Is Global Diversification Dead?

24 July 2013
David Cleary, CFA
Managing Director, Portfolio Manager/Analyst

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Global Overview

- US equity markets continue to post strong returns
  - Slow and steady recovery coupled with accommodative monetary policy is sustaining rally
- Interest rate normalization in the United States is impacting global bond markets
  - All major bond markets have sold off globally with many posting negative returns
- Emerging markets equities continue to significantly underperform
  - Slowing Chinese economy is weighing on the entire emerging-market asset class
- Japan is quietly taking market leadership for returns
  - Aggressive policy making is fueling Japanese equity market
- The average World Allocation strategy returned 0.12% YTD through 30 June 2013
  - Investors are questioning the value of global investing
## Returns by Major Market Asset Class

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>YTD 2013</th>
<th>1 Year</th>
<th>3 Years</th>
<th>5 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSCI Japan Index</td>
<td>16.5</td>
<td>22.2</td>
<td>8.9</td>
<td>-0.1</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>13.8</td>
<td>20.6</td>
<td>19.1</td>
<td>7.3</td>
</tr>
<tr>
<td>MSCI World Index</td>
<td>8.4</td>
<td>18.6</td>
<td>14.2</td>
<td>2.8</td>
</tr>
<tr>
<td>Global Market Exposure Index²</td>
<td>2.5</td>
<td>9.7</td>
<td>9.4</td>
<td>4.6</td>
</tr>
<tr>
<td>MSCI Europe Index</td>
<td>2.2</td>
<td>18.9</td>
<td>10.9</td>
<td>-1.4</td>
</tr>
<tr>
<td>Barclays US Aggregate Bond Index</td>
<td>-2.4</td>
<td>-0.7</td>
<td>3.6</td>
<td>5.4</td>
</tr>
<tr>
<td>MSCI Pacific ex-Japan Index</td>
<td>-4.7</td>
<td>12.2</td>
<td>11.5</td>
<td>3.4</td>
</tr>
<tr>
<td>MSCI Emerging Markets Index</td>
<td>-9.6</td>
<td>2.9</td>
<td>3.5</td>
<td>-0.4</td>
</tr>
</tbody>
</table>

*As of 30 June 2013*

1. Returns for periods over one year are annualized.
2. The Global Market Exposure Index is a blended index and is comprised of 36% Barclays Capital US Aggregate Index, 15.6% S&P 500 Index, 12% MSCI Europe Index, 12% MSCI Pacific Index, 12% MSCI Emerging Markets Index, 4.8% S&P MidCap 400 Index, 3.6% S&P SmallCap 600 Index, and 4% Three Month London Interbank Offered Rate (LIBOR).

The performance quoted represents past performance. Past performance is not a reliable indicator of future results. This information is for illustrative purposes only and does not represent any product or strategy managed by Lazard. One cannot invest directly in an index.

Source: FactSet
Global Diversification

Year to date, Global Diversification Has Not Worked…
YTD through 30 June 2013

...But Global Diversification Has Worked Over the Longer Term
20 Years Ended 30 June 2013

As of 30 June 2013
* The Global Market Exposure Index is a blended index and is comprised of 36% Barclays Capital US Aggregate Index, 15.6% S&P 500 Index, 12% MSCI Europe Index, 12% MSCI Pacific Index, 12% MSCI Emerging Markets Index, 4.8% S&P MidCap 400 Index, 3.6% S&P SmallCap 600 Index, and 4% Three Month London Interbank Offered Rate (LIBOR)

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Source: Lazard, FactSet
Global Market Exposure

- Wider opportunity set
- Better risk-adjusted returns over time
- Valuation differentials
- Smoothing of cycles

As of 30 June 2013
For illustrative purposes only.
Allocations and security selection are subject to change. The securities identified should not be considered a recommendation or solicitation to purchase or sell these securities.
Risk/Return Profile of Global Markets

20-Year Risk/Return

Return (%)

Standard Deviation (%)

<table>
<thead>
<tr>
<th>Index</th>
<th>Sharpe Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Market Exposure Index</td>
<td>0.47</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>0.37</td>
</tr>
<tr>
<td>MSCI Europe Index</td>
<td>0.27</td>
</tr>
<tr>
<td>MSCI Pacific Index</td>
<td>-0.06</td>
</tr>
<tr>
<td>MSCI Emerging Markets Index</td>
<td>0.26</td>
</tr>
<tr>
<td>Barclays Capital US Aggregate Index</td>
<td>0.77</td>
</tr>
<tr>
<td>MSCI World Index</td>
<td>0.26</td>
</tr>
<tr>
<td>MSCI Japan Index</td>
<td>-0.17</td>
</tr>
</tbody>
</table>

As of 30 June 2013

1 The Global Market Exposure Index is a blended index and is comprised of 36% Barclays Capital US Aggregate Index, 15.6% S&P 500 Index, 12% MSCI Europe Index, 12% MSCI Pacific Index, 12% MSCI Emerging Markets Index, 4.8% S&P MidCap 400 Index, 3.6% S&P SmallCap 600 Index, and 4% Three Month London Interbank Offered Rate (LIBOR). The performance quoted represents past performance. Past performance is not a reliable indicator of future results. This information is for illustrative purposes only and does not represent any product or strategy managed by Lazard. One cannot invest directly in an index.

Source: Lazard
The Interest Rate Conundrum

US Treasury Yields, 1925–Present

Distribution of UST 10-Year Yields, 1925–2012

US Tsy 10-Year Price Returns at Various Yield Levels

As of 30 June 2013
1 As of 31 December 2012

This information is for illustrative purposes only.
Japan Still Matters

- Third largest economy in the world.
- GDP per Capita comparable to the US and higher than UK, Germany, and France.
- 10% of Global GDP; 9% of world equity market cap; 20% of total number of companies in developed markets.¹
- Deep and broad capital markets, with world class global companies.

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¹ Market cap and number or companies data are based on the MSCI World Index, as of March 2013.
Estimated or forecasted data are not a promise or guarantee of future results and are subject to change. This information is for illustrative purposes only.
Source: IMF World Economic Outlook, Haver Analytics, MSCI
Reasons for Optimism in Japan

- Aggressively targeted inflation and GDP growth via BoJ-induced quantitative easing
- Announced moves toward free-trade agreements
- Announced plans for deregulation of the agriculture, utilities, and leisure industries
- Initiated sale of public assets
- Announced plans to cut corporate tax rates in exchange for wage hikes

Nikkei 225 Index Performance

As of 30 June 2013

The performance quoted represents past performance. Past performance is not a reliable indicator of future results. This information is for illustrative purposes only and does not represent any product or strategy managed by Lazard. One cannot invest directly in an index.

Source: Bloomberg
Japan – Recent News Headlines

- Japanese exports rose a stronger-than-expected 10.1% in May from a year earlier, the fastest annual rate in more than two years.

- Japan’s housing starts rose for the ninth straight month in May, the longest streak since the period ended February 2011.

- The Bank of Japan’s closely-watched Tankan survey of corporate sentiment showed that the mood among businesses improved sharply in the three months to June.

- Consumer confidence in Japan has now improved for five consecutive months and is elevated relative to history.

- Abenomics propels Japan’s public pension fund to record profit.

- Shinzo Abe’s campaign to revive Japan has triggered a surge in luxury spending, prompting manufacturers and retailers to review their growth strategies.

- Japan’s Cabinet Office reporting annual economic growth of 3.5% for the first quarter, much quicker than the 2.7% increase expected by analysts.

- Japan’s annualized GDP accelerated to a 4.1% rate in the first quarter of 2013.

- Japanese companies plan to increase capital outlays by 12% in 2013, the fastest since the Lehman shock.
Non-US Markets Are Attractive on a Relative Valuation Basis

<table>
<thead>
<tr>
<th></th>
<th>United States</th>
<th>Japan</th>
<th>Europe</th>
<th>Emerging Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/E (est. 2013 earnings)</td>
<td>14.6</td>
<td>13.6</td>
<td>12.2</td>
<td>9.8</td>
</tr>
<tr>
<td>Forward P/E</td>
<td>13.7</td>
<td>13.2</td>
<td>11.4</td>
<td>9.2</td>
</tr>
<tr>
<td>Forward P/B</td>
<td>2.1</td>
<td>1.2</td>
<td>1.4</td>
<td>1.2</td>
</tr>
<tr>
<td>ROE 2013 (%)</td>
<td>16.1</td>
<td>9.0</td>
<td>11.8</td>
<td>13.3</td>
</tr>
<tr>
<td>Revenue Growth 2013 (%)</td>
<td>2.2</td>
<td>7.6</td>
<td>0.6</td>
<td>6.7</td>
</tr>
<tr>
<td>Earnings Growth 2013 (%)</td>
<td>6.8</td>
<td>63.1</td>
<td>1.9</td>
<td>11.8</td>
</tr>
<tr>
<td>Implied Profit Margin 2013 (%)</td>
<td>9.8</td>
<td>4.3</td>
<td>7.5</td>
<td>6.5</td>
</tr>
<tr>
<td>Revenue Growth 2014 (%)</td>
<td>4.3</td>
<td>3.1</td>
<td>3.5</td>
<td>7.7</td>
</tr>
<tr>
<td>Earnings Growth 2014 (%)</td>
<td>11.2</td>
<td>10.1</td>
<td>12.2</td>
<td>11.5</td>
</tr>
</tbody>
</table>
Europe – Improving Off of a Low Base

European Purchasing Managers Index (PMI): Manufacturing

As of 30 June 2013

An index above 50 indicates an increase in activity. An index below 50 indicates a decrease in activity. This information is for illustrative purposes only.

Source: Haver Analytics
Emerging Markets – Too Important to Ignore

Emerging Economies as a Percentage of the Total World

Population
Landmass
Energy Consumption
GDP at PPP
Exports
GDP at Market Rates
Market cap (full market)
Market cap (float adjusted)

Emerging Markets
Developed Markets

Population as of October 2012; landmass as of 2010; FX reserves as of December 2012; and GDP as of December 2011. Based on IMF country classifications of Advanced Economies and Emerging and Developing Economies.
Market capitalization based on MSCI ACWI IMI as of December 2012.
This information is for illustrative purposes only.
Source: IMF, World Bank, CIA The World Fact Book, MSCI, Lazard
Summary

- US markets have led post-financial crisis

- Near-term economic data points indicate an ongoing global recovery

- Valuation disparities across regions have become significant

- Fixed income is unlikely to produce same return pattern

- Meaningful fundamental change appears to be happening in Japan

- A broad, global opportunity set is still valid

Opinions as of July 2013 and are subject to change.
Q&A
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David Cleary is a Managing Director of Lazard Asset Management LLC. David is responsible for the management of the Lazard Capital Allocator Series (“LCAS”). LCAS is a global tactical asset allocation investment strategy. David works on asset allocation modeling and total portfolio risk management and is a member of the LCAS Advisory Board. Additionally, he provides oversight and management to Lazard’s U.S.-based fixed income and asset allocation platform. He is also a member of the Lazard Investment Council. Previously, he spent nine years as a senior fixed income portfolio manager at Lazard with a focus on risk control, sector allocation and total portfolio management. David began working in the investment field in 1987. Prior to joining Lazard in 1994, David worked as a portfolio manager with Union Bank of Switzerland and an assistant treasurer with IBJ Schroeder, both primarily in fixed income asset management. He has a BS from Cornell University.
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