

# US Dynamic Large Cap Value

## Fourth Quarter 2009 Investment Commentary

### Investment Environment

The US stock market closed out its best year since 2003, representing a dramatic turnaround from the negative performance of 2008 when the global economic crisis resulted in the market's worst year since the Great Depression.

During the fourth quarter, global equity markets advanced as investors were encouraged by positive data pointing to economic recovery in 2010. 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 ultimately disappointing, with most of the gains coming 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

Relative to past quarters, the year finished rather unremarkably as economic skepticism subsided and stock market optimism moderated. The US Dynamic Large Cap Value strategy underperformed its benchmark, the Russell 1000 Value Index, during the fourth quarter of 2009 (based on net-of-fees performance). Difficult stock selection accounted for much of the underperformance. Financials and Utilities proved most challenging, whereas Energy and Information Technology most rewarding.

### Sector Review

**Energy** – Although the sector finished middle of the pack, very solid stock selection helped the portfolio. The natural gas tilt added value as the commodity rallied 100% during the quarter.

**Information Technology** – The sector cooled off a bit but still finished the year strong, with stock selection being particularly solid. During the quarter, names exposed to enterprise spending did particularly well on the realization that the segment would improve throughout 2010 following a very lackluster 2009.

**Financials** – The sector sold off on increased concerns over too much government intervention and capital market activity slow-down. Moreover, REITs, where we have no exposure, was the best-performing sub-sector and benefited from short covering.

**Utilities** – This defensive sector did well as markets slowed and our underweight hurt. Additionally, alternative energy names struggled to keep pace as carbon regulation expectations were dampened due to reform timing delays.

### Looking Forward

Overall, we remain positive on the economy and encouraged by improving corporate confidence and a resilient consumer. We anticipate a more favorable employment environment in 2010 given positive leading indicators and improving corporate budgets. Moreover, we believe large financial institutions have sufficient capital and stand ready to lend as demand picks up, which is a trend we think will happen in 2010 to further stimulate the economy.

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THE BOSTON COMPANY

ASSET MANAGEMENT, LLC

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Despite the strong 2009 market performance, continued high levels of skepticism suggest a recovery has not been fully discounted, thereby creating additional opportunity for equities in 2010. We have positioned the US Dynamic Large Cap Value portfolio appropriately for such an environment, yet as always, lean heavily on our bottom-up, stock-specific analysis to identify companies at the intersection of valuation and business improvement.

Information Technology remains our largest active weight. Large corporate cash balances and pent-up demand should fuel top-line growth in the space. Our focus is on the larger, multi-national and more defensive names with sustainable competitive advantages (and not the high beta names that bounced in 2009). We also have a meaningful overweight in Healthcare, driven by names that offer solid valuations, strong product pipelines, and should benefit most from the elimination of Healthcare reform uncertainty.

We start 2010 with our largest absolute weighting in Financials (roughly consistent with the sector weighting of the Russell 1000 Value). However, we differ from the benchmark in how we construct our weighting, preferring capital market and consumer credit sensitive names over others. Of note, we are monitoring our underweight to commercial real estate closely as we continue to assess if concerns to the downside are overdone.

Industrials and Telecommunications are our largest underweights. In the former, we've moved on from early-cycle names that rallied sharply in 2009 and no longer offer compelling valuations, while at the same time we are not yet ready to fully embrace late-cycle companies given negative business improvement. In the latter, even though an improving employment environment will help Telecom companies, we believe the lack of cyclicality, peakish wireless margins, and increasing competition will continue to pressure the stocks.

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