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TACTICAL ASSET ALLOCATION COMMITTEE

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ASSET ALLOCATION VIEW

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Asset and Market Survey

Economy — Recent news highlights fragility

Many headline economic numbers have been positive, but weakness on other fronts betrays an underlying fragility. Export-driven economies like China, Brazil and South Korea have shown weak numbers recently. And Europe's weaker economies like Portugal, Ireland and Spain confront extremely high unemployment and the prospect of years of slow growth due to an urgent need to cut government spending. Even Great Britain's prospects are dim: Spending cutbacks loom after an expected spring election and the Bank of England needs to unload huge quantities of debt onto the market.

Attention remains focused on when global stimulus will be unwound. While most concern has been about a premature exit, the Australian central bank's decision today to pause raising interest rates highlights the risk that monetary authorities could be on hold longer than expected due to protracted economic weakness.

Fixed Income — Positive on high yield

Credit spreads remain well above historic norms and while it will take a while before economic conditions can support normal spreads, high yield remains most undervalued and is likely to see the biggest spread tightening this year. Investment grade spreads are also expected to tighten in, but associated gains could be offset by the expected rise in underlying government bond yields later in the year.

Equities — Short-term value seen at lower levels

Global equities have sold off, but are seen falling further in the next few weeks. The weakness is being driven by falling risk appetites and concerns that impending fiscal and monetary tightening could be premature and undermine the nascent economic recovery. Investor sentiment has weakened to the low 60% range from a recent high of 75%, but it remains to be seen whether it will stay there.

Corporate results have been exceeding expectations, however, with above-consensus gains showing up not just in earnings, but in revenues. This trend is expected to prevail in the short term and select equities, like relatively hard hit cyclical stocks, will become attractive again if a correction continues to play out. However, the opportunity for gains may be limited to the first half. Key bearish features after June are expected to include the unwinding of global stimulus and higher bond yields, which are expected to help push equity multiples lower.

Emerging Markets — Negative short term

Despite superior economic fundamentals, emerging markets still face greater risk sensitivity than developed markets. The growing recognition that other emerging markets besides Greece and Iceland face deteriorating fiscal positions could weaken sentiment.

Currency — Positive short term on commodity, trade plays; prefer USD to sterling, yen

The rally in commodity currencies is expected to continue in 2010. Currencies leveraged to rebounding global trade, like the Korean won, should also do

*"Short term" </= 6 months, "Long term" > 6 months

well. The U.S. dollar is expected to gain relative to other majors on an earlier tightening in monetary policy and, in the case of the yen, on Japanese efforts to roll back last year's gains.

Commodities — Seen higher short term in line with economic growth

Commodity prices are expected to remain generally well-supported by the ongoing pick-up in economic activity going into the first half of 2010.

REITs — Short-term neutral; long-term positive

Sector fundamentals are expected to continue to weaken in 2010, but prices should find support from an investor focus on 2011-2012, when renewed demand is expected to come up against an expected dearth of new supply and send values higher.

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