



Lazard Insights
Conference Call Series

Buy or Beware? Investing at the Crossroads

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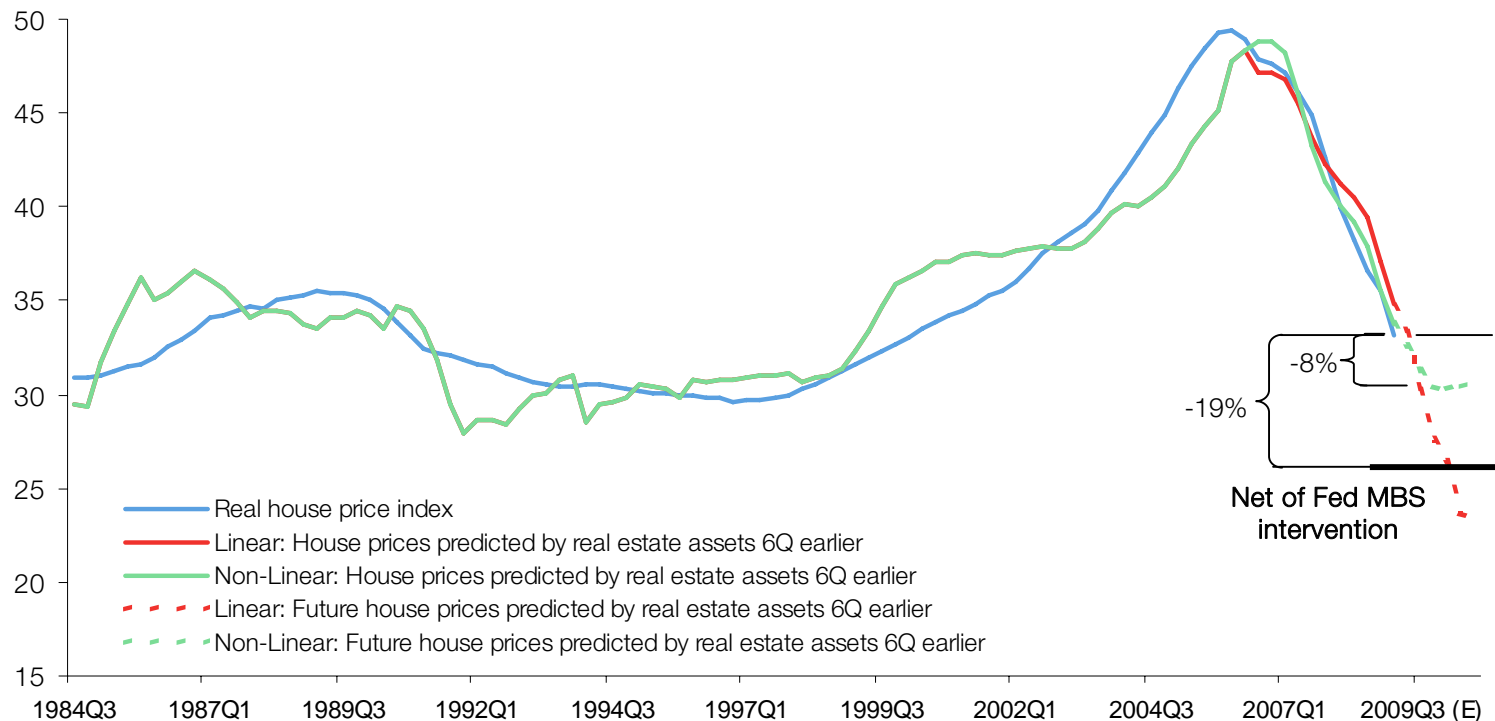
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Agenda

- Housing update
- Takeaways from earnings season
- Credit market update
- Investment implications

We Expect House Prices to Decline Further

- We are including both a linear and non-linear model in our report as the forecasts have diverged this quarter
- The non-linear model could be considered a scenario reflective of successful government intervention
- The linear model could be considered a scenario reflective of failed government efforts



As of March 31, 2009

Source: Board of Governors of the U.S. Federal Reserve System, Flow of Funds Accounts of the United States, Section B.100 Balance Sheet of Households and Nonprofit Organizations, OFHEO, Standard & Poor's/Case-Shiller Home Price Indices, Bureau of Labor Statistics, Bloomberg¹
Seasonal adjustments were made using a linear moving average.

Predicted changes in mortgage debt based on a single-factor linear regression model and a single-factor non-linear regression model. Both models were developed by Dr. Emma Rasiel, Assistant Professor of the Practice of Economics, Duke University. For more information, refer to the Lazard Investment Research paper "The Crumbling Foundation of U.S. House Prices: August 2009 Update," available at http://www.lazardnet.com/lam/us/literature_research.shtml.

There is no guarantee that the stated forecast will be realized.

But We are Not as Negative as Before

- Our May forecast was for house prices to decline 17% to 23% from the end of March levels
- Prices at the end of May were unchanged from the end of March
- Our updated scenarios better reflect the uncertainty around forecasting in a down market as well as the unprecedented degree and form of government intervention in the housing market

- Government intervention appears to be working, at least for now
- We expect house prices to increase for next 2-3 months
- Even in the base case, 20-25 million homeowners could end up underwater

| | |
|------------------|---------------------|
| Bull Case | -8% |
| Base Case | -10% to -15% |
| Bear Case | -19% |

As of March 31, 2009

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Takeaways from Earnings Season

- A wide range of companies indicated that the deterioration in economic conditions has decelerated, if not stopped

- Few, however, pointed to any signs of an imminent upturn

- The two quotes to the right offer examples within the same sector

- **A.G. Lafley (CEO, Procter & Gamble):**

“Our planning basis is the same market growth rates that we saw in the last quarter, which was essentially flat. So we really haven’t—we’re really not going to be in the business of calling the bottom, so to speak....

What I will tell you, though, is that the rates of decline have clearly decelerated. So, it’s not as bad sequentially as we’ve seen in the past, and it appears to have flattened out quite a bit.”

- **Paul Polman (CEO, Unilever PLC):**

“Although many keep quoting the increased amount of green shoots that are coming up, we’d just like to continue to be realistic, hopefully proven wrong, but I’d like to plan the business accordingly. **This is, without any doubt, the longest and deepest recession we’ve seen during the post-world-war period. And, whilst it might have bottomed out, we do not believe that there are any signs of a fast recovery. In fact, we expect that many parts of the world, such as Western Europe, Eastern Europe, will still soften before they bottom out.**”

Takeaways from Earnings Season

S&P 500 Income Statement (ex-Financials)

| Particulars | 2Q09 | 2Q09E | Diff | % Diff | 1Q09 | Q/Q% | 2Q08 | Y/Y % |
|-----------------------------------|--------------|-------------|--------------|-------------|-------------|---------------|--------------|---------------|
| | Actual | Expected | | | | | | |
| Revenues | 1,409.7 | 1,406.2 | 3.5 | 0.3% | 1,359.7 | 3.7% | 1,744.5 | -19.2% |
| Operating Costs | 1,218.6 | 1,228.7 | (10.1) | -0.8% | 1,205.2 | 1.1% | 1,489.9 | -18.2% |
| EBIT / Operating Income | 191.1 | 177.5 | 13.6 | 7.7% | 154.5 | 23.7% | 254.6 | -24.9% |
| EBITDA | 277.2 | 259.6 | 17.6 | 6.8% | 243.9 | 13.7% | 344.0 | -19.4% |
| Pre-Tax Income | 148.8 | 156.1 | (7.4) | -4.7% | 106.1 | 40.2% | 205.3 | -27.5% |
| Net Oper. Inome (Earnings) | 102.5 | 97.6 | 4.9 | 5.0% | 77.9 | 31.5% | 142.9 | -28.3% |
| Margins | | | | | | | | |
| EBIT | 13.6% | 12.6% | 90 bp | | 11.4% | 220 bp | 14.6% | -100 bp |
| EBITDA | 19.7% | 18.5% | 120 bp | | 17.9% | 170 bp | 19.7% | -10 bp |
| Pre-Tax | 10.6% | 11.1% | -50 bp | | 7.8% | 270 bp | 11.8% | -120 bp |
| Net Operating | 7.3% | 6.9% | 30 bp | | 5.7% | 150 bp | 8.2% | -90 bp |

- Distinguish data points: Leading, lagging, or coincident
- Determine demand factors: Restocking or sales, domestic or international
- Earnings drivers: Cost reduction or revenue growth

As of August 7, 2009

Source: Morgan Stanley Research, Thomson Financial, Compustat

The Fed's Influence on Credit Markets

- In the U.S. alone, almost \$2.0 trillion has been deployed to purchase a broad range of assets
- These purchases comprised about 35% of all non-Treasury debt issued in the United States in the first half
- The impact of this intervention extends well beyond the specific assets being purchased
- The exit strategy for the Fed remains unclear

| Program Name | Potential Size | Outstanding |
|---|-----------------|-----------------|
| GSE MBS Purchases (Federal Reserve) | \$ 1,250 | \$ 742 |
| GSE MBS Purchases (Treasury Department) | No limit | \$ 172 |
| GSE Debt Purchases (Federal Reserve) | \$ 200 | \$ 111 |
| Subtotal - GSE and MBS Intervention | \$ 1,450 + | \$ 1,025 |
| Commercial Paper Funding Facility | \$ 1,300 | \$ 58 |
| TALF | \$ 1,000 | \$ 41 |
| PPIP | \$ 1,000 | \$ - |
| TARP | \$ 700 | \$ 457 |
| Designated but not yet deployed | | \$ 184 |
| Subtotal - TARP | \$ 700 | \$ 641 |
| US Treasury Purchases (Federal Reserve) | \$ 300 | \$ 220 |
| Subtotal - Cash Intervention | \$ 5,750 | \$ 1,986 |
| TLGP-Debt Issuance | \$ 789 | \$ 339 |
| TLGP-Transaction Account Guarantees | \$ 700 | \$ 700 |
| FHA Loan Guarantees | \$ 300 | \$ - |
| Subtotal - Non-cash Guarantees | \$ 1,789 | \$ 1,039 |
| Total | \$ 7,539 | \$ 3,025 |

As of August 14, 2009

Source: U.S. Treasury Department, Federal Reserve, Federal Housing Finance Administration, Federal Deposit Insurance Corporation, Federal Home Loan Administration, Fannie Mae, Freddie Mac, Bloomberg

Investment Implications: Questions We Have

- How much of investor expectations are already priced in?
 - Are short-term risks to the upside?
 - Have markets come too far, too fast?
- How far in advance are markets anticipating economic conditions?
- How much insight can we derive from credit markets relative to equity markets?

Investment Implications: Answers We Know

- Anchoring of expectations can be dangerous:
 - Do you reference March 6th of 2008?
 - Do you reference March 6th of 2009?
- Backward-looking strategies are no longer relevant
 - The era of disinflation has ended
- Forward-looking analysis is a necessity
 - Recovery will not be led by the consumer
 - Recovery will not be led by leverage
 - Differentiation has only just begun

Important Information

1. Aggregated U.S. house price data were obtained from two sources, the Office of Federal Housing Enterprise Oversight (OFHEO) (<http://www.ofheo.gov/hpi.aspx>), and the Case-Shiller Home Price Index (available from Robert Shiller's website: <http://www.econ.yale.edu/~shiller/>).

The OFHEO data begins in the first quarter of 1975, while the Case-Shiller Index begins in 1987. We chose to merge the two series, because the Case-Shiller Index provides what we view to be a more accurate assessment of U.S. house prices in recent years. We used a simple regression model to “backdate” the Case-Shiller Index from its starting point in 1987 back to the OFHEO data starting point in 1975.

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