

LAZARD GLOBAL FIXED INCOME / JUNE 2009

Focus on Country Allocations

We believe this is an opportune time to re-examine the global fixed income environment, as investors with a “domestic home-bias” (U.S.- and U.K.-based, for example) who are tied to one interest rate and economic cycle should, in our opinion, consider expanding their opportunity set. The recent and aggressive quantitative easing policy actions in both countries initially enriched local government bonds, but yields have moved sharply higher since mid-March on supply concerns, perceptions of inflationary pressures, and “green shoots” of economic growth (not to mention deteriorating fiscal conditions). Having access to a broad global universe allows investors to benefit from country, credit sector, and currency rotation, potentially adding value and diversification to a fixed income allocation.

Country rotation is an important driver of returns in the Lazard Global Fixed Income strategy, and allocations can be positioned to add value by being both opportunistic and defensive, and by taking a thematic approach.

Following is a summary of our current country allocations.

Overweights

- Australia, Canada, Norway, Brazil, Chile: Commodity-rich countries which provide a natural and direct “hedge” against commodity-based inflation
- Core Europe (e.g., Germany, France, Netherlands): May have more potential to rally or hold their value, especially if the euro strengthens further, or inflation fears are overblown
- Poland: Attractive yields with further potential for monetary policy easing; strong convergence play in coming years
- Indonesia, India: Select countries with high levels of internal/domestic demand, which are better equipped to ride out the global downturn (recent positive election results in both countries also crucial)

Underweights

- U.S., Japanese, Italian, U.K. government bonds: Poor valuations, fiscal deterioration, supply concerns
- Singapore, Taiwan, Japan: Select export-dependent countries
- Russia, Baltic countries: Fiscal, political, currency vulnerability

DECIDING WHERE TO INVEST

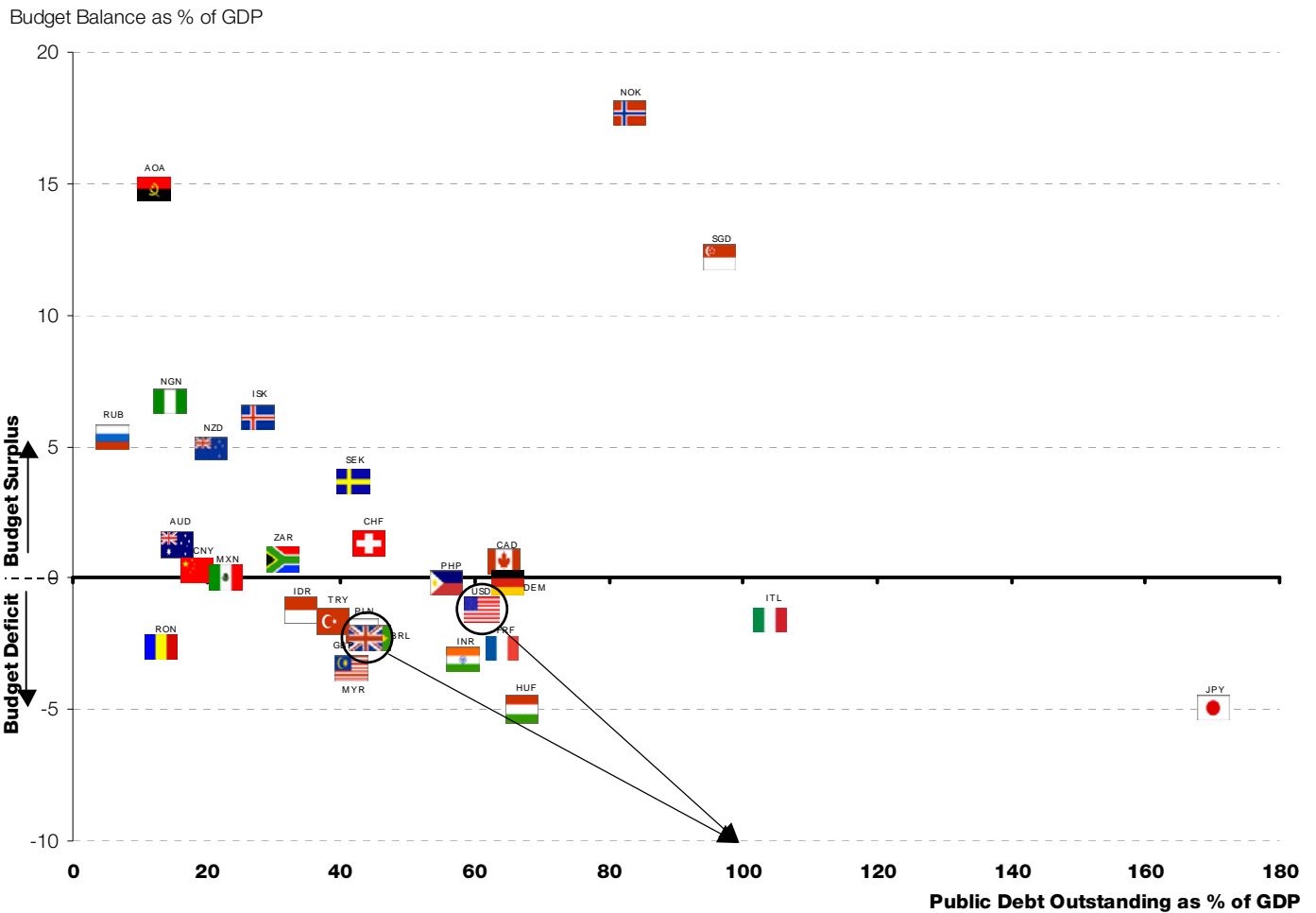
We believe that a top-down, macro-driven checklist of factors and metrics, with a truly global perspective, is the most relevant and effective way to filter and gauge sovereign fundamentals and opportunities for investment:

- Policy tools (monetary, fiscal, currency)
- Composition of GDP (drivers, trends)
- Economic stabilization / Public Finances (current account sustainability, debt structure)
- Capital flows (FDI, remittances, seasonal flows)
- Politics / government (elections, central bank credibility)
- Demographic factors
- Market characteristics (ownership structure, regulations, liquidity)

Furthermore, we believe that profiling countries as “emerging” may be an outdated method of characterizing risk and reward. Perhaps this is a contrarian idea, but many Latin American and Asian countries, in particular, have been stress-tested over the past ten to fifteen years, and are coming through this crisis with better economic and financial resilience than most mature economies (refer to the chart below). Favorable demographic trends and the rapid growth of the middle-class are helping to diversify sources of GDP (increased domestic demand) in many smaller countries (even Australia has relaxed its immigration policy while Japan attempts to deport more immigrants). Furthermore, while the United States and other core countries are now nationalizing banks, auto companies, and other industries, many smaller countries are benefiting from privatization. In the past four years, more than a dozen countries have achieved investment-grade status and are now included in mainstream fixed-income indices.

It is important, however, to distinguish sovereign from corporate credit, as the latter introduces additional complicated layers of risk. Pure sovereign external debt priced in hard currencies (i.e., USD, EUR, GBP) has performed extremely well year to date, reflecting the relative strong fundamentals of this sector.

Fiscal Comparison: Public Debt Outstanding vs. Budget Surplus/Deficit - Many smaller/developing countries are in a more favorable fiscal position compared to G7



For illustrative purposes only

Sources: CIA World Factbook 2008, Standard Bank, JP Morgan, Worldbank Group

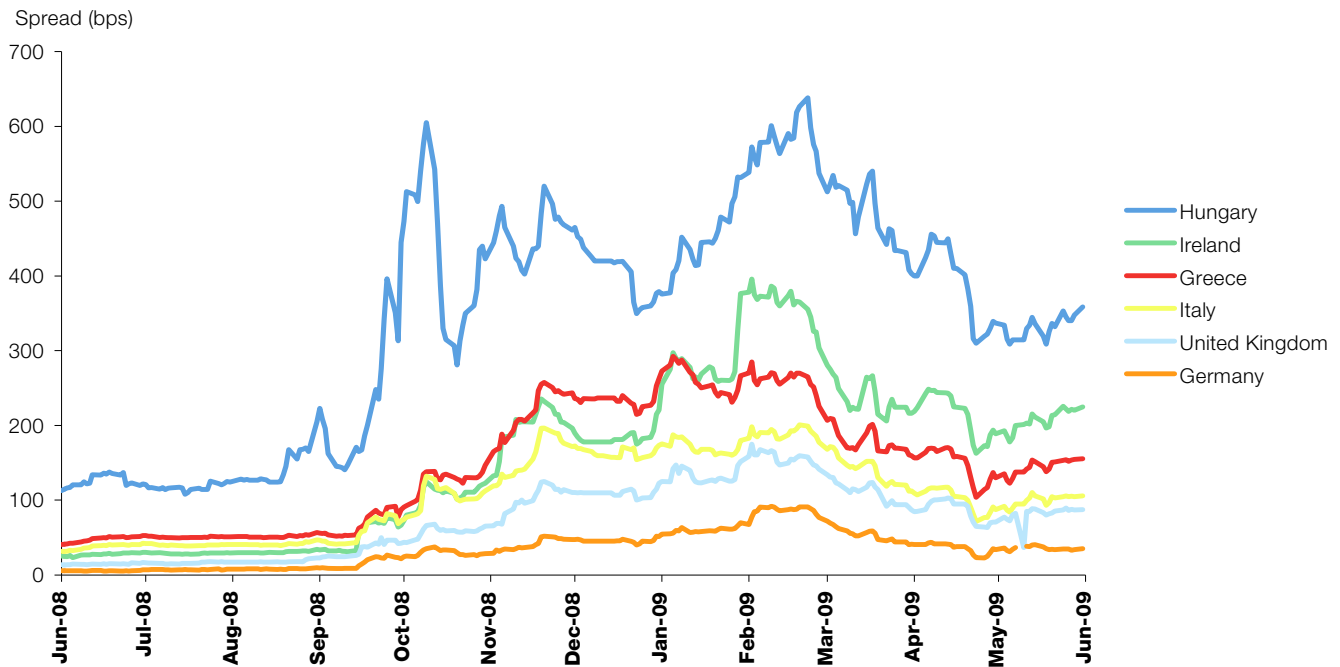
All data as of December 31, 2007, except for Angola and Nigeria budget surplus as of % of GDP which are as of December 31, 2006

IN DEFENCE OF THE EUROZONE

We believe that Eurozone bonds are attractive, and that the euro will continue to gain ground as an alternative reserve/funding/transaction currency, as the BRIC¹ nations (and others) become more vocal about diversifying away from the U.S. dollar. We intend to maintain our slight overweight positions in core and select peripheral European markets (such as Greece) at this stage. Turmoil over the past year has repriced country spreads across the Eurozone (as shown in the chart below) and they now appear more appropriate relative to their individual fundamentals. Peripheral markets under attack include Italy, Greece, Spain (and more recently Ireland), but perhaps they were too expensive for way too long, having all traded at a spread of only 50 basis points (higher) relative to Germany for many years. In contrast, Italian bonds were trading at a spread of approximately 400 basis points higher than German bonds in the mid-1990s, prior to the launch of the euro.

Members of the European Economic and Monetary Union (EMU), have benefited greatly during the past 10 years from a more integrated and transparent economic environment, and a lower cost of financing government debt. In contrast, Eastern European countries such as Hungary are faced with high interest rates and volatile currencies. In fact, these higher interest rates are to blame for the rush into (cheaper) external borrowing, and the resulting currency mismatches, which have caused Eastern Europe so much pain over the past year; essentially, a repeat of the late 1990s Asian currency crisis, relocated. Countries such as Italy and Greece do not seem to be complaining, and it appears other countries would strongly favor joining the “euro club.”

5-Year European CDS Spreads

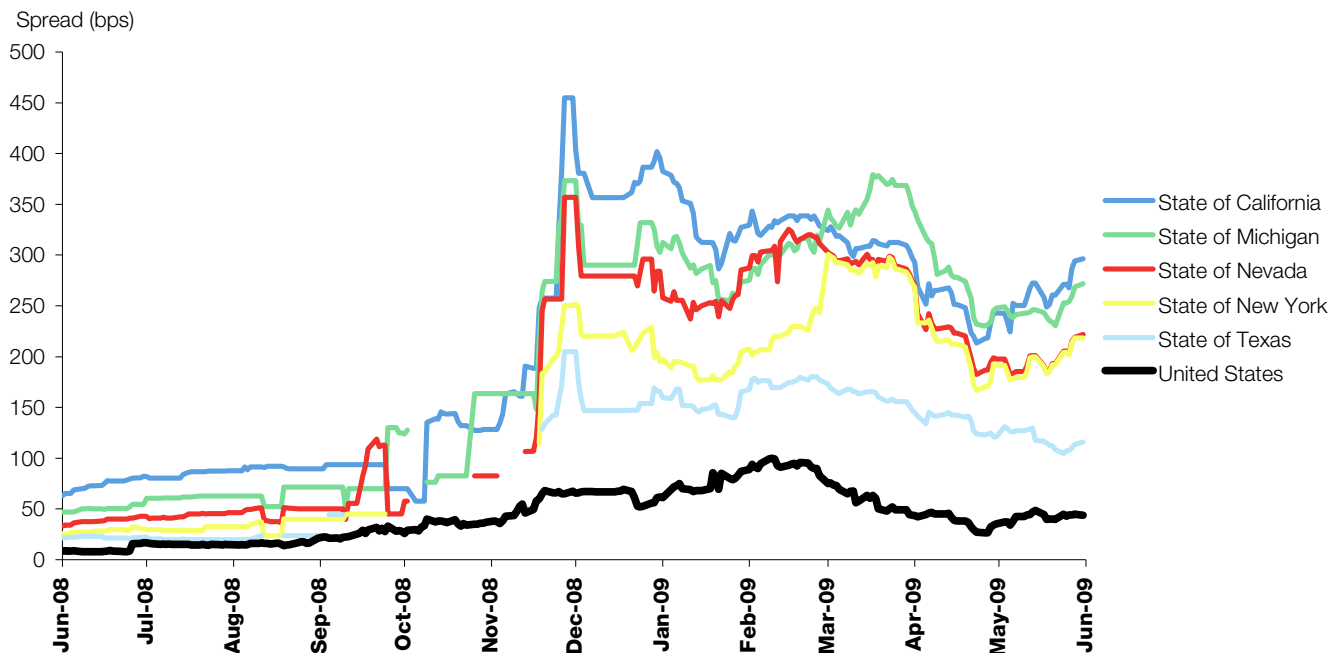


As of June 18, 2009

Source: Bloomberg

As a comparison, it is interesting to note a similar pattern of spread widening in the 5-year credit default swap (CDS) spreads for various states in the United States, (as illustrated in the chart below), in line with their respective differentiation in fundamentals. California has been the hardest hit from real estate and fiscal woes (and recent negative outlook from the ratings agencies). Michigan and New York have been negatively affected by the adverse auto and financial sectors, respectively. On the other hand, Texas seems to be an outlier, benefiting from higher oil prices and other factors. In many ways similar to Europe, the various American states appear as a diverse collection of “economies” trying to regain footing under the roof of one interest rate and currency policy. Just as the nineteenth century belonged to England and the twentieth century to America, we believe that there will be some serious contenders (outside of the United States and Europe) for this honor (and great investment potential) during the twenty-first century.

5-Year U.S. and Select State CDS Spreads



As of June 18, 2009
Source: Bloomberg

CONCLUSIONS

Lazard’s dynamic relative value approach is driven by our macro view of global interest rates, yield curves, sector spreads, and currencies, combined with an opportunistic, but disciplined, security selection process. Diversifying the sources of alpha to help manage risk is a hallmark of our style. Our strong, historically consistent pattern of performance has benefitted, and we believe will continue to do so, from Lazard’s vast research platform with more than 200 Investment Professionals (Fixed Income, Equity, and Alternative Investments), which provide an unparalleled global perspective with local expertise.

Looking forward, we are optimistic that our positioning is designed to take advantage of opportunities by rotating through countries, sectors, and currencies, with good underlying fundamentals and asymmetrical upside risk/reward profiles. Market euphoria and strong gains in risky assets during the second quarter of this year have resulted in better equilibrium for pricing across many markets, in line with current fundamentals. We believe that policy actions in the United States (and elsewhere) seem to have largely eliminated the tail risk of a global depression. With that tail risk out of the way, the main uncertainty for global markets lies in the timing and shape of the global recovery moving forward. As discussed previously, in our country analysis we maintain a discipline of carefully filtering and comparing fiscal conditions (sovereign balance sheets) and policy framework for our decisions on position weightings. We are still concerned about the abysmal fundamentals confronting the U.S. economy, and the increase in U.S. Treasury supply (over half of which is financed from outside the United States), making the case for U.S. dollar weakness for the medium and long term all the stronger. We think that countries outside of the United States may recover faster, especially select emerging markets and commodity-based countries. We are especially optimistic about some glimmers of a revival in China and select Asian and Latin American countries. External vulnerability

in many countries has diminished thanks to stronger trade balances, renewed risk appetite, and IMF liquidity. We believe that the case for an allocation to global fixed income has never looked so good.

NOTES:

1 Brazil, Russia, India, and China

Published on June 26, 2009.

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. Securities in certain non-domestic countries may be less liquid, more volatile, and less subject to governmental supervision than in one's home market. The values of these securities may be affected by changes in currency rates, application of a country's specific tax laws, changes in government administration, and economic and monetary policy.

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