

2011 3rd Quarter Review



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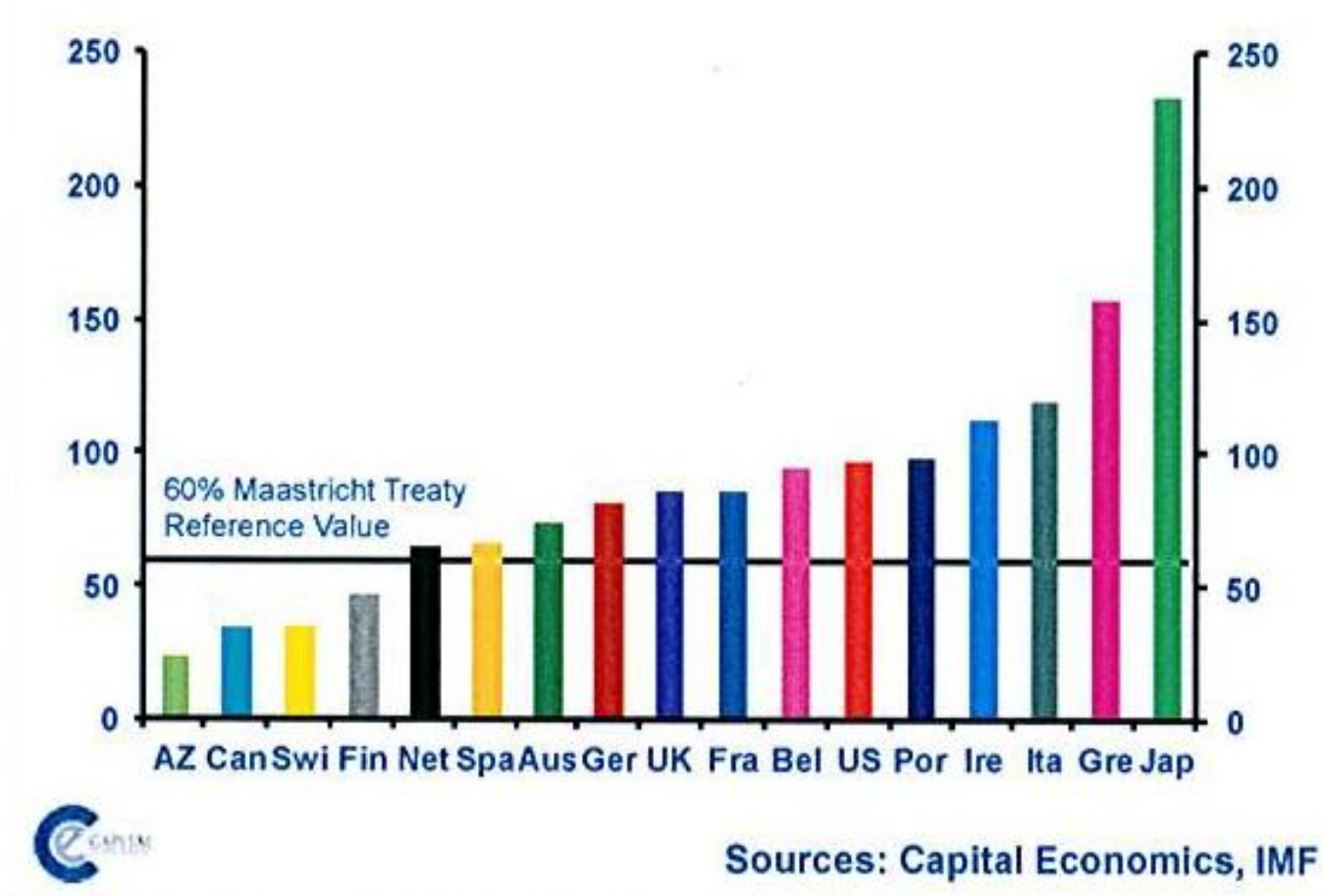
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Agenda

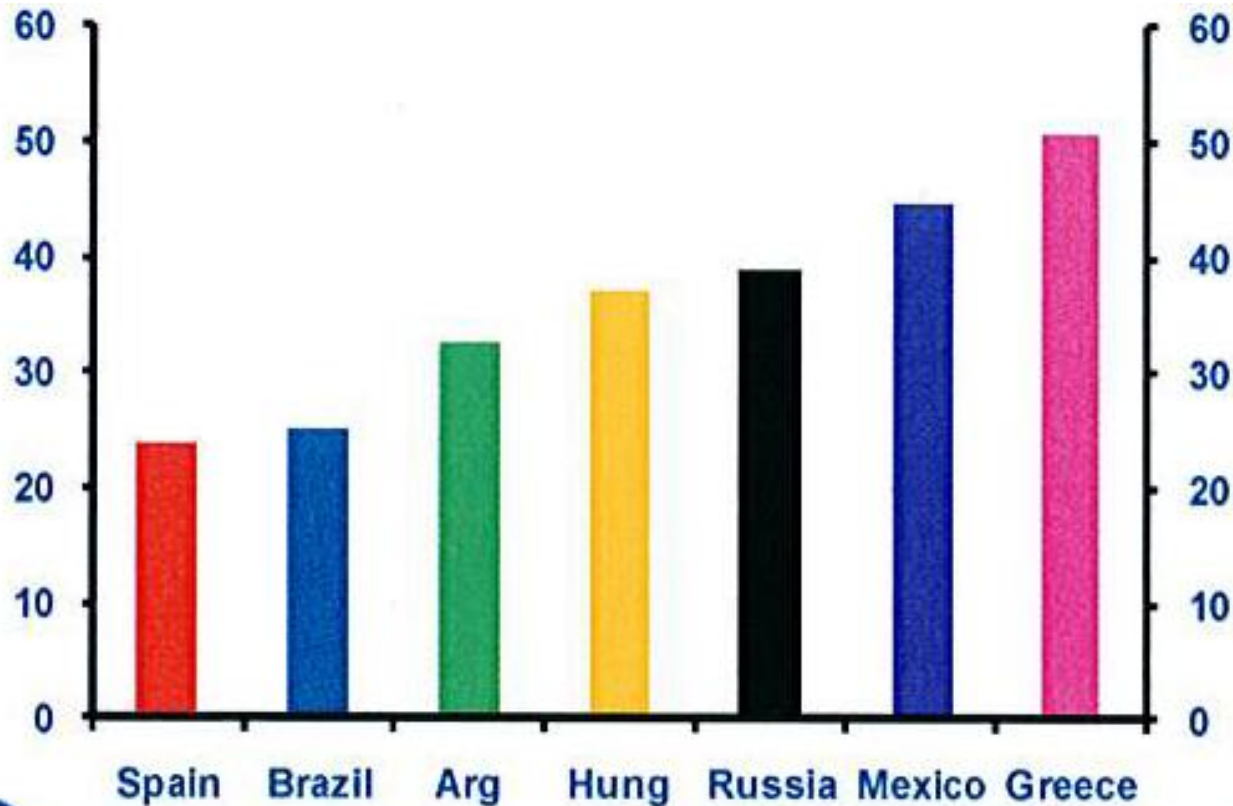
- **The European Sovereign Crisis**
- **What Stocks and Bonds Are Telling Us**
- **The Twist and Turns of Monetary Policy**
- **A Benchmark for the 21st Century**
- **Conclusions**

The European Sovereign Crisis

Gross Government Debt (% of GDP) – 12/31/2011



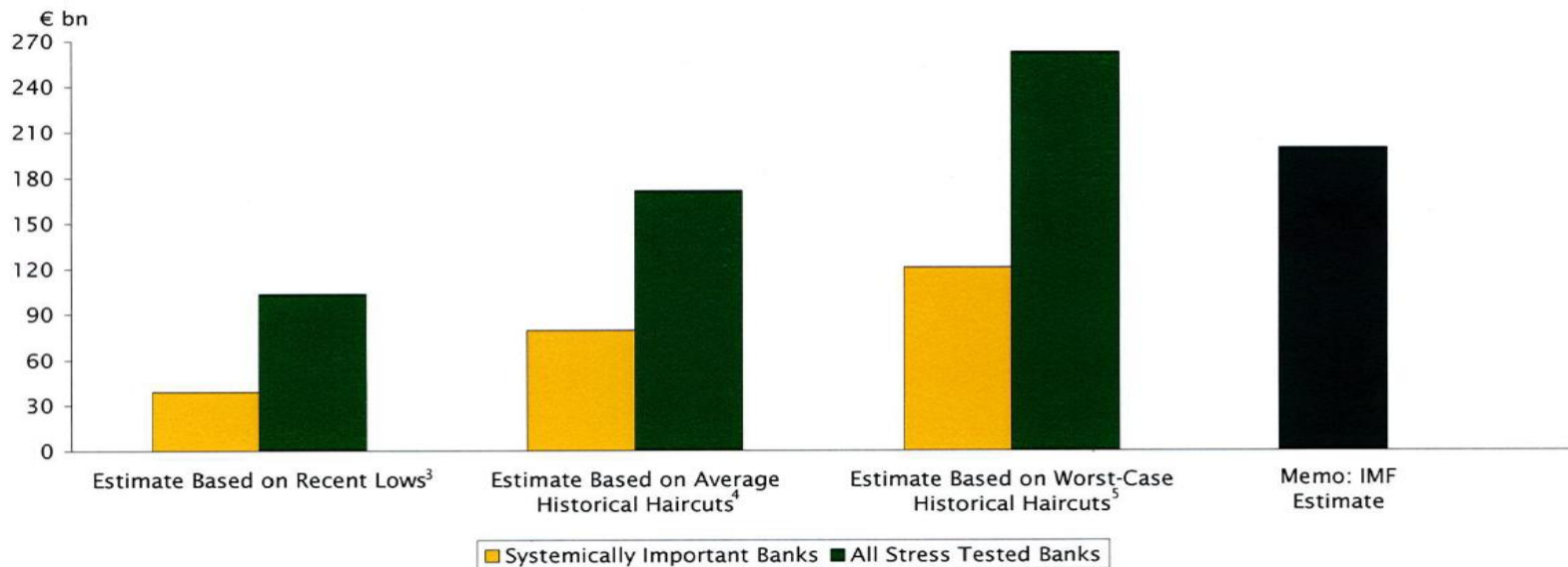
Years in Default (%) – Since 1800 or Independence



Source: Reinhart and Rogoff, "This Time is Different"

Potential Sovereign Debt Losses are Manageable...

Europe Potential Sovereign Debt Losses¹ Through Mid-September 2011²



¹ Trading book adjusted for year-to-date change in bond price.

² Sovereign holdings and Core Tier 1 Capital are as of December 2010.

³ Marks on the bank book are: Greece 49%, Ireland 34%, Italy 8%, Portugal 35%, Spain 5%.

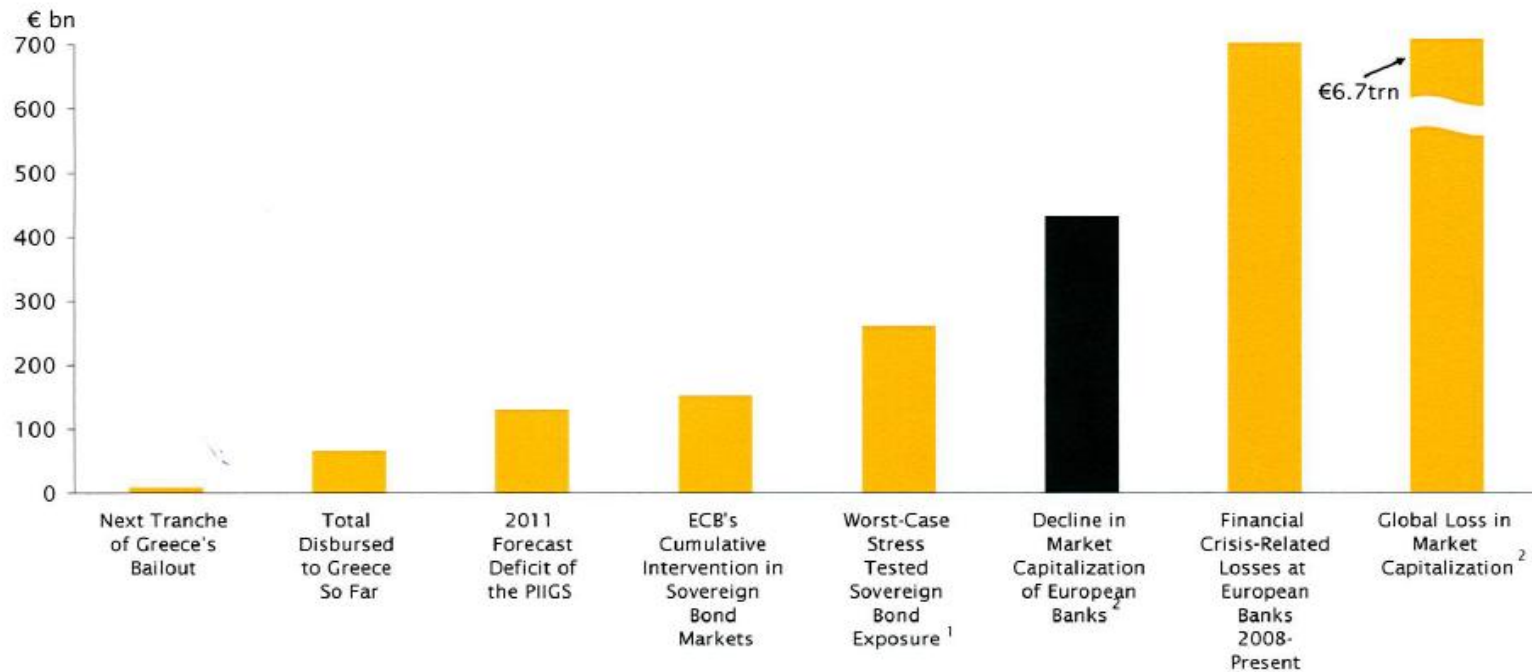
⁴ Marks on the bank book are: Greece 47%, Ireland 47%, Italy 20%, Portugal 47%, Spain 20%.

⁵ Marks on the bank book are: Greece 73%, Ireland 73%, Italy 30%, Portugal 73%, Spain 30%.

Source: Empirical Research Partners

But, Europe's Leaders Let Problem Get Out of Control

Europe and the World The Multiplier Effects 2011 Through Late-September

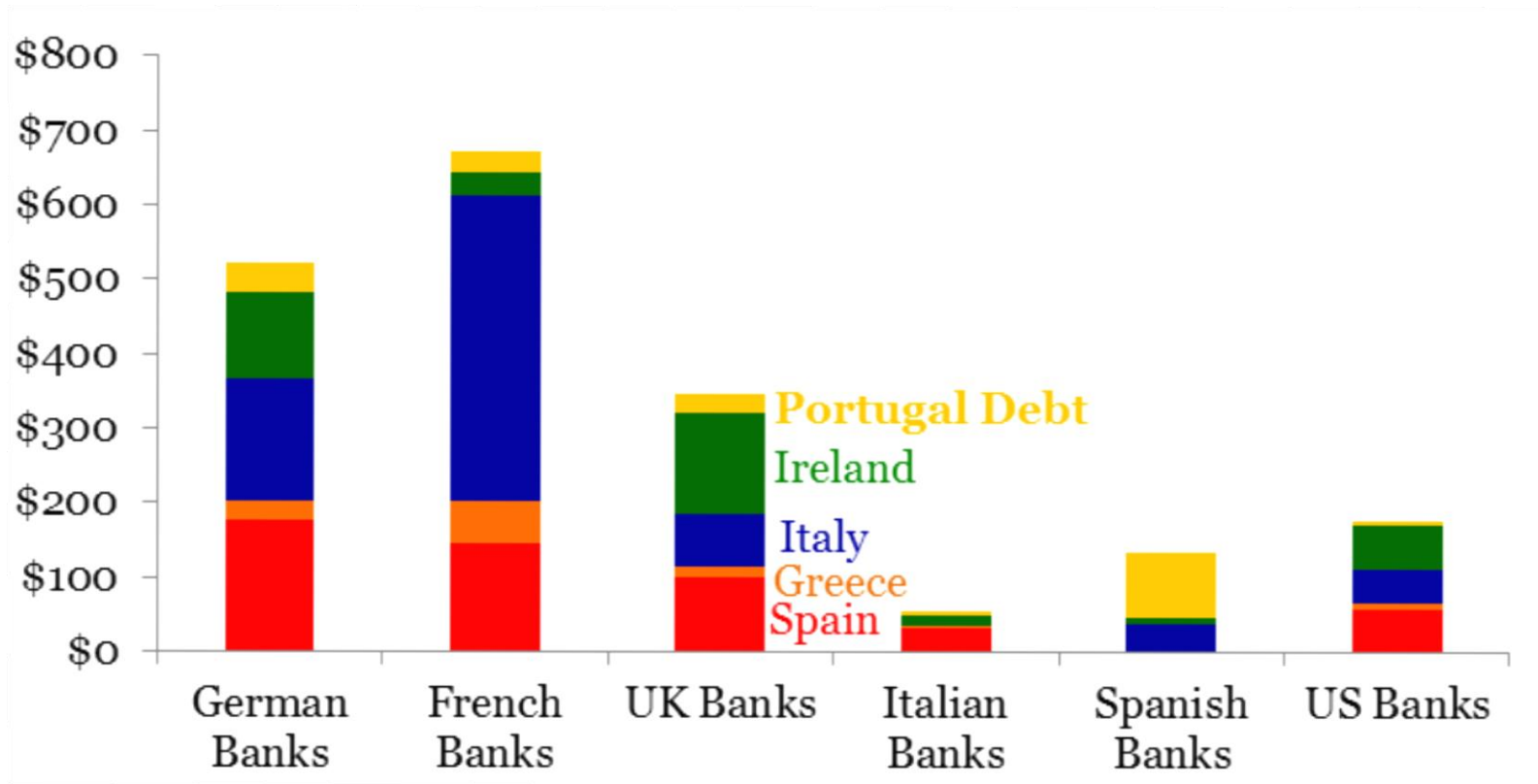


¹ Global Portfolio Strategy September 2011. "Europe's Debt Crisis - Recapitalizing the Banks? Finding Opportunities in the Turmoil."

² Early-May through Late-September 2011.

Source: Empirical Research Partners

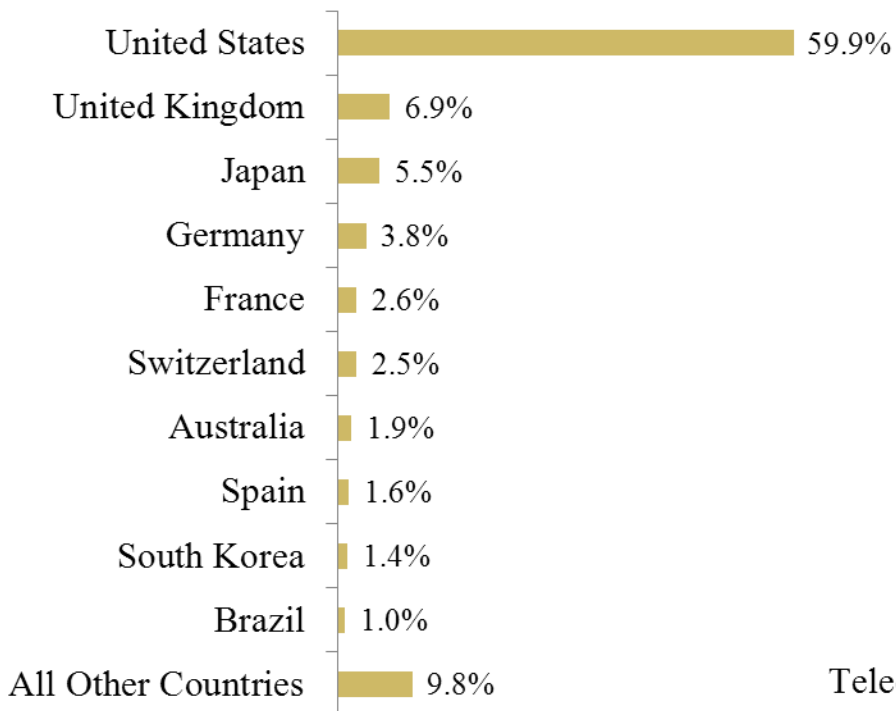
Foreign Banks' Exposure to PIIGS Total Debt – 3/31/2011



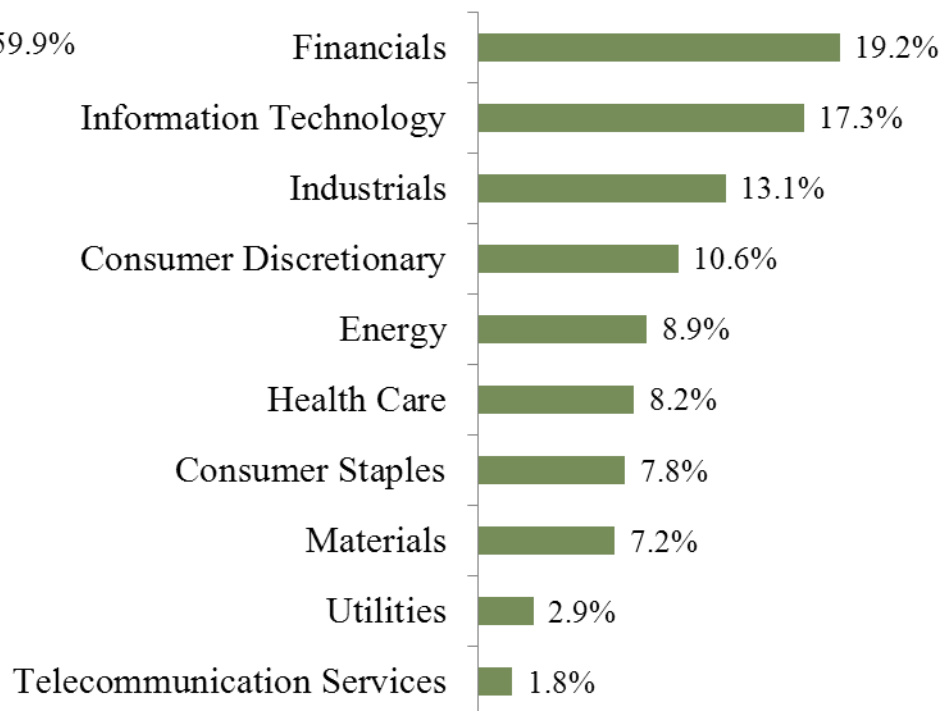
Source: Strategas Research Partners

GMC Portfolio Composition – 8/31/2011

Country Exposure



Sector Exposure



- Total exposure to Portugal, Italy, Greece and Spain is 2.2%
- Within Financials, 62% (12% of total portfolio) of exposure comes from North America, while 21% (4% of total portfolio) comes from Europe.

*Country and Sector Exposure of a Global MultiCap Rep. Account with a Cash Exposure of 3%, managed against the MSCI AC World IMI. Calculated by FactSet.

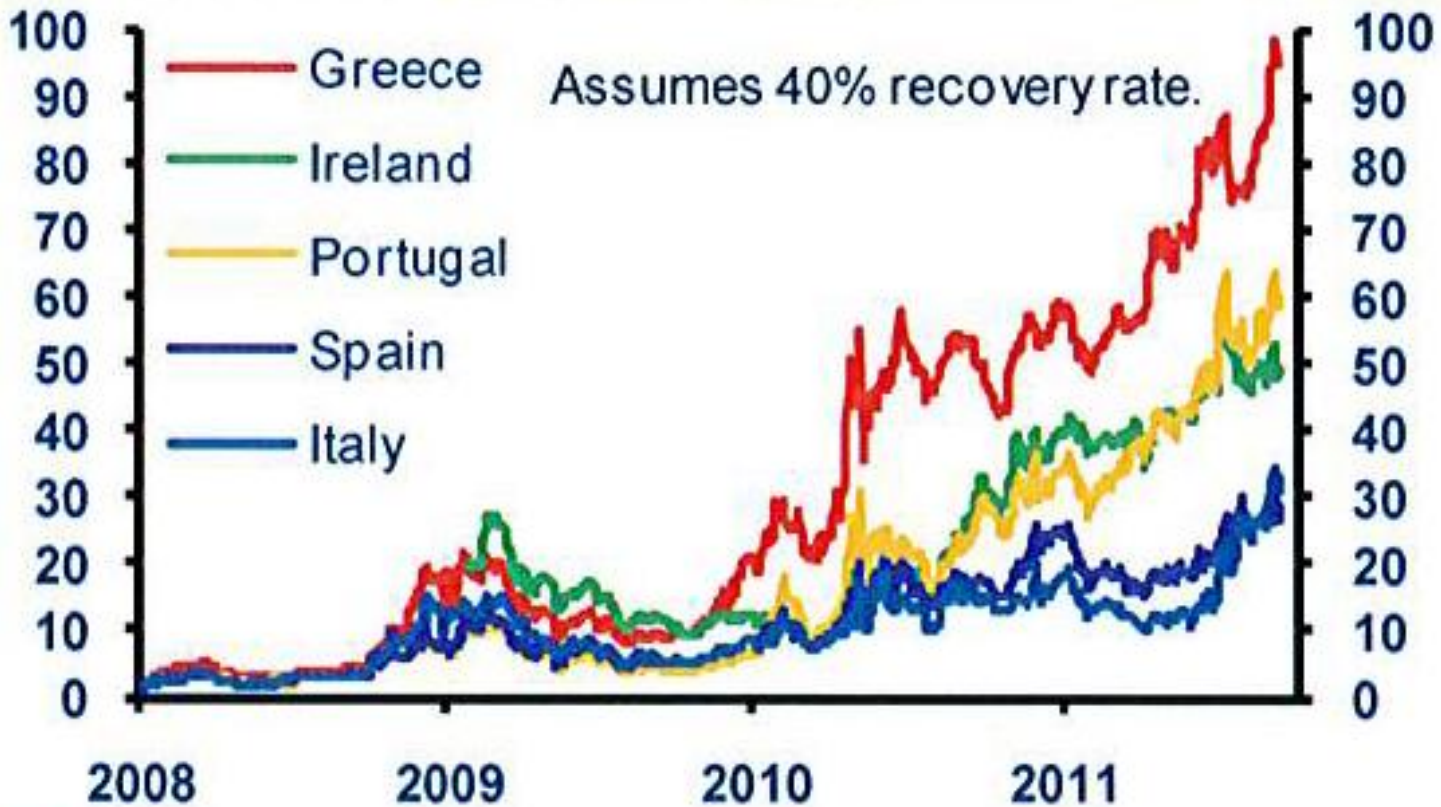
Recent Changes in Asset Allocation – GMC

August 31, 2011	<u>Strategic Allocation</u>	<u>MSCI AC World IMI</u>	<u>Shift</u>	<u>Relative</u>
US Equities				
<i>US Large Cap</i>	41.0%	31.3%	-9.0%	9.7%
<i>US Mid Cap</i>	13.5%	6.2%	4.0%	7.3%
<i>US Small Cap</i>	4.5%	6.5%	0.0%	-2.0%
TOTAL	59.0%	44.0%		
Non-US Equities				
<i>International Large Cap</i>	22.0%	37.3%	0.0%	-15.3%
<i>International Small Cap</i>	10.0%	4.7%	0.0%	5.3%
<i>Emerging Markets</i>	7.0%	14.0%	5.0%	-7.0%
TOTAL	39.0%	56.0%		
Other				
Cash	2.0%	0.0%		2.0%
GRAND TOTAL	100.0%	100.0%		100.0%

*Asset allocations are formulated by the GMC team and may change over time.

What Stocks and Bonds Are Telling Us

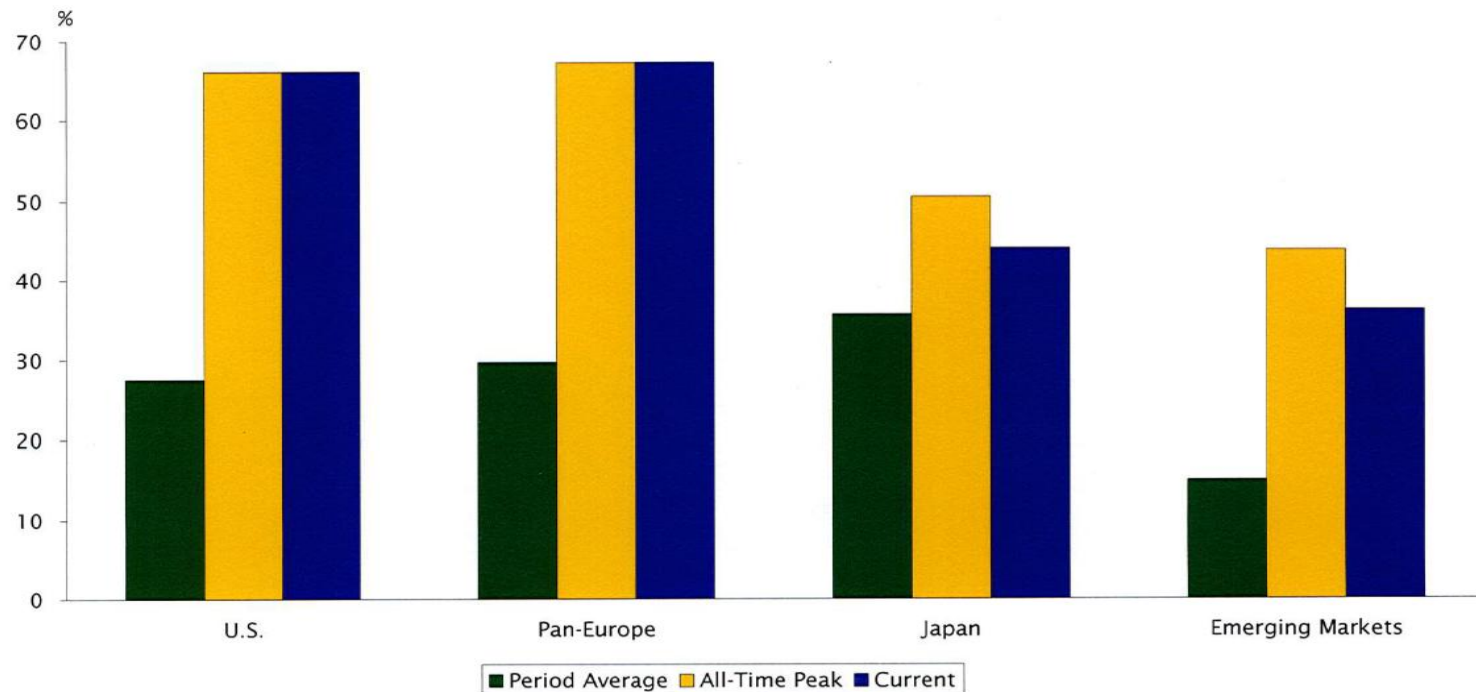
Bond Market Expectations – Default Probability (5yr CDS)



Source: Bloomberg

Global Stocks On Edge...All Markets Trading Together

Developed and Emerging Markets
Correlations of Equity Returns by Region¹
1987 Through Late-September 2011

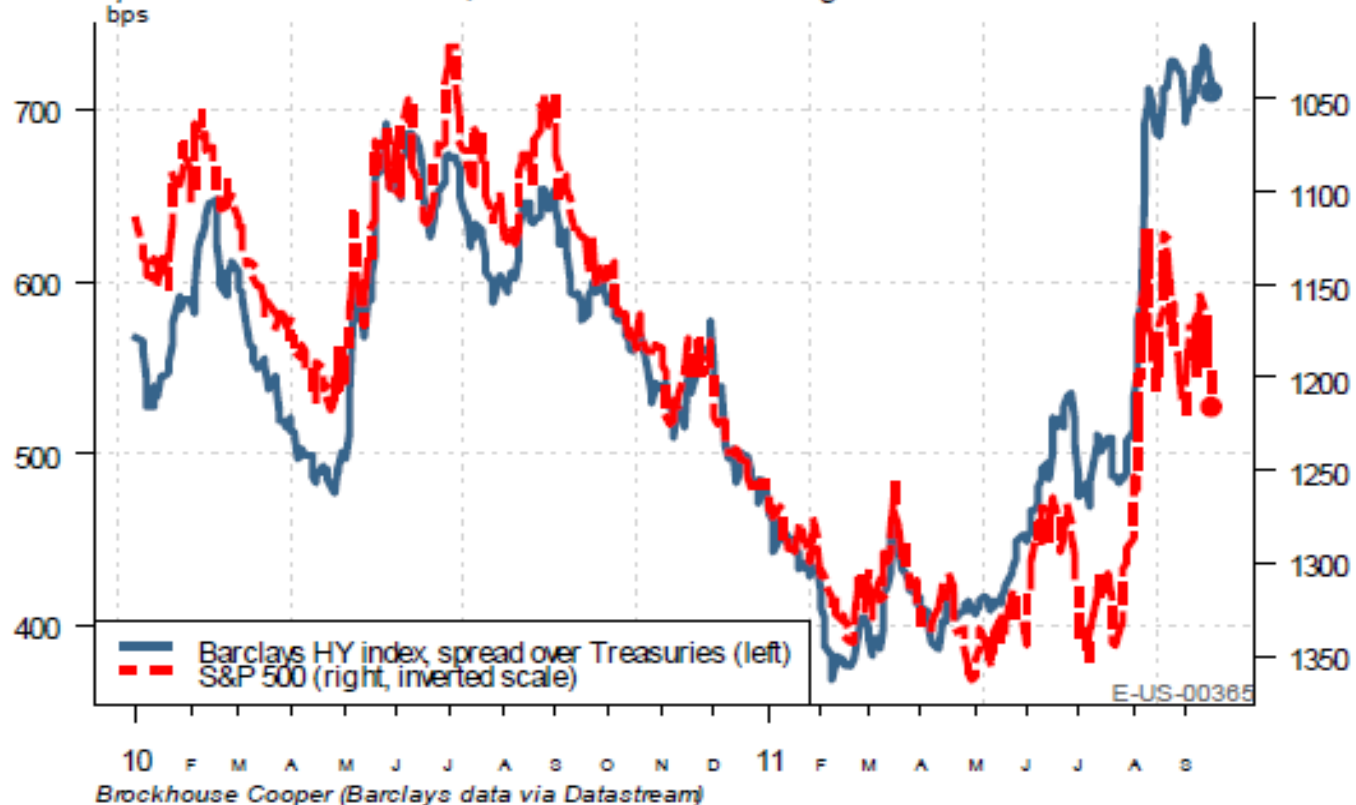


¹ Based on daily U.S. dollar data, measured quarterly.

Source: Empirical Research Partners

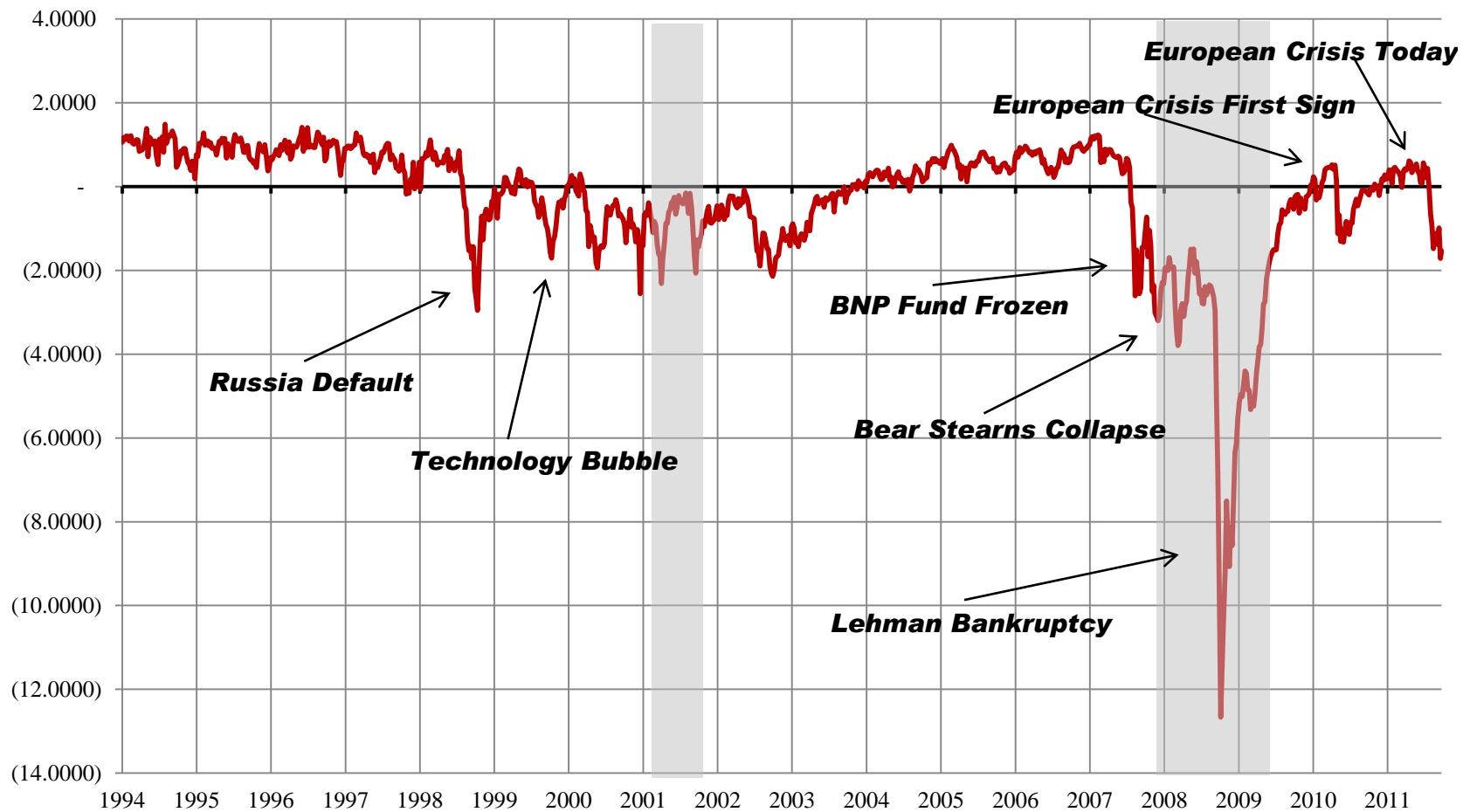
Bonds Pricing in More Pessimism than Stocks

Either high yield bond market is wrong, or equities are wrong (or both are wrong!)
Spreads over Treasuries, defensive investment-grade sectors



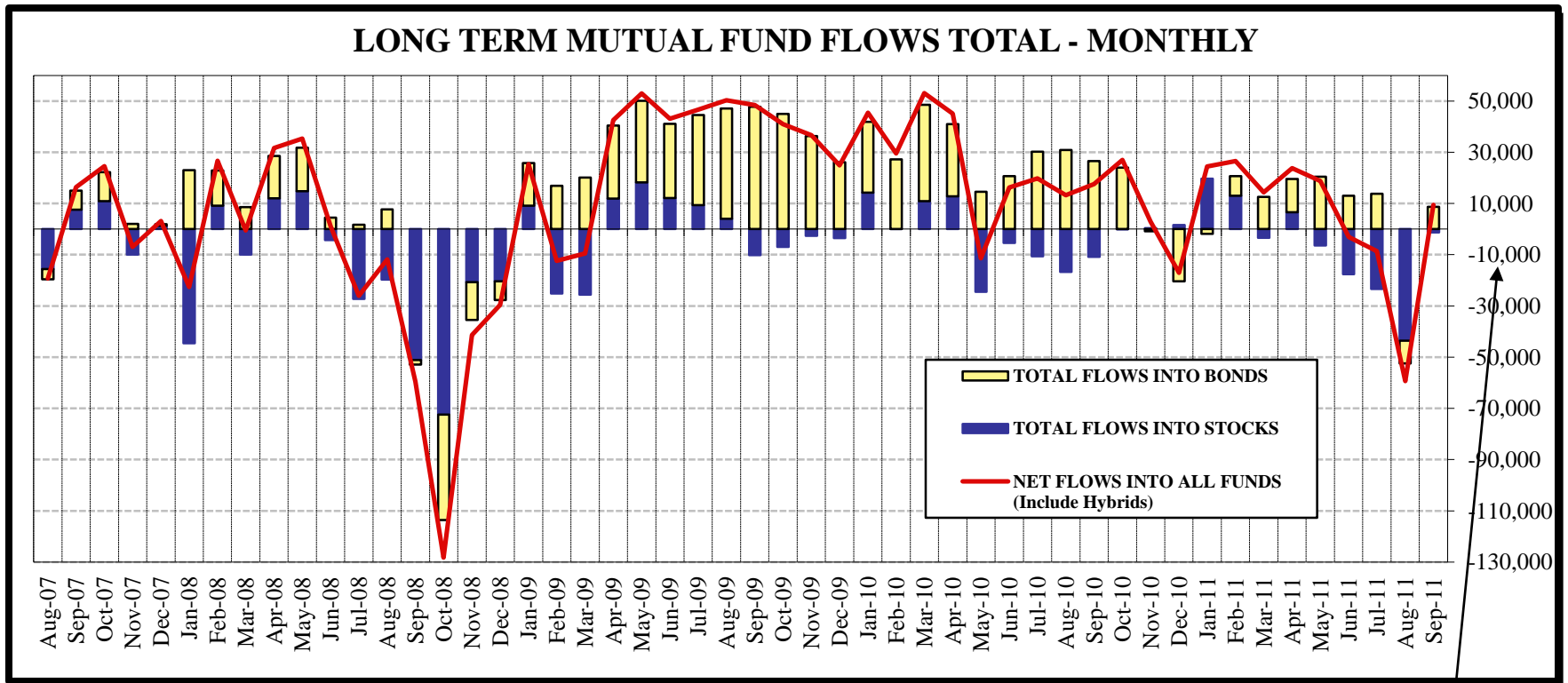
Source: Brockhouse Cooper & Barclay's Capital

Market Stress on High Alert – Bloomberg Financial Condition Index



Source: Bloomberg

Investor Money is Going into Bonds or Leaving Market Altogether



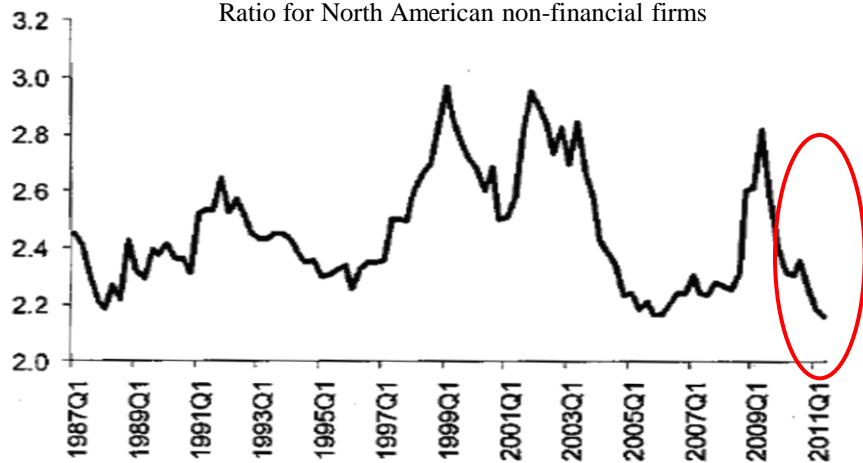
First two weeks
in September

Source: Bloomberg & ICI Institute

Corporate Credit Fundamentals Strong

Debt-to-EBITDA Ratio is Lowest in 24 years

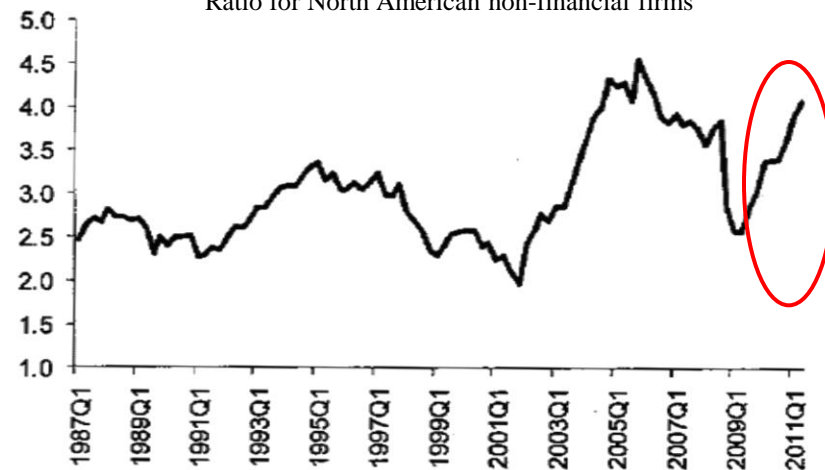
Ratio for North American non-financial firms



Source: Goldman Sachs Credit Strategy, Compustat.

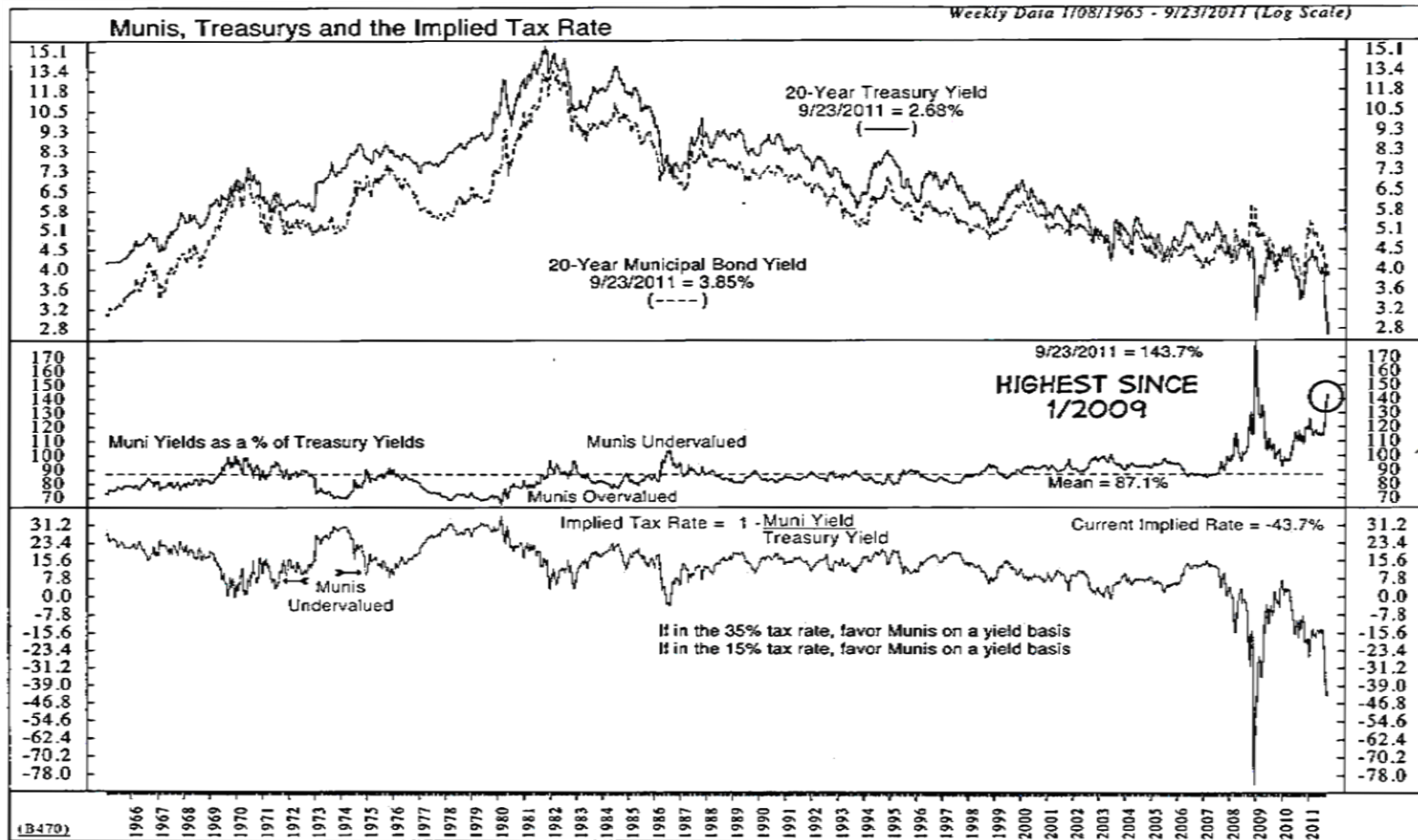
Interest Coverage Ratio has Improved Substantially

Ratio for North American non-financial firms



Source: Goldman Sachs Credit Strategy, Moody's.

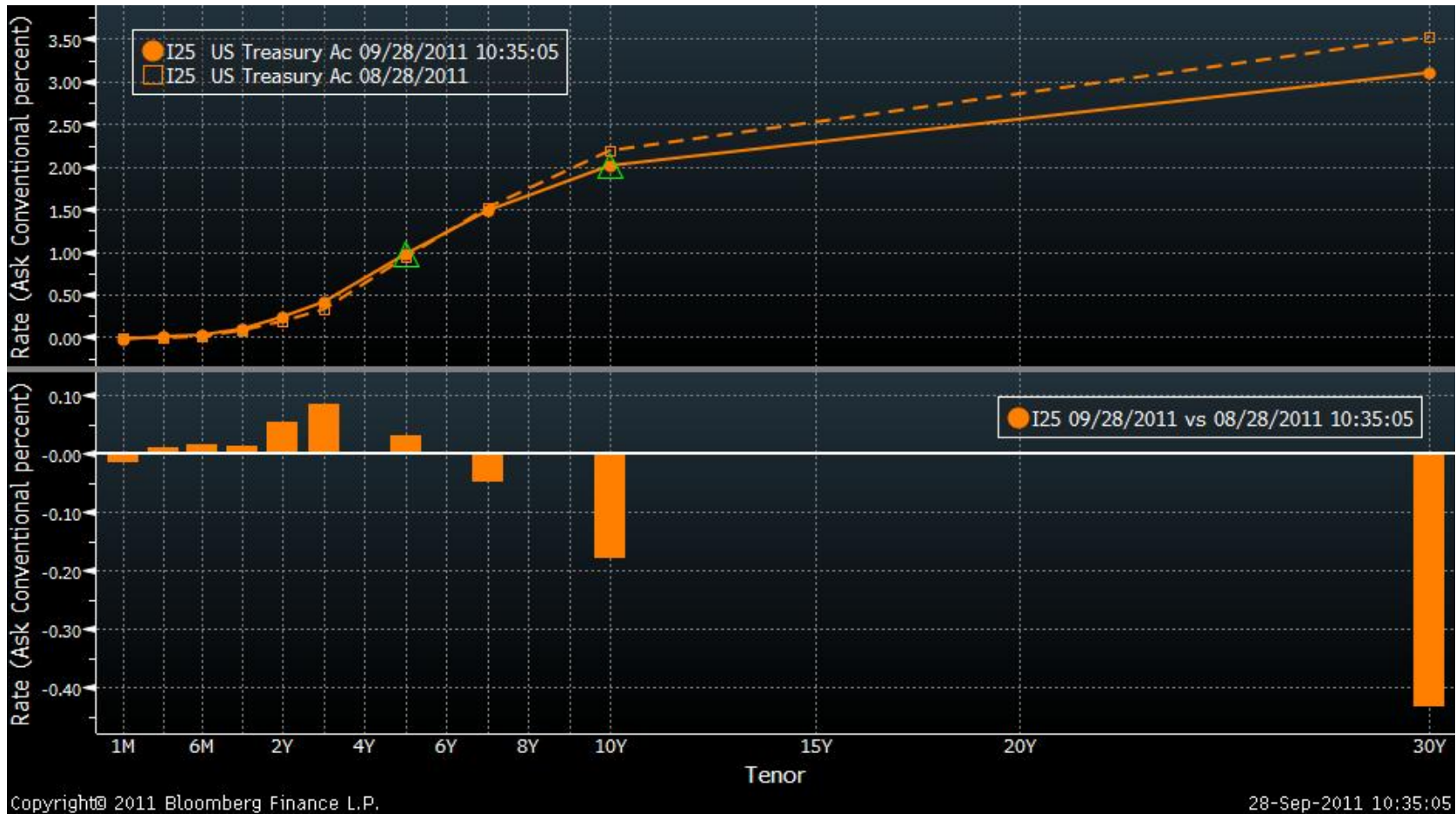
Municipal Bond Value



Source: Ned Davis Research

The Twist and Turns of Monetary Policy

Operation Twist



Source: Bloomberg

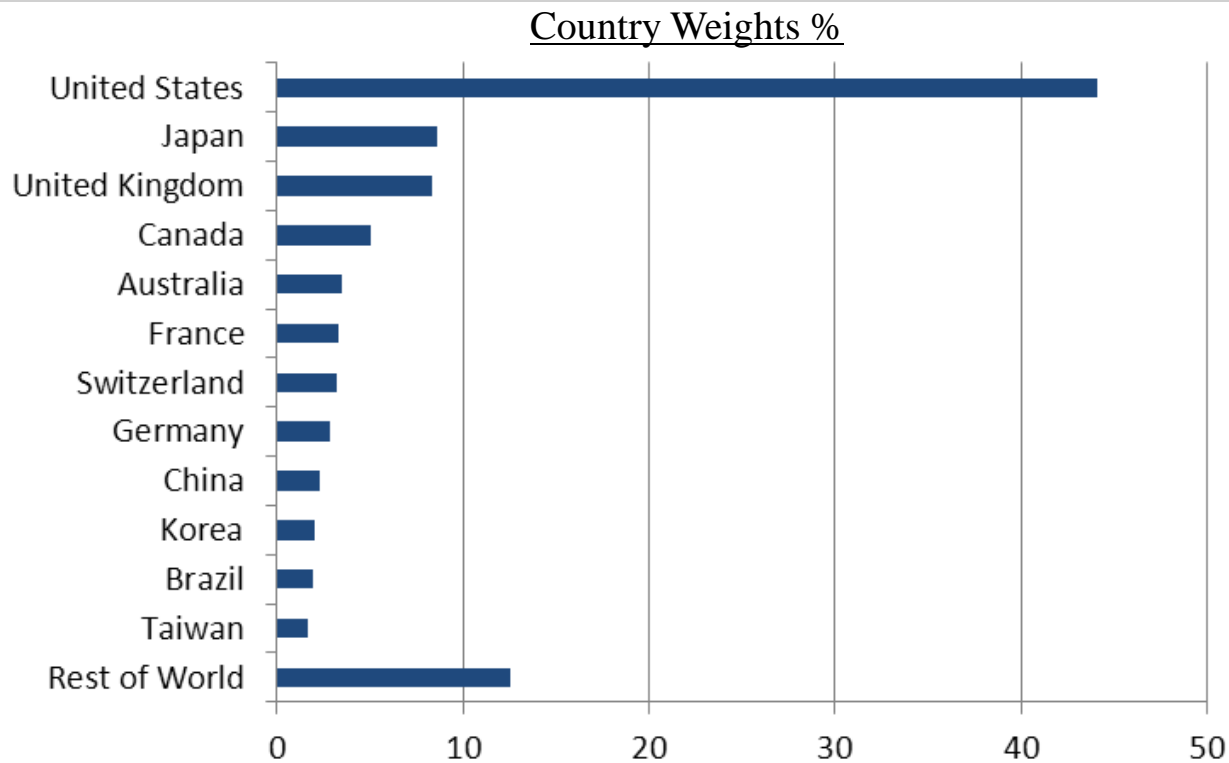
Twisting Interest Rates...Technically Speaking



Source: Strategas Research Partners

A Benchmark for the 21st Century

MSCI ACWI IMI Country Weights and Performance – 8/31/2011



Returns as of 8/31/2011	YTD	1 Year	3 Year	5 Year
MSCI World Index – Net	-3.90	14.46	-1.28	-0.21
MSCI AC World IMI – Net	-4.78	14.36	0.09	1.01

*Source: FactSet.

Conclusions

- **Range-bound Returns** – Policy uncertainty and the lack of investor confidence have caused returns to be range-bound. Historically, this condition does not last for long.
- **Valuations** – Equity and Credit valuations are compelling, but policy decisions could swing markets dramatically in either direction. Caution is warranted.
- **Equity Strategy** – Our recent shifts in International Small Cap, Mid-Cap Value and Emerging Markets have positioned us well for a positive outcome in policy, without taking on excessive risk.
- **Interest Rates** – The Fed and “Fear” will keep rates low until 2013. Until there is more clarity in policy, we remain neutral on interest rates and modestly overweight credit.