



C A M B R I D G E A S S O C I A T E S L L C

GLOBAL MARKET COMMENTARY

STAY THE COURSE OR ABANDON SHIP?

October 2008

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Stay the Course or Abandon Ship?

*“When the Fed insists it has no choice but to print up hundreds of billions of new dollars and when the keepers of accounting standards bend in the face of criticism that market prices hurt, what they are really saying is [that the] financial truth is too awful to bear. Heaven help us all if they’re right.”—James Grant, “Bad Medicine,” *The Washington Post*, October 5, 2008.*

“Excessive credit expansion lies behind the current crisis, yet the authorities’ actions are directed at promoting more credit expansion! They want to remove some of the toxic waste from balance sheets so that banks will expand lending, and the Fed’s ultimate objective in lowering interest rates is to encourage consumers and companies to boost their borrowing. That is the ironic nature of the Debt Supercycle: the solution to each crisis is to force the system to take on more leverage, even though that may be what caused the problems in the first place. It is like taking more alcohol to try and dull the pain of a bad hangover.”—Martin Barnes, “Bailouts, Deleveraging and the Debt Supercycle: What’s Next?” BCA Research, October 6, 2008.

“U.S. stocks are now undervalued. I realize how unusual that might sound, given my persistent assertions during the past decade that stocks were strenuously overvalued (with a brief exception in 2003). Still, it is important to understand that a price decline of over 40% (and even more in some indices) completely changes the game.”—John Hussman, “Why Warren Buffett Is Right (and Why Nobody Cares),” October 20, 2008.

Since July 2007, global financial markets have been buffeted by two opposing forces: an ongoing implosion in the financial sector on one side, and government officials determined to do everything in their power to stem the crisis on the other. As a result, markets have seen dramatic moves both up and down, pulled lower by continued troubles in the financial sector (and, of late, rapidly deteriorating economic fundamentals, particularly outside the United States), but with occasional violent upward moves in response to myriad government interventions in markets and the economy. This has made navigating the investment environment next to impossible, as sound fundamental analysis has often been trumped, at least for the short term, by government actions that have led to enormous volatility.

Perhaps the two most notable examples of this were the vicious short-covering rallies induced by, first, the Securities and Exchange Commission’s announcement that it would enforce the existing ban on “naked shorting,” and second, its blanket order that actually made it temporarily *illegal* to short nearly 1,000 securities. Further, by picking winners (such as AIG) while allowing others to fail (e.g., Washington Mutual and Lehman Brothers), the government has had a huge impact on relative returns of managers that did or did not hold securities of the affected institutions. These frequent and unprecedented interventions, meanwhile, have yet to stem the growing panic in global financial markets, with virtually all risk assets down sharply in 2008, and the only safe havens government bonds and gold. The question now, of course, is to what extent price declines and government interventions have restored value to financial assets. Our conclusion is that more pain remains on the horizon, perhaps to a significant degree, but *also* that markets are finally beginning to move through the painful but necessary step of restoring value to asset prices.

A further positive to recent volatility is that it has created a wide array of bargain-priced assets, as selling has been largely indiscriminate. Jason Zweig, writing in the *The Wall Street Journal* October 11, quipped that “the stock market now abounds with so many bargains it’s hard to avoid stepping on them.” According to Zweig, about 10% of U.S. equities that day traded for less than their per-share holdings of cash, an even greater percentage than Benjamin Graham found when he famously surveyed the market at the depths of the Depression in July 1932. Some of this is likely due to firms hoarding more cash for working capital needs; still, it is indicative of the indiscriminate nature of much of the recent selling in equity markets. In other words, while overall market valuations are not yet cheap, the wreckage *within* markets has created opportunities for nimble investors with access to capital. Opportunities in credit markets—where there have been multiple avalanches of forced selling by investors forced to delever, managers raising cash for redemptions, or failed institutions—are likely even greater than those found in equity markets. (To cite just one glaring example, Fannie Mae debt, which is now *explicitly* guaranteed by the U.S. government, presently trades at wider spreads to U.S. Treasuries than it did before the company was effectively nationalized.)

Finally, a note on third quarter returns. We expect many investors will be shocked at the magnitude and widespread nature of losses. Indeed, returns are likely to be poor even for those who have taken our advice to be defensive, as the broad damage to financial markets, coupled with the extreme volatility and uncertainty introduced by the government actions discussed above, left few places to hide outside government bonds (Table A). October returns will change this picture considerably for the worse, at least as of this writing.

Where Are We Now?

We continue to believe we are in a secular bear market in which excessive optimism, expressed in terms of high earnings multiples, is worked out of the market (i.e., expectations are so grim that multiples sink to levels well below historical long-term averages). While the secular bear market began with the bursting of the tech bubble in 2000, the more fundamental cause of the bubble was a deluge of easy credit that fueled economic growth and boosted asset prices. Table B, for example, shows U.S. credit market debt as a percentage of GDP. This is critical to understanding the notion that recent growth was based *not* on an expansion of real resources or productivity, but rather on a substantial and sustained increase in debt used to finance consumer spending, financial assets, and houses. Table C, meanwhile, shows the effect of such a trend—each marginal dollar of debt has a decreasing impact on real economic growth as more and more of it goes to nonproductive activities (such as paying back existing debt).

Indeed, we have been talking for years about the fact that credit-driven booms are inherently unsustainable, and destined to end badly. Nevertheless, we have been surprised by the rapid deterioration of the global economy and financial markets. The violent moves in equity and credit markets, as well as government responses, have been unprecedented. Of course, some of these moves are a readjustment to dramatically lower expectations for global economic growth, which is part and parcel of the credit bubble that preceded the current crisis. Since much of the growth over the past ten years or so has been ephemeral (i.e., demand driven by loans that would never be paid back), it is tautological that such a period will necessarily be followed by a period of below-trend growth as bad debts are written off and individuals begin to rebuild savings. Still, it is worth noting the progress of the current bear market (dated from its 2000 peak) is quite

similar to that of prior secular bears in the United States (1929–42 and 1973–85) and Japan (1990–2002). While history never repeats, in this case a picture truly is worth a thousand words (Table D).

Historical secular bear markets have not ended until valuations have reached high single-digit or low double-digit levels on the basis of normalized (i.e., cyclically adjusted) earnings. The good news today is that the process of value restoration has finally begun. While this news is little consolation to those that have suffered major losses this year (i.e., the vast majority of investors), the bottom line is that financial asset prices have been out of touch with reality for several years, and the ongoing adjustment, while wrenching, is nevertheless a *necessary* condition to lay the groundwork for a *sustainable* economic expansion (i.e., one based on increases in productivity and real wealth, rather than increased debt used to fuel consumer spending and house purchases) in the future. Unfortunately, we are still at a relatively early stage of the economic and earnings recession, and investors should not expect a sustainable bull market to begin until valuations are at much lower levels *and* earnings show signs of improvement.

We expressed this viewpoint in a comprehensive piece produced in April, *Asset Allocation in the Current Environment: The Eye of the Storm*, and the following provides a summary of our updated views.¹

- Tables E–G show the increased strains on a variety of credit markets, an indication that even the massive government intervention seen to date has not yet been sufficient to “unfreeze” such markets, although recent actions to guarantee bank-to-bank lending and deposits, as well as government capital injections to large banks, have had a larger effect.
- Table H shows the gap between financial sector write-downs and capital raised. While it appears the formerly yawning gulf between the two has finally begun to narrow, there is a slight inconsistency in the data in that recent government investments in banks are reflected, while fourth-quarter write-downs (which have not yet been reported) are not. Thus, we expect banks will need to raise further sums.
- Tables I–N show a variety of earnings measures for global equity markets, adjusted either for average levels of return on equity or ten years’ worth of inflation-adjusted earnings. Put simply, these measures are intended to strip out the effects of the business cycle and give a better reading on underlying *sustainable* earnings. Multiples are not yet screamingly cheap, but they have come well off their highs. Global equity markets are now in the range we consider fair value, but there is a significant caveat to this reading of the data: We do not know how much global economic growth over the past decade or so was driven by debt expansion and should be expected to evaporate in an environment of debt deleveraging. Thus, it is possible these measures make equity markets look cheaper than they really are. For example, according to Bridgewater Associates, the U.S. savings rate has fallen by nearly 0.5% a year for the past 15 years, which has clearly been a huge boost to growth. The reversal of this trend (Bridgewater expects the rate to climb between 0.5% and 1% over the next year), while ultimately healthy for the economy, will cause demand to decline sharply in the near term, which will of course flow through to corporate profits.
- Along similar lines, Tables O–R show growth rates of various earnings measures and where earnings stand relative to their long-term trend, as well as the (in our view) profoundly unrealistic expectations

¹ Our most recent discussion of this topic was in our August 2008 Market Commentary *The Case Against Containment*.

analysts still espouse for 2009 profits. While fundamentals have deteriorated quite a bit in the U.S. market, with S&P 500 earnings per share falling 40% thus far (and now at their historical trend line), they have only just begun to roll over outside the United States. Further, to this point the earnings downturn has been largely confined to the financial sector, although this is clearly in the process of broadening as the credit crisis spills over to the “real” economy. As shown, earnings are highly cyclical and tend to move well below the trend line before recovering.

What to Do?

With the benefit of hindsight, cash was clearly the best place to be for the last year, and particularly the last several months. However, even as we were confident the 2003–07 rally would end badly, such information is not particularly useful without the proper timing. Indeed, we wrote about the perils of making such decisions 18 months ago.² At the time, we noted valuations were unusually high across asset classes, and investor risk appetite at unsustainably high (and potentially dangerous) levels; however, we concluded it still did not make sense to hold a large allocation to cash. While it is easy to second-guess this advice, the reality is that holding cash (or implementing a derivatives-based hedge) is far more complicated than it first appears. In short, in order for such market timing to work (i.e., for a cash-laden portfolio to achieve higher returns than those attained by the existing policy portfolio) investors must get *two* decisions correct—the initial decision to move to cash, and the subsequent decision of when to re-enter the market. A derivatives-based hedging program requires more decisions, and thus may be even more complicated to get “right.”

Looking forward, we would make a similar argument. While there is a natural temptation in times such as these to seek safety above all else, we do *not* believe investors would be best served by making drastic shifts in policy portfolios. We continue to recommend investors be as defensively positioned as possible, but that they do so *within the broad confines of the policy portfolio*. In other words, investors should maintain allocations to major asset classes such as equities and bonds, while making tactical shifts, if appropriate, to capture relative under/overvalued areas within such markets (e.g., high quality versus low quality). While it is certainly possible investors will look back five years from now and conclude a 100% commitment to cash would have been the best option, in our opinion the dangers of such a strategy (e.g., opportunity costs, inflation risk, etc.) outweigh the upside (i.e., safety). One way of thinking about this is that just about everyone has already gotten the first decision “wrong”—in other words, the time to sell equities and raise cash was October 2007—and thus a shift to cash at this point not only locks in losses-to-date, but also imposes enormous pressure to get the next decision (i.e., when to get back in) exactly right.

To illustrate this, Tables S and T show rolling five-year returns for hypothetical portfolios, which differ only in that one holds 20% cash and one does not (rebalanced annually). As you can see, it has only been in rare cases (such as during the Great Depression) that holding cash has been beneficial to portfolio returns over a five-year period. Further, even when such an approach has worked, it has been critical to get the timing right, as the cash portfolio has typically suffered dramatic *under*performance once the crisis has passed.

² Please see our May 2007 Market Commentary *Why Not Hold Cash?*

Conclusion

The bottom line is that the credit crisis is extremely severe, and it is not yet clear when or how things will be resolved, although it seems inevitable more government action will be involved. The good news, if you can call it that, is that market pricing, particularly for equities, has finally begun to reflect the true state of the real economy, and thus our expectations for future returns have improved. In sum, we recognize and appreciate the severity of the credit crisis, and believe a good deal of additional pain lies ahead. However, we do not believe investors should respond by panicking, scrapping their policy portfolio, and hunkering down in cash (with the obvious exception of those with short-term spending and/or capital call needs).

More specifically, our advice is that investors should first make sure they have adequate liquidity to meet near-term needs as discussed in our recent research report *Liquidity Considerations in Today's Environment*. The severity of the recent market decline has dramatically decreased liquidity for many types of investments, creating challenges for investors, particularly those with large alternative assets portfolios and inflexible spending needs. Such investors may find they lack sufficient cash resources to sustain spending and meet capital calls, forcing them to sell assets at distressed prices. Investors in this situation should evaluate their liquidity needs and take appropriate action in this difficult environment.

Following this, investors should look to move money from areas that have appreciated/outperformed to those that have fallen, particularly where valuations have become most attractive. For most investors this will mean taking bonds and hedge funds back down to policy (which will of course take time), and using the funds to replenish equities, particularly those with the most attractive valuations (emerging markets, for example). We also continue to believe investors would do well to have on hand some dry powder for subsequent deployment into the many attractive opportunities we expect to emerge from the turmoil of the bear market. Investors should begin to think about when and how they plan to move capital into higher-risk areas as these become more attractively priced. Distressed assets, for example, got dramatically cheaper during the early October sell-off, but remain extremely volatile. Given these openings, it may make sense to begin scaling slowly into positions, but only with very experienced managers. Prices could certainly get even cheaper before ultimately recovering, though in some cases the risk-reward balance now appears skewed to the upside.

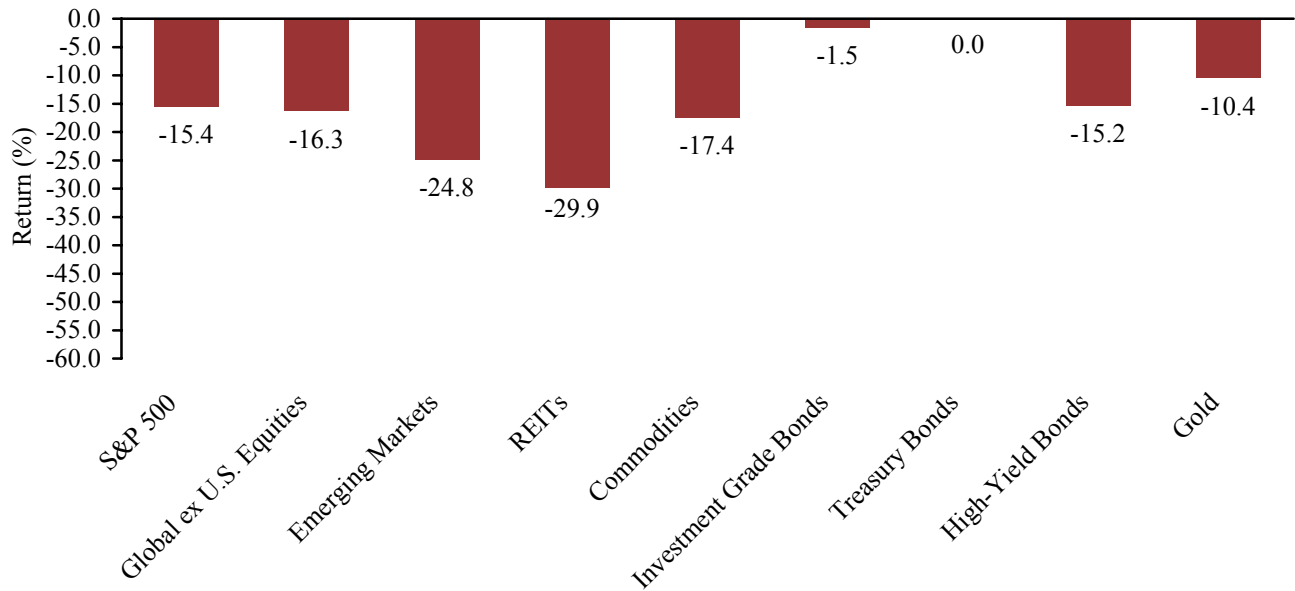
The bottom line is that the world has changed dramatically in recent weeks. That said, there are fundamental reasons to believe equity-centric portfolios will outperform bond or cash-heavy portfolios over the long term (with the critical proviso that prices are in reasonable balance with underlying fundamentals). Indeed, this is not mere theory, but *must* be the case if capitalism is to work—otherwise no sane individual would invest in equities. Thus, while it is only natural for investors to crave safety after such intense market volatility, we are specifically *not* advocating such a shift. Instead, we believe the best course of action is to stick to long-term policy weights—remaining defensive within these weights for now—and to continue a strategy of frequent rebalancing in order to build liquidity reserves if necessary, maintain desired broad policy exposures, and benefit from short- to medium-term swings in asset prices.

Table A

RETURNS FOR SELECTED INDICES

U.S. Dollar (\$)

Month-to-Date Returns
October 1, 2008 – October 20, 2008



Third Quarter Returns
July 1, 2008 – September 30, 2008

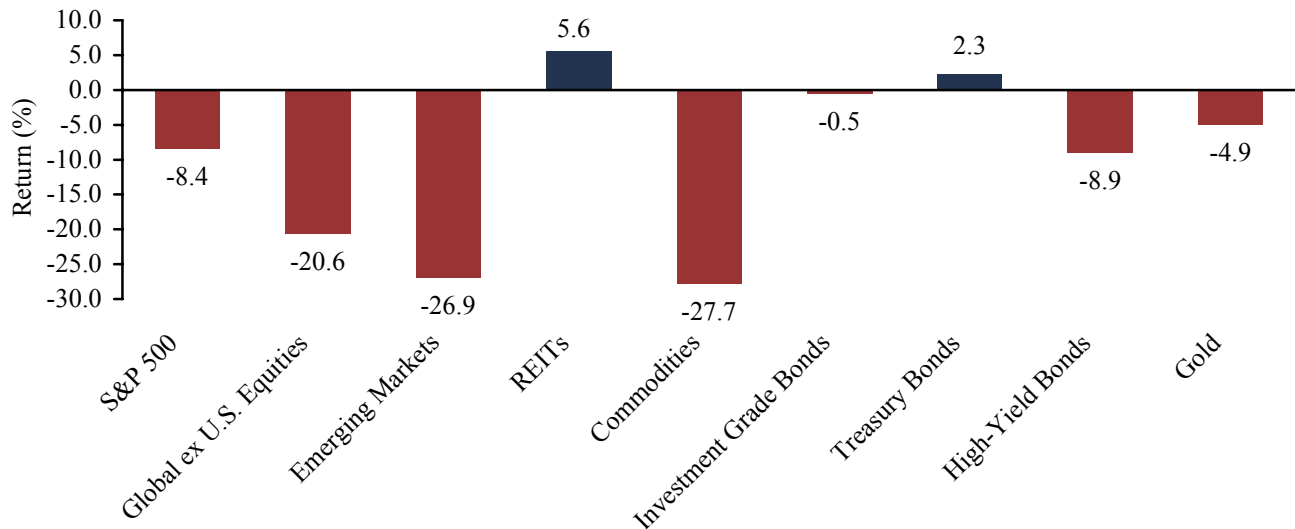
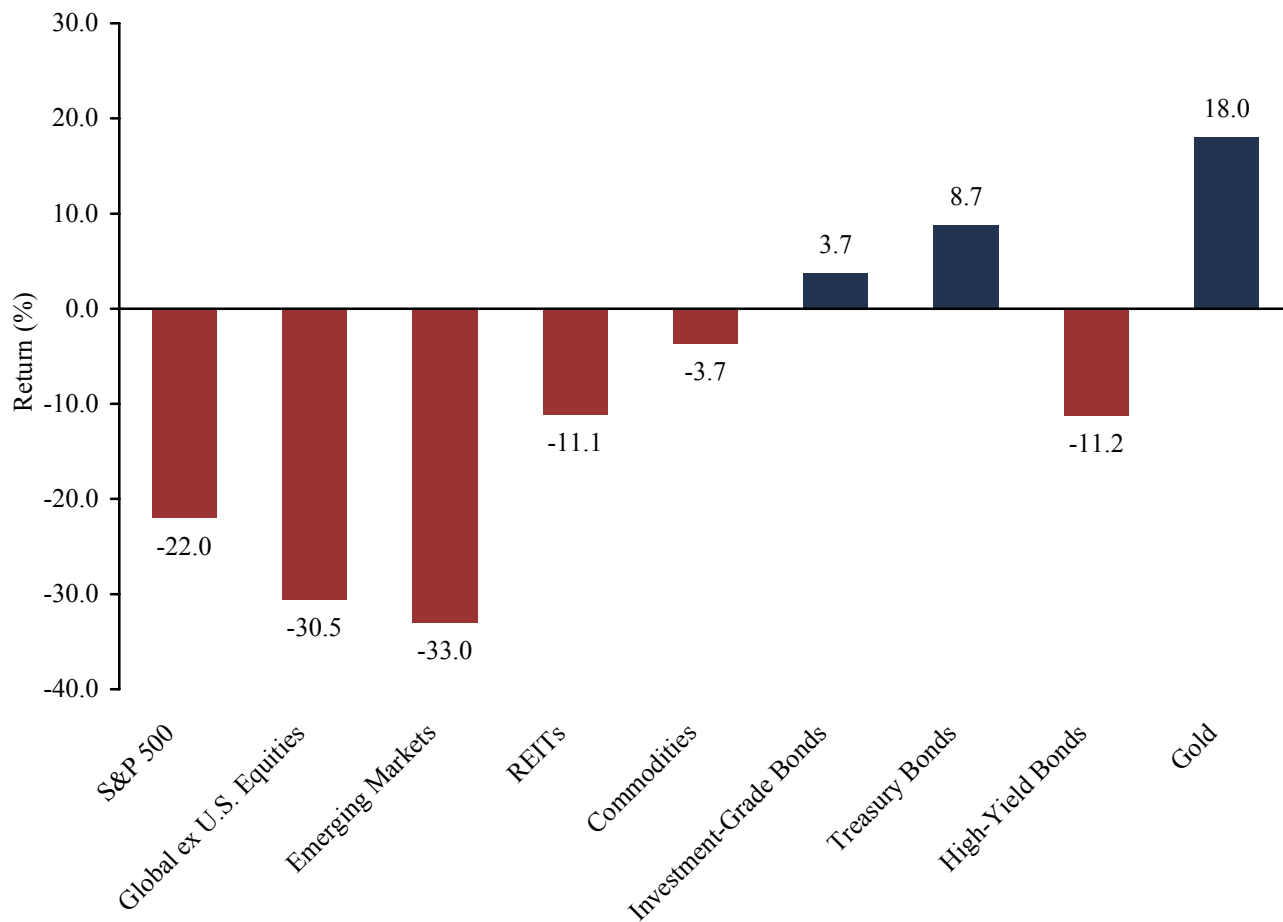


Table A (continued)

RETURNS FOR SELECTED INDICES

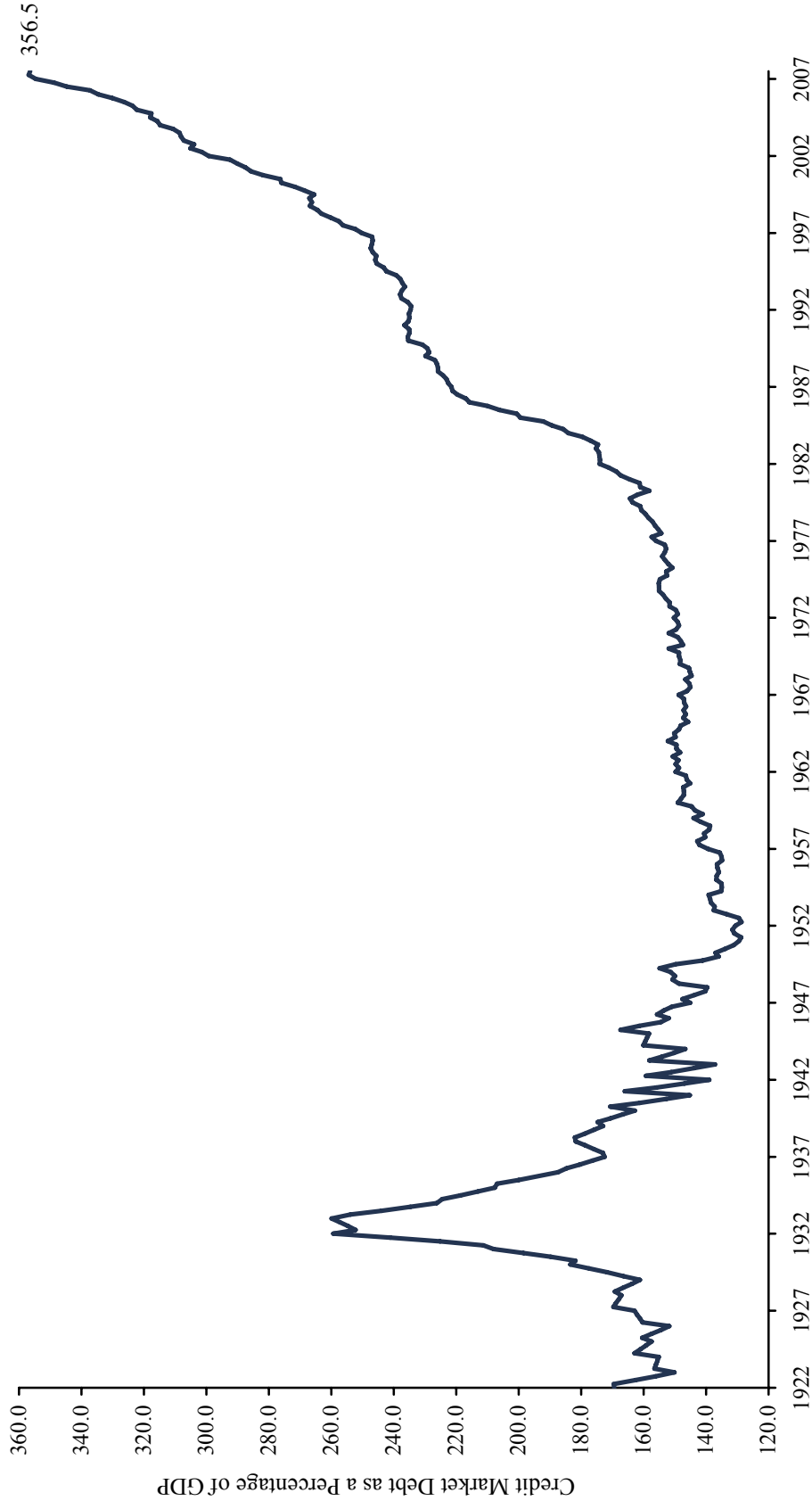
U.S. Dollar (\$)

Trailing 12-Month Returns
October 1, 2007 – September 30, 2008

Sources: Dow Jones & Company, Inc., FTSE International Limited, Lehman Brothers, Inc., MSCI Inc., National Association of Real Estate Investment Trusts, Standard & Poor's, and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Global ex U.S. Equities represents the performance of the MSCI EAFE Index. Emerging Markets represents the performance of the MSCI Emerging Markets Index. REITs represents the performance of the FTSE NAREIT Equity Index. Commodities represents the performance of the Dow Jones-AIG Commodity Total Return Index. Investment-Grade Bonds represents the performance of the Lehman Brothers Aggregate Bond Index. Treasury Bonds represents the performance of the Lehman Brothers U.S. Treasury Bond Index. High-Yield Bonds represents the performance of the Lehman Brothers High-Yield Composite Bond Index. Gold data are price return only. Total returns for MSCI developed markets indices are net of dividend taxes. Total returns for MSCI Emerging Markets indices are gross of dividend taxes.

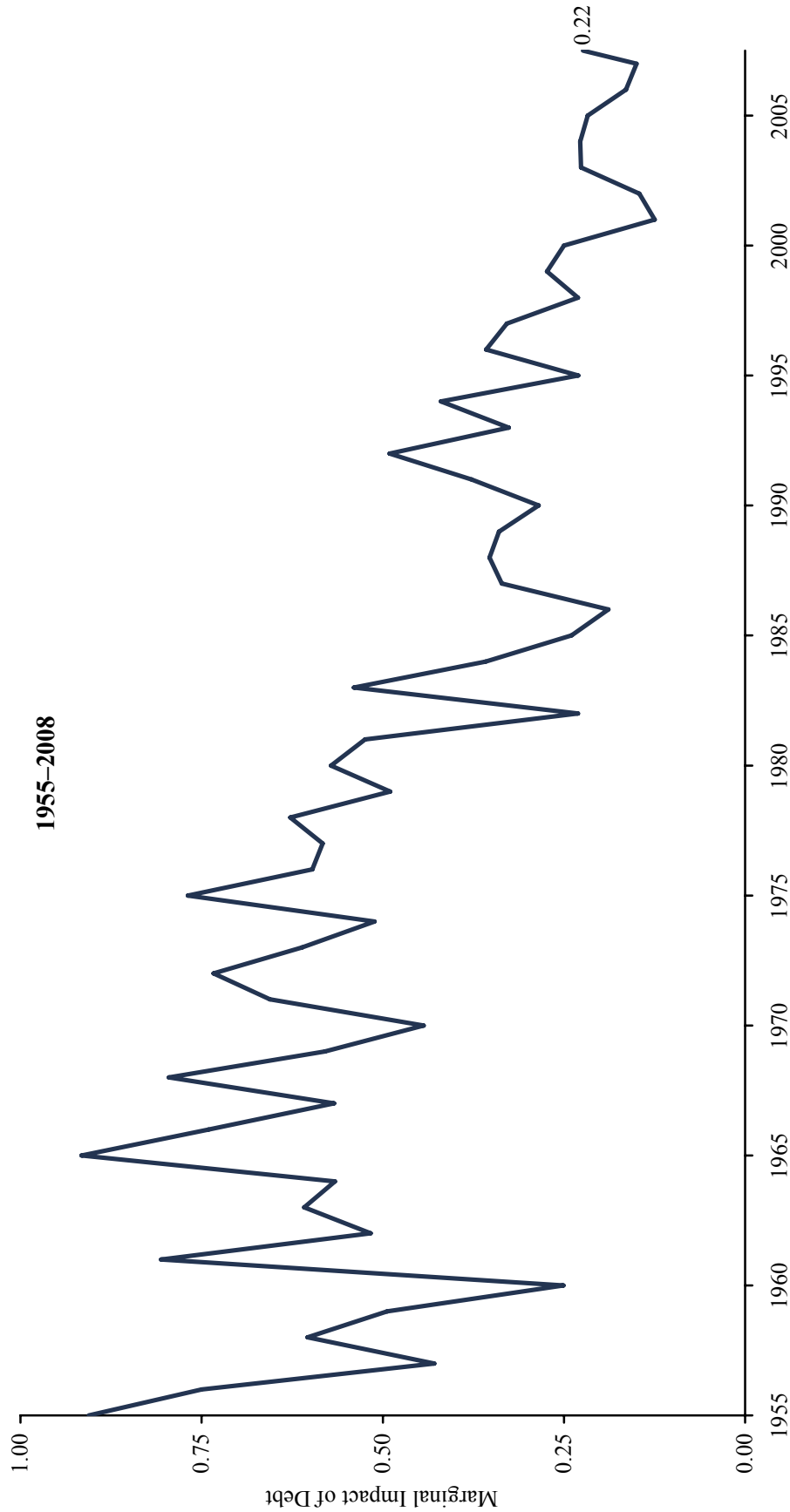
Table B
CREDIT MARKET DEBT AS A PERCENTAGE OF NOMINAL GDP
December 31, 1922 – June 30, 2008



Source: Ned Davis Research, Inc.

Note: Graph represents quarterly data.

Table C
THE DIMINISHING IMPACT OF CREDIT ON THE U.S. ECONOMY
1955-2008



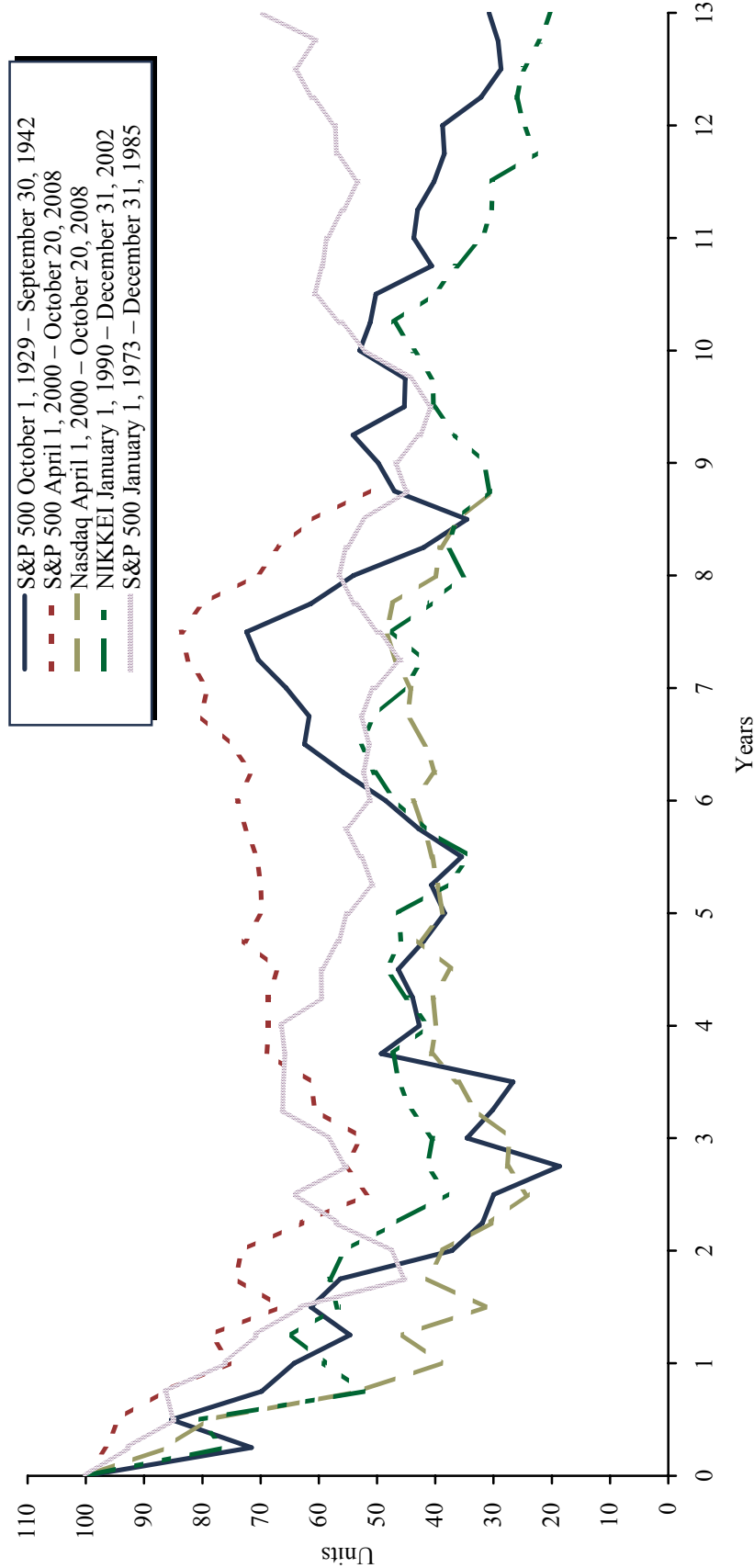
Sources: Global Financial Data, Inc. and Ned Davis Research, Inc.

Notes: Data for 2008 are as of June 30. The marginal impact of debt is measured as the year-over-year dollar change in U.S. nominal GDP divided by the dollar change in total credit market debt. In 2007, for example, \$4,414 billion in new debt was accompanied by only a \$661 billion increase in nominal GDP, implying that every \$1 of additional debt resulted in \$0.15 of growth.

Table D

CUMULATIVE WEALTH DURING VARIOUS BEAR MARKETS FOR THE S&P 500, NASDAQ AND NIKKEI INDICES

In Real Terms
(Base Value = 100)



Sources: Global Financial Data, Inc., Standard & Poor's, Thomson Datastream, and *The Wall Street Journal*.

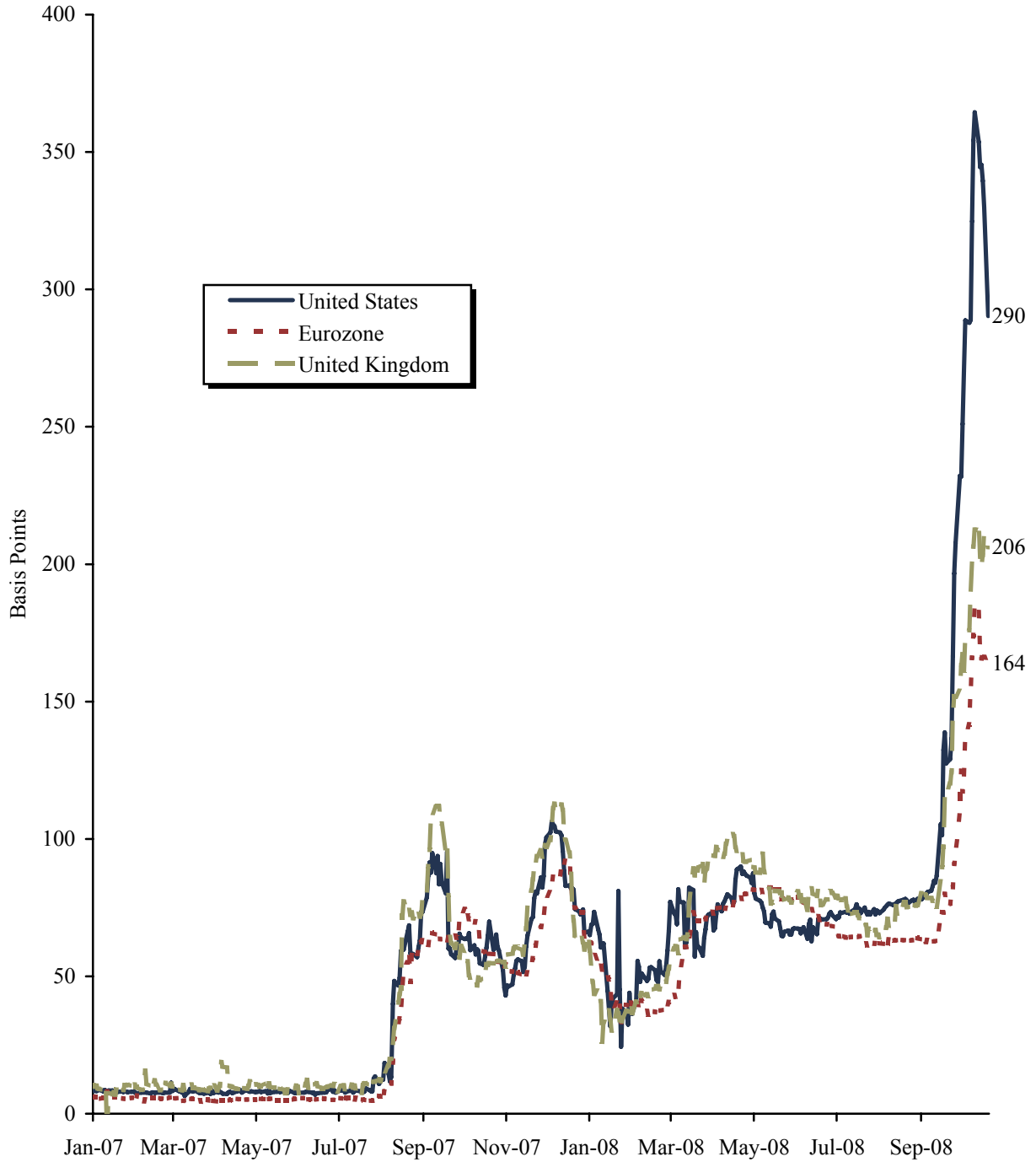
Notes: All units are in local currency unless otherwise noted. Cumulative wealth calculations use CPI-U data through September 30, 2008.

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Table E

SPREAD OF LIBOR TO OVERNIGHT INDEX SWAPS

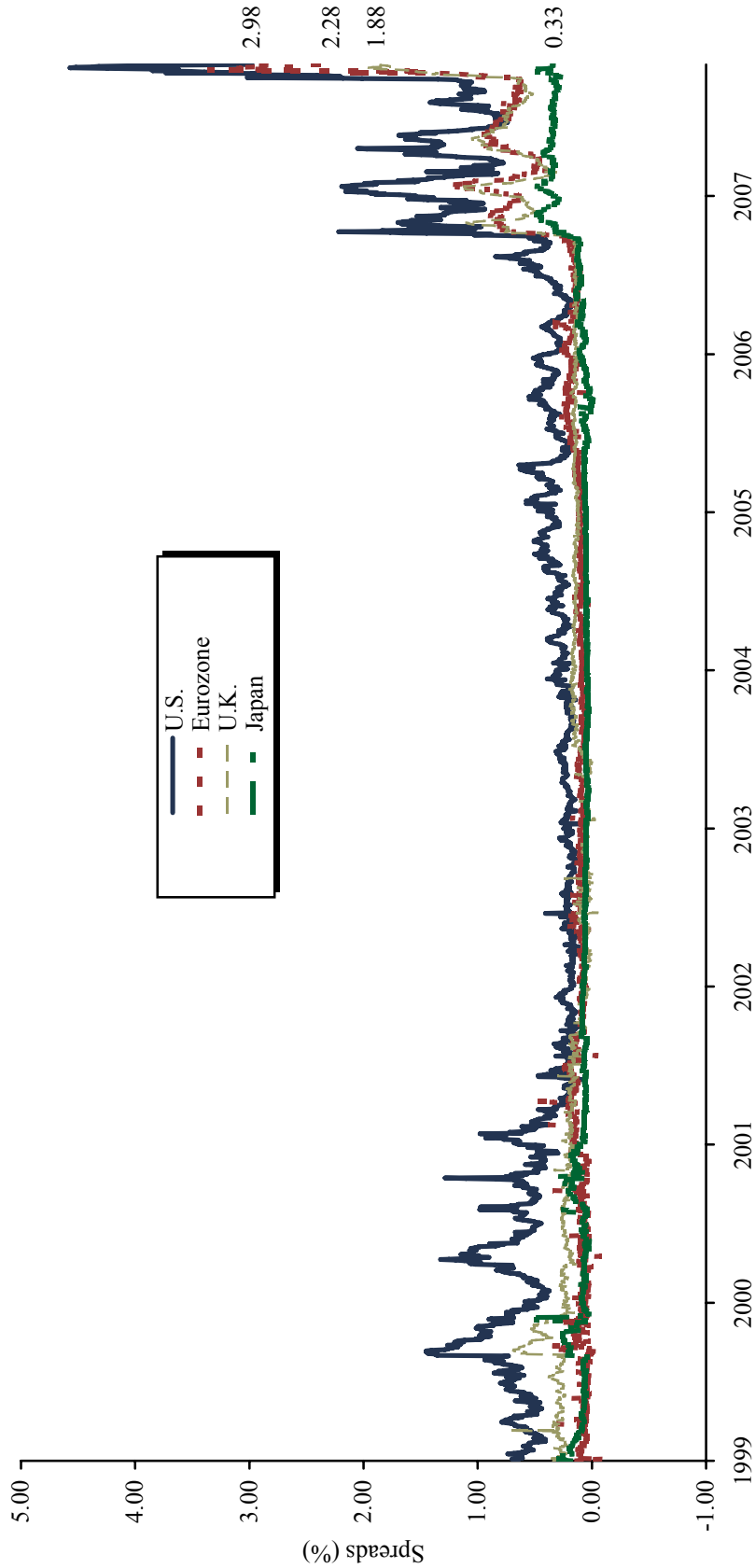
January 1, 2007 – October 20, 2008



Sources: Bloomberg L.P. and Thomson Datastream.

Table F
TED SPREADS

January 4, 1999 – October 20, 2008

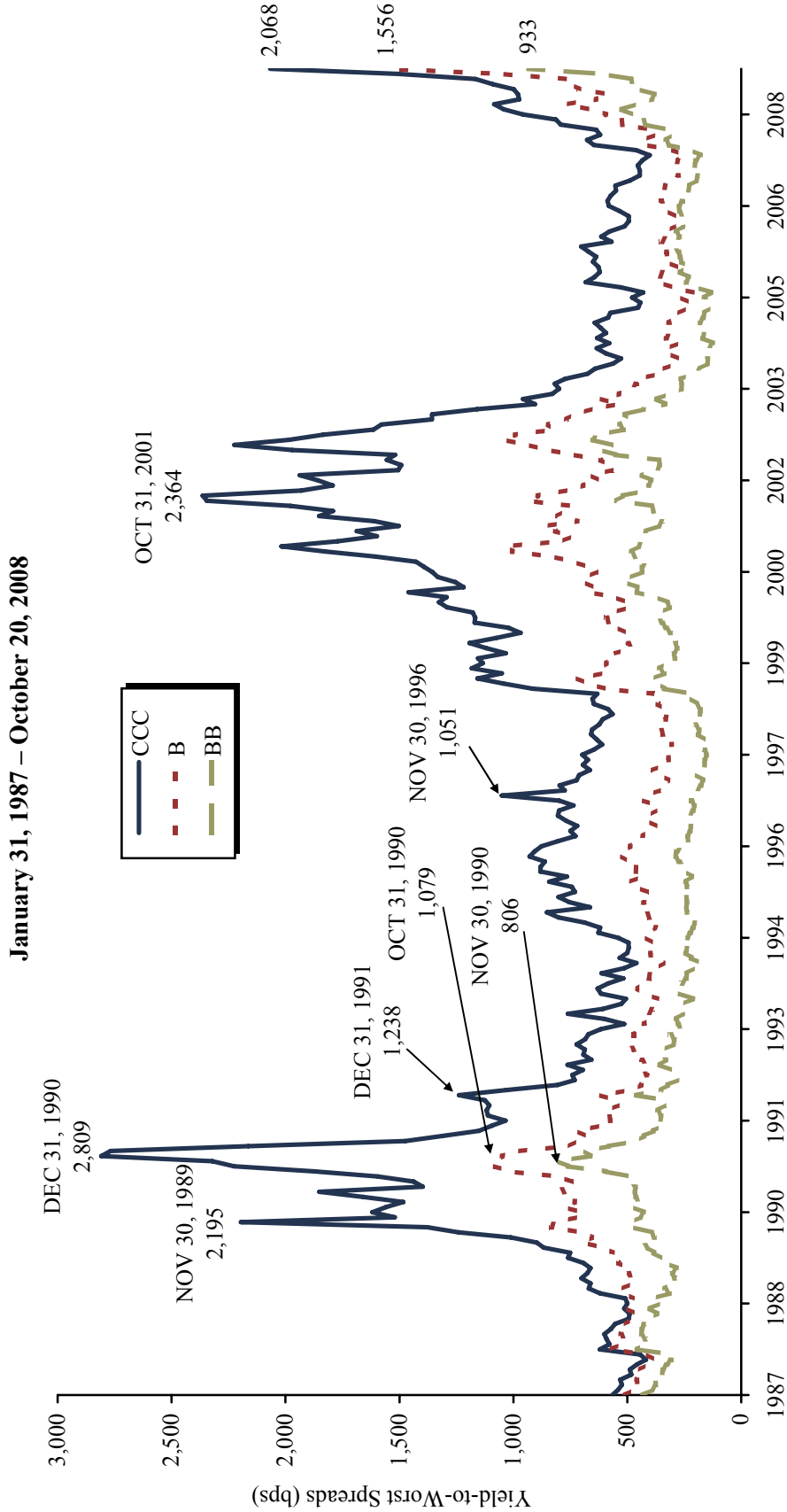


Sources: FactSet Research Systems and Thomson Datastream.

Note: TED spreads are calculated by subtracting the three-month LIBOR and three-month Treasury bill in local currency for each region.

Table G

YIELD SPREADS FOR SELECTED HIGH-YIELD BOND RATING CATEGORIES RELATIVE TO TEN-YEAR TREASURIES

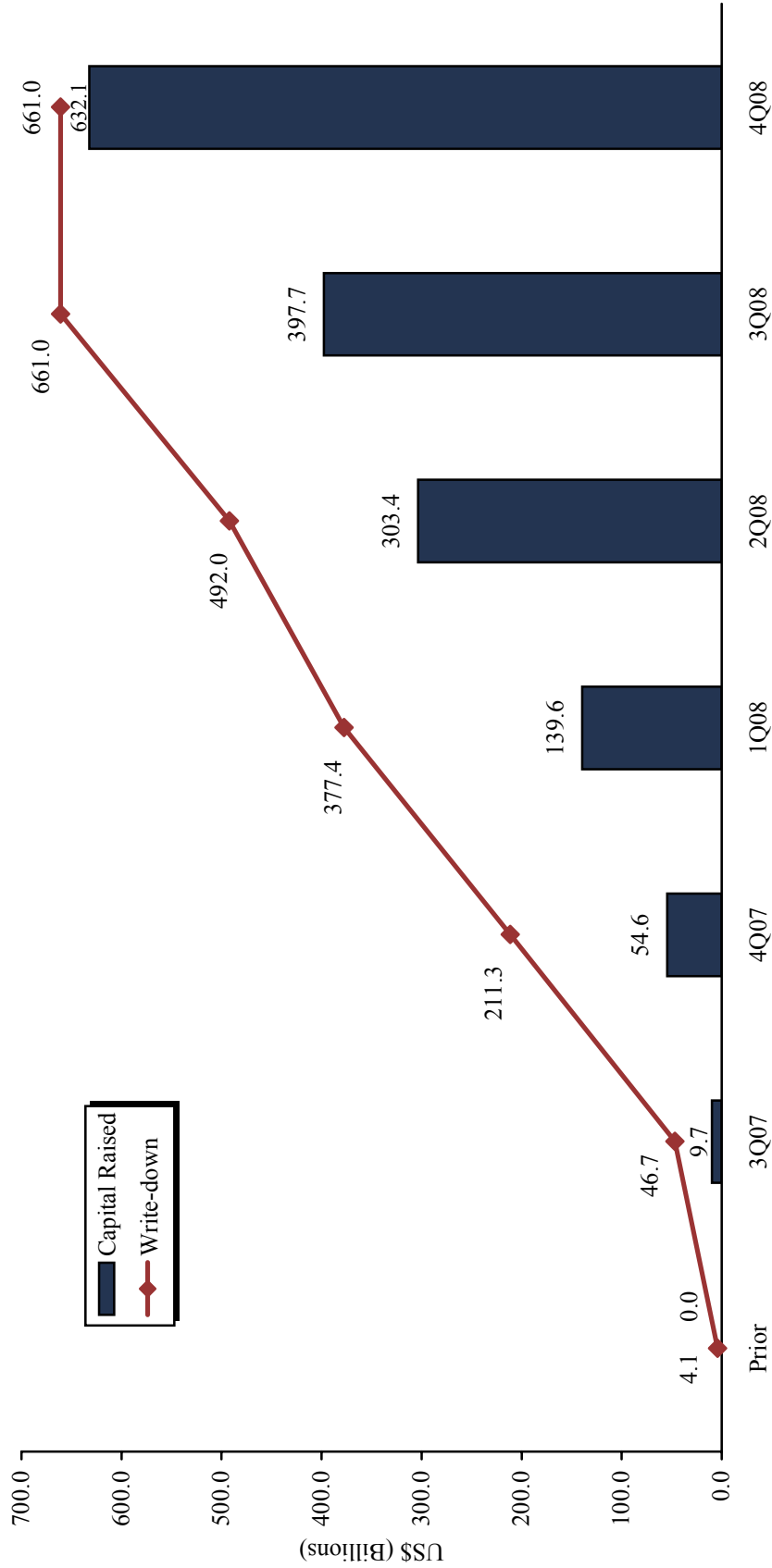


Sources: Lehman Brothers, Inc. and Thomson Datastream.

Notes: Yield spreads are based on the difference between the weighted-average yield-to-worst (the lower of yield-to-maturity and yield-to-call) for each high-yield rating category and the yield-to-maturity for ten-year Treasury securities. Quality ratings are shown in the equivalent S&P rating category.

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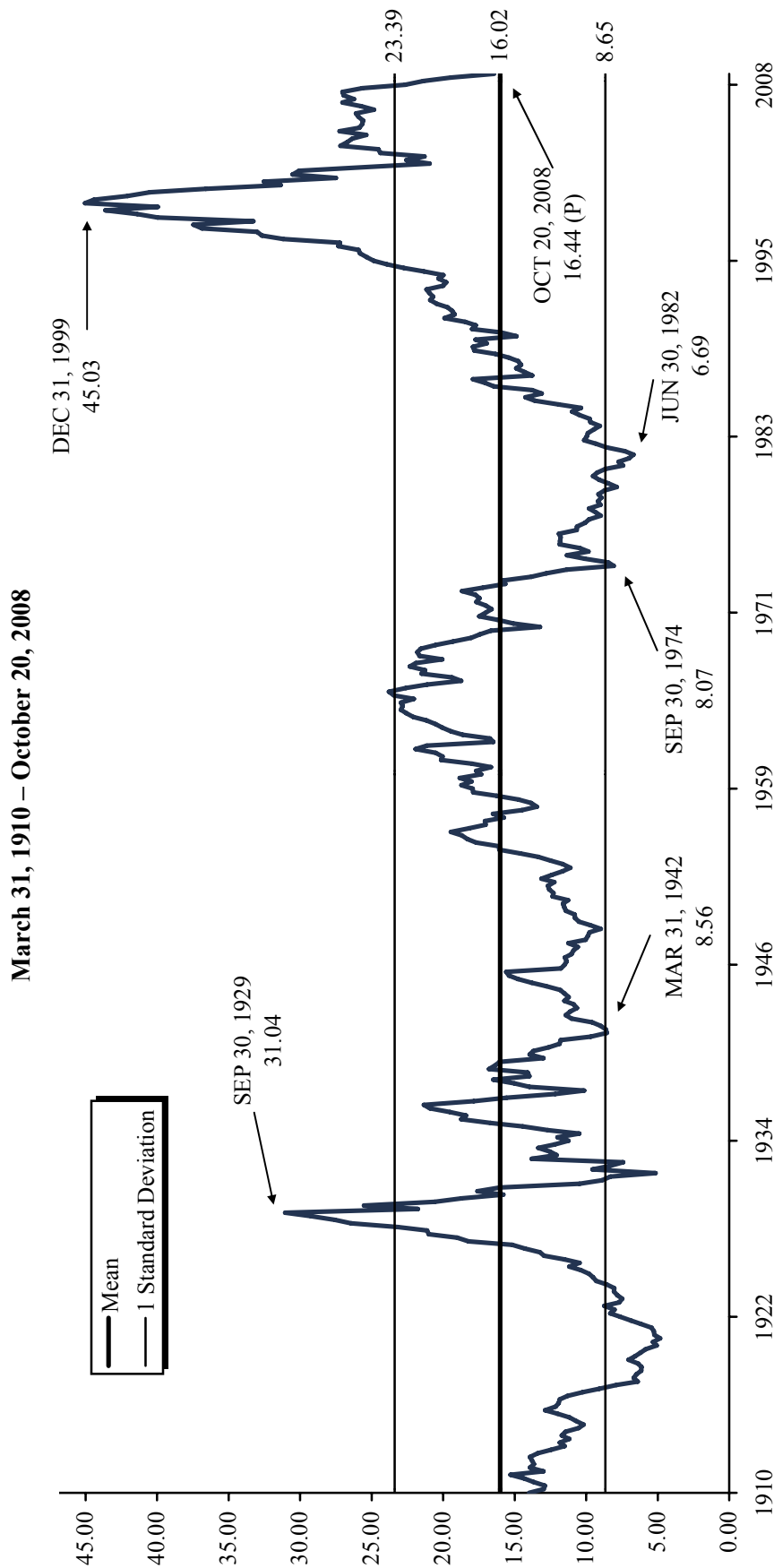
Table H
CUMULATIVE WRITE-DOWNS AND CAPITAL RAISED BY GLOBAL FINANCIAL INSTITUTIONS
Third Quarter 2007 – Fourth Quarter 2008



Source: Bloomberg L.P.

Notes: Graph shows cumulative write-downs and capital raisings by financial institutions based on quarterly filings compiled and reported by Bloomberg. Data for write-downs are as of third quarter 2008. Data for capital raised are as reported by Bloomberg on October 20, 2008.

Table I
S&P 500 NORMALIZED REAL PRICE-EARNINGS RATIOS SINCE 1910



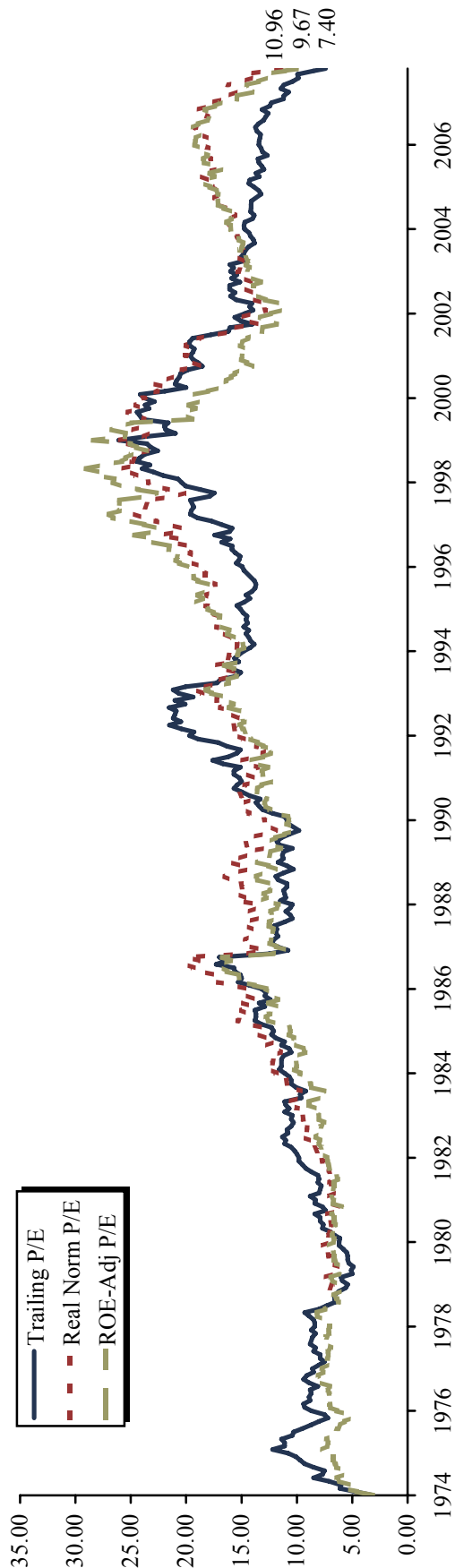
Sources: Calculated from data provided by Standard & Poor's, Standard & Poor's Compustat, U.S. Department of Labor - Bureau of Labor Statistics, and *The Wall Street Journal*.

Notes: (P) Preliminary. Normalized real price-earnings (P/E) ratios for the S&P 500 are calculated by dividing the current index value by the annualized average real earnings for the trailing ten years. CPI-U data are through September 30, 2008. Graph represents quarterly data. Real P/E ratios for October 20, 2008, are calculated by holding September 30, 2008, preliminary earnings constant.

Table J
PRICE-EARNINGS RATIOS USING VARIOUS EARNINGS DEFINITIONS

MSCI United Kingdom

December 31, 1974 – October 20, 2008



P/E Ratios – By Types of Earnings

	Trailing 12 Months		Trailing 10 Years	
	Reported	Real Normalized	Real Normalized	ROE-Adjusted
October 20, 2008	7.40	10.96	10.96	9.67
Common Period Mean	14.19	15.52	15.52	14.56
Std Dev Above/Below Mean	-1.54	-0.97	-0.97	-0.93

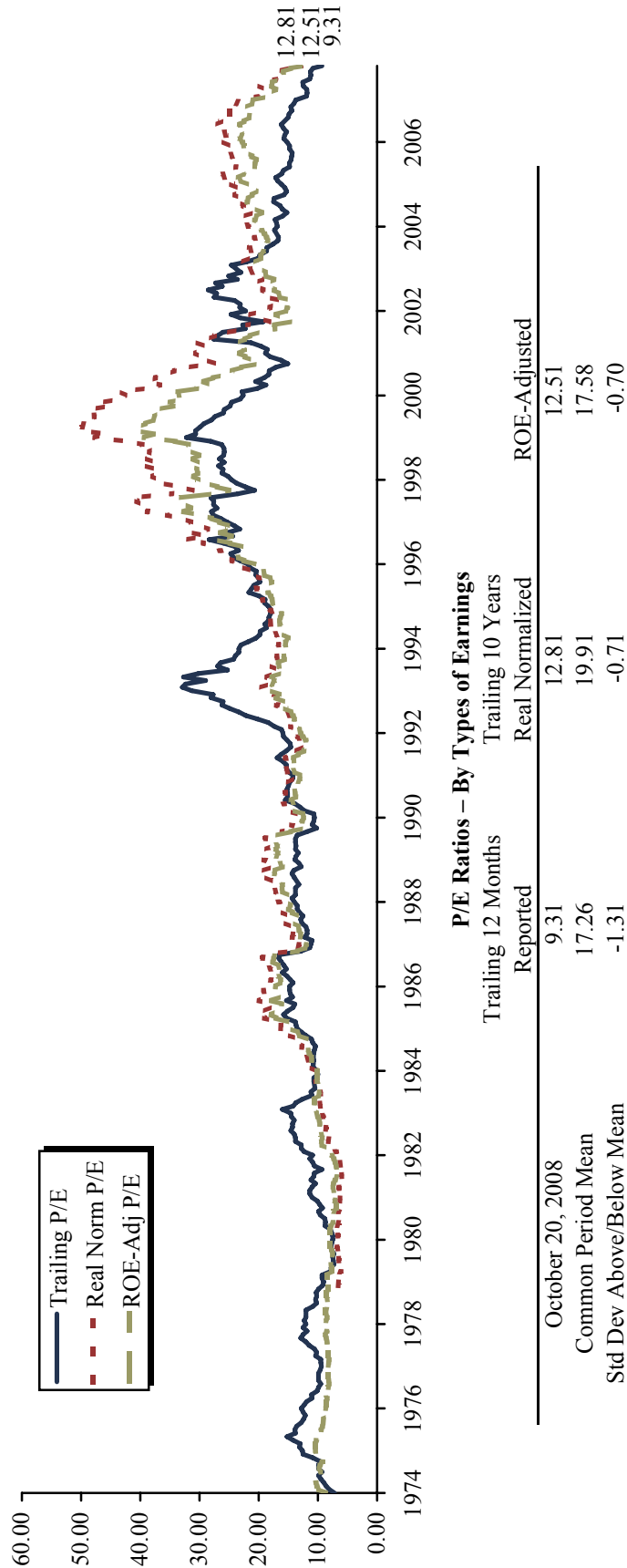
Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Normalized real price-earnings (P/E) ratios are calculated by dividing the current real index value by the annualized average real earnings for the trailing ten years. U.K. inflation data represents the Retail Price Index from 1974 through November 2003 and the U.K. CPI from December 2003 onward. Inflation data are through September 30, 2008. Return on equity (ROE) is calculated by dividing the index's price-to-book ratio by its P/E ratio. The ROE-adjusted P/E ratio is the current P/E based on trailing 12-month earnings multiplied by the ratio of the current ROE to its post-1974 average. Common period represents data from November 1979 onward. Data for October 20, 2008, use current price and earnings and book value for September 30, 2008.

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Table K
PRICE-EARNINGS RATIOS USING VARIOUS EARNINGS DEFINITIONS
MSCI Europe ex U.K.

December 31, 1974 – October 20, 2008

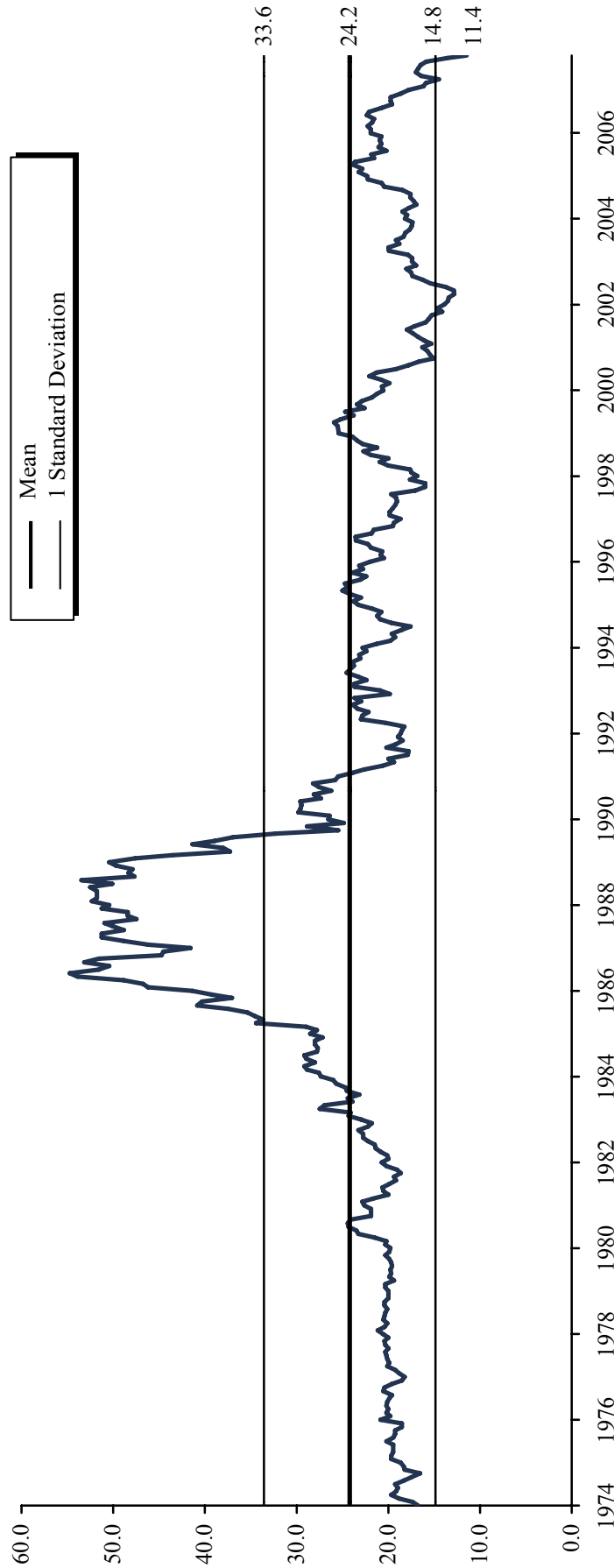


Sources: Global Financial Data, Inc., MSCI Inc., and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Normalized real price-earnings (P/E) ratios are calculated by dividing the current real index value by the annualized average real earnings for the trailing ten years. Inflation data are through September 30, 2008. Return on equity (ROE) is calculated by dividing the index's price-to-book ratio by its P/E ratio. The ROE-adjusted P/E ratio is the current P/E based on trailing 12-month earnings multiplied by the ratio of the current ROE to its post-1974 average. Common period represents data from November 30, 1979, onward. Data for October 20, 2008, use current P/E's and book value for September 30, 2008.

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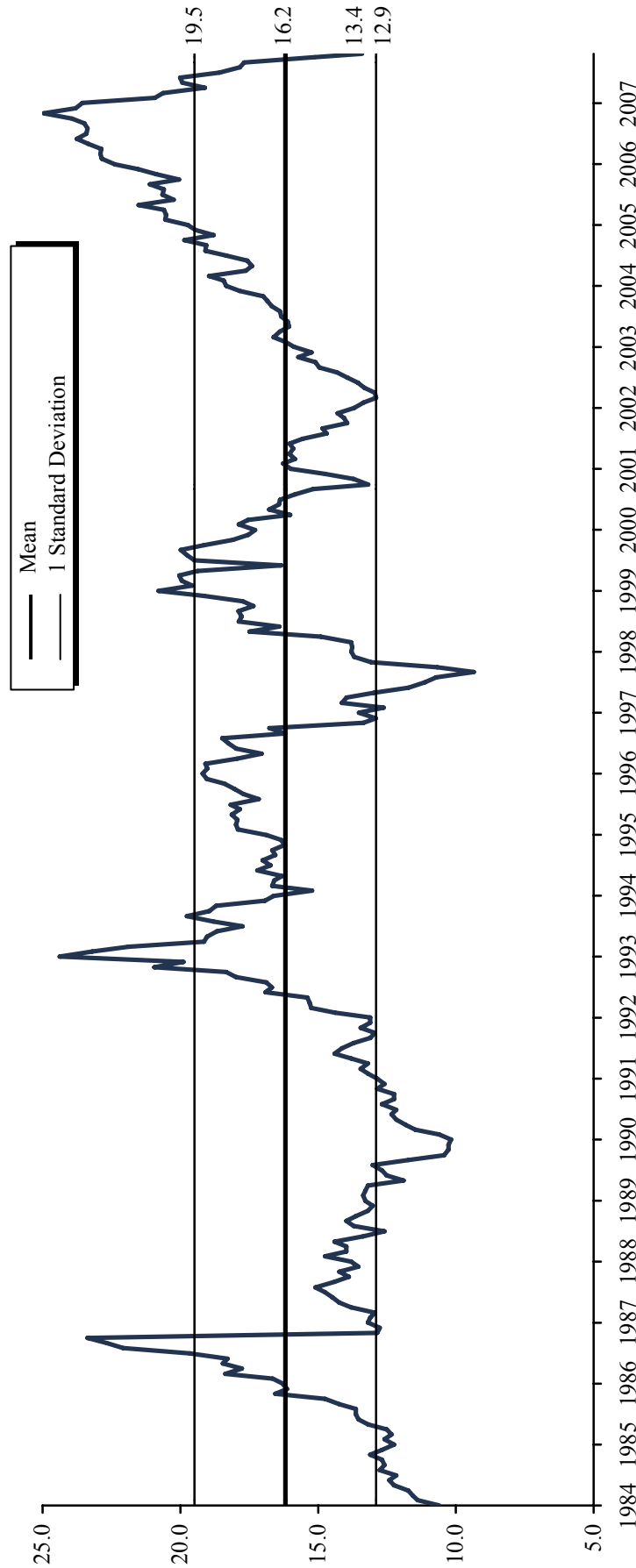
Table L
MSCI JAPAN: RETURN ON EQUITY-ADJUSTED P/E RATIO
December 31, 1974 – October 20, 2008



Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Return on equity (ROE) is calculated by dividing the index's price-to-book ratio by its price-earnings (P/E) ratio. The ROE-adjusted P/E ratio multiplies the current trailing P/E multiple by the ratio of current ROE to historical ROE average. The long-term historical average ROE for Japan was calculated from December 31, 1974 to December 31, 1991.

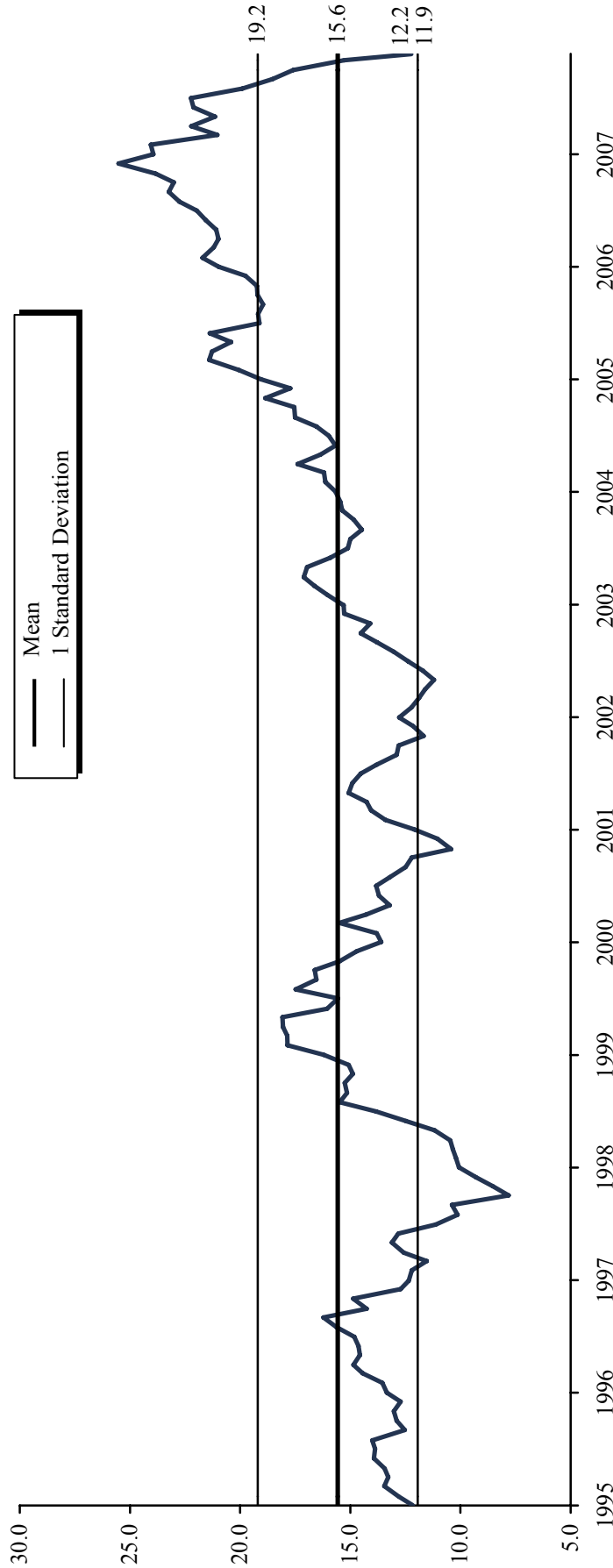
Table M
MSCI PACIFIC EX JAPAN: RETURN ON EQUITY-ADJUSTED P/E RATIO
December 31, 1984 – October 20, 2008



Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Return on equity (ROE) is calculated by dividing the index's price-to-book ratio by its price-earnings (P/E) ratio. The ROE-adjusted P/E ratio multiplies the current trailing P/E multiple by the ratio of current ROE to historical ROE average for MSCI Pacific ex Japan.

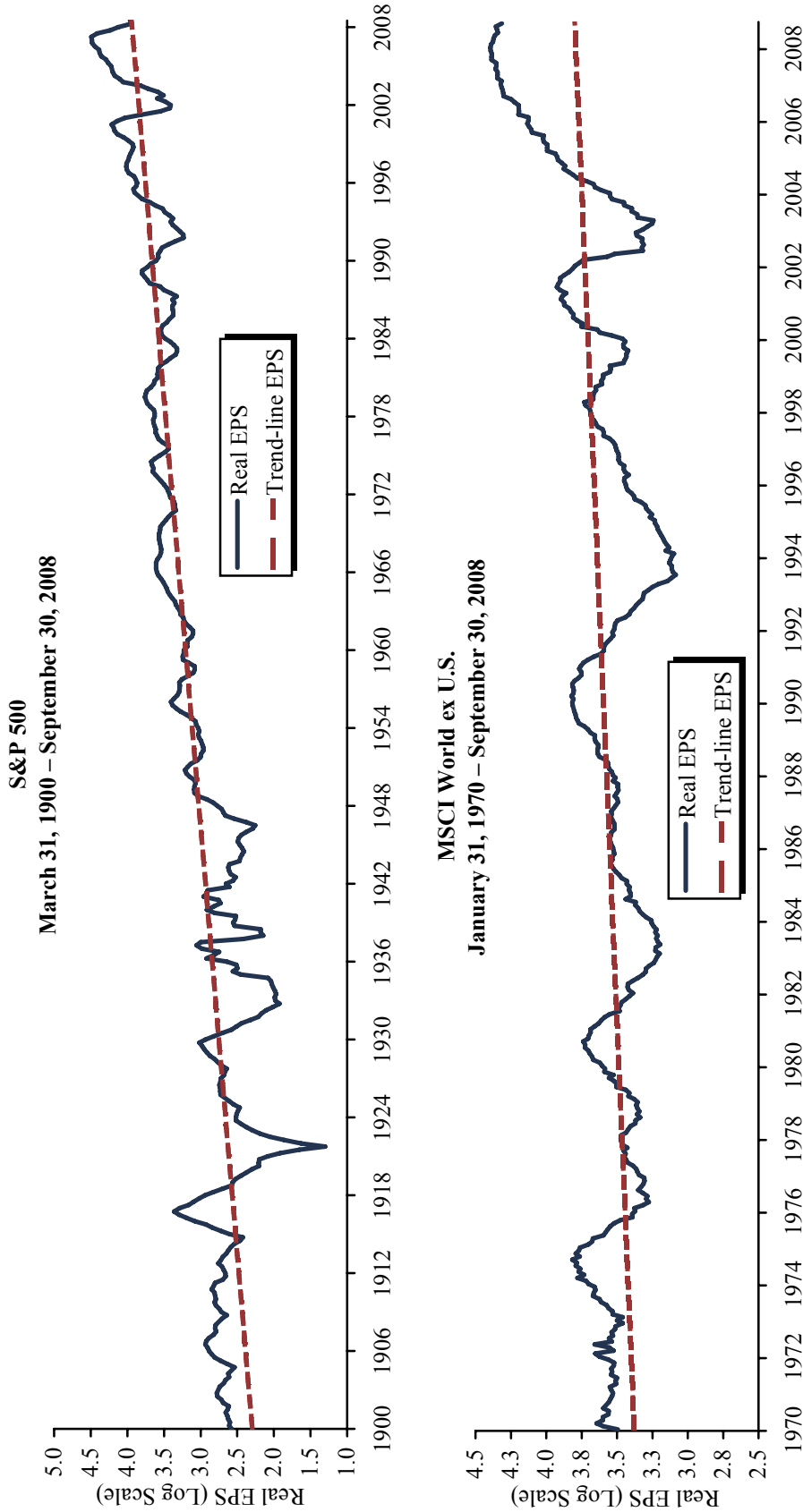
Table N
MSCI EMERGING MARKETS: RETURN ON EQUITY-ADJUSTED P/E RATIO
November 30, 1995 – October 20, 2008



Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Return on equity (ROE) is calculated by dividing the index's price-to-book ratio by its price-earnings (P/E) ratio. The ROE-adjusted P/E ratio multiplies the current trailing P/E multiple by the ratio of current ROE to historical ROE average for MSCI Emerging Markets.

Table O
REAL EARNINGS OF S&P 500 AND MSCI WORLD EX U.S.

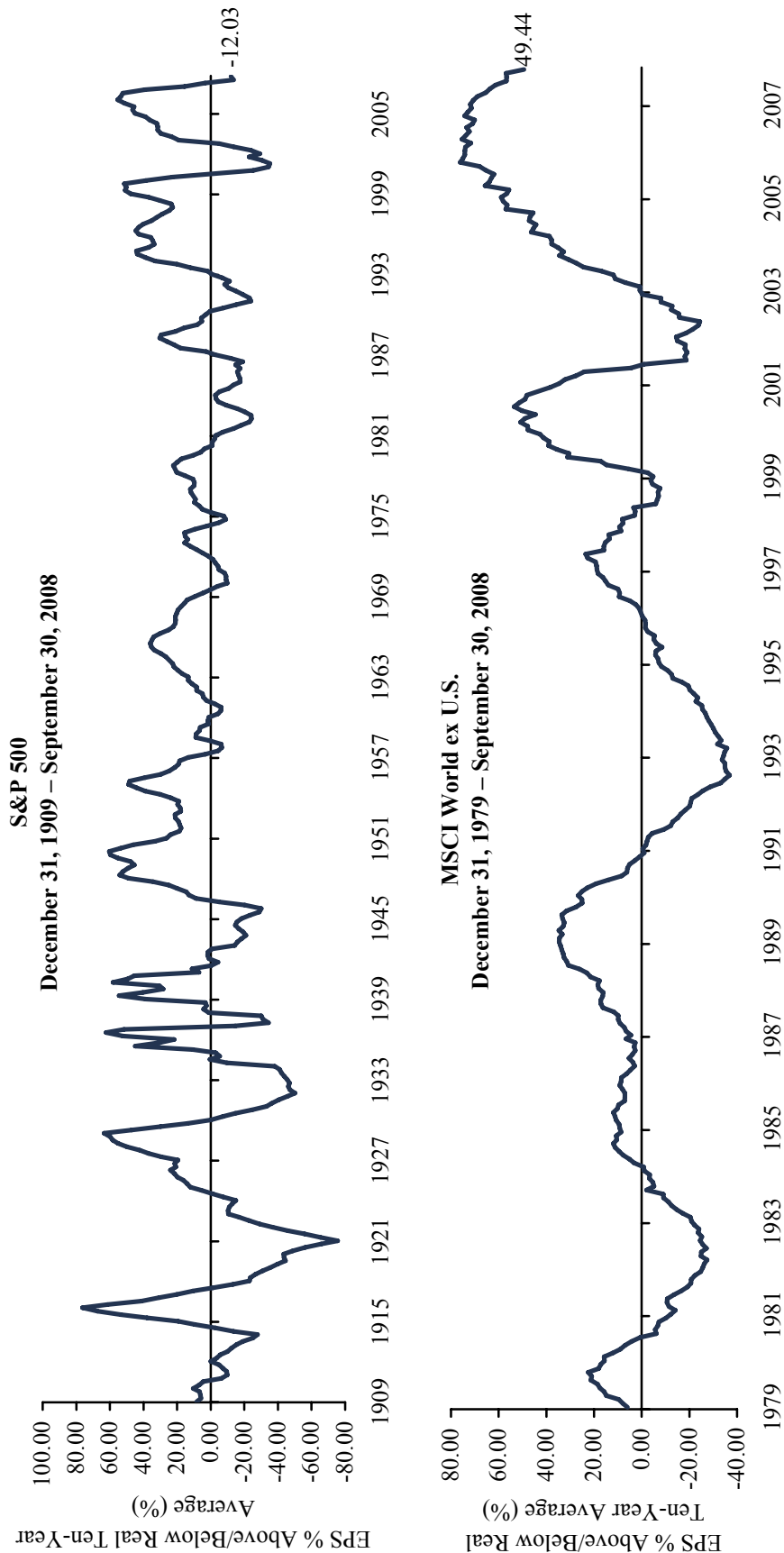


Sources: MSCI Inc., Standard & Poor's, and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: S&P 500 earnings per share (EPS) deflated by CPI-U, based on September 30, 2008, level. MSCI World ex U.S. EPS deflated by G7-CPI, based on August 31, 2008, level. Trend-line earnings based upon simple linear regression.

Table P

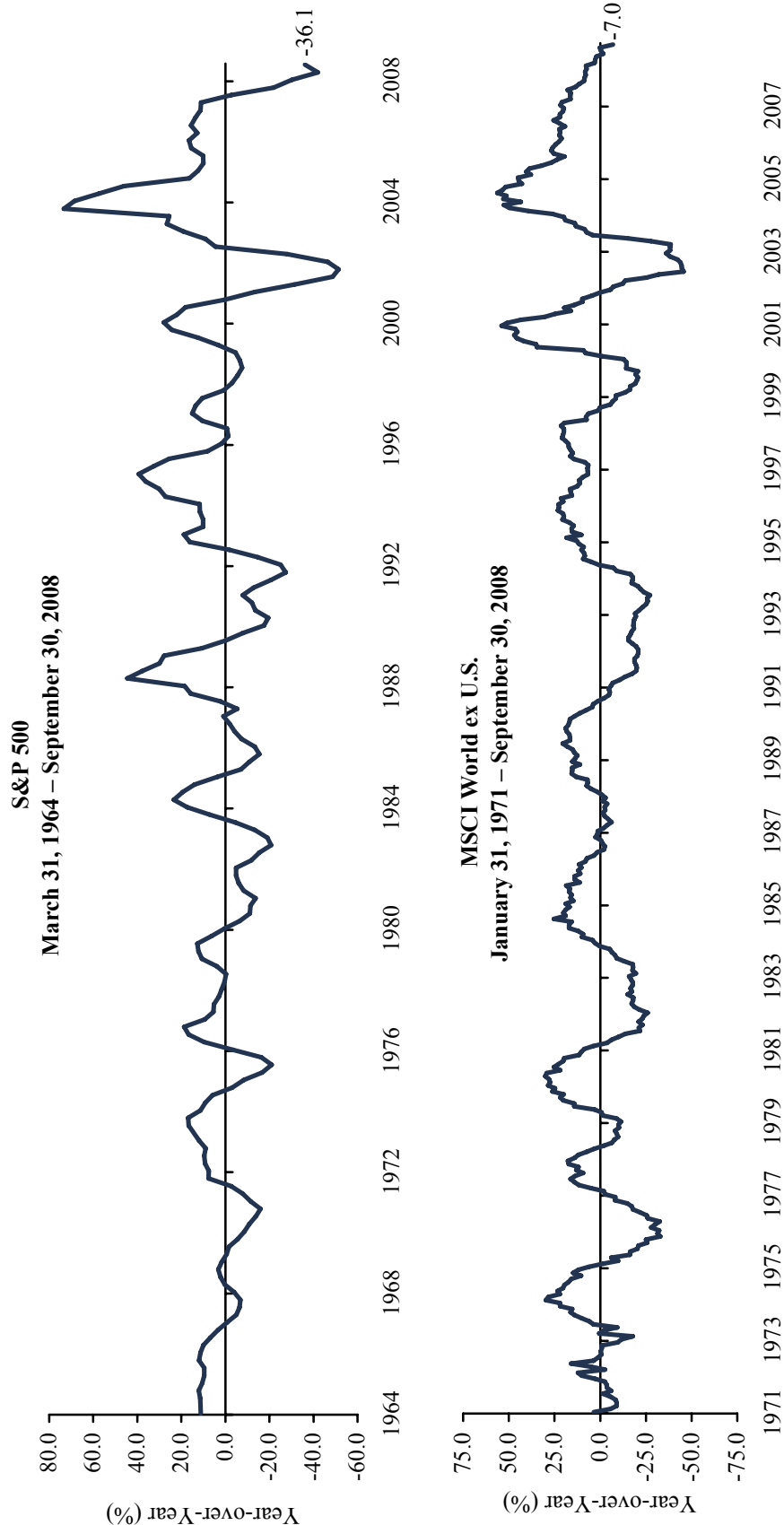
REAL EARNINGS PER SHARE PERCENT ABOVE/BELOW NORMALIZED TEN-YEAR AVERAGE LEVEL



Sources: MSCI Inc., Standard & Poor's, and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: S&P 500 earnings per share (EPS) deflated by CPI-U, based on September 30, 2008, level. MSCI World ex U.S. EPS deflated by G7-CPI, based on August 31, 2008, level.

Table Q
REAL ANNUAL EARNINGS PER SHARE GROWTH OF S&P 500 AND MSCI WORLD EX U.S.

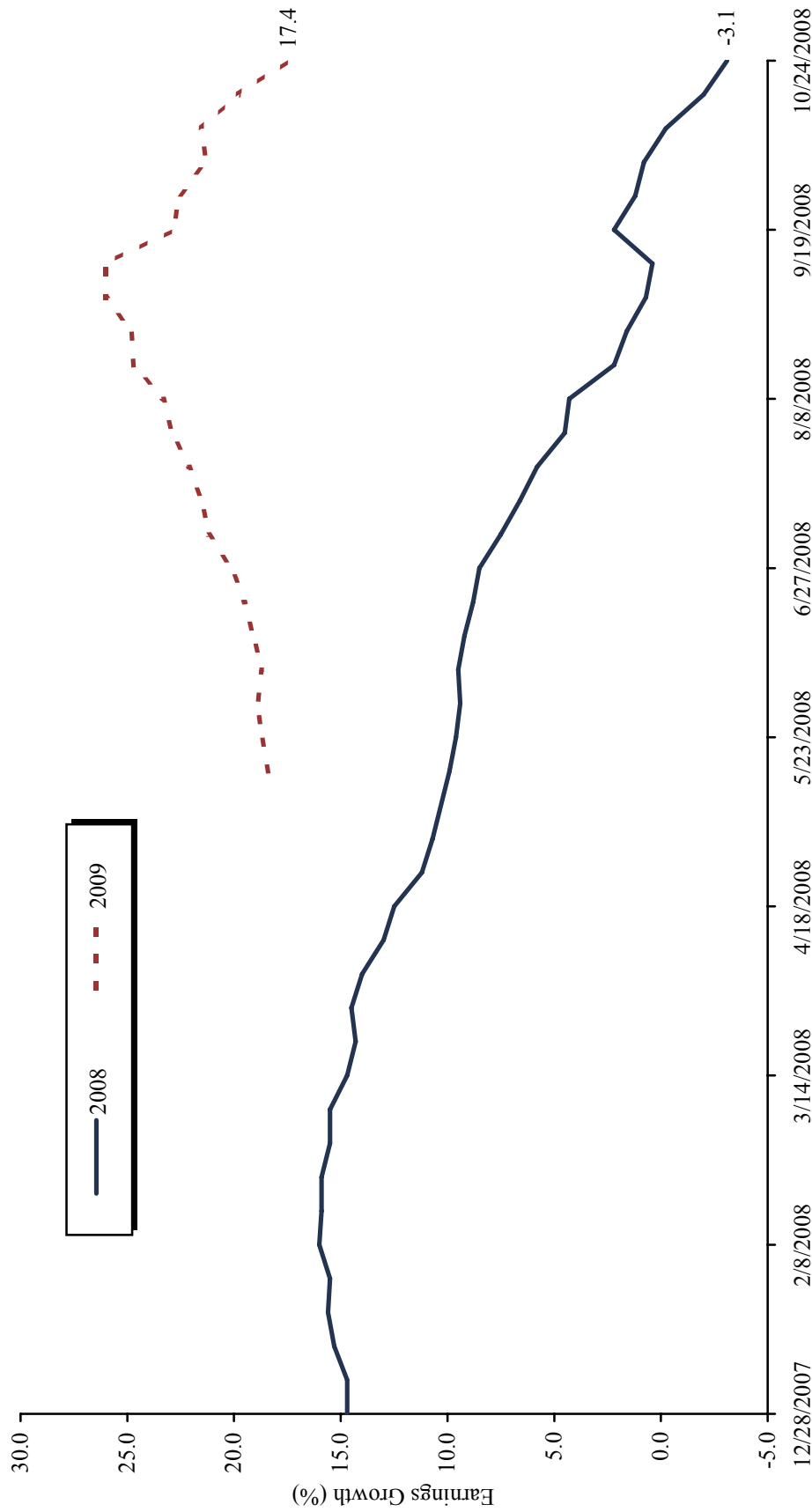


Sources: MSCI Inc., Standard & Poor's, and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: S&P 500 earnings per share (EPS) deflated by CPI-U, based on September 30, 2008, level. MSCI World ex U.S. EPS deflated by G7-CPI, based on August 31, 2008, level.

Table R
S&P 500 INDEX EARNINGS GROWTH FORECASTS

December 28, 2007 – October 24, 2008



Sources: FactSet Research Systems, Morgan Stanley Research, and Thomson Financial.

Notes: Data are weekly and reflect each week's consensus estimate forecast for operating earnings growth.

Table S

FIVE-YEAR AVERAGE ANNUAL COMPOUND RETURN COMPARISON OF PORTFOLIOS

March 31, 1970 – March 31, 2008

Simple Portfolio Comparison

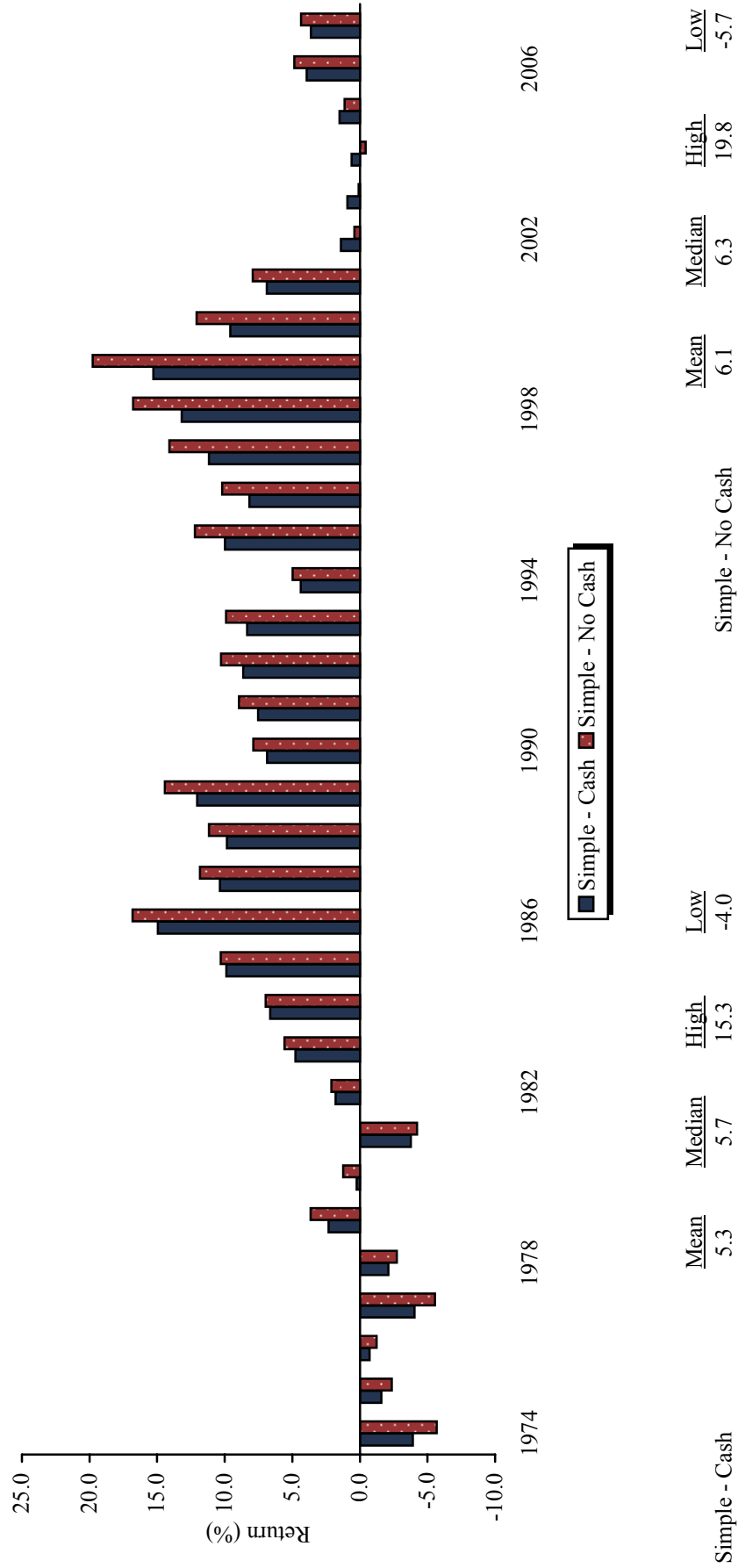
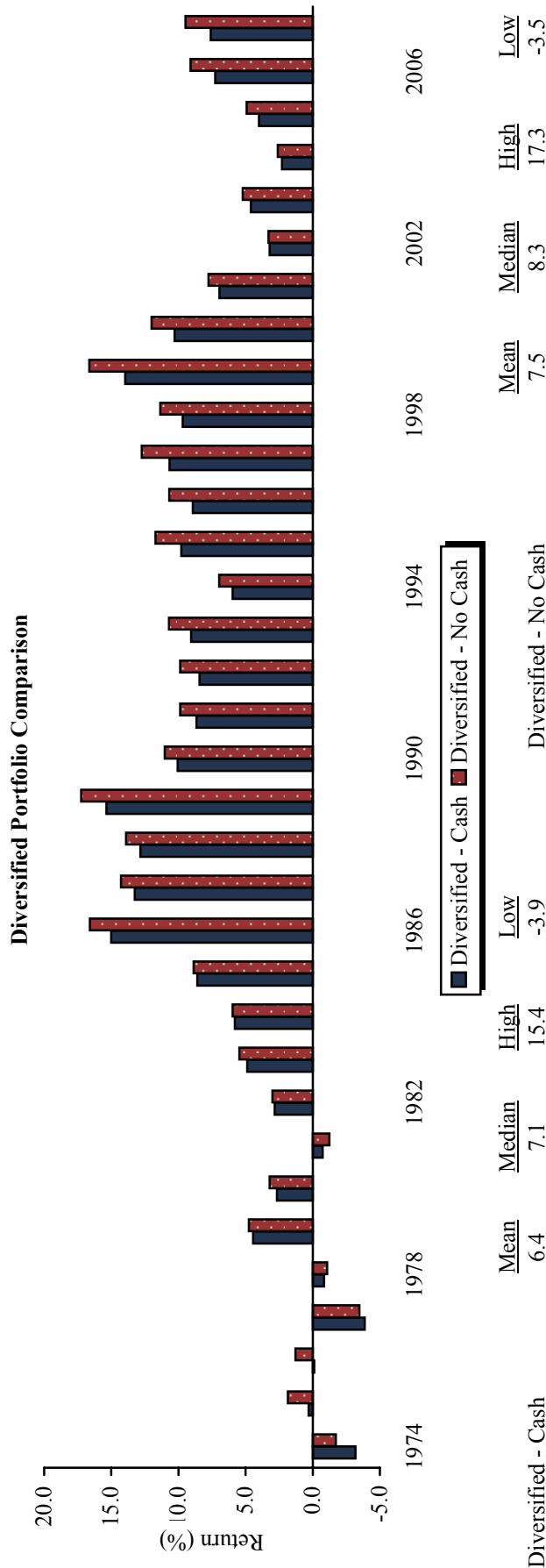


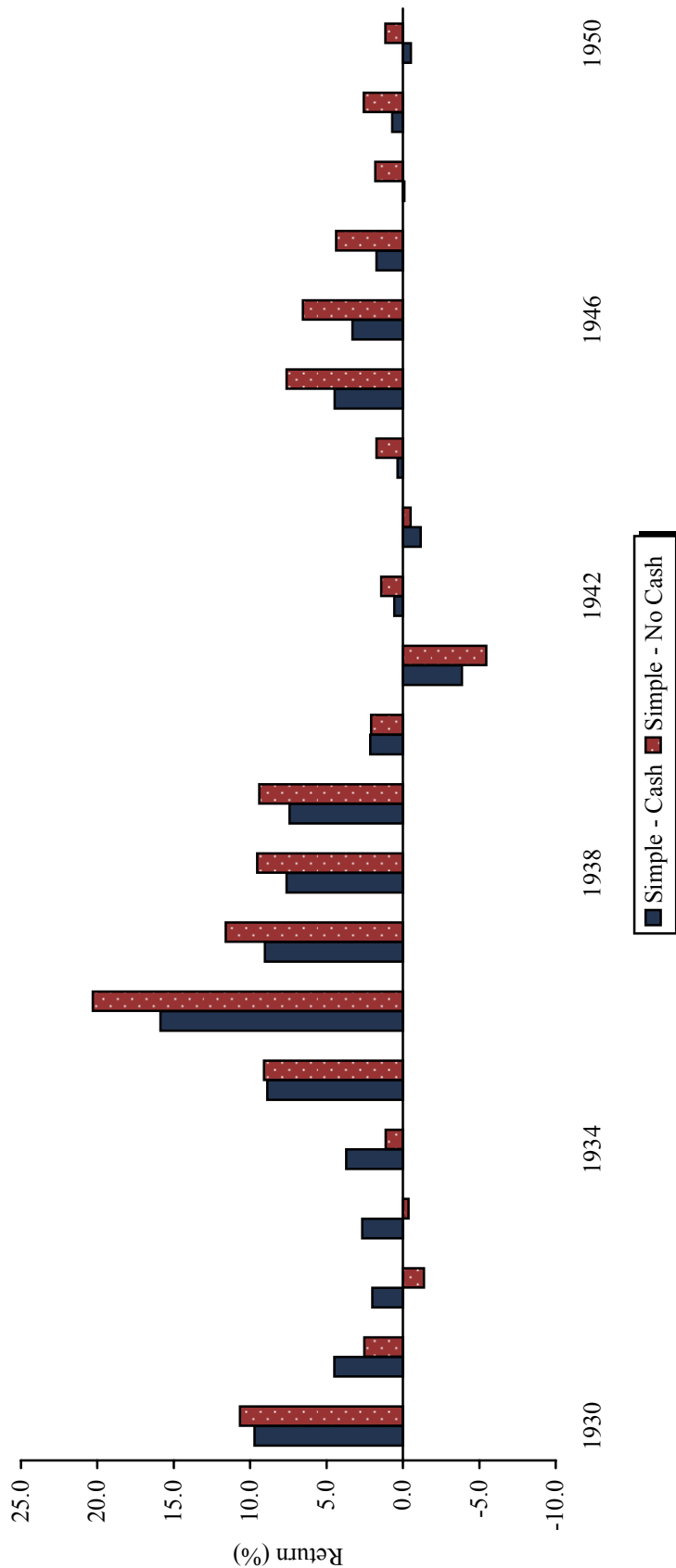
Table S (continued)
FIVE-YEAR AVERAGE ANNUAL COMPOUND RETURN COMPARISON OF PORTFOLIOS
March 31, 1970 – March 31, 2008



Sources: Cambridge Associates LLC Investment Manager Database, Cambridge Associates LLC Non-Marketable Alternative Assets Database, Citigroup Global Markets, Dow Jones & Company, Inc., Federal Reserve, FTSE International Limited, Goldman, Sachs & Co., J.P. Morgan Securities, Inc., Lehman Brothers, Inc., Merrill Lynch & Co., MSCI Inc., National Association of Real Estate Investment Trusts, National Council of Real Estate Investment Fiduciaries, Prudential Real Estate Investors, Standard & Poor's, Standard & Poor's Emerging Markets Database, Thomson Datastream, U.S. Department of Labor - Bureau of Labor Statistics, and Wilshire Associates, Inc. MSCI data provided "as is" without any express or implied warranties.

Notes: The simple portfolio consists of 70% U.S. equity and 30% high-quality corporate bonds. The simple portfolio including cash consists of 50% U.S. equity, 30% high-quality corporate bonds, and 20% cash. The diversified portfolio is the average portfolio for clients with more than \$1 billion in investable assets.

Table T
FIVE-YEAR AVERAGE ANNUAL COMPOUND RETURN COMPARISON OF SIMPLE PORTFOLIO
March 31, 1926 – December 31, 1950



	<u>Mean</u>	<u>Median</u>	<u>High</u>	<u>Low</u>
Simple - Cash	3.8	2.7	15.9	-3.9
Simple - No Cash	4.6	2.5	20.3	-5.5

Sources: Citigroup Global Markets, Federal Reserve, Standard & Poor's, Thomson Datastream, and U.S. Department of Labor - Bureau of Labor Statistics.

Notes: The simple portfolio consists of 70% U.S. equity and 30% high-quality corporate bonds. The simple portfolio including cash consists of 50% U.S. equity, 30% high-quality corporate bonds, and 20% cash.