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To: Undisclosed recipients;

Subject: Thoughts on Recent Market Pullbacks

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Attachments: GIO_Trade_Alert_2011-01-27_(Middle_East_Conflict).pdf

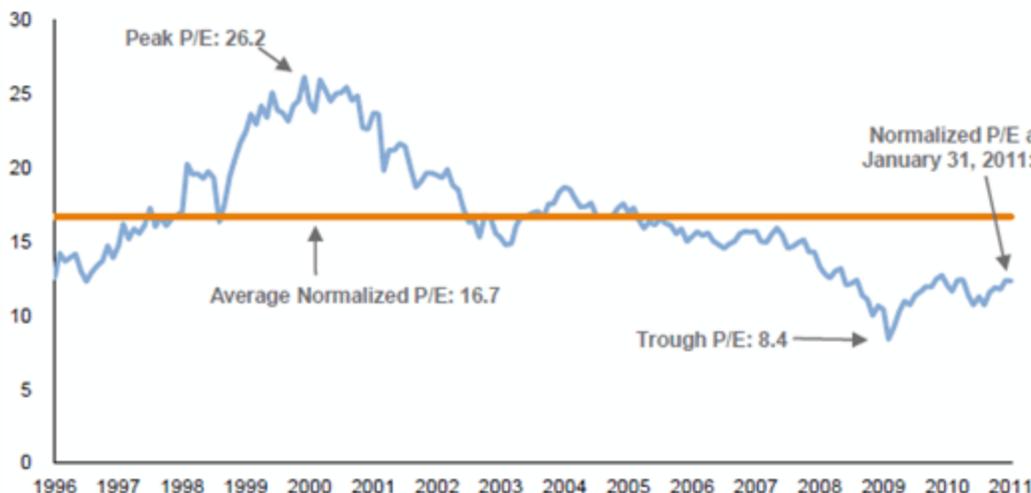
Inline-Images: image001.png; image002.png

The last three days of trading in global markets have exhibited a sharp jump in volatility and declines in broad risk markets driven by the increase in global political uncertainty and its impact on oil prices. As we take a step back to digest the market action, we find it difficult to predict with certainty how the political events in the Middle East will unravel. However, we continue to believe that the improvements in the global macro recovery story, for now, remain intact. While we are closely watching oil prices and would be concerned to see sustained high prices for multiple months, we believe equity market valuations remain attractive and ultimately view sell offs as buying opportunities in specific sectors with strong fundamental stories.

Equities:

Although equity valuations may vary by different analyst approaches, most metrics continue to show cheap valuations relative to history. More importantly, equity valuations continue to show strength compared to alternative asset classes. The two charts below from our Asset Management partners exhibit these points. US equities currently trade at just over 12x normalized earnings vs the last 15 year historical average of almost 17x. The asset class also looks attractive relative to fixed income: equity risk premiums vs corporate bond yields are above peak levels of prior cycles. We continue to focus on buying internet mobility related stocks, shipping container leasers, high dividend paying blue chips, and airlines (even though we strongly recommend pairing the trade with long oil exposure).

Price to Earnings Ratio - JPM Normalized Earnings



Equity Risk Premiums vs. Corporate Bonds



Source: Morgan Asset Management, Bloomberg. As of January 31, 2011.

Oil:

Oil is certainly important to watch as high prices sustained over long periods of time may force the Fed's hand prematurely or even worse may derail the current recovery. However, we believe that the 10-15% increase in global oil prices since Friday has been a result of heightened uncertainty. With Libya accounting for 2-3% of world oil supply, disruptions isolated to the country should be manageable and offset by other oil producers. Clearly, disruptions amongst the larger producers in the area would force us to reconsider. In the meantime, we are taking partial profits on our long crude commodity positions and replacing them with non-Middle East dependent oil producers.

Protection:

Despite our preference for adding to risky assets on these pullbacks, we also acknowledge that newsflow and events will continue to create volatility in global markets and as such, hedging strategies still make sense. The most obvious hedge is to have long exposure to oil either through the commodity outright or buying oil stocks. As we mentioned in our previous note from late January (see attached), we also see value in buying credit default protection on other countries in the Middle East. We are also considering adding credit protection on large Southeast Asian countries that may be particularly sensitive to higher sustained oil and food prices. Also, for Euroskeptics, we still like short Euro / long Swiss positions.

On a side note, we are watching Wisconsin closely to make sure that public sector labor disruptions in the US don't spill over into the private sector.

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