



CHANGE IS IN THE AIR: The US sub-prime crisis hits global lending

The superb absolute performance in the MSCI EAFE and EM asset classes over the past five years has been driven by an intoxicating mix of low global interest rates, easy credit conditions, an explosion in private equity LBO and M&A activity, surging GDP growth in Emerging Markets (primarily China and India), and the strongest global earnings and profitability boom that has taken place in the past four decades.

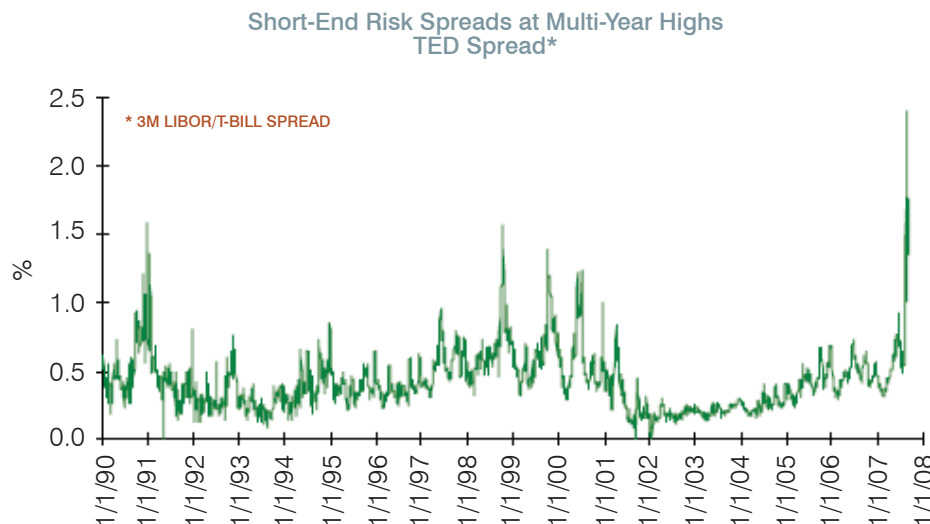
Some have called the global economy a “Goldilocks economy”, where the growth and inflation tradeoff continues to be “not too hot, not too cold”. However, financial market events over the past eight weeks have been dramatic, and in our opinion should significantly change the dynamics of international equity markets over the next couple of years.

As a result of these developments, we have identified the emergence of five key issues that are likely to influence these markets going forward.

1) A liquidity crunch in credit markets is driving higher risk aversion in global equities - Is the M&A boom over?

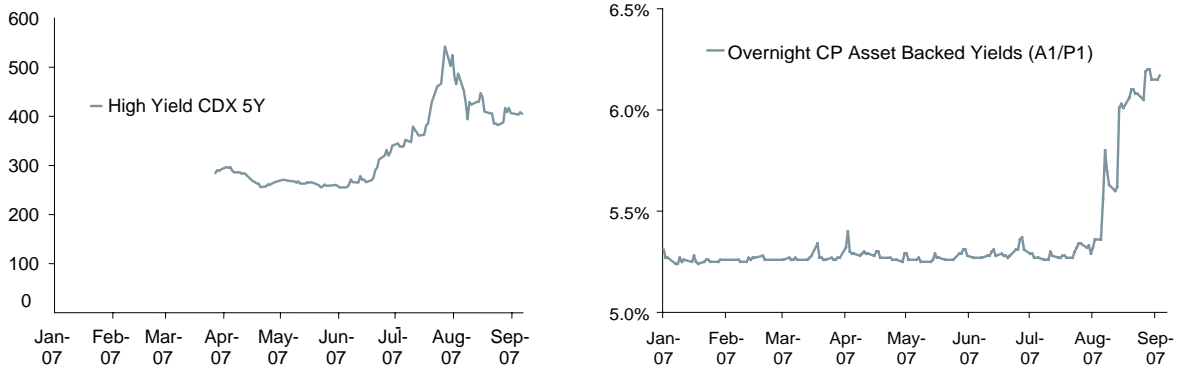
How the credit market turmoil has unraveled:

- The TED spread measures the US T-bill/Eurodollar spread. Historically it is viewed as an indicator of investor confidence and has a reading between 0.1 – 0.5%. A widening spread implies elevated concern over corporate default in the future. The spread recently came within 50 basis points of the crash levels of 1987. *What is this telling us? Banks would prefer to lend to the government and lack confidence in the private sector. As a result, risk is now more expensive.*



Source: Bloomberg, Morgan Stanley Research

- Credit woes have reverberated across a wide range of debt markets. High-yield and Commercial Paper (how businesses fund short-term cash needs) were the hardest hit due to a crisis in confidence that pushed investors to the sidelines.

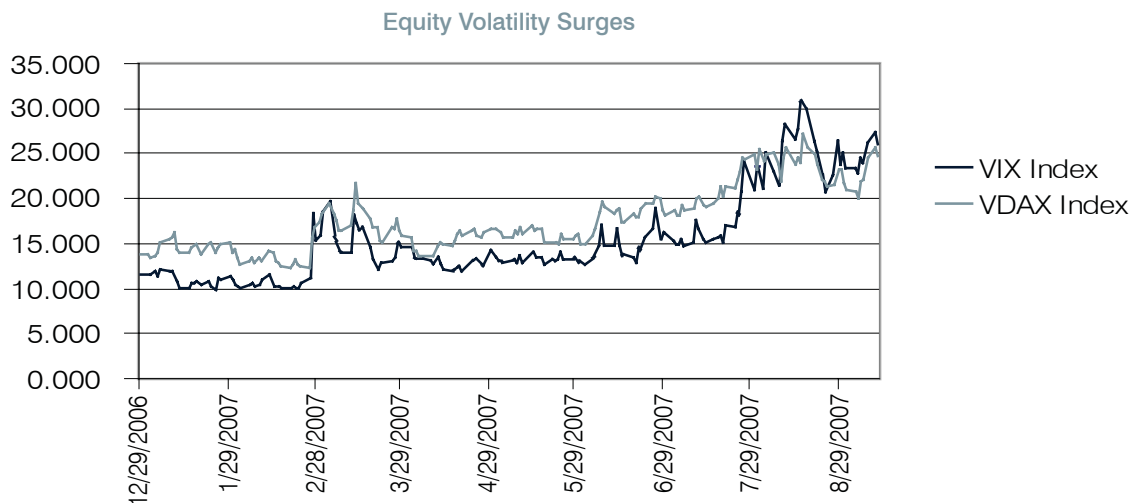


Source: Deutsche Bank

- This trend could signal an abrupt halt to the private equity activity that has fueled gains in US and European markets.
- A huge backlog of levered loans sparked by the private equity M&A/LBO boom suffered from the spike in risk aversion – many of these deals have yet to be sold to investors and could remain on investment banks' balance sheets.

2) Volatility has risen sharply as a result of liquidity drain

- After a period of historically low volatility that has challenged our style of active stock selection, the VIX Index has nearly tripled, while the VDAX Index (which measures the volatility of the German DAX index and serves as a proxy for Europe) has nearly doubled.
- Like bond spreads, these indices measure the cost of risk. The current one-way bet on low volatility has reflected higher risk appetites; this elevated risk threshold has been unwinding since the end of July, as seen in the volatility spike.



Source: FactSet

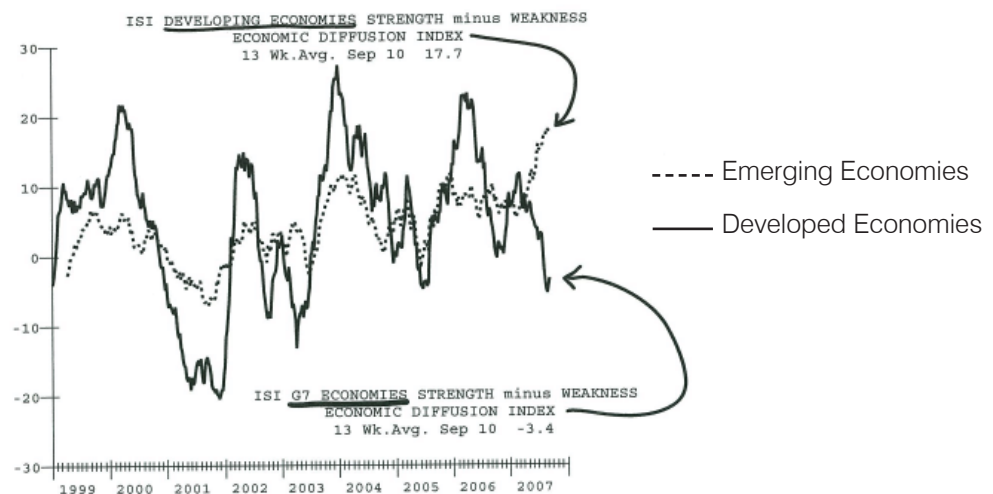
3) The Impact on the Global Economy

- The market's initial reaction was based on the theory that the "sub-prime mortgage problem" was a US-specific issue, which would modestly affect US GDP, but not pose a major threat to US or global growth.
- This assumption has been subsequently re-assessed. Since the end of August, a wide range of economists have begun to materially downgrade US, Europe, Japan and Global GDP forecasts for H207 and 2008. While most still feel that a recession will be averted, there could be a period of sub 1.5% GDP growth in US.
- Several sell-side economists have downgraded GDP forecasts (see table below.)

	Real GDP % Change (previous months, if changed)				
	Low / high range		2008	Average	
	2007	2008	Previous Low	2007	2008
Australia	3.5 / 4.4	3.0 / 4.3	2.8	4.1 (3.8)	3.5 (3.4)
Belgium	2.4 / 2.8	1.9 / 2.5	2.1	2.6	2.1 (2.3)
Britian	2.7 / 3.2	1.6 / 2.5	2.0	2.9	2.1 (2.4)
Canada	2.2 / 2.9	2.0 / 2.9	2.3	2.5	2.5 (2.7)
France	1.7 / 2.0	1.5 / 2.2	1.8	1.8 (2.0)	2.0 (2.2)
Germany	2.4 / 3.0	1.9 / 2.5	2.0	2.7 (2.8)	2.2 (2.3)
Italy	1.3 / 2.0	1.0 / 1.8	1.4	1.8 (2.0)	1.5 (1.7)
Japan	1.8 / 2.4	1.5 / 2.5	1.6	2.0 (2.4)	1.9 (2.2)
Neterlands	2.4 / 2.8	1.8 / 2.6	2.2	2.5 (2.7)	2.2 (2.6)
Spain	3.3 / 4.0	2.4 / 3.1	2.4	3.7	2.7 (2.8)
Sweden	3.2 / 4.0	2.7 / 3.5	2.9	3.4 (3.5)	3.0 (3.2)
Switzerland	2.4 / 2.7	1.7 / 2.4	1.9	2.6 (2.4)	2.1
United States	1.9 / 2.1	1.3 / 2.6	2.0	2.0	2.2 (2.6)
Euro area	2.5 / 2.8	1.7 / 2.3	2.1	2.6 (2.7)	2.1 (2.3)

Source: The Economist, 10/6/07

- While some strategists believe that emerging markets are now decoupled from the US and will support continued global expansion, most agree that these markets will not be able to offset a prolonged downturn in US consumption.
- Historical evidence suggests that if US GDP growth falls below 1.5%, emerging markets will suffer.

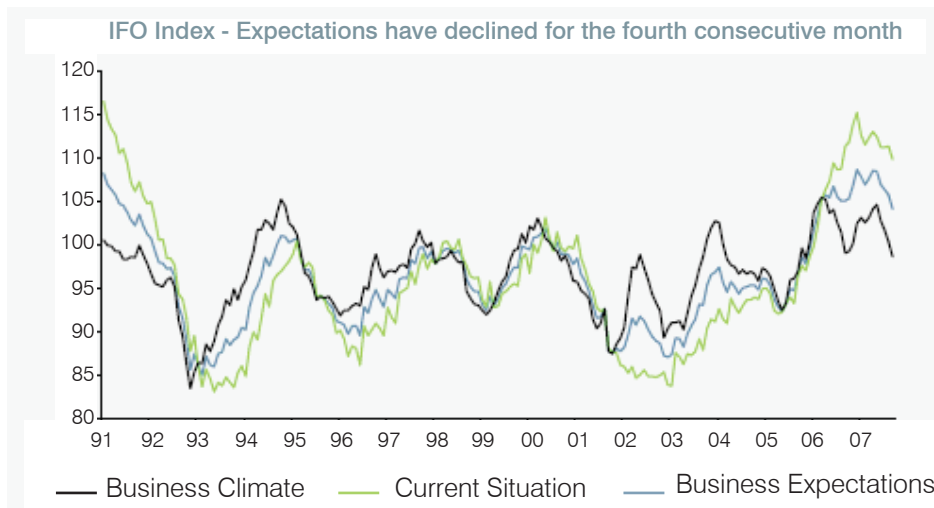


4) A Question of Sustainability

- The four-year-plus bull market in developed and emerging equities has been historically significant due to its duration and consistency.
- Against a backdrop of record-setting earnings growth, much of which has been driven by excess liquidity and corresponding demand, sustainability becomes a key variable in the outlook for global equities.
- With credit markets under siege, the US economy slowing down, and risk becoming more expensive, it is very likely that we are entering a period of higher volatility and more fragile equity markets.

Things to look out for:

- **OECD Leading Economic Indicators** – The G7 Indicators weakened for the second consecutive month in September. Conditions have deteriorated in the US, Japan, and Europe.
- **Business Surveys** – Germany's Ifo business confidence survey has declined for the fourth consecutive month. It is important to note that Germany is one of the world's largest exporters, a relevant barometer for global demand.



Source: Thomson Datastream, Dresdner Kleinwort Research

- **Jobs Data** – US payroll reports and jobs data has been mixed at best during the past few months. In August, payroll surprised on the downside, declining by 4,000 jobs. Although September showed improvement, the trend in new job creation is clearly weakening. At 1.2%, it has fallen to the lowest level since 2004.
- **Corporate earnings revisions** – This trend started in September with the big US investment banks. Financials have been the hardest hit sector since the equity markets began weakening on July 23rd. With Financials making up nearly 30% of the EAFE index (higher in the US, lower in EM), it will be difficult for the market to go higher in the face of severe earnings erosion in this sector.
- **Capital market deterioration** – Preceding a US recession, the S&P has fallen 30% on average and the high-yield spread has widened to 600 basis points. Thus far, the S&P is off 6% and spreads have widened by 200 basis points.

5) Central Banks to the Rescue

- With additional rate cuts, inflation becomes a key risk. Input costs remain firmly high. Producers have been able to offset these costs through hedging and operational efficiency, but they are facing increasing pressure to raise prices.
- In Europe, the ECB is not looking to cut rates, as growth remains sound. The Bank of Japan cannot lower rates much more. And a frothy real estate market has the Bank of England cautiously monitoring the lending environment.
- Although the US economic outlook has weakened and household debt is high by global standards, unemployment remains low, and consumption has held up relatively well. Further central bank action could trigger another period of aggressive borrowing, further stretching consumer balance sheets.
- The more likely outcome is an “on-hold” position for Europe, the US, and Japan. That means that the cost of risk will stay at realistic levels, alleviating the liquidity bubble, and bringing markets back to traditional measures of economic value.

As our Non-US Value Equity investment team digests this changed global economic backdrop, we believe that this environment of elevated volatility and uncertainty will eventually drive investors back to critical evaluation of equity fundamentals and valuation. This would benefit our style which has recently been out of favor due to momentum investing. We continue to implement a proven, disciplined relative value process and philosophy. Our investment team remains stable and has recently added analytical talent to deepen our fundamental capabilities. As always, we continue to run a broadly diversified portfolio of securities with attractive value characteristics and solid business prospects. We are confident that the value in our portfolio will prevail and produce strong risk adjusted returns when the sentiment for today’s market leaders wanes.

This presentation or any portion thereof may not be copied or distributed without TBCAM’s prior written approval. Statements are correct as of the date of the material only.

This document may not be used for the purpose of an offer or solicitation in any jurisdiction or in any circumstances in which such offer or solicitation is unlawful or not authorised.

The information provided within this presentation is aimed at institutional investors only.

Past performance is not indicative of future performance.