



**LAZARD**

PRODUCT FILE NOTE

# Lazard Global Thematic Equity

JUNE 2011

## **DESCRIPTION**

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Lazard Asset Management's Global Thematic Equity strategy is a long-only, style agnostic investment discipline that targets long-term investment returns with low absolute risk. The portfolio is structured on a series of uncorrelated global investment ideas or themes rather than any benchmark; "tracking error" is not an aspect that is managed. The portfolio normally comprises approximately 80-120 holdings, primarily of securities of companies that are listed on the major equity markets; Emerging Market investment is limited to 25% of the portfolio and investment is normally confined to companies that have market capitalisations of US\$1 billion or greater.

Investors can access through separately managed portfolios direct with Lazard Asset Management or through unitised vehicles offered by Zurich Investment Management Ltd.

## **WHO SHOULD INVEST?**

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- Investors using **several global equity managers** can add an allocation to Lazard's Global Thematic Equity strategy to increase manager and style diversification because the returns it produces tend to be less volatile, and the discipline is style agnostic.
- In particular, investors can use Lazard's Global Thematic Equity strategy as a **complement to a "book-end" line-up of Growth and Value managers** because its addition tends to reduce the volatility in returns and increase diversification from the total global equity portfolio.
- Investors considering using a **single global equity manager** can expect Lazard's Global Thematic Equity strategy to target above index performance over the longer term, with less than index volatility in returns.

Investors with **separate allocations to US and EAFE equities** should consider some reallocation from both of these into Lazard's Global Thematic Equity strategy. In a globalising economy, this strategy aims to capitalise on global opportunity sets, which, by definition, managers who focus on regions or countries are less well positioned to identify.



## **MARKET INEFFICIENCIES EXPLOITED**

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- **Benchmark hugging.**

Many equity market participants use the major market-capitalisation-weighted indices as their starting point for portfolio construction, or as benchmarks for short-term performance measurement, or both. A consequence, deliberate or not, is that these managers tend to invest a substantial part of their portfolios, in line with other managers, in large companies.

- **Short termism.**

High levels of turnover and large share price responses to short-term news are clear symptoms of the equity markets' inability to understand and discount longer-term change.

By contrast, Lazard's Global Thematic Equity approach ignores index compositions. Rather, it builds portfolios around 8 to 12 themes (or opportunity sets), which seek to exploit medium to long-term change and have favourable return asymmetries (i.e. have greater upside than downside potential). These are retained until the asymmetries no longer exist.

## **PHILOSOPHY**

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Lazard's Global Thematic Equity Team ("the Team") believes that major companies compete for customers and capital in a single global marketplace and that investing therefore requires a global perspective. As geographic boundaries become less relevant, it makes sense to structure an investment portfolio that seeks to understand the complexity of this single system by focusing on its global connections, relationships and themes rather than, for example, geographic regions or traditional industry sectors.

The Thematic approach seeks to identify the major secular, cyclical and structural influences on the world's economies and stock markets in the early stages of their development. The associated social, economic, industrial or demographic investment themes which the Team believes represent investment opportunities that are asymmetric in the investor's favour, determine the shape and strategic direction of the portfolio.

This Thematic approach has built a framework for the portfolio manager's thinking, giving consistency, a context for the themes and diversification in the portfolio and seeks to reduce overall portfolio risk. It is based upon the rigorous and independent bottom-up analysis of corporations as well as an understanding of how companies are evolving and fit into the global business environment.

The Team aims to understand and exploit changes in the global economy. It does not seek unique sources of information but it does apply unique thematic analysis.

## **PROCESS**

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- **Global Framework Identification**

The Global Framework has evolved with the global economy, changing business models and geopolitical developments and, at any time, is a structure based on company observations, which the Team believes capture the critical strategic imperatives to which companies that compete globally must respond. It relies on the aggregation of Lazard's global research observations, observations from company managements, analysis of cultural and historical factors, and inputs from strategists and economists.



This Framework provides definition within the investable universe by focusing the Global Thematic portfolio managers on what is believed to be most relevant. It is constantly reviewed by debate between the Team and other relevant Lazard investment professionals. These can include members of Lazard's global sector analyst teams, its emerging market and regional mid-cap and small-cap portfolio management teams, and its country-based analysts. The current Global Framework is described in Appendix 1.

- **Global Theme Identification**

Global themes are investment opportunity sets inspired by global industry observations, and by the Global Framework. They are drawn from the same sources as the Global Framework. Themes should represent favourable asymmetric investment opportunity sets. The Team believes that asymmetry can be found in a long investment time horizon, the prevalence in markets of the benchmark mentality and conventional wisdom, regulatory distortions, and the complexity of the global system.

All theme ideas, regardless of their origins, are researched and debated within the Team as well as with Lazard's analysts, in order to establish their validity and value. The next step is to determine the degree to which a theme is investable, i.e. the extent to which it can be populated with attractively valued stocks.

- **Portfolio construction**

The portfolio is constructed thematically, with each theme representing a distinct opportunity set with favourable asymmetric characteristics. It is also critical to determine how the theme might affect the rest of the portfolio in terms of investment and correlations.

The portfolio typically contains 8-12 fundamentally uncorrelated themes, each represented by 8-12 stocks. Experience has shown that this construct provides the necessary degree of diversification of opportunity sets and, as residual factors only, sufficient diversification by holdings, sectors and countries, which are appropriate for our absolute risk objectives. The portfolio itself typically holds about 80-120 stocks.

Security weightings are determined by portfolio managers based on theme and stock conviction, subject to a maximum exposure to any individual stock of approximately 3% of the portfolio, with 1% as the normal position. No reference is made to index weights, or to market capitalisation ranges. The portfolios are normally fully invested and cash limits are used for operational purposes only.

Country allocation and sector weightings are residuals of thematic selection, with the result that the portfolio can be weighted significantly differently from the benchmark index. The portfolio is not managed with regard to tracking error. The discipline focuses on absolute risk, measured by the standard deviation of returns.

The Team considers emerging markets to be part of the global economy, and invests in emerging market companies if the thematic discipline indicates that promising investments can be found in such markets, though investment in them is limited to approximately 25% of the portfolio.

## **CONCLUSION**

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Lazard's Global Thematic Equity strategy is a unique, logical, proven and truly global methodology for identifying and populating a range of uncorrelated medium to long-term investment ideas with attractive asymmetric risk return characteristics. Diversification by theme and stock is designed to ensure relatively low volatility in returns. The strategy should meet or augment the investment requirements of equity investors using single global managers, several global managers, or separate allocations to regional and / or emerging market managers.



## PEOPLE

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The Team comprises:

### **Nicholas Bratt**

*Managing Director, Portfolio Manager/Analyst  
Lazard Asset Management LLC (New York)*

Mr. Bratt is a Portfolio Manager/Analyst on the Global Thematic Equity team. He began working in the investment field in 1973. Prior to joining Lazard in 2003, Mr. Bratt served in various capacities at Scudder, including Head of International Portfolio Management, Head of the Global Equity Group, and Global Chief Investment Officer. His most recent role had been as Director of Global Products at Deutsche Asset Management. Mr. Bratt attended Columbia University on a Fulbright scholarship, and holds a BA in Politics & Philosophy and in Economics from St. John's College of Oxford University. He is Director of the Korea Society, and an Advisory Director of La Maison Francaise, as well as a member of council for Foreign Relations. He is fluent in French and reads German.

### **Irene T. Cheng**

*Managing Director, Portfolio Manager/Analyst  
Lazard Asset Management LLC (New York)*

Ms. Cheng is a Portfolio Manager/Analyst on the Global Thematic Equity team. She began working in the investment field in 1984. Prior to joining Lazard in 2003, Ms. Cheng was a senior international equity portfolio manager with Scudder. She has also worked as a research analyst with Blackstone Group and Sanford Bernstein. She has an MBA from Harvard Business School, a BA in Chemistry from Harvard University, and an MS in Chemical Engineering from MIT. She speaks some French and Mandarin.

### **William Holzer**

*Managing Director, Portfolio Manager/Analyst  
Lazard Asset Management LLC (New York)*

Mr. Holzer is a Portfolio Manager/Analyst on the Global Thematic Equity team. He began working in the investment field in 1971. Prior to joining Lazard in 2003, Mr. Holzer worked at Scudder, where he initiated the Global Thematic Product in 1986. He has been the senior portfolio manager on this product since its inception. Before moving to Scudder, he was a credit analyst at Bankers Trust. Mr. Holzer received an MBA from New York University, and a BA in Economics from the University of Lancaster.

### **Andrew Norris**

*Managing Director, Portfolio Manager/Analyst  
Lazard Asset Management LLC (New York)*

Mr. Norris is a Portfolio Manager/Analyst on the Global Thematic Equity team. He began working in the investment field in 1973. Prior to joining Lazard in 2003, Mr. Norris worked at Zurich Scudder as a managing director and product investment specialist. Before joining Scudder, he served in various capacities at Barings, including as Head of Global Equity Capital Markets, Head of Equity Syndicate, and Head of Barings' Middle East Office. He has studied at Edinburgh University, and at the Middle East Centre for Arabic Studies in Lebanon. He is fluent in French and Arabic.

### **Steve Wreford, CFA**

*Director, Portfolio Manager/Analyst  
Lazard Asset Management Limited (London)*

Mr. Wreford is a Portfolio Manager/Analyst on the Global Thematic Equity team. He began working in the investment field in 1995. Prior to joining Lazard in 2010, Steve was a Partner and Portfolio Manager with Hampstead Capital. Previously he was a Portfolio Manager with Scudder/Deutsche Asset Management, Equity Research Analyst with CCF Charterhouse, and Chartered Accountant with KPMG. He has a BSc (Hons) in Computer Science from Aston University.

## Appendix 1

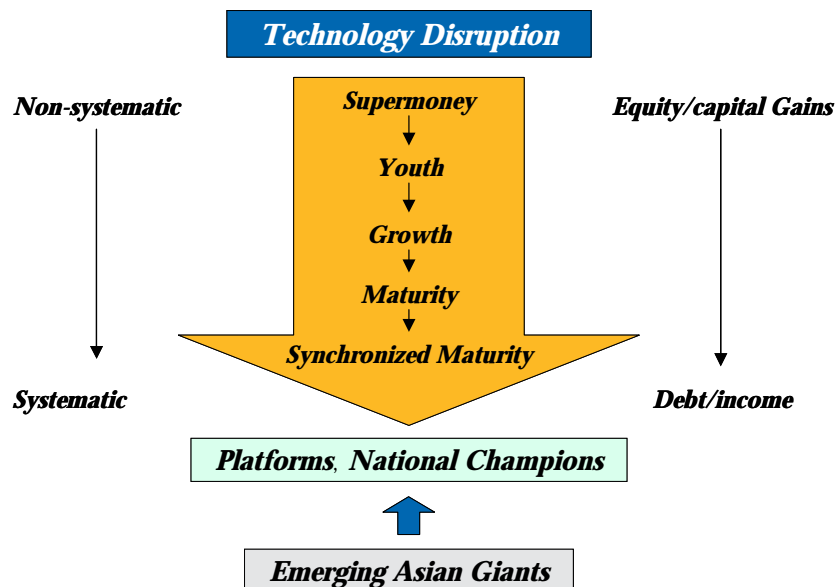
### Current Global Framework

(June 2011)

The positive feedback loop linking technology and globalisation continues. Driving change are the world's corporations, particularly those based in the United States, but also some from Europe and the occasional Asian company. The benefits, so the management consultants have been explaining for years, come from concentrating on a core activity and outsourcing less interesting stuff to best-in-class subcontractors. The outcome has been for the exponents of the idea to retain customer relationships, distribution and service and to give up the capital-intensive stuff. We call these asset light companies "platforms."

Improvements in technology and logistical systems ("pipelines") accelerated the process, and those who were early to understand grabbed the customers. Economies of scale are important in reducing the cost of technology and securing terms from subcontractors, so, in an environment of easy credit, industrial concentration has happened quickly.

The question is what now? With many industries down to so few players, acquisition is no longer a



source of growth. The re-investment rate is now a problem. The companies we have in mind are too large for private equity finance. The choices are:

- Increased dividends and special dividends
- Buy backs
- New investment projects
- Acquisitions in new areas
- Price wars



This evolution applies to what we call rational industries. Not all industries are rational. Those dominated by government regulation, national interest, and technology shifts have different dynamics and more-diverse paths into the future. They are also more susceptible to insightful analysis. Anyway, the big stocks are those in the market that have underperformed for five or six years. Smaller companies have outperformed, based on the promise of bringing cheap debt to their balance sheets. The credit cycle will be the important driver of any reversal here.

New themes were introduced in April 2010. It is important to emphasise that this is an evolutionary shift that focuses our investment thinking as we look forward and not a large change in overall strategy. The immediate stock-specific consequences of these changes have already largely been undertaken. The theme changes are in summary as follows.

Recognising the continued challenges of synchronised maturity, the large Assets of Choice theme is being divided into two new themes. The old theme will be eliminated.

The first is named Synchronised Maturity – Harvesters. Under this theme, we will hold companies that we believe have recognised the challenges we refer to, and that have adopted strategies that allow them to potentially harvest the benefits of an acquired market position. A characteristic of this theme will be great capital discipline, and, as a function of this, possibly the accelerated return of capital to shareholders.

The second is named Synchronised Maturity – Platform Expanders. Under this theme, we will hold companies that we believe are less constrained by the challenges of synchronised maturity, that have real investment opportunities, and that have the possibility of growth (other than the universal promise of growth in the emerging markets). Good examples of this might be companies whose products and services allow those in the previous category to become more efficient.

Most stocks held under the old Assets of Choice theme have been reallocated between these two themes. Those not considered relevant to the new themes have been eliminated. A small number of holdings under Other have been allocated to these new themes.

The second series of changes relate to the Emerging Economies, National Platforms, and Taiwan themes. The old Emerging Economies theme requires a more precise focus. The Taiwan theme has run its course now that political rapprochement, in our opinion, has become a fact of life. The National Platforms theme is still valid and is being expanded.

The Emerging Economies and Taiwan themes, but not their holdings, are being eliminated. A new theme, named Emerging Markets Real Estate, is being introduced. This new theme recognises the risk and opportunity set derived from developed world interest rates, the currency regime practiced principally in Asian countries, and its implications for asset prices.

Holdings under the old Emerging Economies and Taiwan themes, where relevant, are being reallocated between the National Platforms and Emerging Markets Real Estate themes. Some previous holdings under the National Platforms theme are also being reallocated to the Emerging Markets Real Estate theme.

The current themes are described in Appendix 2.



## Appendix 2

### Current Themes

(June 2011)

#### 1. Antimatter

- Japan is outside the Anglo-world's credit cycle.
- Corporations are flush with cash and assets.
- Expectations are low, efficiency gains are possible.
- Higher long-term interest rates may be positive for stocks.

By this we mean that expectations embedded in these investments are so low that an adverse turn in the operating environment is unlikely to have an adverse effect on their market value. More specifically, in the case of Japan we think stocks are priced on a yield basis, not on earnings, implying there will be no growth in Japan, which is consistent with demographics. In contrast, we think that almost any change in the economic environment which pushes interest rates higher (inflation, or debt crowding as government financing needs and lower savings rates collide) may be positive for stocks.

Alternative scenarios are plausible. There is a huge inventory of economic inefficiencies in Japan. Using capital more efficiently will eventually happen as

- i) the advantages of substituting capital for labor become more evident and
- ii) servicing a huge debt burden forces the government to incentivise the corporate sector to do more for the economy.

#### 2. Gold & Precious Metals

- Gold is the only alternative currency not subject to the printing press.
- Its market capitalisation is small.
- Its value as a hedge to the rest of the portfolio magnifies small portfolio exposure.

A generation of investors and central bankers either ignore it or reject it as a financial asset. But inflation is becoming a plausible subject of discussion.

The current crisis in the financial industry has now imparted to gold the status of the ultimate counterparty, a positive attribute in a deflationary context.

#### 3. Synchronised Maturity - Platform Expanders

- Many industries have rationalised to a limited number of participants.
- Platforms have high market shares and, unable to expand at the expense of their competitors, low growth. Global competition, especially in growing emerging economies, is intense.
- Strategic choices are either to invest in growth and migrate capital, or to cut costs and/or prices, or buy back shares/pay dividends.
- Wealth creative opportunities are scarce and valuable.

The most evolved industry structure is one in which the very last three or four global platforms learn to co-exist. Competing for market share may be impracticable (monopoly authorities) or even self-destructive. These franchises are cash positive, multicurrency, and they are globally recognised winners.

Under "synchronised maturity," managements have choices for the deployment of cash. As industries mature, buy-backs are a signal to competitors, as well as investors, that after years of working for the market share and giving away premium for acquisitions, it is now time to reap.



Meanwhile, in emerging economies, where market shares have only just begun consolidating, competition will be fierce. Foreign corporations will compete for market shares and a piece of the future in these markets. Running returns will not be important to the competitors, and projects will not have to be self-financing. New global competitors may also emerge.

Against this background, wealth creative opportunities are scarce and therefore valuable.

#### 4. Synchronised Maturity - Harvesters

- Many industries have rationalised to a limited number of participants.
- Platforms have high market shares and, unable to expand at the expense of their competitors, low growth. Global competition, especially in growing emerging economies, is intense.
- Strategic choices are either to invest in growth and migrate capital, or to cut costs and/or prices or buy back shares/pay dividends.
- Recognition of maturity and the discipline to harvest and return capital is an acceptable choice.

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The recognition of maturity and the discipline to return capital is an acceptable, but still infrequent, choice for management.

#### 5. National Platforms

- Fast growing emerging economies, where traditional wealth creation is under way, are creating their own platform companies.
- They have the same characteristics as global platforms, but are subject to physical or regulatory boundaries.
- These boundaries mitigate extreme competitive pressures and so enhance the ability to create wealth.

The local version of global platforms, but subject to physical or regulatory boundaries. We are interested in the emergence of government sponsored (through regulatory protection) or spontaneous national champions or “New Giants.”

#### 6. Emerging Markets Real Estate

- Traditional capital and labour intensive wealth creation is underway in the large emerging countries, but competition is very fierce.
- Domestic demand will be captured in real estate and banks.
- Infrastructure, including housing, is a vital precondition.
- Low global interest rates and currency regimes support asset prices.

Deleveraging in the OECD will place the burden of world growth on these countries. Their internal policies will be critical.

The sources of growth can be separated into external and internal. External - their role as subcontractors including in some cases, the emergence of government sponsored or spontaneous national champions or



“New Asian Giants.” Internal - subsequent domestic demand can be captured in the stock market via housing demand and general growth in banks. Infrastructure development, including housing, is essential to support demand. In addition, low global interest rates and currency regimes support asset prices.

### 7. Intergenerational Assets

- There has been a shortage of traditional intergenerational investment (e.g. infrastructure) in recent decades, especially in the Anglo-Saxon economies.
- The environment is a key new intergenerational challenge.
- Until recently the stock market has not been willing to finance long duration assets.
- Supportive public policy and regulation is a necessary precondition.

Existing infrastructure in many parts of the OECD, especially that relating to the energy chain, has not been renewed for many years. Coincident with this are the emergence of the environmental lobby and infrastructure construction in emerging economies.

Since these assets will be paid for by one generation but enjoyed by the next one, the issue of equity automatically raises questions of intergenerational choices and of regulation. Returns on existing projects have to be high enough to incentivise new projects by accommodating both high risk and the long time horizon.

### 8. Regulatory Change

- Intergenerational conflicts, lopsided wealth distribution, and crisis in the financial system are challenges which require secular and structural change.
- Markets cannot provide solutions.
- Supportive public policy and therefore regulatory change are necessary preconditions for meeting these challenges.
- The political cycle supports this.

Dysfunction in the financial sector, competition for resources between ageing boomers and generation X, between developing and less developed countries, and environmental concerns are all questions that will not be left to markets to provide solutions.

The combination of market mechanisms, abundant low cost capital, and changing national and global political consensus relating to the environment and other intergenerational issues will drive regulatory change. We believe this will provide both risks and opportunities in future years.

### 9. Oil

- Capacity is limited, and balance sheets are solid.
- Capital discipline prevails.
- Geopolitical factors (Middle East, Chinese access) create a strategic underpinning.

Most of the world's important reserves are in the Middle East and the ex-Soviet Union. The world's greatest consumers are in North America and now China. Inability to access national resources is likely to force further asset-based consolidation in this mature industry.



## Appendix 3 Current Portfolio

(June 2011)

Industry/Holdings	% of Equity	Industry/Holdings	% of Equity	Industry/Holdings	% of Equity
<b>Antimatter</b>	<b>11.5%</b>	<b>National Platforms cont'd</b>		<b>Synchronised Maturity - Platform Expanders</b>	<b>13.7%</b>
Daiwa House Industry Co Ltd		DBS Group Holdings Ltd		Air Liquide SA	
Daiwa Securities Group Inc		HDFC Bank Ltd Spon ADR		Cisco Systems Inc	
Fanuc Ltd		Hong Kong & China Gas Ltd Ord HKD0.25		EMC Corp	
JS Group Corp		Hong Kong Exchanges & Clearing Ltd		Johnson & Johnson	
Kajima Corp		Metro AG NPV		Oracle Corp	
Mitsubishi Estate Co Ltd		New World Dept Store China		Visa Inc Cl A	
Mitsui Fudosan Co Ltd		Parkson Retail Group Ltd		Google Inc Cl A	
Nomura Holdings Inc		Prudential Plc 5p		Danone	
Seven & I Holdings Co Ltd		Redecard SA		Teva Pharmaceutical Inds Spon ADR	
Shimizu Corp		Uni-president Enterprises Co		Mead Johnson Nutrition Company	
Sumitomo Realty & Development Co Ltd		China Life Insurance Co Ltd		SABMiller Plc	
T&D Holdings Inc		Industrial & Commercial Bank of China		Wal-Mart Stores Inc	
Toray Industries Inc		Itau Unibanco Banco Holding SA		Air Liquide SA - Loyalty Bonus Shares	
Yamato Holdings Co Ltd		Standard Chartered Plc		SAP AG	
Mitsubishi UFJ Financial Group Inc		Banco Santander Brasil SA		<b>Synchronised Maturity - Harvesters</b>	<b>14.5%</b>
Dai-ichi Life Insurance Co Ltd		China Minsheng Banking Corp Ltd		Amgen Inc	
Sumitomo Mitsui Financial Group Inc		Cielo SA		British American Tobacco PLC Ord 25p	
Sumitomo Mitsui Trust Holdings Inc		Tingyi Holding Corp		Exxon Mobil Corp	
<b>Gold &amp; Precious Metals</b>	<b>8.5%</b>	AIA Group Ltd		GlaxoSmithKline Plc	
Barrick Gold Corp		<b>Oil</b>	<b>10.2%</b>	Intl Business Machines Corp	
Gold Fields Ltd		Anadarko Petroleum Corp		Merck & Co Inc	
Goldcorp Inc		Apache Corp		Microsoft Corp	
Impala Platinum Holdings Ltd		Canadian Natural Resources Ltd		Pfizer Inc	
Impala Platinum Holdings Ltd Spon ADR		Chevron Corp		Taiwan Semiconductor Mfg Co Spon ADR	
Newmont Mining Corp		China Shenhua Energy Co Ltd		Vodafone Group Plc	
SPDR Gold Trust		Encana Corp		Zurich Financial Services AG	
Yamana Gold Inc		Marathon Oil Corp		Royal Dutch Shell Plc Cl A	
Kinross Gold Corp		Occidental Petroleum Corp		Unilever Plc	
<b>Intergenerational Assets</b>	<b>11.3%</b>	Genovus Energy Inc		Verizon Communications Inc	
ABB Ltd SEK		EOG Resources Inc		Swiss Re Ltd	
Bunge Ltd		<b>Other</b>	<b>2.6%</b>	ThyssenKrupp AG	
Entergy Corp New		Actelion Ltd		<b>Emerging Markets Real Estate</b>	<b>6.4%</b>
Exelon Corp		Bristol Myers Squibb Co		Capitaland Ltd	
Hochtief AG		Hirco Plc		China Overseas Land & Investment Ltd	
LM Ericsson AB		Lonza Group AG		Cyrela Brazil Realty	
Mitsubishi Heavy Industries Ltd		Covance Inc		Hang Lung Group Ltd	
Monsanto Co		Charles River Laboratories Inc		Hang Lung Properties Ltd	
National Grid PLC		A123 Systems Inc		Sun Hung Kai Properties Ltd	
Pearson Plc 25p		<b>Regulatory Change</b>	<b>4.3%</b>	Taiwan Fertilizer Co Ltd	
Siemens AG		CVS Caremark Corp		Far Eastern New Century Corporation	
Spectra Energy Corp		Deutsche Boerse AG		CapitaMalls Asia Ltd	
Foster Wheeler AG		UnitedHealth Group Inc			
<b>National Platforms</b>	<b>16.9%</b>	CME Group Inc			
Bank of East Asia Ltd		NextEra Energy Inc			
Cathay Financial Holding Co		Autonomy Corp Plc			
Chinatrust Financial Holding Co Ltd					
				<b>Grand Total</b>	<b>100.0%</b>

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