

outlook & strategy

december 2011

Markets took a year-end holiday from the Euro-zone crisis, after digesting the December Summit and the arguably more important ECB decision to offer three year repo in huge size to European banks. This LTRO (long-term refinancing operation) arguably gives banks enough liquidity to at least slow their balance sheet shrinkage. We believe that massive deleverage by Euro-zone banks was a key driver of wider spreads in the second half of 2011. However, liquidity is not equity, and realized losses on Greek paper this quarter may lead to renewed pressures on banks and risk appetite.

For 2012, we expect the U.S. recovery to be sustained, with GDP growth of 2 percent to slightly higher. Economic data has been improving in recent months, and we find more reasons to be positive than negative on the outlook (a likely bottom in housing starts, the shale gas boom, better auto sales). In Europe, we expect recession, with the ECB providing just enough liquidity to avoid a collapse. We remain underweight the Euro. In Asia, we have grown more cautious, and have reduced some currency positions.

Reviewing sector positioning, we are less negative on U.S. mortgages after the recent spread widening, but still prefer corporates. We see little long term value in lending money to the U.S. Government for ten years at 2.0%. This is our medium term U.S. core inflation forecast, so we would prefer to capture a positive yield in corporates. Quality yield is scarce worldwide and is expected to remain so, as Europe has elected a fiscal contraction solution to its policy dilemmas. We see Europe following a Japan-type path, where fiscal contraction will be employed to deflate domestic demand to a point where Europe as a bloc is in current account surplus, and hence can be self-financing. Ireland is in current account surplus, and Spain may be just getting there. Despite the recent weakness of the Euro, and very one-sided (short) technical trading positions among currency traders, we still see good reason to retain our underweight to the Euro-zone.

government bond markets- developed countries

december 2011

UNITED STATES

The US economy held firm throughout the fourth quarter in the face of the beginning of a European recession and slowing global growth with the GDP figures likely to show a large boost from inventory building. Perhaps the most positive development was the decline in initial jobless claims during December, to the lowest level since June 2008. Job growth has been looking better since the doldrums of summer and the recent improvement in claims has added to optimism about future job growth. While consumer confidence has improved since the August lows, income growth continues to slide as wages rise at slower and slower rates. The fall in gas prices provided a boost to consumer spending as did the resurgence of auto sales from the June lows following the Japanese parts shortage. This resurgence coincided with a drop in the personal saving rate from 5.0% in June to 3.5% in November. New orders for nondefense durable goods excluding aircraft showed weakness at the end of the year, perhaps in part due to the 100% tax depreciation allowance that expires at the end of 2011, although the PMI surveys continue to show strength. The steam has come off of core inflation in recent months and should start to affect the annual numbers shortly. During Q4 the yield curve flattened by three basis points with the 2 to 10-year spread falling from 167 to 164 basis points with little movement in either the 2-year or 10-year yields. Overall the US government market rose 0.8% in Q4 2011.

EUROPE

The fourth quarter included a worsening of the sovereign and financial crisis as well as a deterioration of economic activity. Consensus expectations shifted toward recession in 2012, with ECB President Draghi confirming the likelihood of recession next year. Although inflation remained above the ECB's 2% target, inflation expectations declined as economic activity weakened. Credit conditions tightened as banks were given a 9% capital target to meet by June 2012. The financial system grew increasingly fragile as unsecured money market lending further evaporated, and tensions escalated in secured funding (repo) markets. The ECB adopted a more forward-looking stance, easing policy rates 50 basis points to 1%. The ECB continued its purchases of government bonds under its Securities Market Program. Funding market strains led to major global central banks expanding swap lines and reducing the cost of dollar funding for non-US banks. A crisis package agreed in late October collapsed in November, with plans to leverage the EFSF dissolving, and negotiations with private sector Greek bondholders unresolved. The December summit generated only a rough blueprint and pledge to move toward greater fiscal framework in coming years. The overall euro area government bond market returned -0.43% for the quarter. Dispersion remained significant and intra-EMU spreads widened. Germany returned 1.9%, Italy returned -3%; the 10-year spread widened from 365 basis points to 528 basis points, as Italian yields closed the year trading at 7.1%.

UNITED KINGDOM

Fiscal tightening intensified its drag on economic growth in the fourth quarter. Industrial and manufacturing production deteriorated further, and PMI surveys slipped to levels consistent with recession. The slowing industrial sector and deteriorating growth in export markets continued to restrain the economic rebalancing away from consumption-driven growth. Consumers faced a tougher environment as labor market indicators, including income, softened, credit conditions remained tight, and the real estate market remained in the doldrums. Consumer confidence weakened past 2008-2009 lows. Although inflation remained above the Bank of England's 2% target, it did moderate from 5.2% to 4.8%. The Bank of England highlighted that inflation was likely to fall toward target over the 2-year forecast horizon, perhaps more rapidly than had been expected. Thus, despite the persistence of above-target inflation, the Bank of England's MPC held rates at 0.5% and increased its quantitative easing via its asset purchase program from £200 to £275 billion. The benchmark yield curve flattened, as growth and inflation expectations declined and BoE purchases across the curve had a disproportionate impact on the smaller sized securities at the long end. The UK government bond market was the top performer for the quarter, returning 5.46%.

government bond markets- developed countries

december 2011

JAPAN

Economic indicators continued to be mixed in the fourth quarter, though showed signs of deterioration in December as rebuilding activity following March's devastating earthquake and tsunami have been offset by declining activity in the export sector related to slower global growth. Japan's Q4 Tankan survey showed output and optimism among large manufacturers surprise to the downside while the same two indicators for non-manufacturing surprised to the upside, reversing Q3's results. Industrial production fell -4.0% year on year in November, doubling expectations for a 4.0% fall while retail sales tumbled -2.3% year on year, behind expectations for a -0.5% fall. On the positive side, the unemployment rate remained steady at 4.5% in November while the job-to-applicant ratio improved to 0.69, the highest level since 2009. Japan still faces an arduous recovery process and the nascent slowdown in global growth threatens to exacerbate the pain. Japan needs thriving global activity to propel its export industry and generate revenue in an environment of stagnant domestic demand. We had hoped that the crisis would mark an end to political infighting and usher in an era of compromise, but unfortunately, that has not been the case and the failure to address longer-term fiscal challenges is going to adversely affect Japan's overall creditworthiness. The local government bond market returned 0.46% in Q4.

CANADA

The Canadian economy entered 2011 on relatively sound footing and has weathered the global turmoil fairly well. Despite the escalating crisis in Europe, a weakening outlook for the US economy and the earlier supply side disruptions from the Japanese crisis, the Canadian economy proved to be more resilient than initially expected. The two most recent data points show real GDP rising by an annualized 3.5% in the third quarter while the October monthly GDP number was flat. The consumer continues to remain buoyant and retail sales rose 1% in October, taking the year-over-year rate to 4.4%, a faster pace than personal income growth of 3.7%. Headline inflation rose 0.1% for the month of November and at 2.9% year-over-year, remains at the upper end of the Bank of Canada's 1-3% target band. Core inflation also rose 0.1% for the month of November taking the annual rate to 2.1% year-over-year. The Bank of Canada kept rates steady at 1.0% for the course of 2011 with their outlook shifting to reflect the escalation in the global crisis. At the latest meeting the BOC acknowledged that both the Canadian and US economies were showing more strength than expected, however, the downside risks coming from offshore justify the current policy rate. A federal election during the year kept Prime Minister Harper in power and gave his conservative party a majority in Parliament. The Federal Economic and Fiscal update showed a weaker budget position and a delay in the return to a balanced budget by one year to FY 2016-17. A strong Canadian dollar combined with weak global and US growth has turned what used to be a decade long run of surpluses in the current account into 12 quarters of deficit. The Canadian government bond market returned 1.13% for the month of December, 1.65% for the quarter and 9.54% for the year.

NORWAY

The Norwegian central cut its overnight rate by 50 bps to 1.75% in Q4 as Europe's budding debt crisis and a strong NOK weighed on the growth and inflation outlook. Deputy governor Jan Qvigstad issued a statement saying, "the turbulence in financial markets has intensified and external growth is now expected to be clearly weaker, particularly in the euro area." Norwegian economic indicators weakened markedly in Q4. The December purchasing managers index came in at 46.6, missing expectations for a reading of 48.4 and signaling a marked slowdown in the manufacturing sector. It is important to note that a reading below 50 indicates contraction. The unemployment rate remained steady at 2.4% in December while the trade balance widened to 35.5 billion in November from 26.7 billion in October. Inflation missed expectations to the downside in November as core inflation rose 1.0% year on year, missing expectations for a 1.2% perhaps spurring the Norges bank into action. The Norwegian government market returned 0.59% in Q4.

government bond markets- developed countries

december 2011

AUSTRALIA

After keeping interest rates unchanged for most of the year, the Reserve Bank of Australia embarked on an easing cycle aimed at countering the effects of a deteriorating global backdrop. The RBA cut rates twice, in November and December, by 25 basis points each. The minutes from the December meeting noted that the RBA acted on the basis of heightened global risks stemming from Europe and noted that the "likelihood of a further material slowing in global growth has increased." The RBA expects slower growth in China but not a hard landing. The Australian economy expanded by 1.0% in Q3, taking the year-over-year number to 2.5% from 1.9% in the previous quarter. Fourth quarter numbers will not be released until late February/early March. Inflation remains contained with headline CPI at 3.5% year-over-year and underlying inflation at 2.5%, within the center of the RBA's 2-3% target band. Consumer sentiment cooled a touch in December and the unemployment rate inched up to 5.3%. Prime Minister Gillard was able to maintain a fragile hold on power throughout 2011 and will fight to maintain unity across her party during the rest of her term. Treasurer Swan released the government's Mid-Year Economic and Fiscal Outlook. As expected, this update showed deterioration in the Budget's position for 2011-12 due to slower economic growth, yet still returning to a small surplus by 2012-13. The Australian government bond market returned 1.05% for the month of December, 3.45% for the quarter and 14.26% for the year.

NEW ZEALAND

In New Zealand, the RBNZ has been on hold after the earthquake driven "emergency" 50 basis point rate cut in March which took cash rates to a historical low of 2.5%. In the most recent statement, the RBNZ noted that "global developments are having some negative impact on New Zealand, though to date it has been limited" and further stressed that "there remains a high degree of uncertainty around the global outlook and ...there is a risk that conditions weaken further." Additional seismic activity throughout the year, even as recently as December, has delayed the rebuild in the Canterbury region. Economic indicators remain mixed. The unemployment rate rose a touch to 6.6%, business optimism has increased slightly and retail sales were stronger than expected. New Zealand enjoyed a boost from hosting the Rugby World Cup. Prime Minister Key remained in power after winning the November election. The re-election of the National Party is a slightly more positive outcome and will enable a National led government to move forward with select asset sales that will lead to a faster fiscal improvement. The current account deficit widened to 4.3% of GDP and the terms of trade slipped 0.7% in the third quarter after seven consecutive quarterly increases. The New Zealand government bond market returned 1.12% for the month of December, 3.76% for the quarter and 14.71% for the year.

DEVELOPED MARKET GOVERNMENT BOND PERFORMANCE

LOCAL MARKET	ONE MONTH CHANGE	THREE MONTH CHANGE	SIX MONTH CHANGE	NINE MONTH CHANGE	ONE YEAR CHANGE
United Kingdom	1.73%	5.46%	14.93%	17.84%	16.90%
New Zealand	1.12%	3.76%	7.95%	11.95%	14.71%
Australia	1.05%	3.45%	9.46%	12.23%	14.26%
Denmark	3.76%	4.75%	14.66%	16.97%	13.87%
Sweden	1.14%	2.19%	10.00%	13.49%	13.82%
United States	0.92%	0.83%	7.31%	9.82%	9.61%
Canada	1.13%	1.65%	7.59%	10.16%	9.54%
Norway	-0.07%	0.59%	5.58%	8.26%	7.98%
Switzerland	0.94%	1.40%	6.20%	8.09%	7.21%
Singapore	0.01%	-0.46%	3.42%	4.84%	6.55%
Euro	4.01%	-0.43%	3.41%	4.66%	3.41%
Japan	0.66%	0.46%	1.61%	2.83%	2.20%

Local returns; Citigroup. Periods ending 12/31/11.

corporate bonds-investment grade credit (local currency)

december 2011

UNITED STATES

US investment grade (IG) credit finished the year strongly, outperforming duration-matched treasuries over the course of December and 4Q, but 2011 as a whole was quite challenging, which led to significant underperformance for the full year. While US IG and treasuries posted substantially positive total returns throughout the year on significantly lower rates, corporate spreads widened by 84 bps on a number of worries. The IG market experienced notable hiccups in 2Q and 3Q related to US and global growth concerns, the ongoing European sovereign issues and related impact on banks, and China slowdown fears. Markets continue to fluctuate on any headline out of Europe, but the hope is that ECB President Draghi and the newly installed Euro leaders will pass credible fiscal plans, support closer fiscal integration, and the ECB will provide a liquidity bridge while governments apply fiscal austerity to raise potential growth rates. The previous plan to lever up the EFSF did not gain wide acceptance and the original euphoria experienced in October waned during November. During the final quarter of the year, the best performing sectors were Paper, Airlines, and Metals & Mining, while the underperformers included Brokers, Building Materials, and Pharma. The Brokerage sector suffered from the demise of MF Global and concerns surrounding Jeffries. Quality-wise, triple-Bs performed better on a total return basis over the course of the year owing to its longer duration, while higher quality fared better on an excess return basis. Our longer term view of spread product remains favorable due to our base case expectation for the global economy to gradually improve, aided by further Fed and ECB easing if necessary, the solid condition of corporate balance sheets, and favorable technicals.

EUROPE

Euro IG credit performed similarly to US IG, with credit outperforming governments during December and 4Q, but underperforming substantially for the full year. Credit spreads widened by 122 bps over the course of 2011 due to all of the aforementioned issues, with Banks and peripheral country credits bearing the brunt of the weakness. Expectations that bank and fiscal deleveraging will lead to a contraction in European growth, credit concerns surrounding the possibility of one or more countries exiting the Euro, and ongoing Banking uncertainty have all contributed to the weak Euro IG credit performance during the year. During 4Q, tier 1 Bank and Insurance paper continued their wild ride, rebounding in December to be among the top industry performers, along with Metals & Mining. The primary underperformers for the quarter included Aerospace/Defense and LT2 Banks. The Aerospace/Defense sector has lagged due to negative newsflow from Finmeccanica. Looking ahead, while underlying company fundamentals remain favorable, we continue to closely monitor the delicate sovereign situations across the euro-zone and the potential negative effect that newly implemented austerity measures have on growth and corporate earnings. A credible plan from Euro policymakers to stem the crisis such as expansion of the ECB's balance sheet or Eurozone bond issuance would have positive implications for credit.

UNITED KINGDOM

The UK IG credit market underperformed gilts materially on both a total and excess return basis during the 4Q and 2011. Over the course of the year, spreads widened by 99 bps. During 4Q, Aerospace/Defense and Telecom underperformed due to the weak performance of peripheral country credits, while Metals & Mining and Insurance were the primary outperformers. For the full year, the Banking and Insurance sectors underperformed substantially owing to the continuing European sovereign crisis.

corporate bonds-investment grade credit (local currency)

december 2011

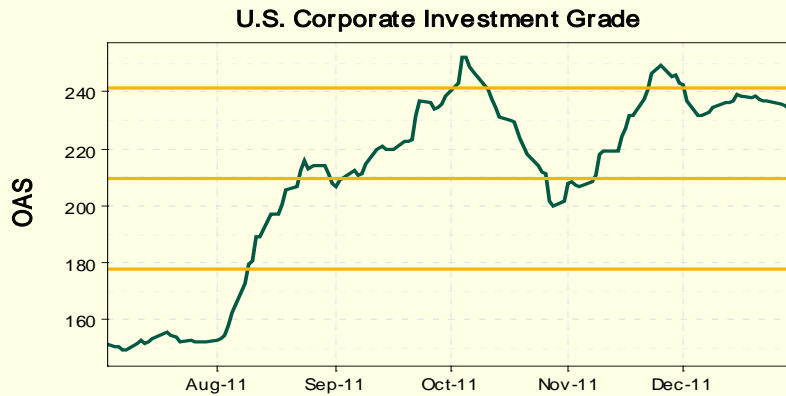
Periods Ending 12/31/11	ONE MONTH CHANGE	THREE MONTH CHANGE	SIX MONTH CHANGE	NINE MONTH CHANGE	ONE YEAR CHANGE
United States	2.14%	1.93%	4.83%	7.23%	8.15%
Aaa	2.09%	1.12%	9.87%	11.93%	12.33%
Aa	2.02%	1.73%	4.72%	6.81%	7.07%
A	2.06%	1.63%	4.56%	6.88%	7.68%
Baa	2.28%	2.40%	5.04%	7.67%	9.05%
US Governments	0.89%	0.84%	6.74%	9.11%	9.02%
	ONE MONTH CHANGE	THREE MONTH CHANGE	SIX MONTH CHANGE	NINE MONTH CHANGE	ONE YEAR CHANGE
Euro	2.58%	1.34%	-0.01%	1.45%	1.49%
Aaa	3.18%	1.22%	5.92%	8.45%	6.97%
Aa	2.38%	1.79%	2.58%	4.35%	3.81%
A	2.70%	1.13%	-0.18%	1.25%	1.21%
Baa	2.52%	1.63%	-2.43%	-1.27%	-0.43%
Euro Governments	3.96%	-0.53%	3.29%	4.08%	3.36%
	ONE MONTH CHANGE	THREE MONTH CHANGE	SIX MONTH CHANGE	NINE MONTH CHANGE	ONE YEAR CHANGE
Sterling	2.64%	3.32%	3.00%	4.78%	6.52%
Aaa	2.00%	1.85%	6.79%	9.12%	8.61%
Aa	2.28%	4.98%	7.21%	9.25%	10.58%
A	2.72%	2.92%	2.18%	3.74%	5.59%
Baa	2.71%	3.35%	1.82%	3.77%	5.72%
UK Governments	1.73%	5.30%	14.67%	17.65%	16.68%

Source: Barclays Capital.

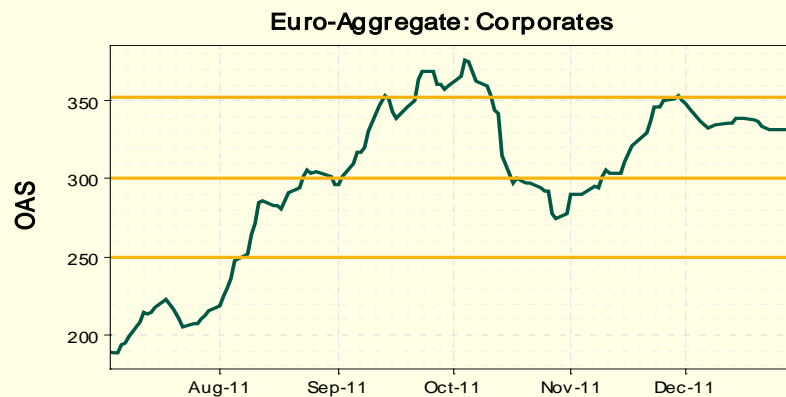
corporate bonds-investment grade credit (local currency)

december 2011

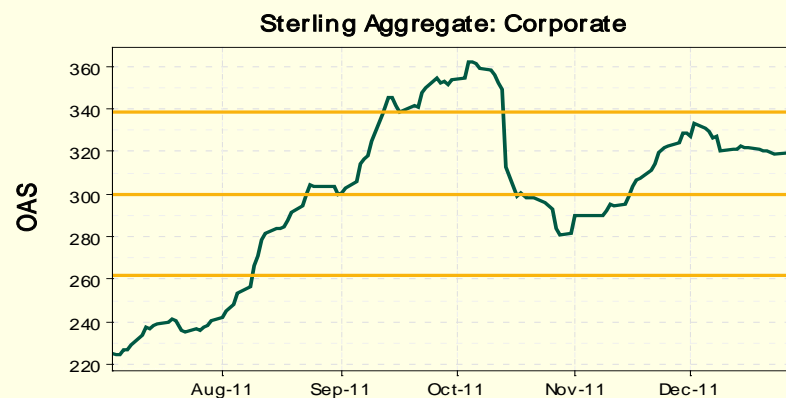
US INVESTMENT GRADE CORPORATE OPTION-ADJUSTED SPREAD



EURO AGGREGATE CORPORATE OPTION-ADJUSTED SPREAD



UK INVESTMENT GRADE CORPORATE OPTION-ADJUSTED SPREAD



Source: Barclays; Spread measured in basis points. Periods ending 12/31/11.

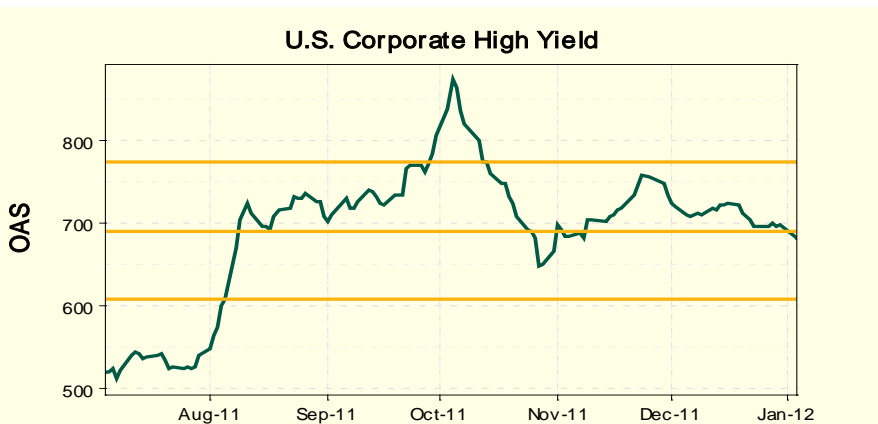
high yield

december 2011

The US high yield market performed quite strongly over the past month and quarter, but underperformed treasuries for the full year. Volatility continues in the high yield space given the uncertainties surrounding global growth and the European sovereign situation. After experiencing a very difficult August and September, the US high yield market rebounded strongly in October on the back of a plan to leverage the EFSF, only to backtrack somewhat again in November as the plan failed to gain traction. Spreads widened by approximately 173 bps over the course of 2011, but have tightened by 139 bps from their October wides. We would expect this type of volatility to continue as European leaders and the ECB continue to grapple with possible solutions while the outlook for global growth remains clouded, but default expectations remain low and profitability appears to be strong. Notable outperformers during 4Q included Home Construction, Construction Machinery, and Life Insurance, while Refining and Airlines lagged due to a couple of bankruptcies. On a quality basis, lower rated credit fared the best on the risk trade during the month and quarter, but underperformed for the year. Despite the fact that spreads are inside their longer-term averages, we believe the HY market offers relative value as the default rate is expected to remain low and the economy continues to be on an improving trend. That said, issue selection is critical and a number of challenges (economic uncertainty, sovereign contagion) need to be closely monitored.

Periods ending 12/31/11	ONE MONTH CHANGE	THREE MONTH CHANGE	SIX MONTH CHANGE	NINE MONTH CHANGE	ONE YEAR CHANGE
US Corp High Yield	2.66%	6.46%	0.01%	%	4.98%
Ba	2.39%	5.61%	1.70%	%	6.84%
B	2.63%	6.40%	0.84%	%	5.39%
Caa	3.31%	8.42%	-4.30%	%	1.18%
Ca-D	4.01%	10.51%	-17.14%	%	-12.41%
NR	4.63%	9.00%	2.99%	%	6.76%

US HIGH YIELD CORPORATE OPTION-ADJUSTED SPREAD



Source: Barclays; Spread measured in basis points. Periods ending 12/31/11.

currency

december 2011

The US dollar was choppy during the fourth quarter as it vascillated between “risk on” and “risk off” from month to month. The DXY rallied 2.1% in Q4 amid on going concerns about European contagion and a resulting decrease in risk appetite. Risk markets remained skittish as investors became concerned that the latest iteration of a comprehensive resolution to the European debt issues was not enough to stem the crisis. The proposal involved using the EFSF as an insurance scheme where the fund would guarantee 20-40% of the losses on PIIGS bonds instead of buying them outright, but it has become increasingly clear to investors that the EFSF, at \$440 billion, is not big enough to service all of the programs it has been earmarked for. The Bundesbank, for its part, is concerned about moral hazard stemming from an EFSF enlargement or greater money printing by the European central bank, saying such measures would discourage politicians from taking tough decisions to cut budget deficits and weaken faith in the euro. The EUR fell 3.2% in Q4 as concerns resurfaced about the viability of the euro zone as an entity in the absence of a comprehensive agreement. The belief in core Europe is that massive budgetary cuts and reformation plans in the periphery will be enough to stabilize markets and allow the Euro area to successfully navigate the crisis. This strategy would be possible if the PIIGS countries could still grow nominally, but as global growth shows signs of slowing debt sustainability becomes impossible if continental GDP contracts. Norway and Sweden outperformed the EUR Q4. As small, open economies, they are often seen as global growth proxies but have been bid up as safe haven alternatives to the EUR given their solid government balance sheets. The NOK fell -1.8% in Q4 while the SEK was off just -0.20%. The Swiss Franc fell 3.2% on the quarter as the Swiss National Bank speculated about further measures to weaken the Franc.

Given the performance of the EUR in Q4, the commodity currencies fared relatively well as markets applauded China’s cut in the reserve requirement as the beginning of an easing campaign. It is too early to tell, but if the Chinese do indeed begin a reflation cycle, the commodity complex is likely to be the key beneficiary. The AUD rose 5.7% while the NZD was up 2.1% during the quarter. The Canadian dollar rose 2.8% as better US economic numbers buoyed demand for the CAD. Nearly 70% of Canadian exports are destined for their neighbor to the south and any perceived pick up in economic fortunes in the US resonates in the Canadian currency.

The economic situation in Japan has improved in the aftermath of the earthquake/tsunami in March. Production has snapped back and automotive supply chain issues are largely resolved. The key for the Japanese economy going forward is how much the global economy weakens on a slowing China and European sovereign concerns. The performance of the Japanese yen remains contingent on the US Fed. The Yen is likely to remain well supported as long as the US Fed retains a dovish tilt. The Japanese currency rose 0.20% in Q4 as the threat of further intervention keep the JPY in a narrow range.

Asian currencies were mixed in Q4 as European sovereign concerns caused investors to shed assets sensitive to global growth. The Korean Won was the outperformer in the space ending the quarter up 2.2%, while the IDR was the laggard, falling -2.1%.

currency

december 2011

CURRENCY	ONE MONTH CHANGE	THREE MONTH CHANGE	SIX MONTH CHANGE	NINE MONTH CHANGE	ONE YEAR CHANGE
Japanese Yen	0.91%	0.20%	4.74%	8.09%	5.47%
DXY	2.29%	2.07%	7.91%	5.70%	1.46%
Australian Dollar	-0.72%	5.66%	-4.78%	-1.16%	-0.23%
Swiss Franc	-2.65%	-3.19%	-10.41%	-2.04%	-0.31%
New Zealand Dollar	-0.42%	2.08%	-6.27%	2.06%	-0.38%
UK Pound	-1.03%	-0.26%	-3.18%	-3.03%	-0.44%
Singapore Dollar	-1.17%	0.83%	-5.25%	-2.78%	-1.02%
Canadian Dollar	-0.39%	2.84%	-5.67%	-4.96%	-2.28%
Swedish Krona	-1.80%	-0.19%	-8.11%	-8.18%	-2.55%
Norwegian Krone	-3.42%	-1.83%	-9.84%	-7.29%	-2.57%
Danish Krone	-3.54%	-3.06%	-10.30%	-8.16%	-2.89%
Euro	-3.61%	-3.18%	-10.63%	-8.45%	-3.16%
Thai Bhat	-2.16%	-1.14%	-2.60%	-4.03%	-4.72%

Source: Bloomberg. Periods ending 12/31/11.

emerging markets

december 2011

Performance during 2011 was mixed for emerging market debt assets. While hard currency bonds (both sovereign and corporate) ended the year on a positive note, local currency debt had a negative year. The former responded to a preference among investors for the US dollar and for less indebted sovereign countries with improving fundamentals. The first half of the year was good for the riskier assets (local currency debt and hard currency corporate bonds), but the second half was less kind for these when compared to hard currency sovereign debt. The second half of the year was characterized by a pattern of one-month with large losses and the next month with large gains. This situation was especially hard for long-term value investors. But emerging markets bonds were not alone: in the risk-off months, the government bonds (with the exception of the Euro markets) had gains and virtually everything else had losses. As has been the case in prior months, the oscillations mostly derive from the market expectations for a solution to the Euro crisis.

In December, the hard currency EM indices posted positive returns for the month, but local currency markets more had a negative month. The outlook for next year remains heavily dependent on a Euro solution and the growth expectations for the developed world. In addition, growth in China will remain the focus for many resource-driven emerging markets.

EXTERNAL MARKETS: SOVEREIGN

The JP Morgan EMBI Global index returned 1.2% during December, bringing the full year performance to 8.5%. There was a wide disparity among the regions with Latin America (+13.4%) and Asia 9.0%) substantially outperforming Africa (5.2%), the Middle East (4.8%) and Europe (2.2%). Countries with the best fundamentals outperformed.

Periods ending 12/31/11	ONE MONTH	THREE MONTHS	SIX MONTHS	NINE MONTHS	ONE YEAR	YEAR- TO-DATE
JPM EMBI Global	1.18%	5.12%	3.21%	7.37%	8.46%	8.46%
JPM EMBIG Spr Chg	13	(39)	138	128	138	138
Africa	-0.06%	1.77%	0.92%	5.40%	5.22%	5.22%
Asia	1.04%	5.26%	5.08%	9.43%	9.04%	9.04%
Europe	-0.22%	2.50%	-2.10%	0.79%	2.19%	2.19%
Latin America	2.33%	7.40%	6.56%	11.76%	13.43%	13.43%
Middle East	0.83%	2.53%	2.91%	5.47%	4.82%	4.82%
EMBI Spread	426					*289

Source: JP Morgan ; Bloomberg. Periods ending 12/31/11.

emerging markets

december 2011

EXTERNAL MARKETS: CORPORATE

The JP Morgan CEMBI Broad Diversified index returned 0.8% in December, bringing the year-to-date performance to 2.3%. In a more volatile environment, corporate debt significantly underperformed sovereign debt this year. In 2011 the high yield sector (-3.8%) was hit hard, while the investment grade sector (5.3%) had sovereign-like returns. As might be expected in a year where bad news out of Europe dominated, European credits were the weakest (-6.1%). The CEMBI tightened by 9 basis points in the month but widened by 174 bps for the full year, bringing the year end spread to 480.

EM CORPORATE	ONE MONTH	THREE MONTHS	SIX MONTHS	NINE MONTHS	ONE YEAR	YEAR-TO-DATE
JPM CEMBI Broad Div	0.84%	4.09%	-0.89%	0.72%	2.32%	2.32%
JPM CEMBI Broad Div Sprd	9	(37)	160	180	174	174
High Grade	0.96%	2.98%	1.91%	4.38%	5.31%	5.31%
High Yield	0.54%	6.79%	-6.71%	-6.61%	-3.80%	-3.80%
Banks	0.03%	1.85%	-2.44%	-1.45%	-0.17%	-0.17%
Retail	1.83%	5.92%	0.57%	2.11%	3.16%	3.16%
Industrials	1.81%	7.31%	-2.26%	-0.98%	1.22%	1.22%
Metals & Mining	0.26%	4.80%	-2.41%	-1.60%	-0.48%	-0.48%
Oil & Gas	0.71%	3.70%	1.40%	4.20%	5.81%	5.81%
Telecom	1.92%	5.06%	3.03%	5.17%	7.83%	7.83%
Utilities	0.31%	2.39%	0.70%	3.90%	4.44%	4.44%
Africa	1.02%	2.88%	-1.74%	0.41%	3.20%	3.20%
Asia	0.90%	5.05%	-0.80%	0.57%	2.07%	2.07%
Europe	-1.56%	2.49%	-7.98%	-9.37%	-6.14%	-6.14%
Latin America	1.76%	5.45%	1.43%	3.44%	5.26%	5.26%
Middle East	0.99%	0.64%	1.39%	5.78%	5.40%	5.40%
CEMBI Spread	480					305

Source: JP Morgan; Bloomberg. Periods ending 12/31/11.

emerging markets

december 2011

LOCAL MARKETS

The biggest retreat in emerging markets was in local government bonds. It lead other asset classes in terms of returns in the first half of the year, and was the only EM asset class to have negative returns in the second half. In terms of fund inflows into EMD, local currency bond funds lead in the first half of the year and then saw the largest outflows in the second half. The return for the GBI-EM Global Diversified was down by -1.5% in December, bringing the full year performance to a negative -1.8%. With continued concerns over the viability of the euro, the European governments were the worst performers with a return of -4.1% for December, but other regions were not unscathed. For the year, Europe (-9.0%) and Africa (-11.1%) clearly show investors concerns with the region and their lack of appetite for risk. In the EM local currency universe, Asia is considered the safer haven and had a full year return of 7.8%.

EM LOCAL (IN USD)	ONE MONTH	THREE MONTHS	SIX MONTHS	NINE MONTHS	ONE YEAR	YEAR-TO-DATE
GBI-EM Global Div	-1.47%	0.48%	-8.12%	-4.49%	-1.75%	-1.75%
GBI-EM Asia	1.74%	2.38%	2.92%	5.56%	7.77%	7.77%
GBI-EM Europe	-4.04%	-3.27%	-16.59%	-14.48%	-8.97%	-8.97%
GBI-EM Latam	-2.43%	2.42%	-7.15%	-0.07%	1.62%	1.62%
GBI-EM ME/Af	0.85%	2.86%	-10.82%	-7.67%	-11.05%	-11.05%
GBI-EM Brazil	-3.31%	3.02%	-7.83%	-0.57%	2.98%	2.98%
GBI-EM Chile	0.47%	0.47%	-5.76%	-1.94%	-2.75%	-2.75%
GBI-EM Colombia	2.29%	9.55%	-0.33%	10.46%	5.60%	5.60%
GBI-EM Czech Rep	-1.43%	-7.90%	-11.98%	-7.54%	0.11%	0.11%
GBI-EM Hungary	-8.77%	-13.55%	-28.06%	-25.48%	-12.74%	-12.74%
GBI-EM Indonesia	4.55%	3.14%	9.07%	16.91%	22.02%	22.02%
GBI-EM Malaysia	0.81%	2.07%	-2.01%	-0.05%	2.09%	2.09%
GBI-EM Mexico	-3.59%	0.63%	-11.05%	-5.33%	-3.34%	-3.34%
GBI-EM Peru	-0.24%	6.20%	10.98%	16.11%	11.72%	11.72%
GBI-EM Poland	-2.21%	-2.93%	-17.91%	-12.57%	-8.76%	-8.76%
GBI-EM Russia	-4.02%	2.96%	-12.15%	-8.93%	0.52%	0.52%
GBI-EM S Africa	0.85%	2.86%	-10.82%	-7.71%	-11.00%	-11.00%
GBI-EM Thailand	-0.44%	1.58%	1.74%	0.30%	0.35%	0.35%
GBI-EM Turkey	-3.17%	-2.68%	-11.96%	-14.70%	-15.84%	-15.84%

Source: JP Morgan Chase; Bloomberg. Periods ending 12/31/11.

Past performance is no guarantee of future results.

All indexes are unmanaged and do not incur fees. You cannot invest directly in an index.

This outlook is provided for informational purposes only and should not be construed as investment advice. Any opinions or forecasts contained herein reflect the subjective judgments and assumptions of the authors only and do not necessarily reflect the views of Loomis, Sayles & Company, L.P., or any portfolio manager. Investment recommendations may be inconsistent with these opinions. There can be no assurance that developments will transpire as forecasted and actual results will be different. Data and analysis does not represent the actual or expected future performance of any investment product. We believe the information, including that obtained from outside sources, to be correct, but we cannot guarantee its accuracy. The information is subject to change at any time without notice.