

# Lazard Insights Conference Call Series

## Identifying Opportunities in a Deleveraged World

David R. Cleary, CFA

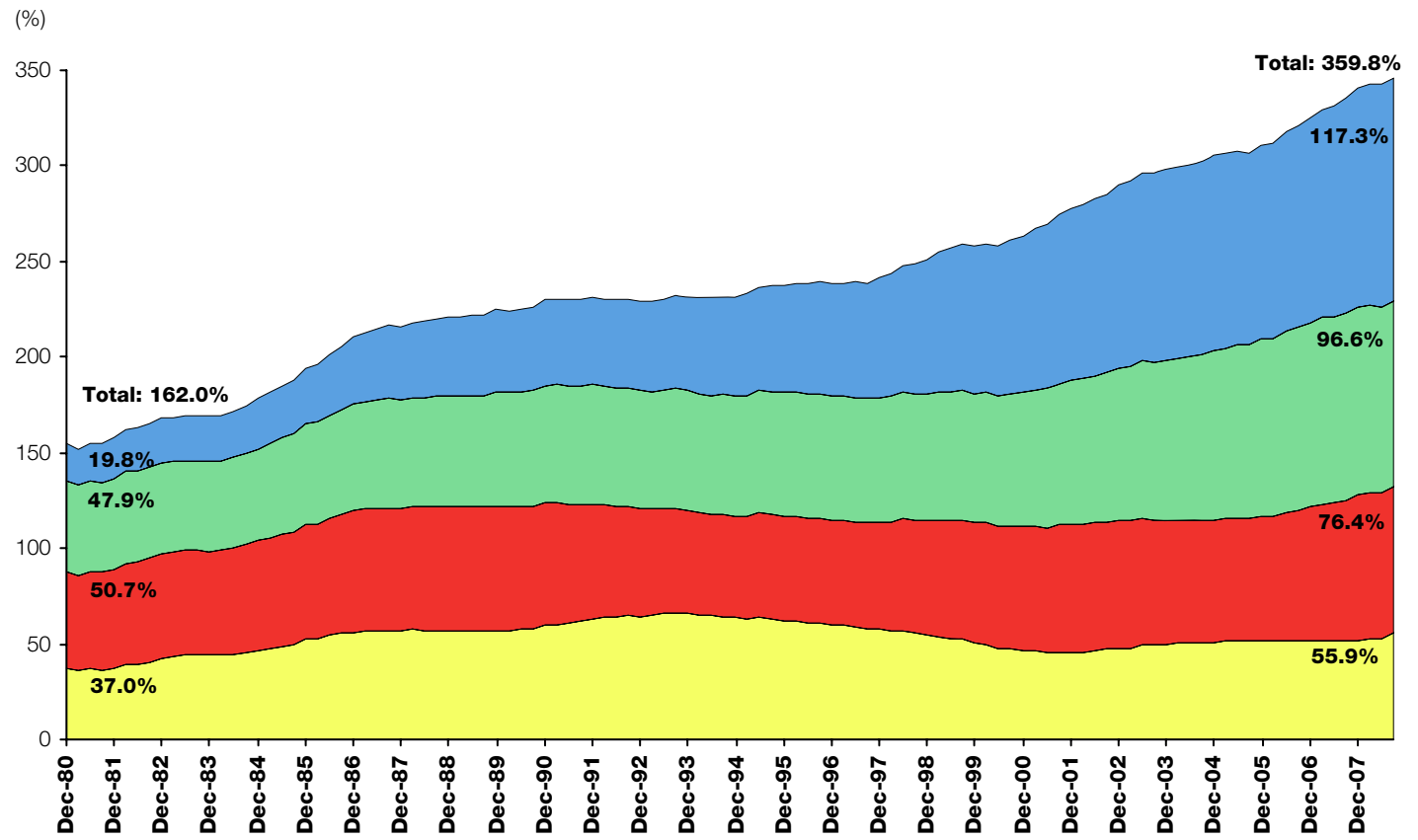
Managing Director, Portfolio Manager/Analyst

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# Total Debt Outstanding has Ballooned

What happens when the market says "Enough"?

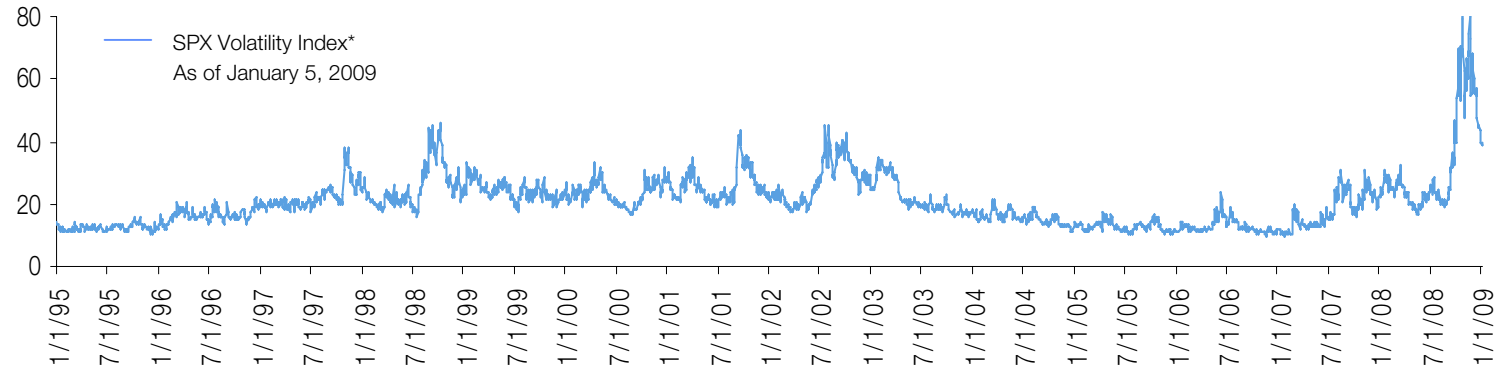


- Financial Debt/GDP
- Consumer Debt/GDP
- Corporate Debt/GDP
- Govt Debt/GDP

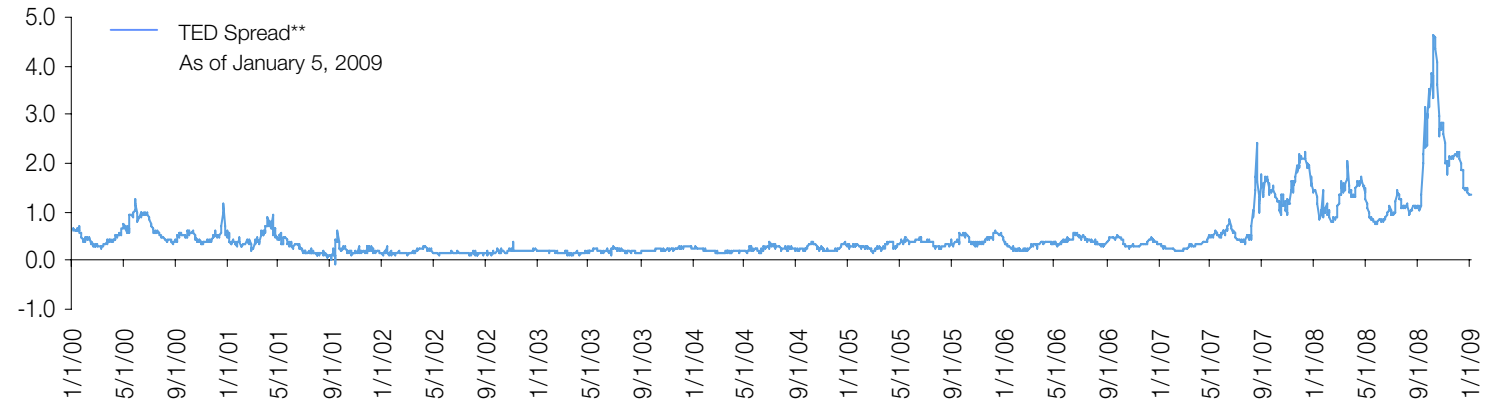
As of September 30, 2008  
 Source: U.S. Federal Reserve, Bloomberg

# Unprecedented Market Volatility

Last Price



(%)

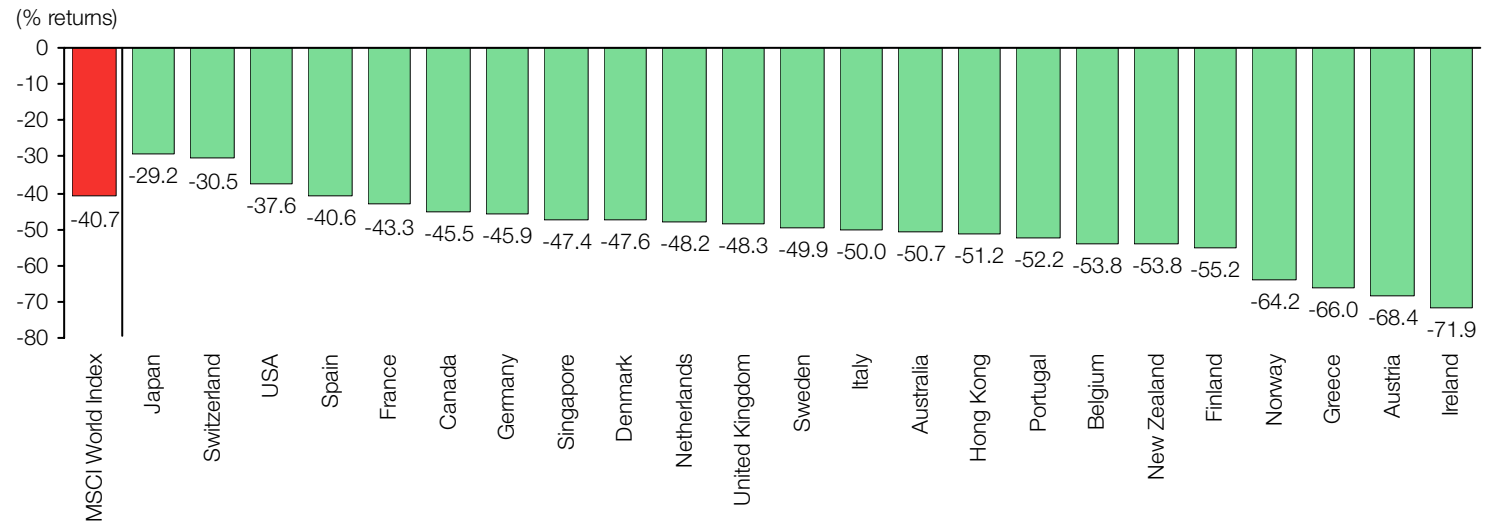


\*The Chicago Board Options Exchange SPX Volatility Index reflects a market estimate of future volatility, based on the weighted average of the implied volatilities for a wide range of strikes. 1st & 2nd month expirations are used until 8 days from expiration, then the 2nd and 3rd are used.  
Source: Bloomberg Markets, LLC

\*\*TED Spread is the difference between the yield on the generic 3-month U.S. Treasury Bills and the British Bankers Association LIBOR 3-month yield  
Source: Bloomberg Markets, LLC

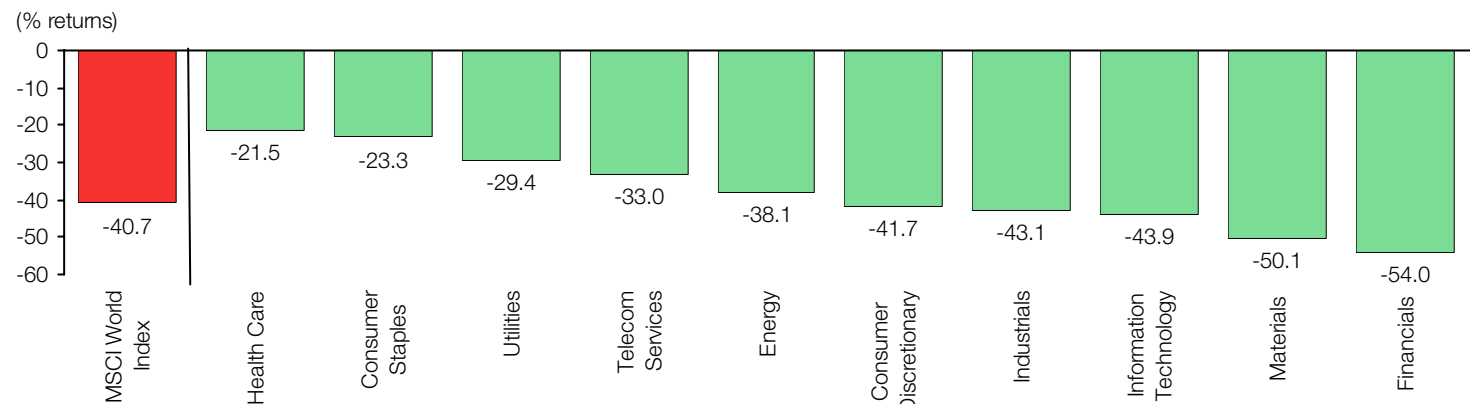
# No Place to Hide: Country and Sector

## Country



Year to date as of December 31, 2008  
Source: Bloomberg

## Sector



In U.S. dollars, net dividend reinvested 1-year returns as of December 31, 2008  
Source: MSCI Barra

The performance quoted represents past performance. Past performance is not a reliable indicator of future results.

# Dispersion of Returns

Fixed income sector returns have had huge dispersion in the last year.

## U.S. Fixed Income Returns (US\$)



Year to date as of December 31, 2008

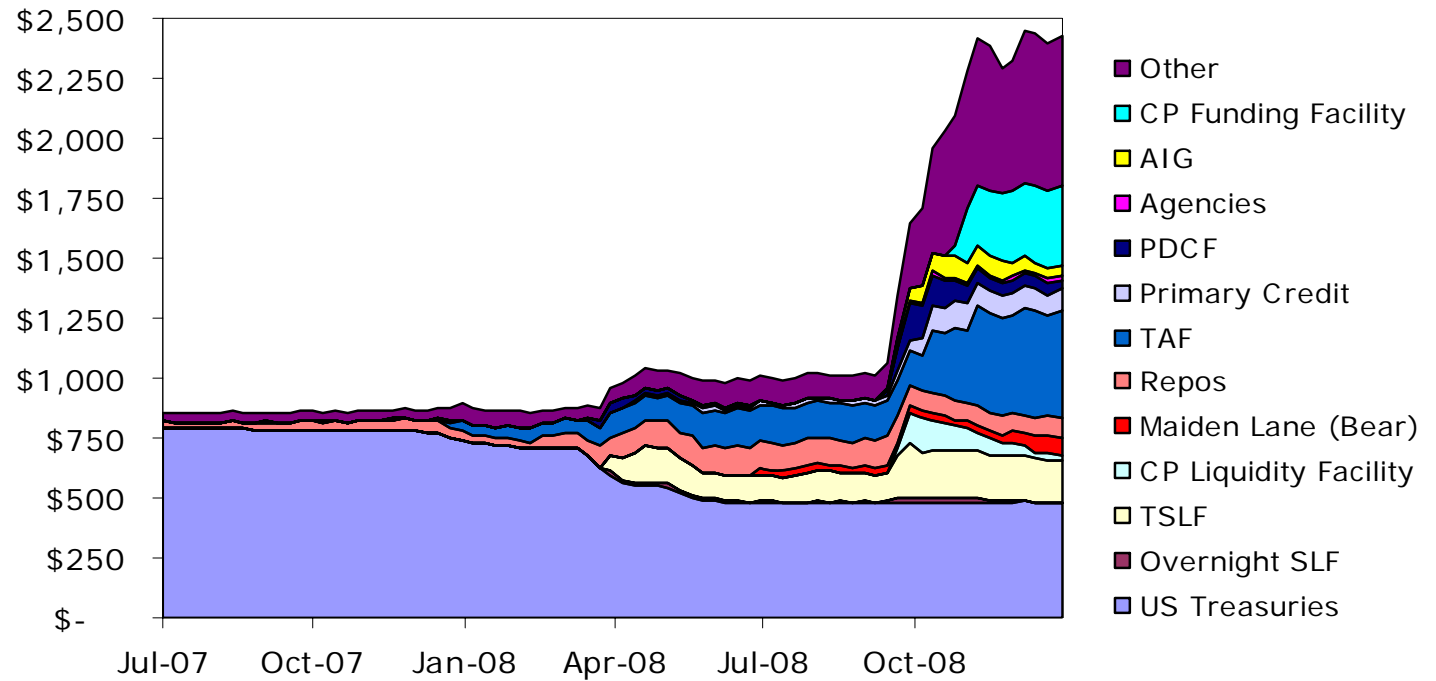
Source: Barclays Capital U.S. Aggregate Index

The performance quoted represents past performance. Past performance is not a reliable indicator of future results.

# U.S. Federal Reserve Assets

Unprecedented central bank intervention to stem the credit crisis.

Federal Reserve Assets (\$billions)



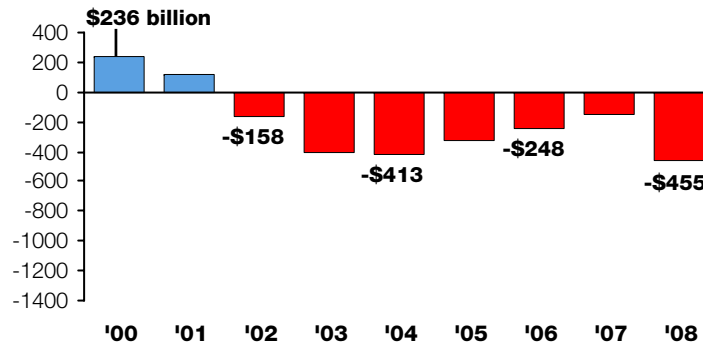
As of January 2, 2009  
Source: Federal Reserve, Yellen (2008)

# Washington Responds

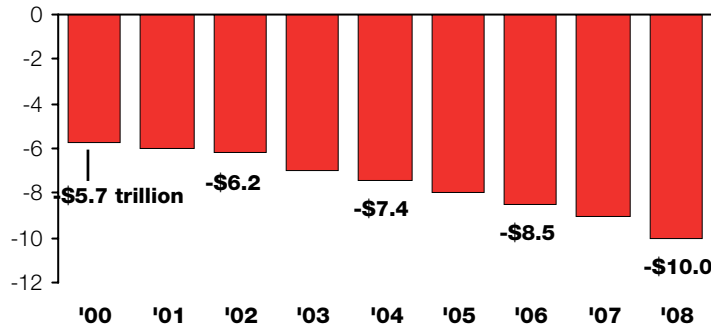
The U.S. Congressional Budget Office forecasts that the annual budget deficit will top \$1 trillion this year.

## Where we are

Actual budget surplus/deficit, by fiscal year ending September 30



Actual public debt, by fiscal year ending September 30

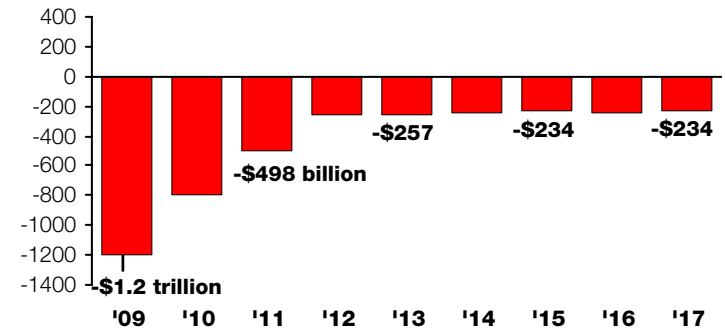


As of January, 2009

Source: U.S. Congressional Budget Office, U.S. Treasury, AP, McClatchy

## Where we are headed

Projected budget deficit, by fiscal year ending September 30



Anticipated 2009 spending not included in deficit projections:

- Stimulus package Up to **\$800 billion**
- Afghanistan, Iraq wars About **\$136 billion**

# 2009 Economic and Market Outlook

## Scenario Analysis

### Characteristics

#### V Shaped Recovery

- Aggressive monetary policy
- Aggressive, constructive fiscal response
- Reduction in tax rates
- Globalization and trade resume
- Rising inflationary pressures
- Economy back to trend growth
- Investors re-engage

#### W Shaped Recovery

- Monetary tightening too early
- Expansion of government in economy
- Stable to rising tax rates
- Volatile inflation expectations
- Moderate recovery of trade and capital flows
- Economic recovery but not back to trend
- Investors slowly embrace risk

#### U Shaped Recovery

- Continuous monetary mistakes
- Ineffective fiscal measures
- Rising tax and regulatory environment
- Continued deflationary pressures
- Increased trade protectionism
- No meaningful pick up in economic activity
- Investors continue to avoid risk

### Market signals

- Rising government rates
- Tightening credit spreads
- High beta equity rally
- Rising commodity prices
- Reduced market volatility

- Volatile government rates
- Improvement of credit fundamentals
- Wide dispersion of equity market returns
- Stable to rising commodity prices
- Market volatility moderate to high

- Short rates remain near zero
- Deteriorating credit risks and rising bankruptcy
- Stock prices fall
- Sharply falling commodity prices
- Market volatility spikes

# 2009 Economic and Market Outlook

## Reasons to be Optimistic

- Unprecedented policy response
  - Monetary and fiscal
- Worst of liquidity crisis likely over
  - Market clearing mechanisms working again
- Worst of credit crisis likely over
  - Tightening of credit spreads
- Valuation of equity and debt markets
  - Multitude of valuation metrics at levels not seen in decades
- Sentiment terrible
  - Investor cash levels

## Reasons to be Pessimistic

- Unprecedented policy response
  - What is the long term impact of government intervention?
- Deflationary market pressures continue
  - Housing
- Broad economic news likely to disappoint
  - Manufacturing, employment, etc.
- Credit crisis part II
  - Commercial real estate, credit cards, Alt-A, etc.
- Sentiment terrible
  - Business, consumer and investor

# Investment Strategy - 1<sup>st</sup> Quarter 2009

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Our view: A W-shaped recovery.

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## Primary Investment Themes

- On-going engagement of risk
  - Prepare for continued change; volatility
  - Liquidity
  - Flexibility
- Maintain portfolio risk levels
  - Neutral weighting between equity and debt sectors
- Focus on cash flow generative investments
  - Large-cap equities; corporate credit

## Secondary Investment Themes

- Longer-term secular trends
  - Overweight emerging markets
  - Targeted infrastructure investments
  - Materials
- New administration initiatives
  - Alternative energy
  - Broadband expansion
  - Health care technology

# Other Thoughts

- Shakeout in the money management industry
  - What does this mean for alpha generation?
- Credit: the biggest opportunity many investors will miss
- Is inflation the big non-consensus risk?

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