with recent concerns that a likely European double-dip will spill over to the rest of the world. Yet for Europe, the bad news never seems to end.
- The Basel III banking regulations' expected liquidity requirements are likely to hit European banks the hardest. It would tighten their excess capital requirements, exacerbating their eventual write-down of Greek debt. Lending could become an obstacle to European stabilization.
- Meanwhile, fiscal austerity continues to be imposed on Europe, whether it is by the market or the more fiscally conservative EU members led by Germany. While austerity policies are welcome during periods of over-heating, implementing such policies now, while Europe is still quite depressed, is very risky. Our underweight of Europe is our strongest equity conviction.

United States

- **Valuations:** Stocks once again look attractive within our Capital Market Line (CML) framework. While earnings may soon stop rising as rapidly as they are now, they are still rising nonetheless. Meanwhile, interest rates and equity prices have fallen quite sharply.
- **Revisions:** Strong earnings have already boosted forward expectations, as the economy bounced off the bottom. Yet with GDP now back at prior peak levels, and with the "V" now behind us, earnings growth will start to decelerate.
- **Fundamental Progress:** Sluggish employment growth, a still-overleveraged consumer base and a strong dollar, combined with an increasingly bloated public balance sheet, make us question the sources of future growth.

However, such concerns are common as the economy passes through the initial part of the recovery. Muted growth from unforeseen productivity and innovation is the more common, likely scenario, with profits continuing to do better than GDP during the expansion.

United States Equity View

In addition to a deceleration, the US is facing financial reform and populist policy leading up to this Fall's election. Afterwards, the country is highly likely to face measurable tax increases. Despite this, we do expect slow but persistent economic growth. Interest rates that are lower-for-longer should establish a positive foundation for equities.

Europe

- **Valuations:** Valuations are likely to remain secondary as market participants ponder whether Europe will fall into a double-dip recession. While the region had looked quite inexpensive over an intermediate-term horizon, that presumed European profitability would remain on par with the United States. We are now questioning that assumption, given the macroeconomic outlook for Europe. As a category, "European Equities" are now closer to fair value on our CML.
- **Revisions:** Relative to prior peak nominal GDP, Europe remains the most depressed region, as nearly all others have either fully recovered or have entered their expansion phases. Despite this trend, an outbreak of austerity is clearly threatening earnings forecasts, which, surprisingly, have not yet fallen by much. The euro has temporarily boosted Germany's exports. Yet with two-thirds of German exports typically bound for the eurozone, we question how long the German economy can continue to show such strength in the face of a double-dip recession in Europe's southern region.
- **Fundamental Progress:** The capital requirement issues relating to Basel III threaten Europe's lending recovery, even if phased-in Greek debt write-downs do not. Liquidity will prove to be a distinguishing factor between US and European banks as we move closer to Basel III reform. Capital issues are already surfacing among regional banks, such as the Cajas in Spain, some of which are showing clear signs of strain and being taken over by the Spanish government.

Europe Equity View

A decoupling of Europe from the rest of the world –

Europe's expected recession will be a real contrast to expected overall global growth – should lead to equity underperformance. The only positive for the region, at the moment, is the sliding euro. Investing in this region on an un-hedged basis remains an extremely risky proposition.

Emerging Markets

Includes emerging Europe, emerging Asia, Latin America, Africa and the Middle East

- **Valuations:** EM is beginning to be perceived as less risky with greater growth prospects. However, it remains at a historically normal valuation discount to developed markets. Given the recent correction in markets, we view EM's forward-looking valuation (on our CML) as extremely attractive.
- **Revisions:** Earnings growth continues to show healthy expansion. Double-digit growth expectations for 2011 and 2012 look achievable in contrast to developed markets.
- **Fundamental Progress:** Core emerging markets, such as China and India, have been successful at moderating their growth. When factoring in some drag by Europe, we now believe they are reaching relatively stable growth paths with reduced pressure of inflation. Some concern exists that historically large IPOs targeted for this summer will restrain their markets a bit longer. However, overall we favor EM based on its general fiscal strength.

Emerging Markets Equity View

China's tactics of government intervention have sparked a necessary correction in lending and in the nation's property markets. With reduced transactions, prices may soon show stability, which is what most market participants are waiting for to turn bullish again. GDP growth may have stopped accelerating and a return to 8% to 9% sustainable growth would be very bullish.

Wage increases have been substantial recently, yet remain a smaller component of most cost structures than commodity prices, which have recently softened. These wage increases should be considered positive, due to their likelihood to increase domestic demand. This is a key area of differentiation for China during this economic cycle, given the shortage of domestic demand that plagues much of the developed world.

Japan

- **Valuations:** Japan remains inexpensive on forward

valuations assuming their profitability gap with the rest of the world makes some progress this cycle.

- **Revisions:** Earnings are expected to increase by 93% this year. Next year, anticipated earnings are in the range of 23%. If this level is achieved, the Tokyo Stock Price Index (TOPIX) will be just below 16 times earnings this year and just below 13 times earnings in 2011.
- **Fundamental Progress:** Last month, military threats between North and South Korea dampened investor appetites for Japan. While this appears to have died down, clearly that pressure could re-emerge.

Deflation may be somewhat less severe than several months ago. On the other hand, the Bank of Japan (BOJ) appears to have backed away from quantitative easing. While Japan has a new Prime Minister who is known for favoring a weak currency, in contrast to his DPJ predecessor, the staying power of a Japanese Prime Minister should never be taken for granted.

Japan Equity View

As a market lacking internal growth, Japan has responded well to episodes of increased liquidity and/or global overheating. While further quantitative easing and global overheating both appeared likely several months ago, they no longer seem to be of concern.

Past performance is not indicative of future results.

PineBridge Investments is a group of international companies that provides investment advice and markets asset management products and services to clients around the world. PineBridge Investments is a service mark proprietary to PineBridge Investments IP Holdings Company Limited. Services and products are provided by one or more affiliates of PineBridge. Certain information may be based on information received from sources PineBridge Investments considers reliable; PineBridge Investments does not represent that such information is accurate or complete. Certain statements provided herein are based solely on the opinions of PineBridge Investments and are being provided for general information purposes only. Any opinions provided on economic trends should not be relied upon for investment decisions and are solely the opinion of PineBridge Investments. Certain statements contained herein may constitute projections, forecasts and other forward-looking statements that do not reflect actual results and are based primarily upon applying retroactively a hypothetical set of assumptions to certain historical financial information. Any opinions, projections, forecasts and forward-looking statements presented herein are valid only as of the date of this document and are subject to change. PineBridge Investments is not soliciting or recommending any action based on any information in this document.

PineBridge Investments Europe Limited is authorised and regulated by the Financial Services Authority ("FSA"). In the UK this communication is a financial promotion solely intended for professional clients as defined in the FSA Handbook and has been approved by PineBridge Investments Europe Limited.