



Lazard Insights

Conference Call Series

Capitalizing on **Post-crisis Dislocations**

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10 November 2009

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Challenging Established Assumptions

- The current crisis has challenged a host of established investment methodologies utilized to identify, measure, and allocate risk
 - Mean reversion
 - Normal distribution pattern of returns
 - Long-term stability of expected correlations

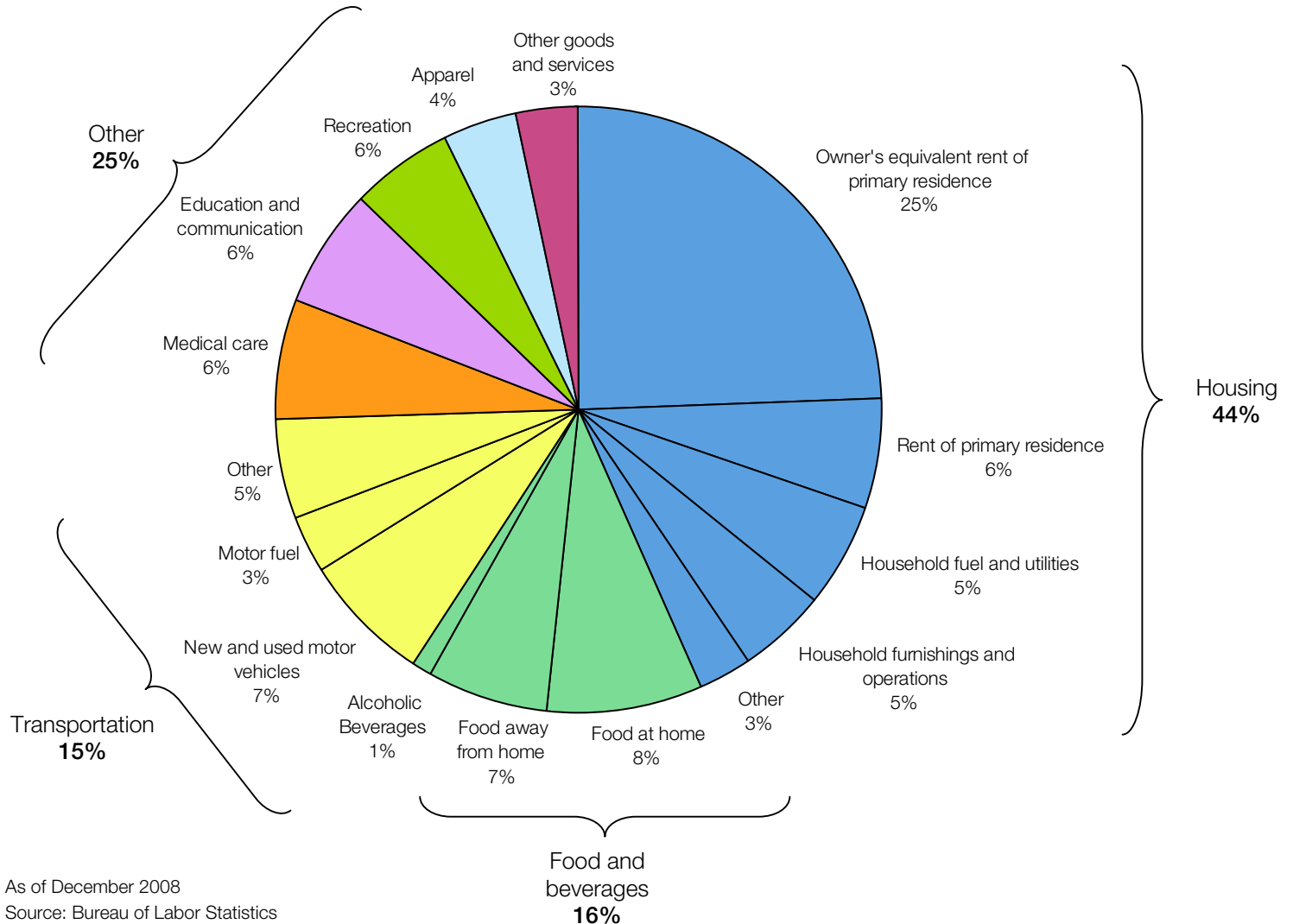
Key Investment Drivers

- Inflation/Deflation
 - Macroeconomic factors
 - Monetary policy
- Volatility
 - The price of uncertainty
 - An underappreciated asset class
- Security Selection
 - Forward-looking, fundamental security analysis
 - Individual winners and losers
 - Dispersion of outcomes

Deconstructing Inflation

CPI Composition

- The components of the Consumer Price Index are well diversified with a few key drivers
- CPI, however, does not necessarily capture the entire story of inflation



Deconstructing Inflation

More Than Just CPI

CPI Components

Deflationary

- Owner's equivalent rent and rent on primary residence (31%)

Neutral

- Food away from home (7%)

Inflationary

- Food at home (8%)
- Energy for housing and vehicles (9%)
- Medical care (6%)
- Education (6%)

Non-CPI

Deflationary

- Unskilled labor

Neutral

Inflationary

- Commodities
- Skilled labor

-
- Inflation needs to be measured in multiple ways. We focus on CPI and on the National Income and Product Accounts
 - Local and global drivers
-

House Prices

Likely to Decline Further

Our expectations for house prices:

- Bull: -8%
- Base: -10% to -12%
- Bear: -19%

- We expect approximately six million homes to be foreclosed in the next three years
- It will take as long as five years to absorb this excess inventory at the current rate, putting even more pressure on house prices
- While modifications help, we still expect between 30% to 50% of modified loans to re-default



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, Bloomberg

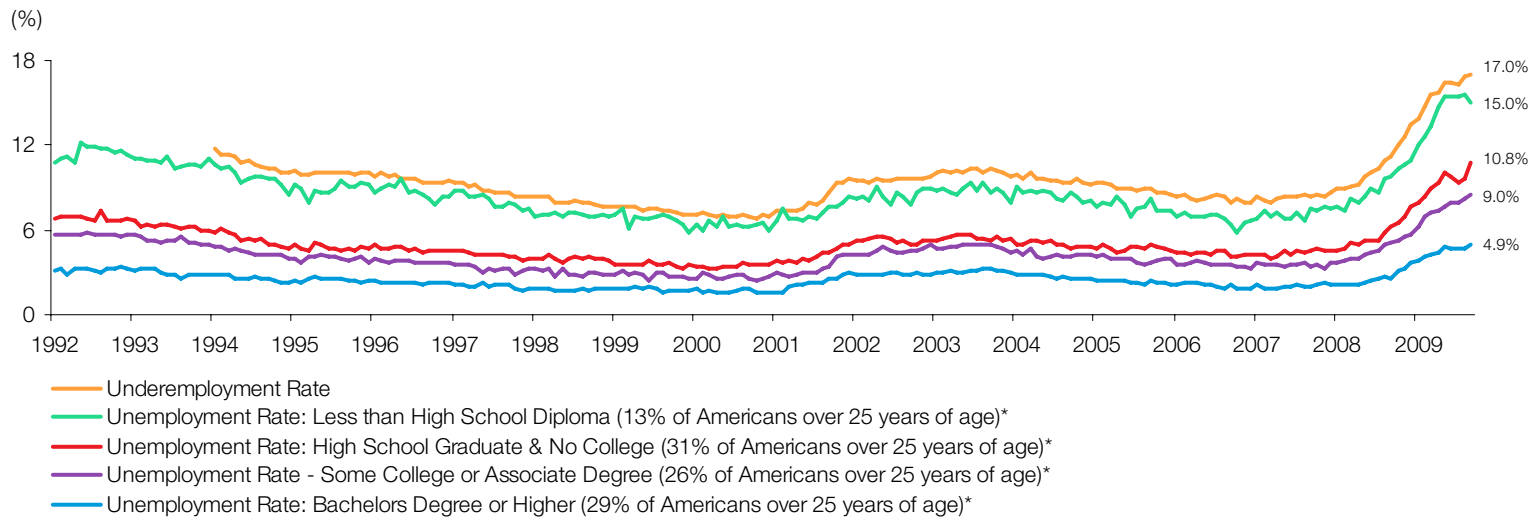
Seasonal adjustments were made using a linear moving average.

Predicted changes in mortgage debt based on a single-factor linear regression model 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.

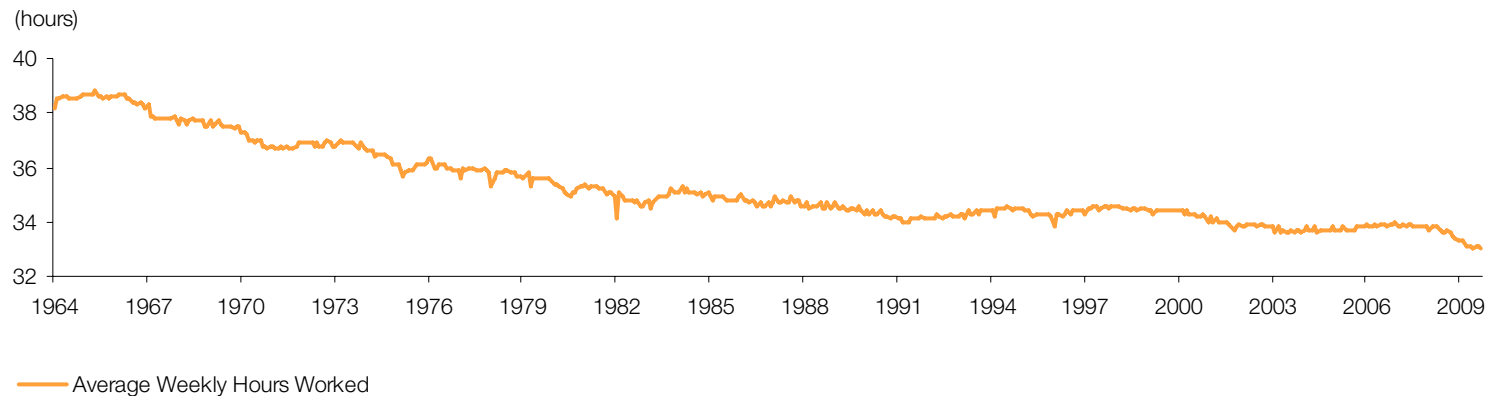
There is no guarantee that the stated forecast will be realized.

Labor

Not As Simple As It Looks



Hourly workers are working fewer hours, making labor inflation even less likely in the near term

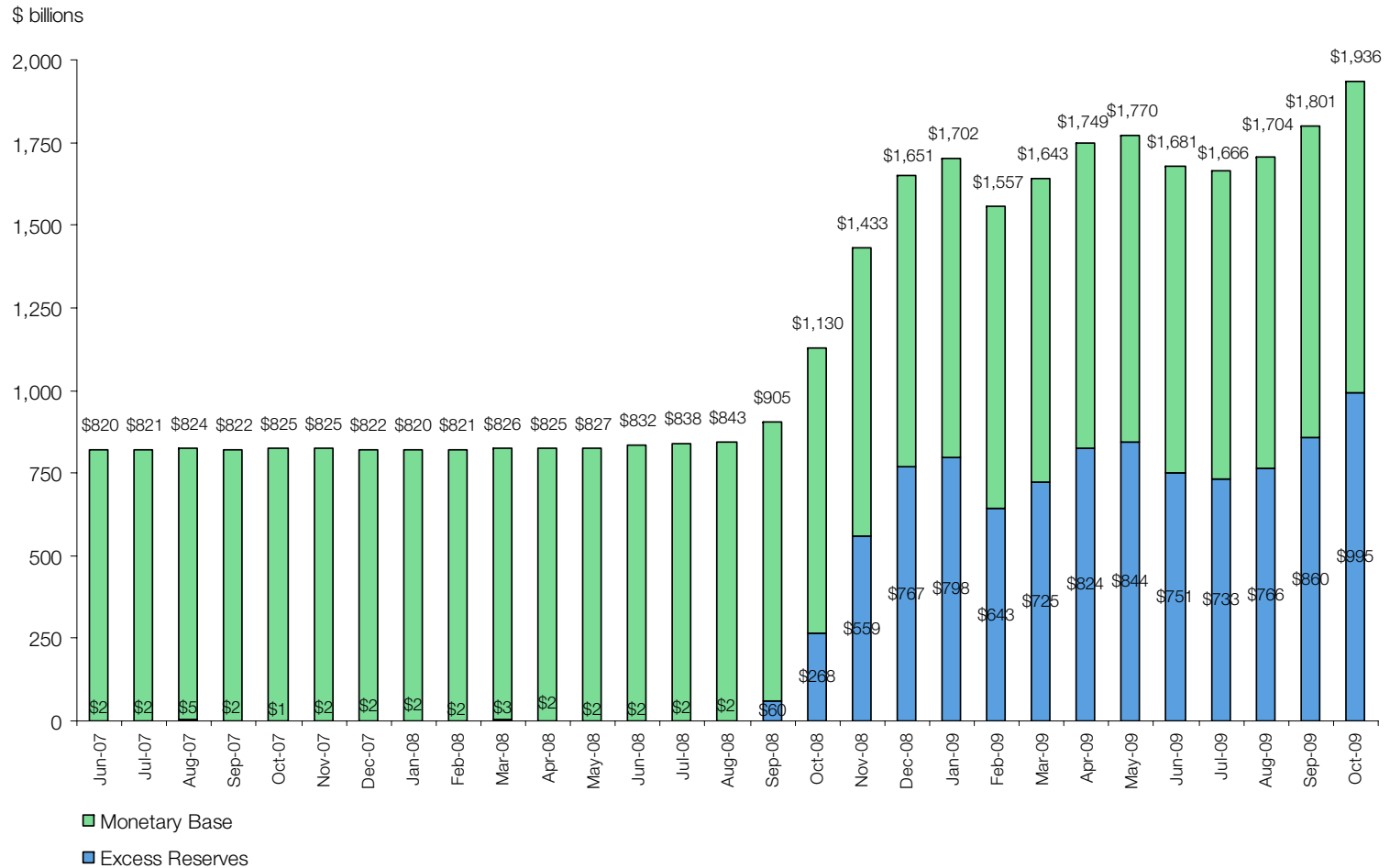


As of September 30, 2009
Source: Bloomberg

* Source: U.S. Census Bureau, Current Population Survey, 2008 Annual Social and Economic Supplement

Monetary Base and Excess Reserves

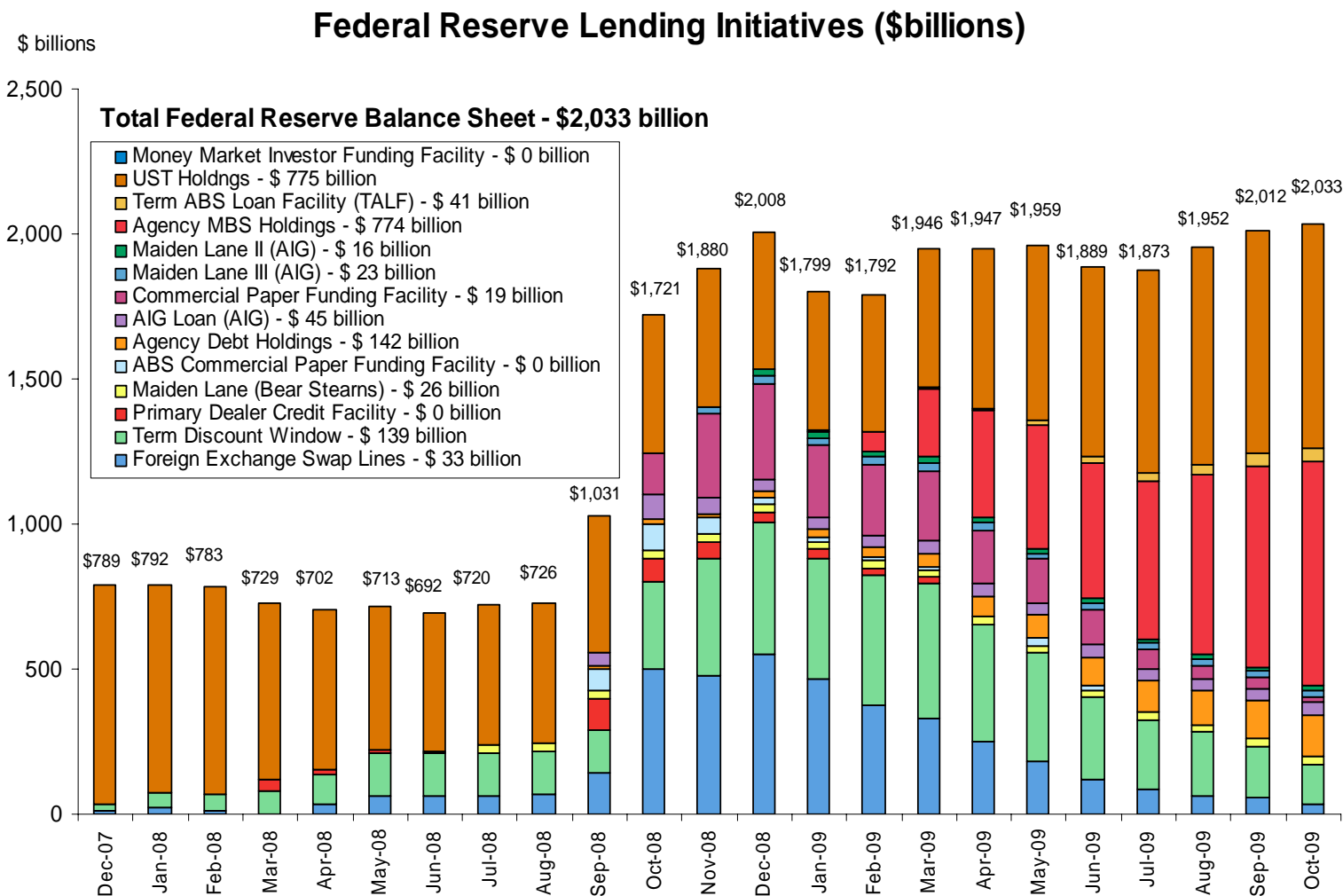
Increasing money supply has not led to increased lending activity



As of October 30, 2009
Source: Federal Reserve

Federal Reserve Lending Initiatives

- The size of the government's balance sheet is a sign of continued weakness in the overall banking system
- The Federal Reserve has intervened directly in funding markets in ways never seen before
- This intervention is not a guarantee of future inflation
- There are numerous tools the Fed can use to manage the liquidity it has created back toward long-term targets

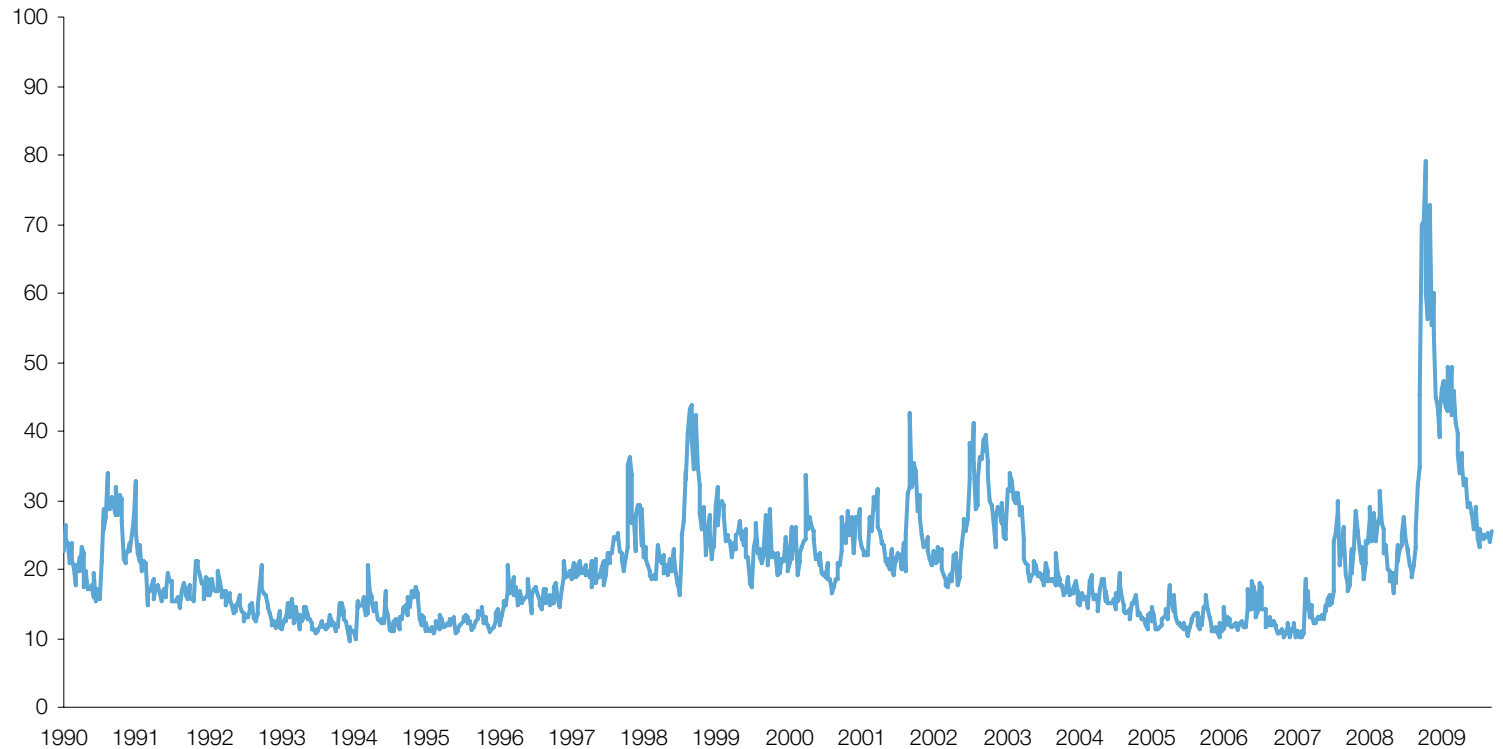


As of October 30, 2009
Source: Federal Reserve

Volatility

The Price of Uncertainty

The VIX Index



As of September 25, 2009
Source: Bloomberg

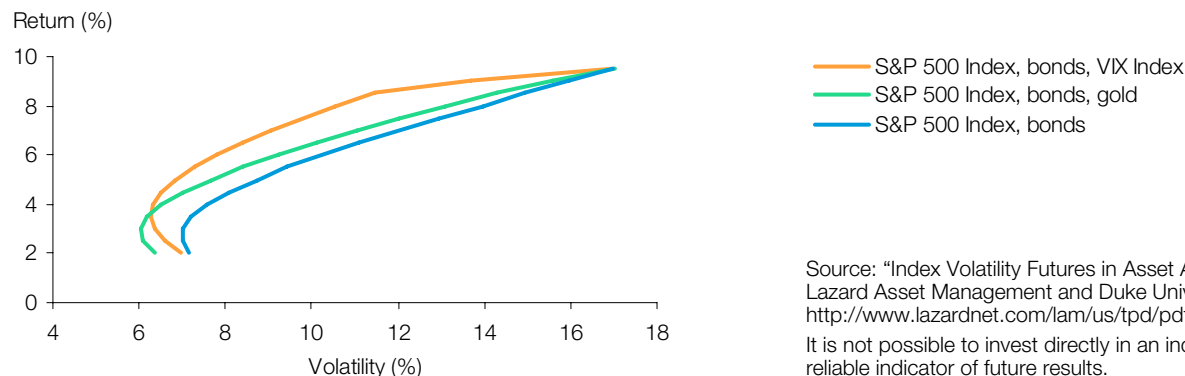
Volatility A Portfolio Diversifier

- The VIX Index is consistently negatively correlated to equities
- The negative correlation increases in times of stress
- Adding volatility as an asset class to a portfolio may improve risk-adjusted returns

Calendar Year Correlations between the S&P 500 Index and Various Assets

	S&P 500 annual returns	Moody's BAA corp bond index	Goldman Sachs Commodities Index	Oil spot price	Gold	Silver	\$/Euro (formerly \$/DM)	VIX Index
1986	14.56%	-0.32	-0.06	-0.14	0.04	0.04	0.04	-0.32
1987	2.34%	-0.32	0.11	0.08	-0.28	-0.19	-0.23	-0.83
1988	12.43%	-0.32	-0.03	-0.05	-0.06	0.10	-0.30	-0.69
1989	28.25%	-0.17	0.05	-0.02	-0.10	0.04	-0.05	-0.66
1990	-8.97%	-0.28	-0.40	-0.28	-0.08	0.07	-0.10	-0.54
1991	27.63%	-0.36	-0.26	-0.24	-0.21	0.01	0.21	-0.56
1992	5.19%	-0.15	0.03	0.06	-0.04	0.03	-0.08	-0.55
1993	7.21%	-0.35	0.02	-0.04	-0.17	-0.03	0.03	-0.51
1994	-2.06%	-0.55	-0.14	-0.16	-0.18	-0.04	-0.20	-0.72
1995	33.18%	-0.44	0.00	0.03	-0.12	-0.07	-0.23	-0.45
1996	22.11%	-0.56	0.03	0.03	-0.10	-0.16	-0.17	-0.68
1997	24.07%	-0.35	-0.16	-0.12	0.00	-0.05	-0.33	-0.70
1998	31.56%	0.21	0.08	0.01	0.02	0.04	-0.17	-0.82
1999	18.54%	-0.30	-0.04	-0.02	0.03	-0.07	-0.38	-0.80
2000	-13.28%	0.00	-0.08	-0.06	-0.03	-0.07	-0.08	-0.78
2001	-9.08%	0.01	0.00	0.01	-0.08	-0.15	-0.22	-0.82
2002	-22.42%	0.50	0.20	0.17	-0.31	-0.11	-0.32	-0.82
2003	20.70%	0.29	-0.24	-0.24	-0.20	0.06	-0.40	-0.66
2004	11.95%	0.04	-0.08	-0.12	0.14	0.09	0.08	-0.75
2005	5.54%	-0.04	-0.06	-0.07	-0.02	0.05	-0.04	-0.82
2006	10.99%	-0.11	0.04	0.01	-0.05	-0.05	0.12	-0.82
	minimum	-0.56	-0.40	-0.28	-0.31	-0.19	-0.40	-0.83
	maximum	0.50	0.20	0.17	0.14	0.10	0.21	-0.32

Efficient frontier for two- and three-asset portfolios, January 1986 to July 2007



Source: "Index Volatility Futures in Asset Allocation: A Hedging Framework," Lazard Asset Management and Duke University, available at: http://www.lazardnet.com/lam/us/tpd/pdfs/index_volatility.pdf

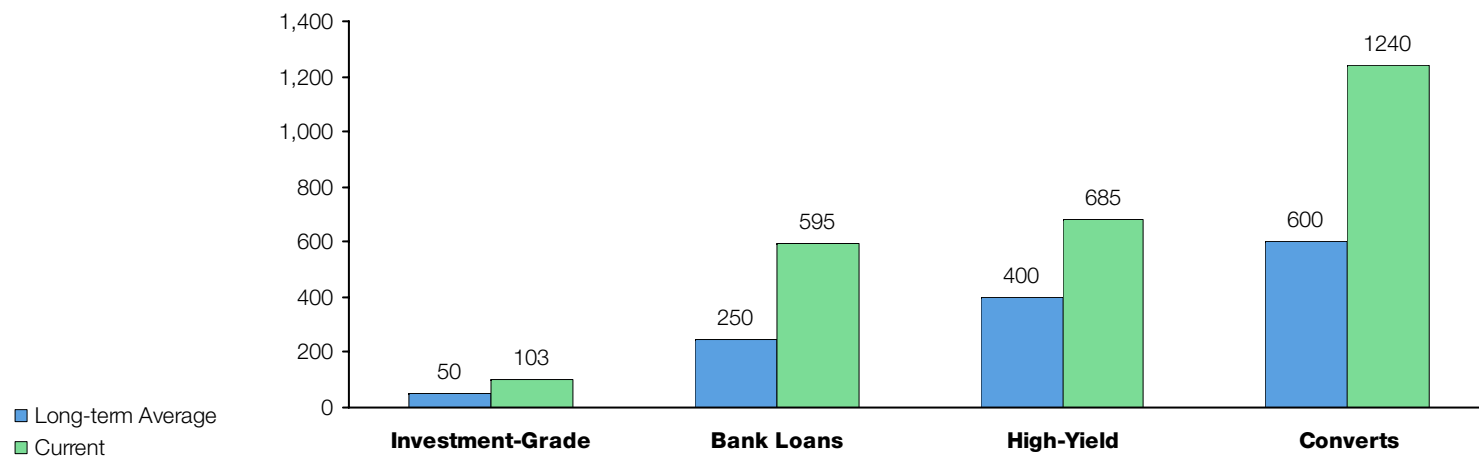
It is not possible to invest directly in an index. Past performance is not a reliable indicator of future results.

Converts

Credit Spreads Still Wide

On a pure valuation basis, convertible securities offer significantly higher implied credit spreads than comparable high-yield, investment-grade, or bank loan instruments

Credit Spread over LIBOR (bps)



Fixed-Income Instrument	Investment-Grade ¹	Bank Loans ²	High-Yield ³	Converts ⁴
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Historical Recovery Rate	60%	70%	40%	30%
Breakeven Default Rate	11%	65%	45%	60%

Information is as of October 7, 2009 and is subject to change. Long-term average returns are for the time period 1990 – Present. Breakeven default rate is assessed over a cumulative 5-year period.
Source: Lazard Asset Management, Bloomberg.

1 Instrument, IG-13
2 Instrument, LCDX13
3 Instrument, HY-13
4 Instrument, Converts ICRD (Implied Credit). Only includes convertible securities with a positive yield to put/yield to maturity.

Security Selection Is Pivotal

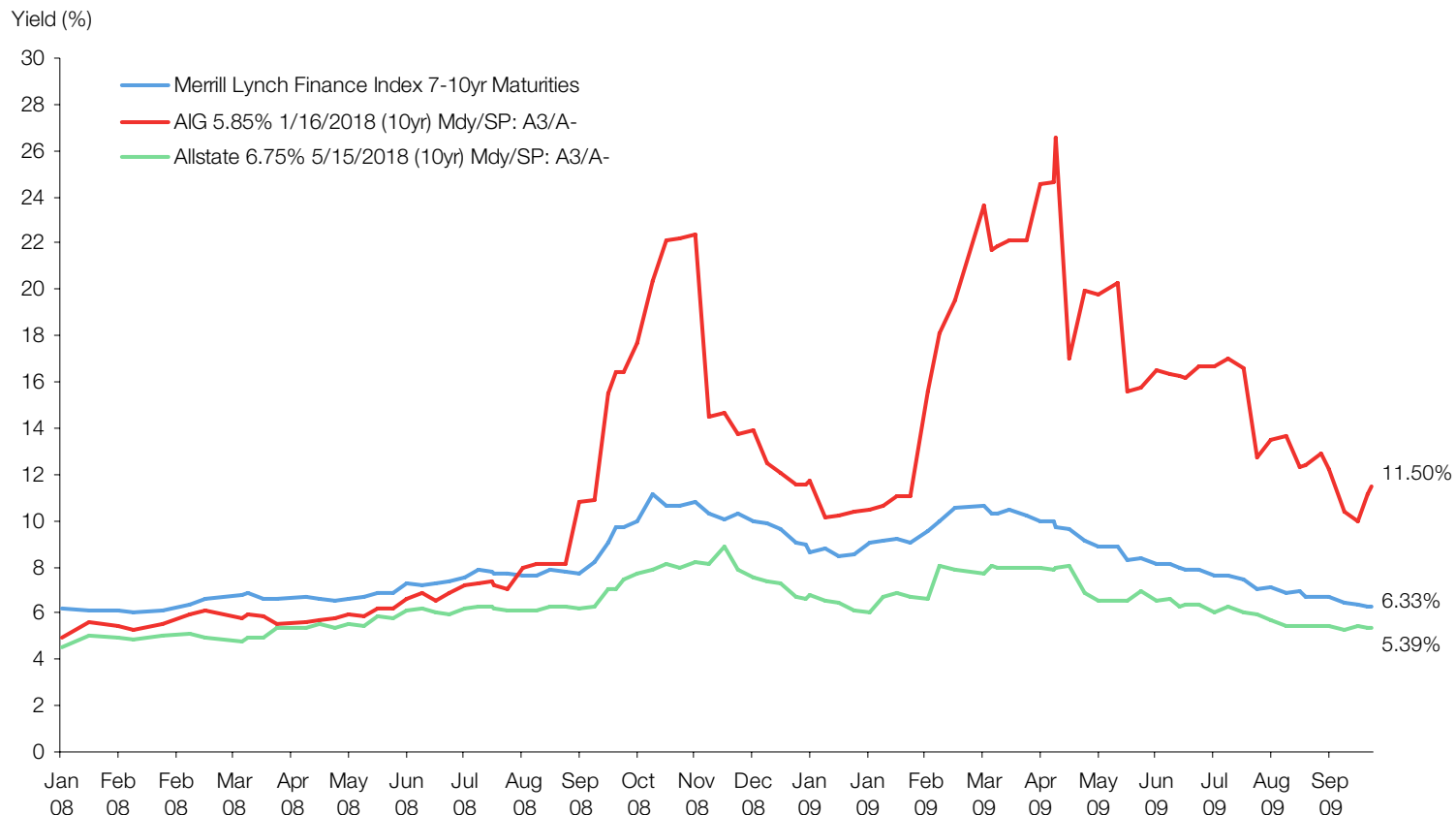
Not All A-rated Credits Are Created Equal

Security Selection:

Significant valuation and return dispersion around industry averages is expected to continue

Volatility: Volatility will continue to exhibit sudden shifts, as market returns will be exaggerated by discontinuous outcomes in specific securities

Investment Grade Fixed Income

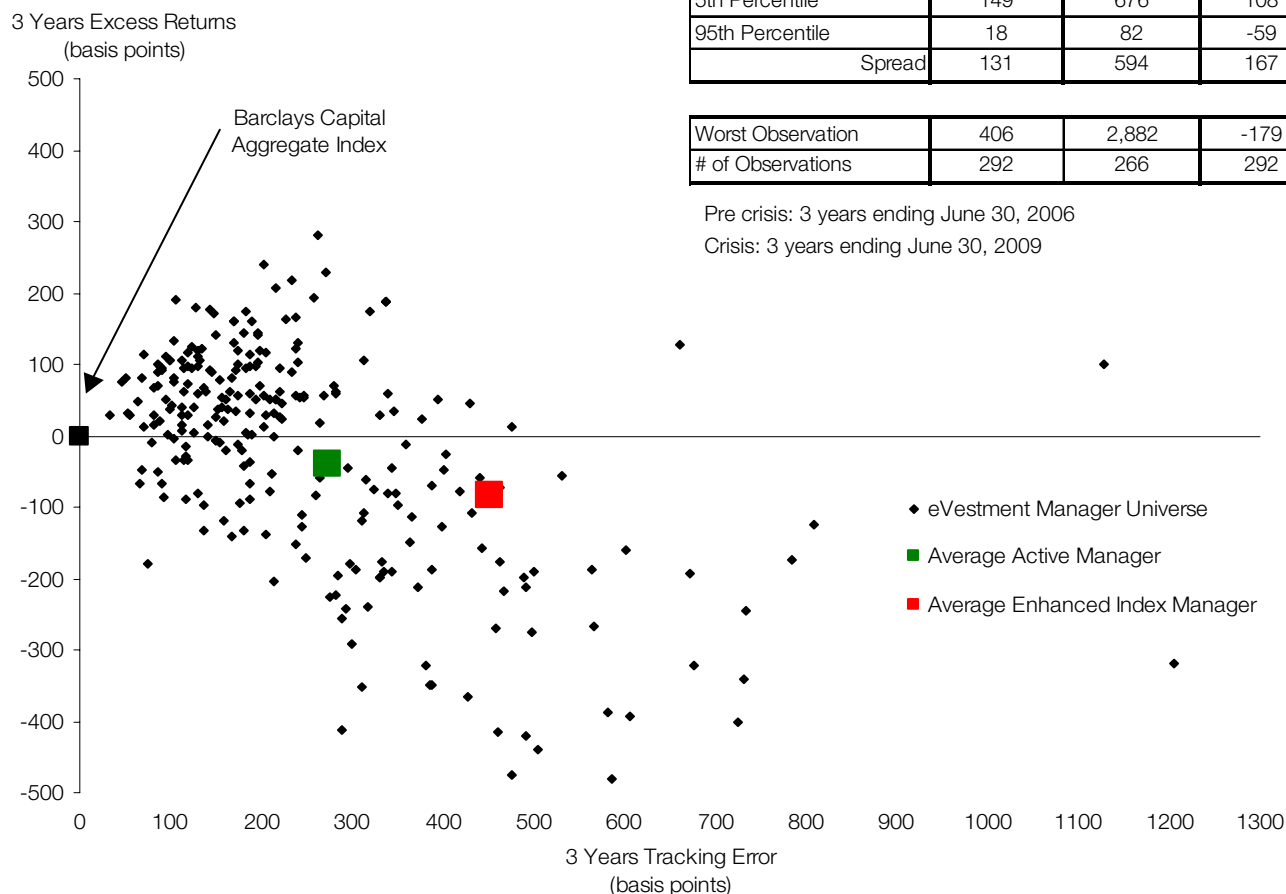


As of October 2, 2009
Source: Merrill Lynch, Bloomberg

Dispersion of Fixed Income Manager Returns Has Increased Substantially

- Statistically based sampling is not reliable in reducing tracking error risk in this environment, as industry populations are not homogenous
- Performance results will be dominated by individual winners and losers in investment portfolios
- This environment poses significant challenges for fixed-income indexation strategies

U.S. Core Fixed Income Universe 3 Years Ending June 30, 2009



	Tracking Error (bps)		Excess Returns (bps)	
	Pre Crisis	Crisis	Pre Crisis	Crisis
5th Percentile	149	676	108	175
95th Percentile	18	82	-59	-398
Spread	131	594	167	573

Worst Observation	406	2,882	-179	-1,093
# of Observations	292	266	292	266

Pre crisis: 3 years ending June 30, 2006

Crisis: 3 years ending June 30, 2009

As of June 30, 2009

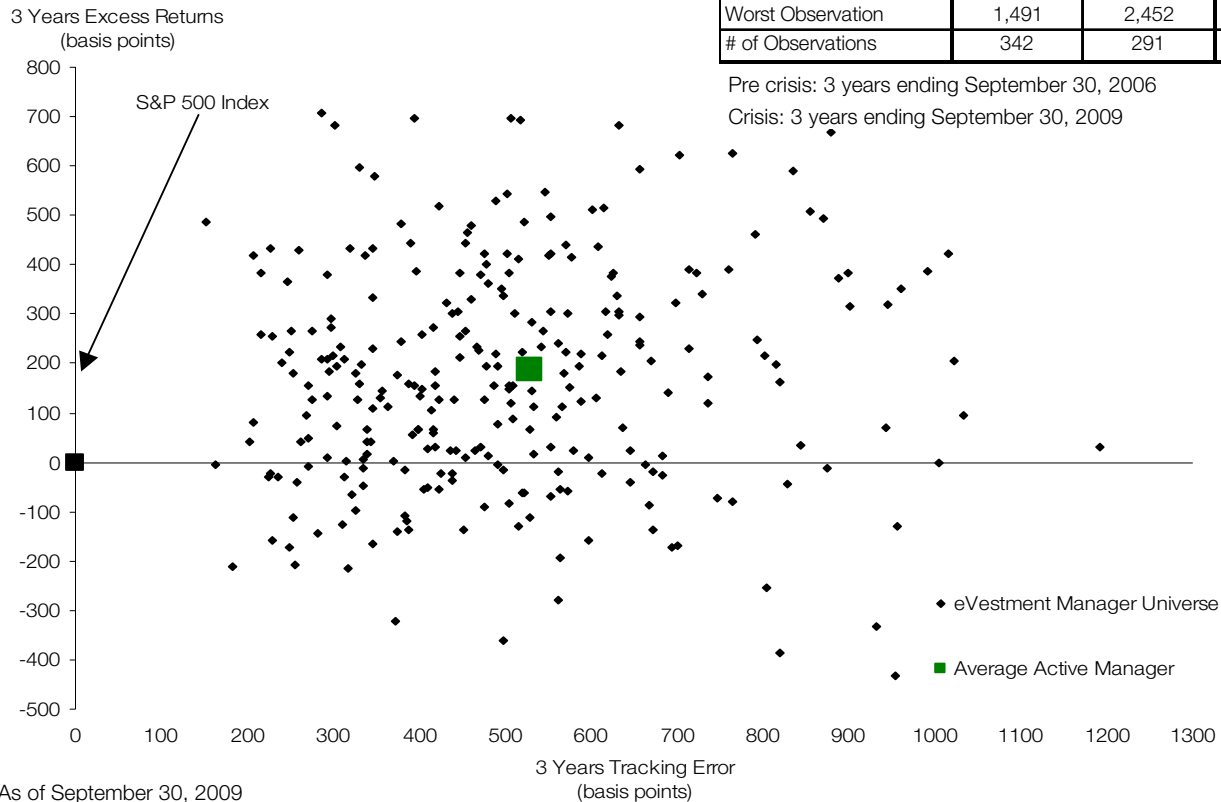
Source: eVestment Alliance, Lazard Asset Management

Y axis truncated at -500 basis points.

Dispersion of Equity Manager Returns Also Has Increased Substantially

- Performance results will be dominated by individual winners and losers in investment portfolios
- While passive, mean-reversion-based, and highly leveraged strategies were the winners in the old era, active, forward-looking strategies with little or no leverage are the likely winners in the new era
- This environment poses significant challenges for equity indexation strategies

U.S. Large Cap Core Equity Universe 3 Years Ending September 30, 2009



As of September 30, 2009
Source: eVestment Alliance, Lazard Asset Management
Y axis truncated at -500 basis points.

	Tracking Error (bps)		Excess Returns (bps)	
	Pre Crisis	Crisis	Pre Crisis	Crisis
5th Percentile	648	959	532	648
95th Percentile	131	244	-331	-170
Spread	517	715	863	818

Worst Observation	1,491	2,452	-794	-634
# of Observations	342	291	342	291

Pre crisis: 3 years ending September 30, 2006

Crisis: 3 years ending September 30, 2009

Conclusion

- We believe we are entering a multi-year period of greater differentiation between winners, survivors, and losers
- Successful investing today requires:
 - Deconstruction of macroeconomic and government forces
 - Forward-looking fundamental research
 - Robust scenario analysis

Inflation-based Investing

Asset Allocation – Relative Weights

Legend:

+ Overweight

- Underweight

= Neutral

Deflationary
Broad Assets
+ Physical Assets
- Financial Assets
Within Financial Assets
- Equity
+ Fixed Income
+ Volatility
Investment Implementation
Inflation Instruments
+ Commodities
+ Derivative Strategies
- TIPS
Leverage
+ Less Leveraged Issuers
- More Leveraged Issuers
Interest Rates
- Short Duration
+ Long Duration
Credit
- Long Credit Risk
+ Long Sovereign Risk

Neutral
Broad Assets
- Physical Assets
+ Financial Assets
Within Financial Assets
+ Equity
- Fixed Income
= Volatility
Investment Implementation
Inflation Instruments
+ Commodities
+ Derivative Strategies
- TIPS
Leverage
+/- Less Leveraged Issuers
-/+ More Leveraged Issuers
Interest Rates
+ Short Duration
- Long Duration
Credit
+ Long Credit Risk
- Long Sovereign Risk

Inflationary
Broad Assets
+ Physical Assets
- Financial Assets
Within Financial Assets
+ Equity
- Fixed Income
+ Volatility
Investment Implementation
Inflation Instruments
+ Commodities
+ Derivative Strategies
- TIPS
Leverage
+ Less Leveraged Issuers
- More Leveraged Issuers
Interest Rates
+ Short Duration
- Long Duration
Credit
+ Long Credit Risk
- Long Sovereign Risk

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An investment in bonds carries risk. If interest rates rise, bond prices usually decline. The longer a bond's maturity, the greater the impact a change in interest rates can have on its price. If you do not hold a bond until maturity, you may experience a gain or loss when you sell. Bonds also carry the risk of default, which is the risk that the issuer is unable to make further income and principal payments. Other risks, including inflation risk, call risk, and pre-payment risk, also apply. High yield securities (also referred to as "junk bonds") inherently have a higher degree of market risk, default risk, and credit risk.

Structured products, derivatives and other types of unregistered securities are generally not publicly traded. Non-publicly traded financial instruments are not readily disposable of, in some cases, may be contractually prohibited an account from disposing of such financial instruments for a specified period of time. An account may be forced to sell its more liquid positions at a disadvantageous time, resulting in a greater percentage of the account consisting of illiquid securities. In addition, the market prices, if any, for such illiquid financial instruments tend to be volatile, and an account may not be able to sell them when it desires to do so or to realize what it perceives to be their fair value in the event of a sale. The sale of illiquid securities also often requires more time and results in higher brokerage charges or dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in the OTC markets. Furthermore, there may be limited information available about the assets of such issuers of the financial instruments which may make valuation of such financial instruments difficult or uncertain.

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