

Non-US Value Equity Management

Fourth Quarter 2009 Investment Commentary

Investment Environment

During the fourth quarter, global equity markets advanced as investors were encouraged by positive data pointing to economic recovery in 2010. The MSCI EAFE Index rose approximately 2.2% as the weak US dollar trade continued to perform well during the first two months of the quarter, benefiting commodity rich markets. Not surprisingly, the UK was a top performer, with the multitude of mining companies listed on the London Stock Exchange. Germany and France also moved higher on solid business sentiment surveys.

Initial weekly jobless claims declined from elevated levels during the quarter, an encouraging sign that the employment picture was beginning to stabilize in the US. At the same time, the manufacturing sector rebounded moderately and business confidence rose. In the United States, third-quarter gross domestic product (GDP) was positive for the first time in five quarters (revised from 3.5 to 2.8, but positive nonetheless), giving investors another milestone marking the end of the current recession.

Markets briefly pulled back during the period on news of Dubai World's decision to suspend their debt repayments, causing risk aversion to take hold in the broader markets as sovereign debt risk more generally came back into focus toward the end of November. While the Q309 earnings season began with a string of positive reports in the US, later in October saw more mixed results, particularly among European, UK and US commercial and investment banks. Third quarter corporate earnings results were moderately disappointing in that most of the gains came from cost cutting while very few companies reported an acceleration of their top-line revenue growth.

Emerging Asia demonstrated exceptional resiliency and has led the overall global recovery as China, India and Indonesia managed to avoid recession. China's manufacturing growth held at its fastest pace in 18 months; India's economy grew 7.9%, its fastest expansion in 1½ years; and South Korea's exports rose 19%, the first gain in 13 months. Japan struggled, as currency headwinds could seriously undermine the country's sizeable export sector. The Organization for Economic Cooperation and Development

predicted that next year the US economy would expand 2.5%, the eurozone would grow 0.9%, and Japan would advance 1.9%.

Portfolio Performance Review

The portfolio performed in-line with its benchmark, the MSCI EAFE Index, during the fourth quarter of 2009 (based on net-of-fees performance), driven primarily by positive stock selection within the Financials, Healthcare and Energy sectors. On a country basis, relative returns were helped by selections in the UK and Switzerland.

Country Review

United Kingdom

UK – The UK market posted solid returns during Q409, handily outpacing the broader MSCI EAFE Index. Brisk moves in metals and mining as well as the big diversified oil stocks helped drive the market higher on the heels of rising commodities and oil prices. UK banks bucked the trend by falling more than 5%, trading down in sympathy with the sector globally after a spike in risk aversion following the Dubai World credit renegotiation. While UK banks had minor exposure to the event, the situation once again placed a spotlight on the continued weakness of the underlying loan books of the major UK Financials. The portfolio outperformed the UK market in the period, led by an underweight and outperformance within Financials, in addition to solid stock selection within Utilities and Energy.

Europe

Switzerland – Signs of a broadening market within Europe were evident in the Swiss market during the period as the more defensive-oriented sectors such as Healthcare and Consumer Staples, the two largest in Switzerland, pushed the market higher. Shares in two of the largest global pharmaceutical companies outperformed, helping not only the Swiss market, but the portfolio even more as a result of our overweight positioning. Solid stock selection within the smaller Materials sector also had a positive impact on relative performance, driven by our holdings in a specialty chemical operator and flavors and fragrances manufacturer.

Asia

Japan – The Japanese market declined in the fourth quarter as the strong yen continued to weigh on recovery prospects for the country's large

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exporters. With Q309 GDP results having been revised down, the domestic recovery thus far appears weak, sending Consumer Staples companies, particularly general retailers, lower in the period. The banks also traded lower despite a report during the quarter indicating that tighter regulations surrounding capital ratios could be phased in over a period of years versus a more immediate event. The portfolio's stock selection lagged during the quarter in Japan, marked by declines in a department store holding and the convenience store/supermarket group.

Country Allocation Review

Country allocation was slightly positive during the fourth quarter, with the biggest positive factor coming from an overweight to the UK, which outperformed the MSCI EAFE Index. This benefit was partially eroded by the portfolio's overweight stance within Japan, the worst-performing large market during Q409. Off-benchmark exposure to the Emerging Markets continued to provide a benefit to the portfolio's relative returns.

Sector Review

Healthcare – After lagging for much of the year, the Healthcare sector outperformed the broader index during the period, indicating some measure of market rotation during the period. The portfolio's overweight positioning in the sector and solid stock selection benefited relative performance. Shares in a UK medical device manufacturer and two large Swiss pharmaceutical companies were key drivers of outperformance.

Financials – Having benefited from the global equity market surge from March 2009 lows, the Financials sector gave back some of their significant gains as regulatory uncertainty surrounding capital ratios, loan-loss provisioning and compensation oversight plagued developed-market investment/commercial banks from Japan to Europe, the UK and US. Positive returns out of the portfolio's two Singapore diversified Financials holdings as well as a positive return from an Australian insurer translated into the sector delivering the top relative return during the quarter.

Consumer Staples – While the Consumer Staples sector was the second-best performing portion of the MSCI EAFE Index in Q409, lagging stock selection within the portfolio's Japanese holdings detracted from relative performance. The bright spots in the sector and portfolio were two key European HPC/FMCG companies posting solid gains during the period.

Sector Allocation Review

Sector allocation was mildly positive as the portfolio's continued underweight stance within the Financials sector helped relative performance, as it was the worst-performing sector on an absolute basis during Q409. This was partially offset by an underweight position in the best-performing sector, Materials. Though the portfolio's stock selection was neutral within the sector, the underweight detracted from performance.

Looking Forward

The outlook for equity markets in 2010 is heavily influenced by the transition from government stimulus to private sector spending. Public expenditure, financial market intervention, and extremely low interest rates have prevented an extended recession and supported higher equity values. Governments will gradually reverse spending and potentially increase taxes to pay for mounting deficits, especially in the UK and US. That trend will curb spending, as will potential interest-rate hikes in Europe when the ECB turns its attention back to inflation. Although neither scenario is imminent, both will likely unfold as the year progresses. Assuming labor markets recover, tighter fiscal and monetary policy should not be detrimental to growth if implemented in a conservative manner. However, top-line growth could be held back by the added tax and financing costs incurred by consumers. With limited cost-cutting remaining, earnings growth could be muted until the following year. It will be important to invest in companies with strong brands, a geographically diversified client base, additional cost-cutting ability, and decent barriers to entry. Valuation and quality of earnings will also be crucial to share price performance.

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