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Outlook on **Emerging Markets**

Growth in emerging markets continues to be resilient amid the sovereign-debt turmoil in the United States and parts of Europe. Relative to developed markets, emerging markets have been supported by better fundamentals, including lower indebtedness. In particular, we believe that demand from China will continue to heavily influence emerging market performance, and that a hard landing is less likely now that China's growth rate has moderated to a more sustainable level.

The emerging market investment landscape is fundamentally different than it was in 2008, given that current levels of corporate and private-sector debt are significantly lower. While emerging market assets are not without risk, we believe that policymakers and market participants are now better equipped to manage these challenges. For example, policymakers have fiscal and monetary tools in place, as well as cross-border foreign-exchange swap lines to counter sustained economic or market dislocations and provide necessary U.S. dollar liquidity. Recently, markets have declined significantly due to contagion from developed markets. As such, we have become more optimistic about emerging markets equities across all time periods.

Equity

Emerging market equities have decreased sharply in recent months, creating broader investment opportunities, in our view. Moreover, emerging market fundamentals have remained robust, despite the far-reaching effects of economic woes in the Eurozone and in the United States. We have raised our short-term outlook from constructive to bullish, despite the possibility of inflationary pressures and substantial equity issuance, which could significantly increase the volume of emerging market shares. We believe that the sell-off in emerging market stocks has driven valuations to attractive levels, despite the possibility of subdued global growth over the next several years. Barring a major global financial crisis, we believe that the return potential of emerging market equities, relative to the risks, is skewed to the upside.

In our flagship Emerging Markets Equity strategies, we have capitalized on recent market volatility and initiated or increased positions in stocks we believe are more likely to reach our price targets. For example, we have been finding value in Russia as well as in the energy and financials sectors. In our strategies, we have also trimmed or sold positions in companies that have performed well this year and are thus closer to our estimates of their fair value. These included positions in Brazilian financials and South African materials.

Conversely, in our Developing Markets Equity strategies, we remain invested in stocks of companies in Brazil and India that are trading at a discount, relative to our projections of their future earnings growth. In addition, shares of certain companies in economically sensitive sectors, such as energy, industrials, and financials appear mispriced versus our estimate of their growth prospects. In contrast, we have reduced our positions in technology companies that have recorded slower growth. Valuations of several South African and Indonesian companies also do not reflect the potential slowdown in earnings growth, in our view, and we have trimmed the strategies' positions accordingly.

In our Discounted Assets strategies, market uncertainty continues to drive discounts to attractive levels, which are nearly 300 basis points wider, relative to their historical average. China remains the largest country exposure in our strategies, driven by both the team's positive macroeconomic outlook and potential investment opportunities that could provide exposure to local equities at an additional 17% discount. We are also uncovering attractive investments in Thailand, India, and the Philippines, where we estimate the average discount to net asset value or the discount to the sum of its parts at approximately 15%, 12%, and 49%, respectively.

Russia remains the largest European country exposure in our Discounted Assets strategies, reflecting our view of the attractive equity market valuation and our ability to access the local equity market at an additional 10% discount. We have also identified several investment opportunities in Turkey, and recently added to investments that are currently trading at more than a 45% discount to our fair-value

estimate. Conversely, we maintain relatively small allocations to Brazil and South Africa, two key emerging market countries where we have found it difficult to identify high quality, deeply discounted investment opportunities.

Fixed Income

We believe strong fundamentals and policy flexibility should support emerging markets fixed income over the medium term. Policy flexibility may help investors access and leverage record foreign exchange reserves, and may allow for looser fiscal conditions, given relatively low debt burdens.

We have observed an increase in interbank lending rates at the very short end of implied forward yield curves for some countries. In our Emerging Income strategies, we believe this dynamic should allow us to take advantage of higher yields as we reinvest maturing positions at those points in the yield curve. As such, we foresee a rebound in our strategies' currency positions as policymakers provide more clarity on debt restructuring in Greece and, possibly, a fiscal union among Eurozone countries.

From a currency standpoint, we believe the strongest opportunities in our Emerging Income strategies are countries with:

- Large, closed economies
- Current account surpluses
- Low external indebtedness
- A flexible, transparent policy framework
- A healthy foreign exchange reserve coverage
- Low levels of banking system leverage

Despite a backdrop of deep investor pessimism, we have become more constructive on emerging markets debt. We believe there are many opportunities to own bonds and currency at very attractive yield and spot-exchange levels. As a result, we have added risk across our Emerging Markets Debt strategies by purchasing positions from distressed sellers. We continue to stress-test our strategies in an attempt to steer clear of potential value traps. In addition, both monetary and fiscal officials, as well as market participants, seem to be more risk-aware. The credit positions that we have added to our strategies have been focused on liquid, large-issuance sovereign and corporate bonds. We also continue to add to long currency positions, particularly in Asia, as we believe that monetary authorities will likely allow emerging market currencies to appreciate further against developed market currencies, in order to maintain an appropriate balance between growth and inflation.

Important Information

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Past performance is not a reliable indicator of future results.

Equity securities will fluctuate in price; the value of your investment will thus fluctuate, and this may result in a loss. 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. Emerging market securities carry special risks, such as less developed or less efficient trading markets, a lack of company information, and differing auditing and legal standards. The securities markets of emerging market countries can be extremely volatile; performance can also be influenced by political, social, and economic factors affecting companies in emerging market countries.

An investment in Emerging Markets Debt positions are subject to the general risks associated with fixed income investing, such as interest rate risk and credit risk, as well as the risks associated with emerging market investments, including currency fluctuation, devaluation and confiscatory taxation.

Investments in global currencies are subject to the general risks associated with fixed income investing, such as interest rate risk, as well as the risks associated with non-domestic investments, which include, but are not limited to, currency fluctuation, devaluation and confiscatory taxation. Furthermore, certain investment techniques required to access certain emerging markets currencies, such as swaps, forwards, structured notes, and loans of portfolio securities, involve risk that the counterparty to such instruments or transactions will become insolvent or otherwise default on its obligation to perform as agreed. In the event of such default, an investor may have limited recourse against the counterparty and may experience delays in recovery or loss.

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