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Summary

Low-volatility Equity Investing: Evolutionary, Not Revolutionary

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Traditional asset allocation models are being re-evaluated as investors look for a more dynamic approach against the uncertain economic and geopolitical backdrop and ongoing volatility in equity markets. The world is grappling with an era of deleveraging, the spectacular growth of the developing world, and challenges to political and financial institutions at a global, regional, and domestic level.

Given this current environment, investors continue to ask how they can effectively moderate equity risk while preserving the long-term return advantages that stocks generally provide. We believe that a strategy that invests in high-quality stocks and creates low-risk portfolios may result in long-term returns that are consistent with the market but with risk that is substantially lower than the market. This return/risk combination may potentially result in higher risk-adjusted returns.

We will explore this theme, starting with the search for equity diversification and then continuing with an examination of why market cap benchmarks are inefficient and how the industry is responding. We will then look at Lazard's research on why investing in high-quality companies and low-risk portfolios works, followed by where this strategy fits into the asset allocation and equity structure process and what makes these strategies truly effective.

When we describe risk, we are focusing on the consistency of total return, measuring volatility or the standard deviation of total returns. Quality is referenced in our discussion to describe our investment in companies with strong management teams and the ability to consistently generate stable cash flows.

Low-volatility investing is not an alternative strategy by structure, but does provide similar return and risk characteristics, in our

view. Our definition of low-volatility investing is long-only, fully-invested portfolios that can be global or focus on specific countries, regions, or capitalization sectors. This discussion and analysis will focus on global equity examples; however the story is similar if viewed within the context of local and regional equities.

Typical Equity Diversification Opportunities

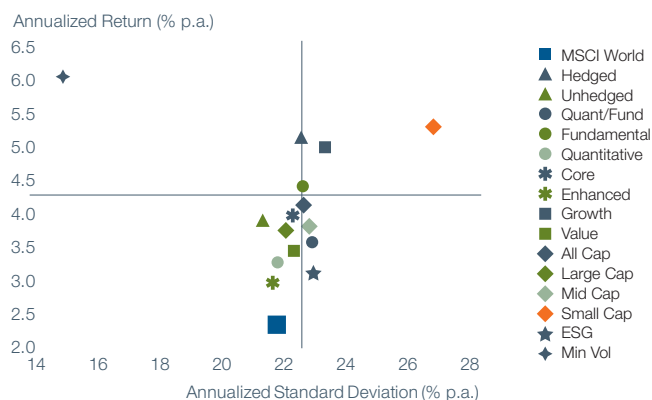
Our experience has been that investors like the idea of diversification, but don't like to sacrifice returns. Exhibit 1 illustrates diversification opportunities by comparing median total risk and return for the last five years for a wide range of global equity strategies, versus the MSCI World Index. The upper right quadrant represents strategies that have higher returns and higher risk than the MSCI World Index. Conversely, the lower left quadrant includes strategies with lower returns and lower risk. The MSCI World Index is the large blue box in the lower center and reflects an annualized return of 2.3% and an annualized standard deviation or volatility of 22.0%.

This exhibit shows that most investment strategies have historically maintained risk levels that are similar to each other as well as to the cap-weighted index. For example, the value and growth universe medians have risk levels that are within 5% of each other. A possible outlier might be global small cap, which has a higher level of risk, but its risk level is similar to a small cap index and therefore does not provide benchmark-relative diversification.

Conversely, the one strategy that is different is the global low volatility strategy that invests in high-quality stocks. This strategy's risk is substantially lower than all of the other global equity strategies for this five-year time period and the returns have been strong.

The question is why. How can this strategy have such a significant risk/return advantage? We believe that the answer has two components – the first is in the nature of how market capitalization benchmarks are constructed and the second is in the types of companies held within the high quality/low volatility strategy.

Exhibit 1 Equity Diversification Opportunities



For the five years ended 30 June 2011

Reporting currency: USD; data based on quarterly observations

The data presented for “Min Vol” represents the combined results of information derived from the Global Managed Volatility Simulation Model from the period January 1996 through December 2008 and the actual Global Managed Volatility strategy managed by Lazard from January 2009 through June 2011. The simulation information is being shown for illustrative and comparative purposes only, and is supplemental to the complete composite performance for this strategy. Please refer to the Simulation Disclosure for the complete disclosure notes, a brief composite description, and simulated performance information. Past performance is not a reliable indicator of future results.

Source: Lazard, eVestment Alliance, and MSCI

Risk Concentration within Market Cap Benchmarks

Market cap-weighted indices are, by definition, constructed on the basis of past performance. The disconnect is that, as investment professionals, we have all been trained to discount past performance. An illustration of the impact of this past performance is in the sector weights in Exhibit 2.

In this exhibit, we illustrate the change in a sampling of sector weights between the ends of December 1999 and June 2011. For example, technology decreases from 23% in 1999 to 13% in 2011, while minerals increase from 7% to 16%. Changes in index sector weights are primarily created by return differences between the sectors. Over this time period, the market return was approximately 14%, while technology stocks were down 45% and minerals stocks were up 215%.¹

For over 35 years, investors have relied on indices weighted by market capitalization. These indices typically have low turnover and the resulting low level of transaction costs. However, the

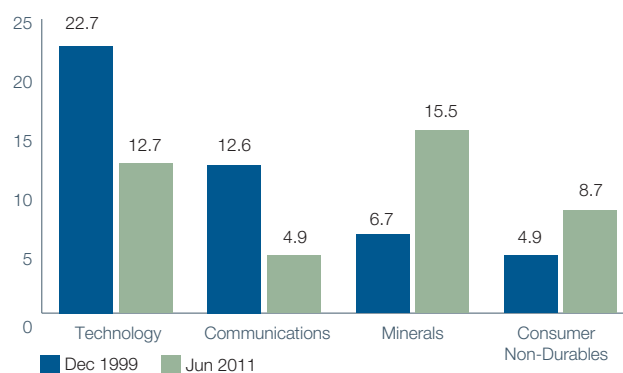
reason for low turnover may also be considered a source of risk as sectors with the largest returns will also have the largest weights. In some cases, the largest sectors and stocks may also be the most overvalued and could incorporate risks that dominate performance.

The investment industry has recognized this issue and organizations that create benchmarks have been happy to provide alternatives. The first index fund was created in the 1970s using an equal-weighted benchmark and, since that time, the availability and use of non-market cap indices has grown substantially.

In the late 1980s, some investors became concerned about the increasingly large allocation to Japan within the MSCI EAFE Index and, after a great deal of research, some of these investors adopted GDP-weighted benchmarks. Today’s fundamental-weighted approaches build on that GDP analysis just as the more recent introductions of low-volatility benchmarks reflect research conducted over the last several decades.

Exhibit 2 Market Cap’s Risk Concentration

FTSE World Large Cap Index Weight (%)



As of 30 June 2011

Source: Lazard, FTSE

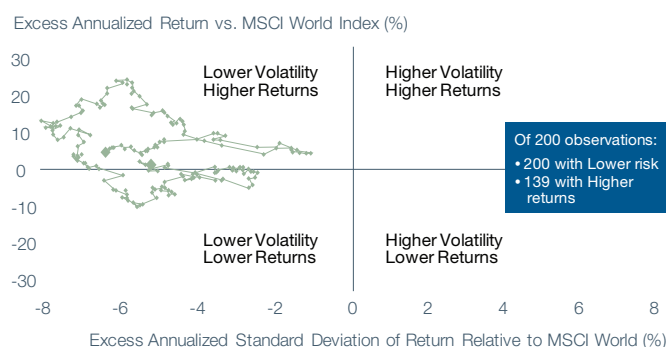
Increasing Equity Risk Does Not Increase Returns

Simply put, low-volatility stocks have historically matched or outperformed market cap indices over a cycle. Exhibit 3 plots the risk and return of low-volatility stocks, relative to the MSCI World Index. This chart plots performance of rolling 5-year periods, with the first period ending in December 1994 and the last period ending July 2011 for a total of 200 5-year periods. Each dot on the graph is one of these periods and represents the difference in risk and return between the lowest volatility stocks and the MSCI World Index.

The result of this comparison is that low-volatility stocks have lower risk in each of the 5-year periods and higher returns in 70%

of these periods. In each period that low-volatility stocks underperformed, the absolute return was positive. Low volatility's average return during these periods was 11.5%.

Exhibit 3 Low Volatility Performance

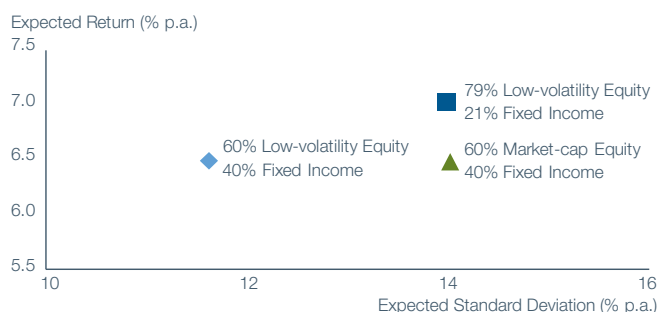


Rolling 60-month periods ending between December 1994 and July 2011. Data represents the stocks in the lowest volatility decile of the MSCI World Index. This information does not reflect the performance of any product managed by Lazard. Source: MSCI, Lazard

Opportunities Created by Low Volatility

Asset allocation decisions typically focus on stocks versus bonds and alternatives and do not include equity strategies beyond an aggregate market cap index. However, as we indicated in Exhibit 1, low-volatility equities have a risk/return profile that is substantially different from other equity strategies and may increase asset allocation flexibility. Exhibit 4 illustrates the potential impact that low volatility equity strategies can have at the asset allocation level.

Exhibit 4 Low Volatility's Impact on Asset Allocation



Low-volatility Equity data was established by maintaining the expected return and applying a 30% reduction to the expected volatility of the Global Equities assumption in the Audit Commission's report.

Market-cap Equity and Fixed Income data were derived from assumptions in the Audit Commission's report.

This data is for illustrative purposes only and does not represent the performance of any strategy managed by Lazard. Expected returns are not a promise or guarantee of future results and are subject to change.

Source: "Local Government Pensions in England," Audit Commission 2010, Lazard All data in GBP.

Our reference point is a 60/40 mix of market cap equities and fixed income using long-term forward-looking expectations and shown as a green triangle on this risk/return chart. The blue diamond's position on the chart is the result of replacing market cap with low-volatility equities. The diamond's vertical position matches the triangle as return expectations are consistent but its position to the left reflects a 30% decrease in expected risk of the equity component.

Alternatively, the reference risk level can be maintained and expected returns increased by 20% if market-cap equity is replaced with low-volatility equity and the equity allocation is increased to 79% as illustrated by the blue square.

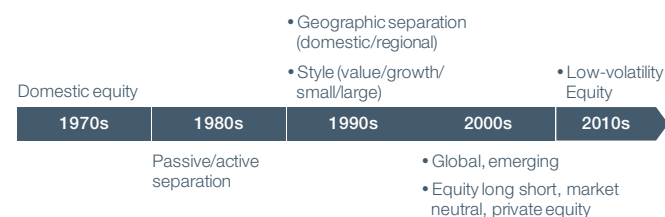
Separate from the asset allocation process, we believe another way to look at low-volatility equities is to use this strategy as an equity diversifier.

The Forever-changing Equity Portfolio

Over the past 40 years, our industry has continually evolved its views on equity diversification, as we illustrate in Exhibit 5. What has remained constant during this time has been a desire to capture returns, control benchmark-relative risk, manage costs, and decrease volatility.

In the 1980s, cost savings helped to boost the popularity of passive investing, while in the 1990s diversification was driven by the desire to control benchmark-relative risk, as well as an interest in identifying managers that had expertise within a specific style or region. In the last decade, the search for returns generated allocations to hedge funds, equity long/short strategies, and other alternatives. Today, our industry is focused on strategies that meaningfully impact total risk and return. We believe that low-volatility equity strategies provide some of the risk reduction benefits of market neutral and private equity investments, within the cost- and risk-efficient structure of a fully invested long-only stock portfolio.

Exhibit 5 The Evolution of Equity Diversification



For illustrative purposes only

Effective Low-volatility Strategies

Lazard's research has revealed that there are several key elements shared by effective low-volatility strategies. We believe the most important measure is the need to maintain balance between the focus on quality and risk as well as the avoidance of style biases.

Focus on Quality Companies

A focus on quality that is incorporated within the stock process can result in portfolios of companies that have strong management teams delivering stable cash flows. These companies serve as the core of effective low-volatility strategies.

Incorporate Changing Market Conditions

We are reminded on a daily basis how quickly market conditions can change and the importance of thoughtfully and selectively incorporating these shifts into the portfolio management process. Our belief is that superior approaches measure and manage the range of risks that may be encountered in the future, rather than to limit the definition of risk to recent history.

Manage Currency Exposures

Strategies that separately manage equity and currency risk increase the portfolio's aggregate quality and decrease equity risk, when compared to strategies that use equity positions to manage currency risk.

Minimize Style and Market Cap Biases

Balanced portfolios may protect against extremes in market cap exposure and style. Return consistency may be improved by avoiding the temptation to allow concentrations of small-cap or value exposures to bias returns.

In summary, we have provided what we believe to be compelling data illustrating the benefits of investing in the combination of high quality stocks and low volatility portfolios. These strategies endeavor to meet an investor's dual goals of return preservation and risk reduction. We believe that the adoption of strategies based on this balance of high quality and low risk may result in the unique combination of maintaining competitive returns while decreasing risk.

Notes

1 As represented by/within the FTSE World Large Cap Index. Source: FTSE

Important Information

Published on September 8, 2011.

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A quantitative investment strategy relies on quantitative models and quantitative filters, which, if incorrect, may adversely affect performance.

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Performance returns for Global Managed Volatility in USD from January 2009 to the present day are based on live accounts and are GIPS compliant returns for the strategy managed by Lazard. This information is being provided for illustrative and comparative purposes only. This information is supplemental to the complete composite performance.

Lazard Asset Management LLC is a U.S. registered investment advisor and claims compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of Lazard Asset Management's composites and/or a presentation that adheres to the GIPS standards, please contact Henry F. Detering, CFA at Lazard Asset Management, 30 Rockefeller Plaza, New York, New York 10112-6300 or by email at Henry.Detering@Lazard.com. Following is a brief description of the Lazard Quantitative Equity - Global Managed Volatility investment mandate: Lazard Quantitative Equity - Global Managed Volatility (USD Hedge) is a diversified equity strategy that seeks to produce stable, equity-like returns with total risk well below market levels. Stocks are selected for the portfolio using a proprietary, multi-factor investment process that seeks stocks with fundamental attractiveness and below average risk characteristics. This strategy includes currency hedging.

The data from the time period from January 1996 through December 2008 is simulated data and has been hedged to the currency specified.

This simulated data is hypothetical performance for the period when the product was not yet offered by Lazard Asset Management (the "Simulated Model"). It is shown for illustrative and comparative purposes only. The Simulated Model's returns were constructed by utilizing LQE's global stock selection model to select stocks within MSCI World Index countries. The MSCI World Index is an unmanaged free float-adjusted market capitalization index that is designed to measure developed market equity performance within North America, Europe, Australia and the Far East. The stocks were screened for data availability and liquidity requirements and only those equity securities that satisfied these data and liquidity requirements were included.

The portfolio's construction methodology unique to the Simulated Model includes limiting exposure to any one MSCI sector group to 20% of the total portfolio as well as a 1.5% maximum allocation to any one stock. The Simulated Model also incorporates a comprehensive and proprietary risk model that ensures market capitalization distribution and industry diversification. Additionally, the risk model employs measures to monitor and control both short and long term portfolio risk characteristics.

The simulated data presented reflect performance information for the period in which information is available from Factset. The Simulated Model analyzes data from January 1996. Performance shown is presented gross of fees and net of transaction costs. Had such fees and expenses been reflected, performance would have been lower. It represents past performance and is not a reliable indicator of future results.

LAM did not manage the Simulated Model during the periods shown. The hypothetical performance presented herein includes historical financial data to show what decisions would have been made if the strategy were employed. Simulated performance results are shown for illustrative purposes only and do not represent actual trading or the impact of material economic factors on LAM's decision-making process for an actual LAM client account. Simulated performance results were achieved by means of a retroactive application of a model designed with the benefit of hindsight.

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