

International Investing in the Era of Globalization

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June 2007

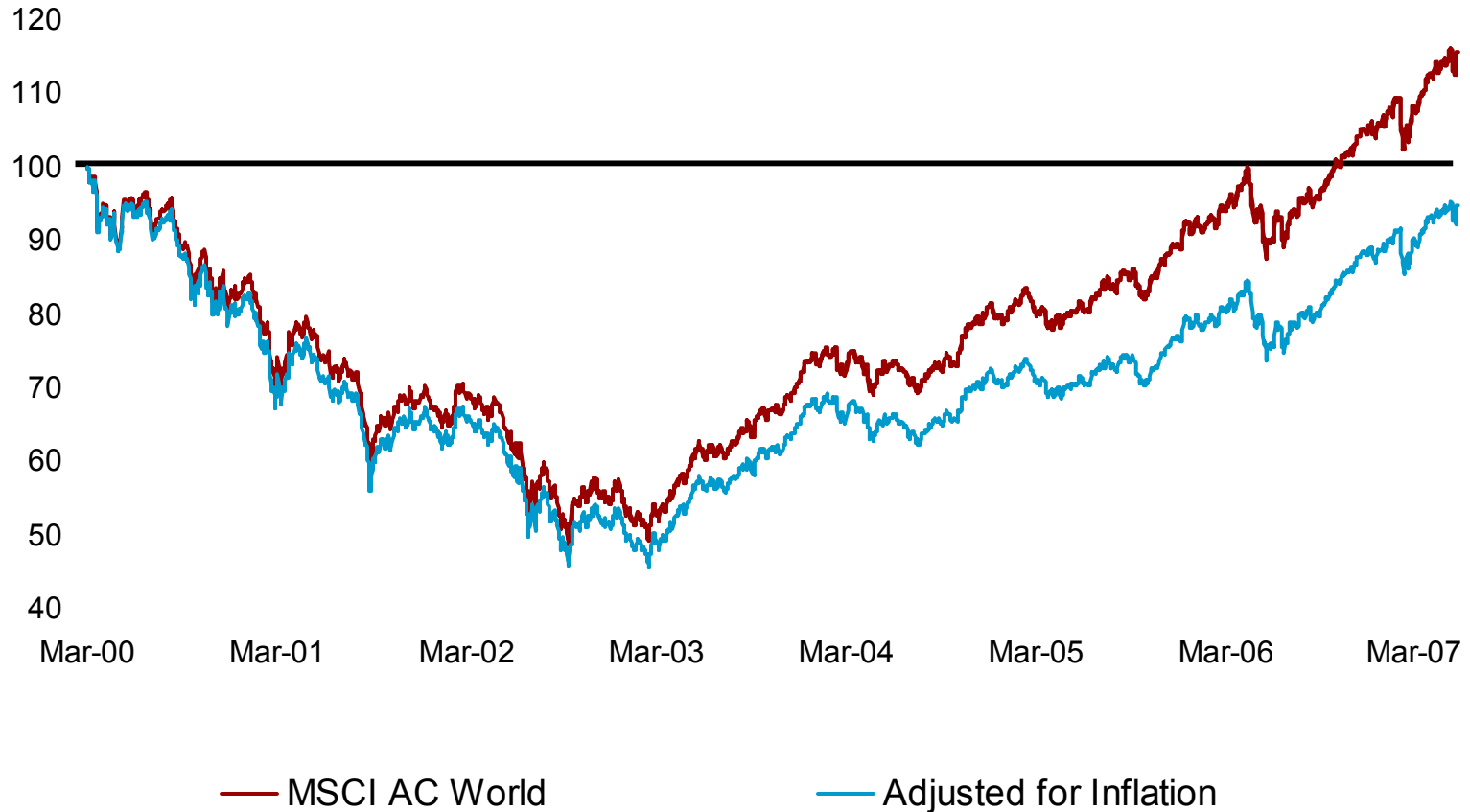
International Investing in the Era of Globalization

- ◆ Prospects for Global Financial Markets

- ◆ Portfolio Implementation

How Much Longer Can the Equity Bull Market Last?

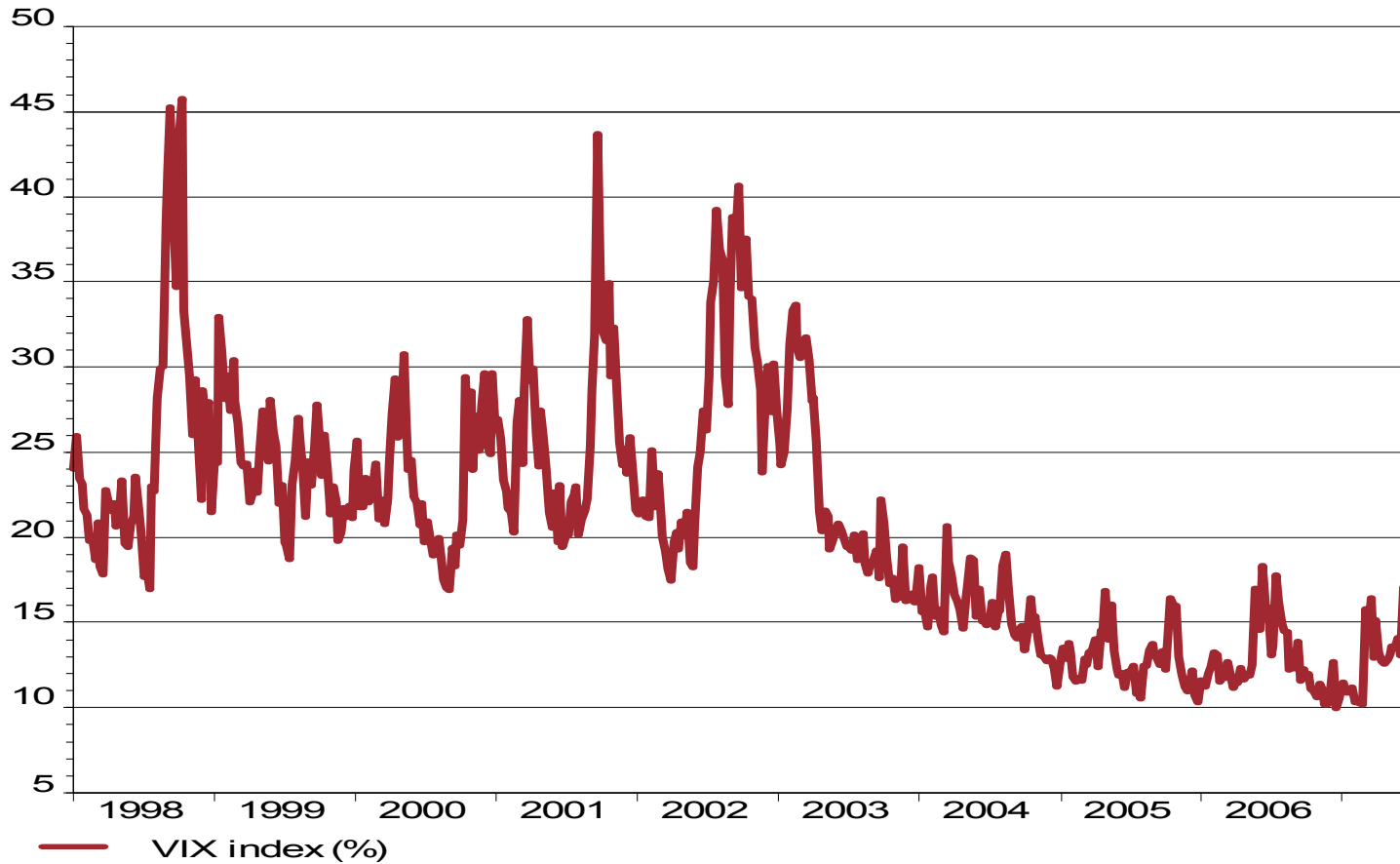
The Rally Is Now in its Fifth Year





Asset Management

Volatility Remains Low but May Be Picking Up



Source: Datastream

Globalisation Has Fuelled the Bull Market

- ◆ Three main drivers of equities:
 - ◆ Growth in GDP/Corporate Earnings
 - ◆ Liquidity
 - ◆ Valuations

- ◆ All three boosted by globalisation

- ◆ Will this continue?

Global Growth: The Beneficial Impact of Globalisation

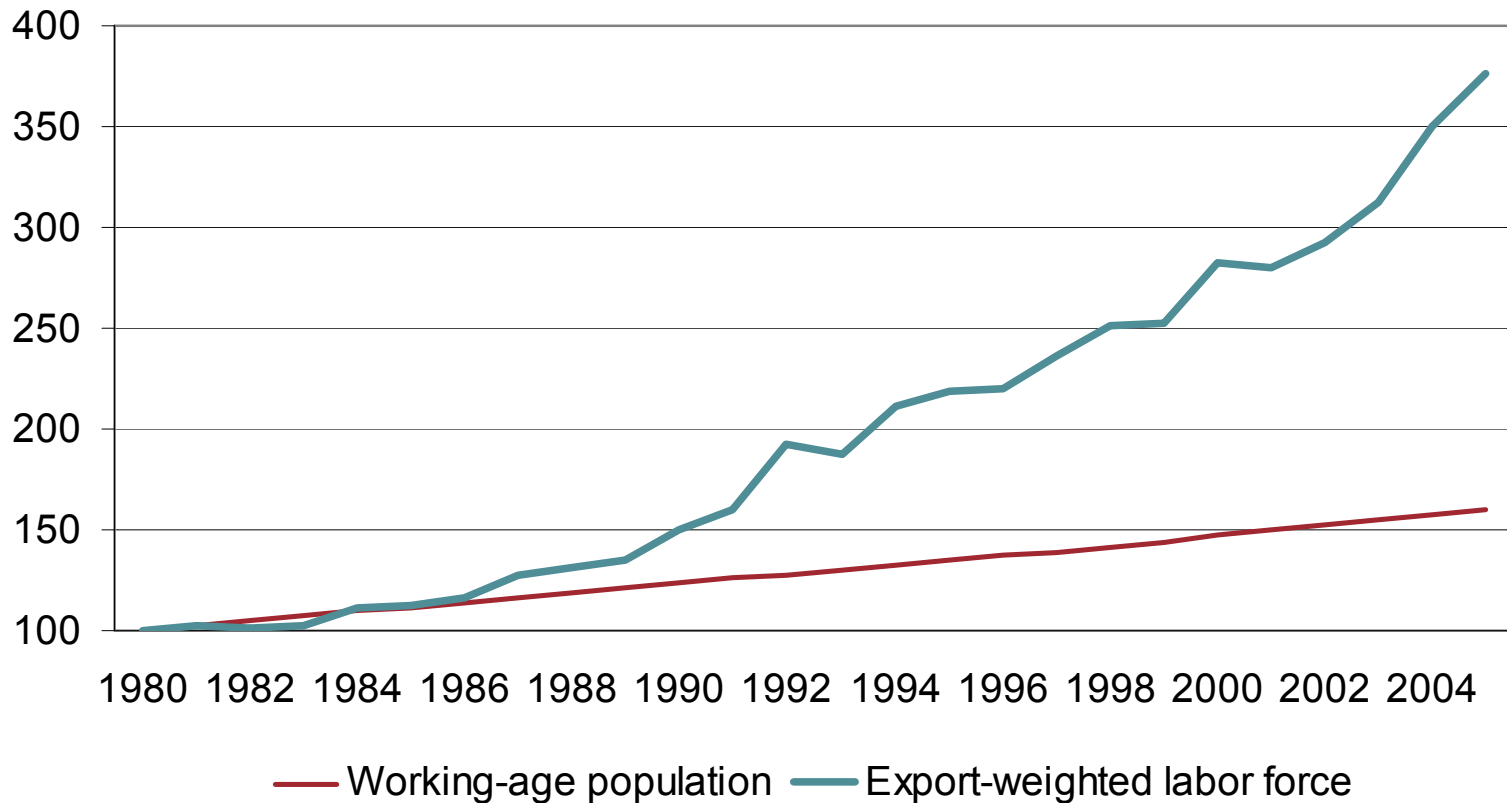
- ◆ Massive increase in global labour supply owing to opening up of China, India and former Eastern bloc
- ◆ Technical progress and trade liberalisation have enabled production processes to be unbundled and located farther from end markets
- ◆ Increasing flows of migrants across borders
- ◆ Globalisation has boosted world economic growth potential and contained inflation

Incorporation of Large New Pool of Labour from Emerging Markets

- ◆ Effective labour supply: workers who compete in the global market
- ◆ Weigh each country's labour force by export-to-GDP ratio
- ◆ By this measure, global supply of labour rose fourfold between 1980 and 2005
- ◆ Most of increase has consisted of less-educated workers

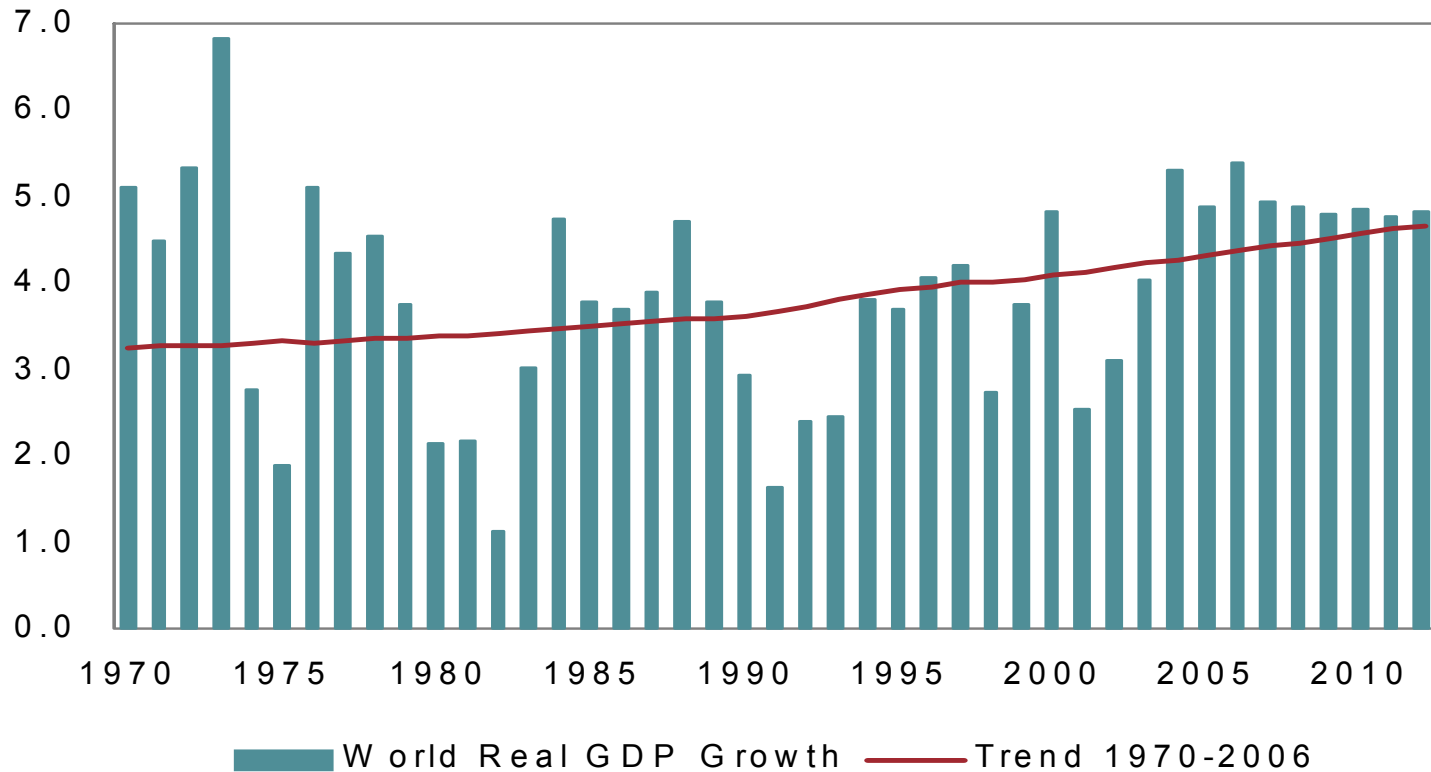
Quadrupling of Effective Labour Supply

Indices (1980=100)



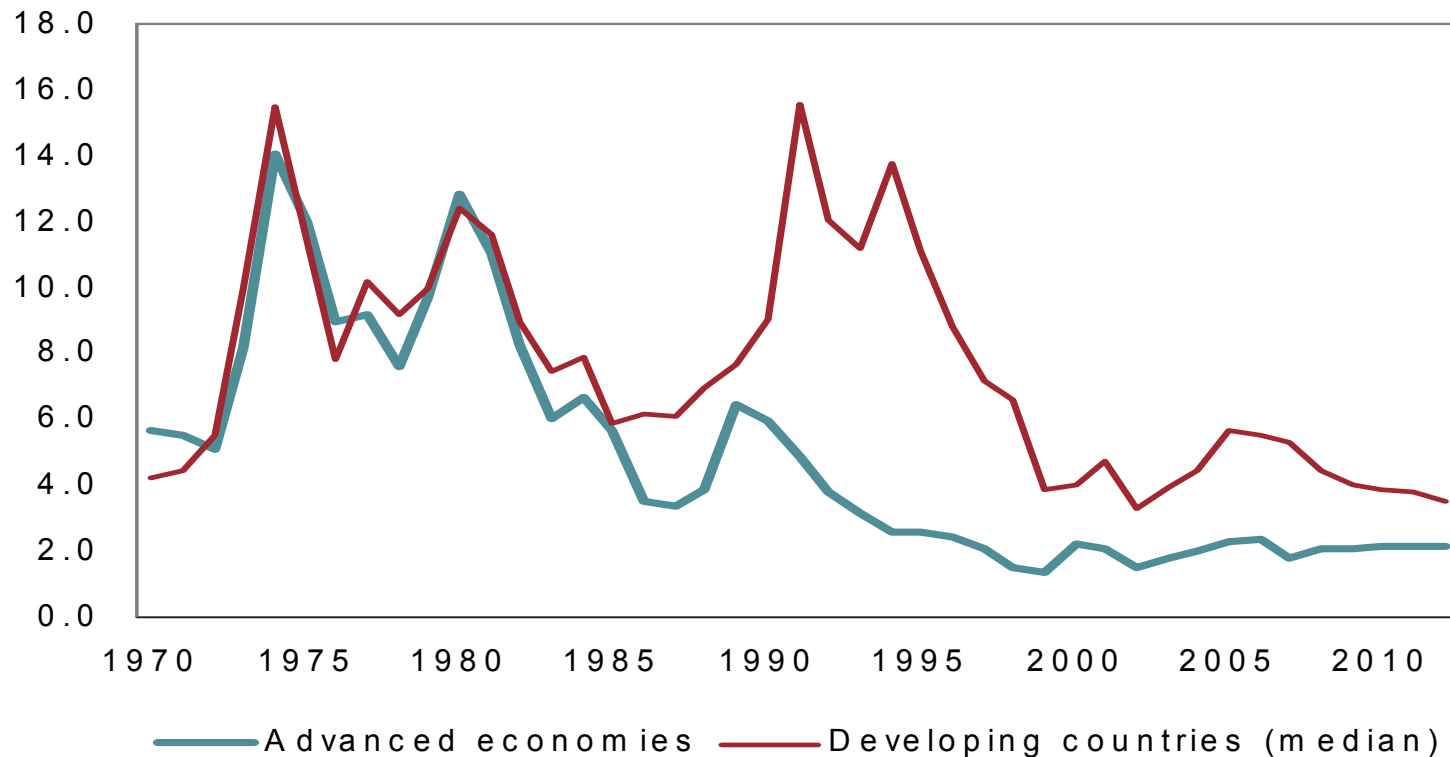
A Golden Era Based on Globalisation: Strong Growth

World GDP Growth (% change)

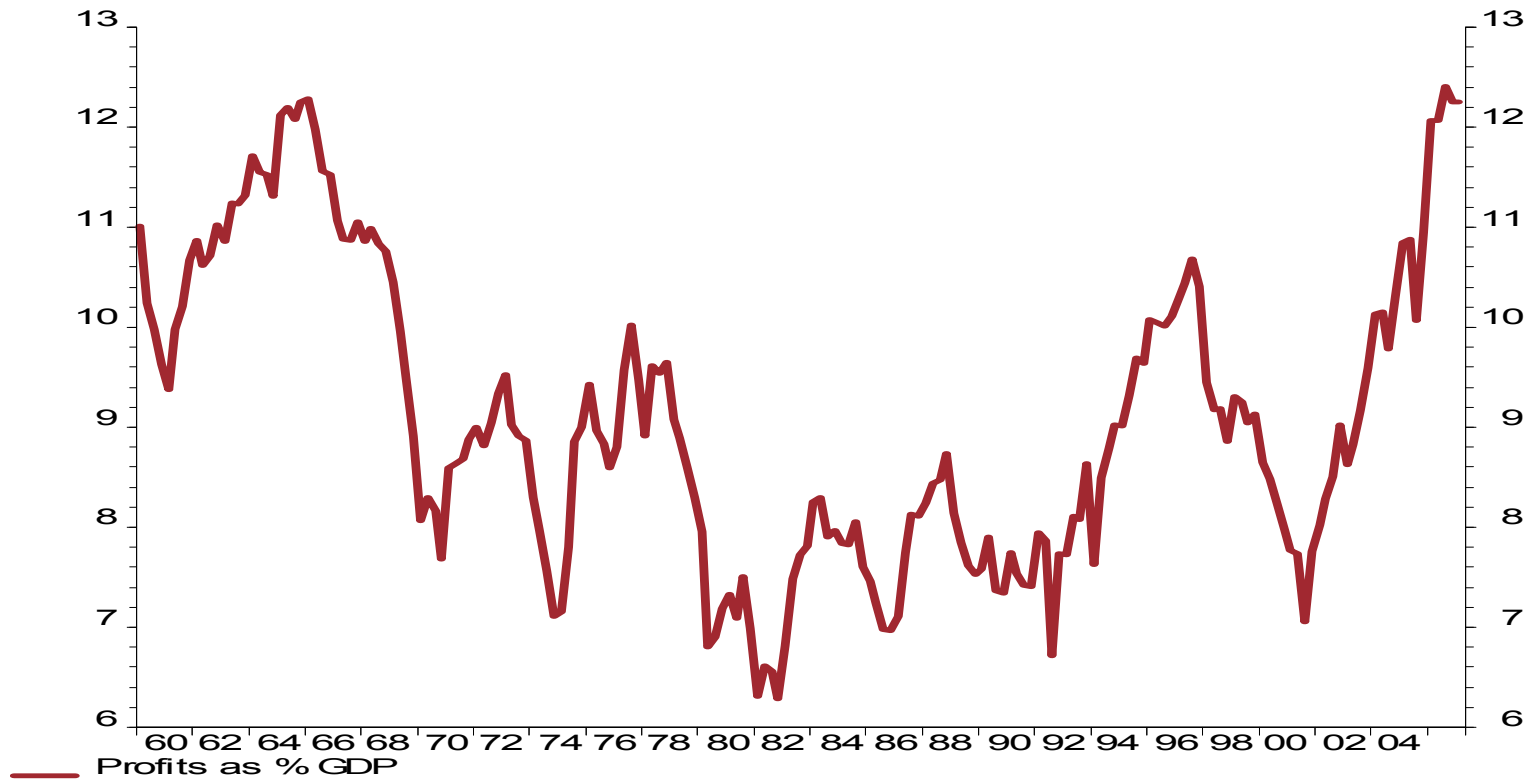


A Golden Era Based on Globalisation: Low Inflation

Consumer Prices (% change)



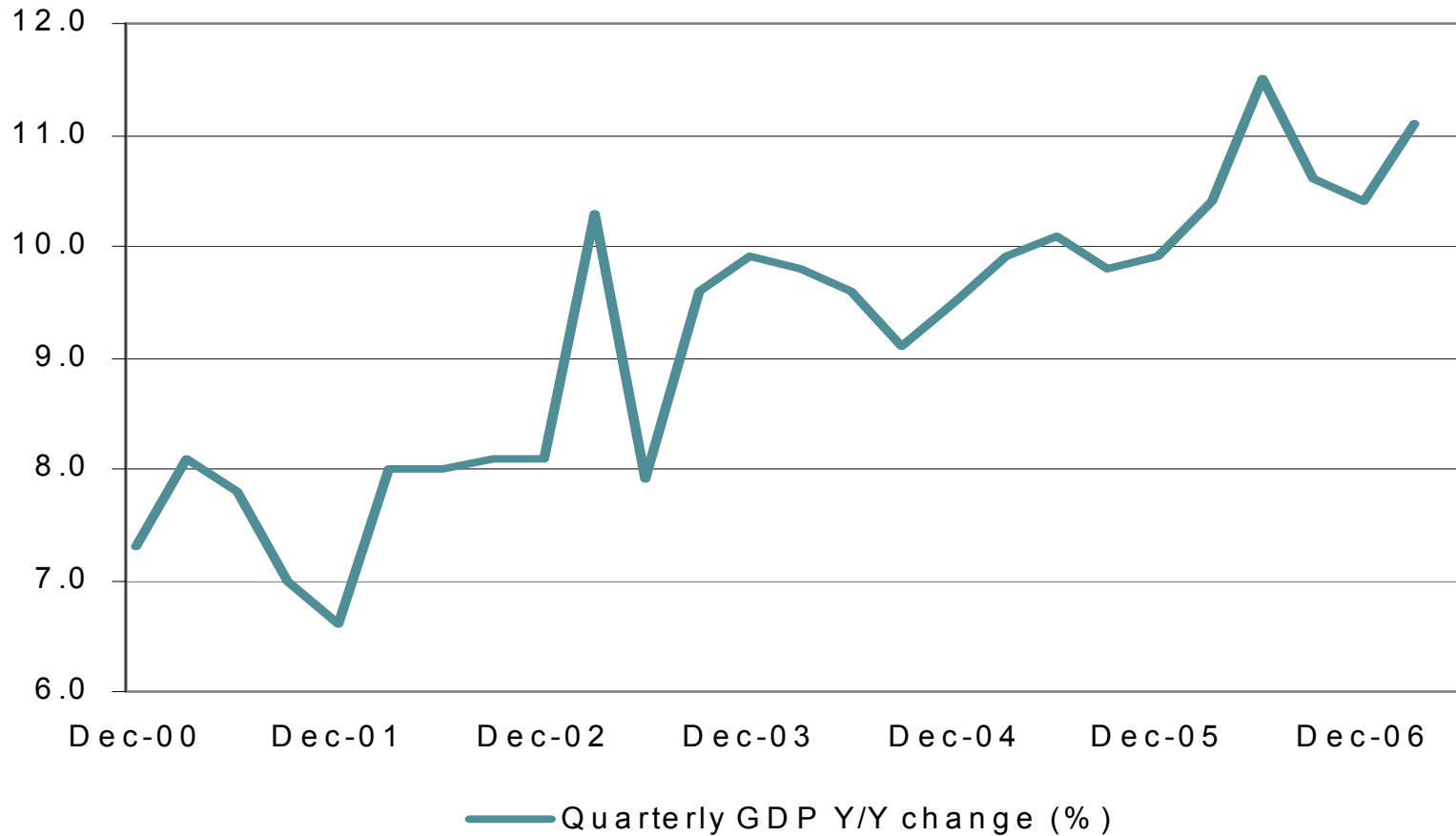
A Golden Era Based on Globalisation: Record Profits



Risks Have Diminished

- ◆ Oil prices have stabilised
- ◆ Chinese hard-landing not on horizon
- ◆ Global imbalances have begun to be corrected
- ◆ US economy has proved to be resilient to housing market downturn

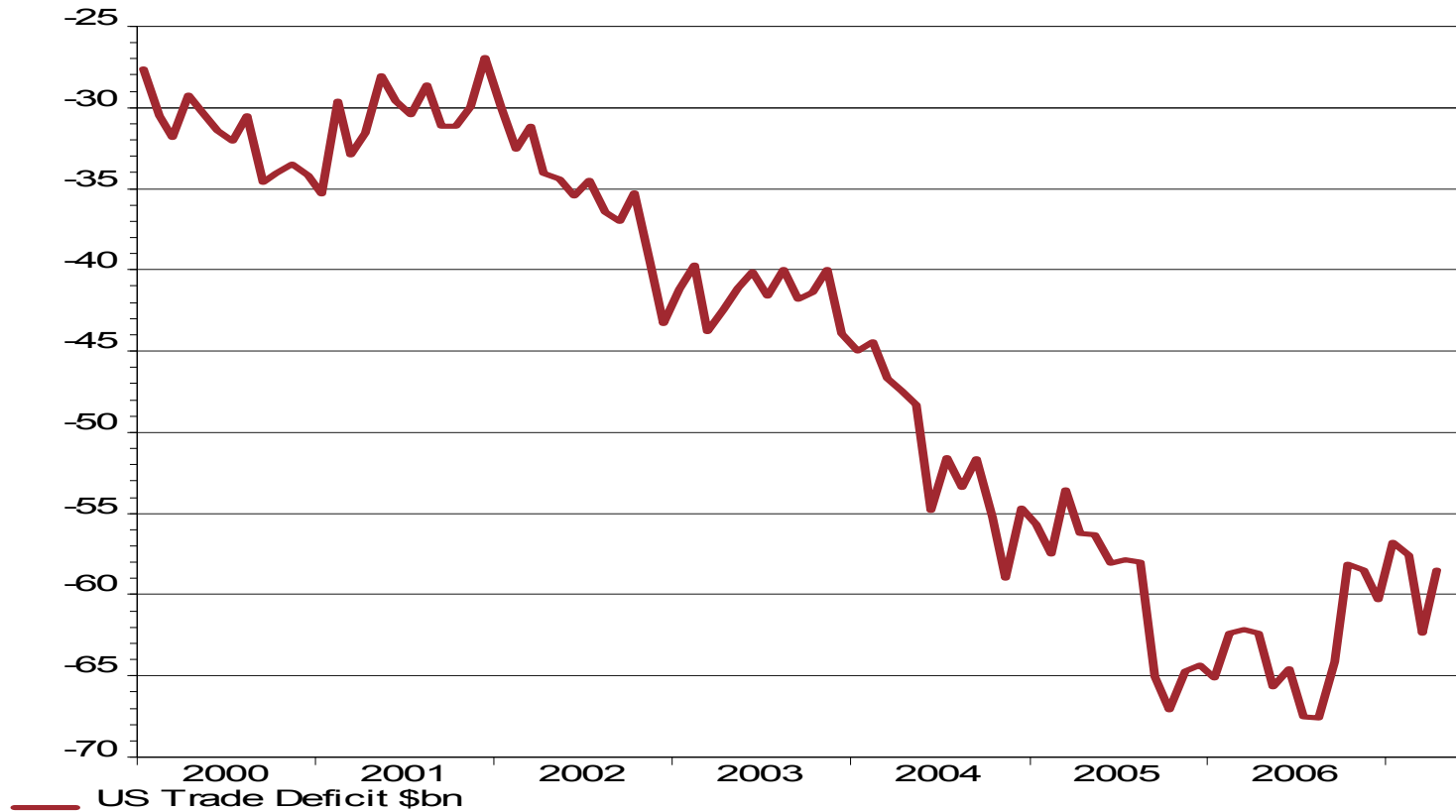
Chinese Hard-Landing – Not For Now



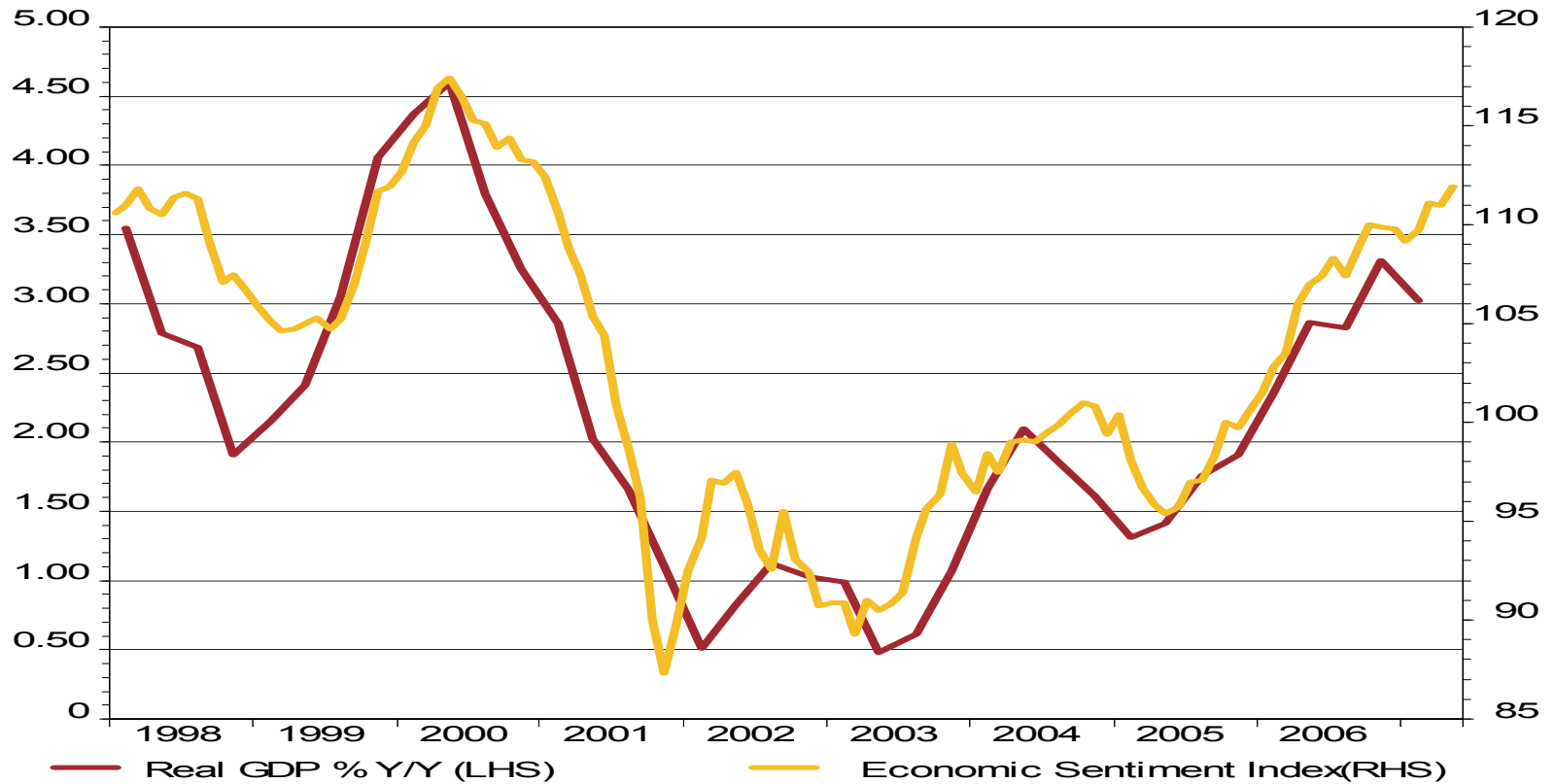
Global Imbalances – Correction Has Started

- ◆ US deficit has stabilised
- ◆ Domestic demand reviving in Eurozone/Japan
- ◆ So far dollar depreciation has been orderly
- ◆ However, US deficit still massive
- ◆ Chinese surplus/reserves still soaring

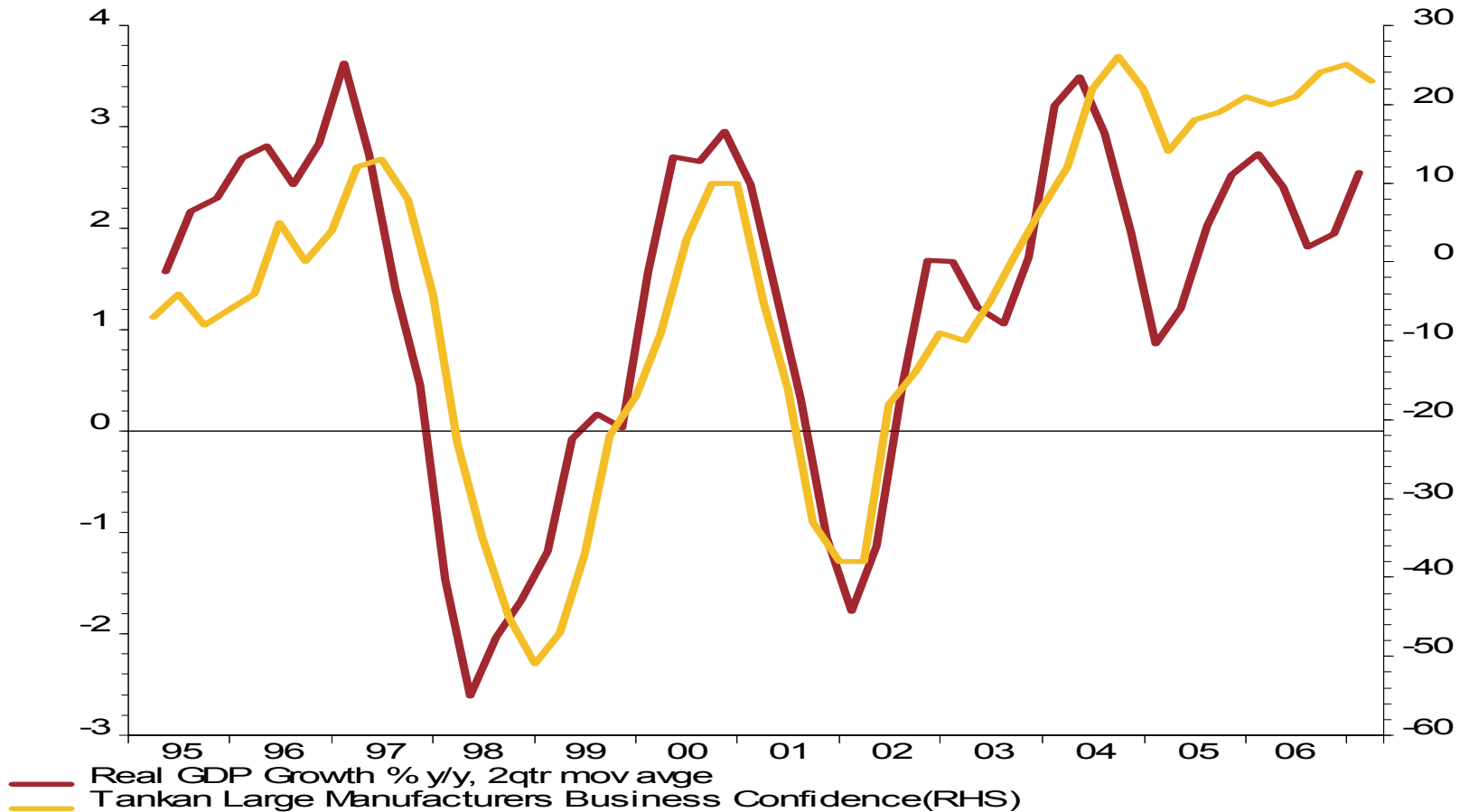
US Trade Deficit Has Stopped Widening



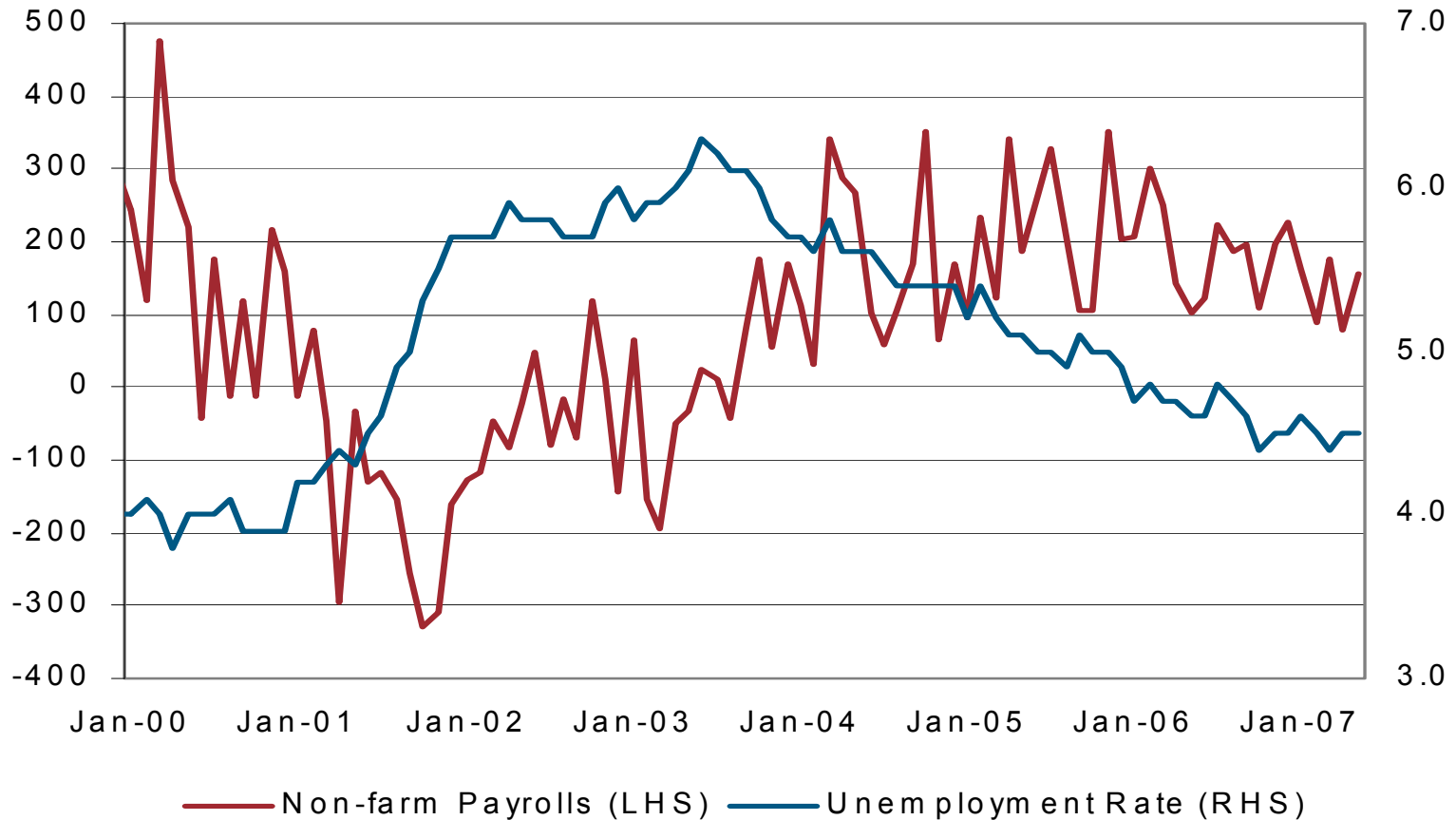
Eurozone Makes a Comeback



Japanese Recovery Still on Track



Strong Labour Market Sustaining Consumption in US



The Expansion Has Entered a More Mature Phase

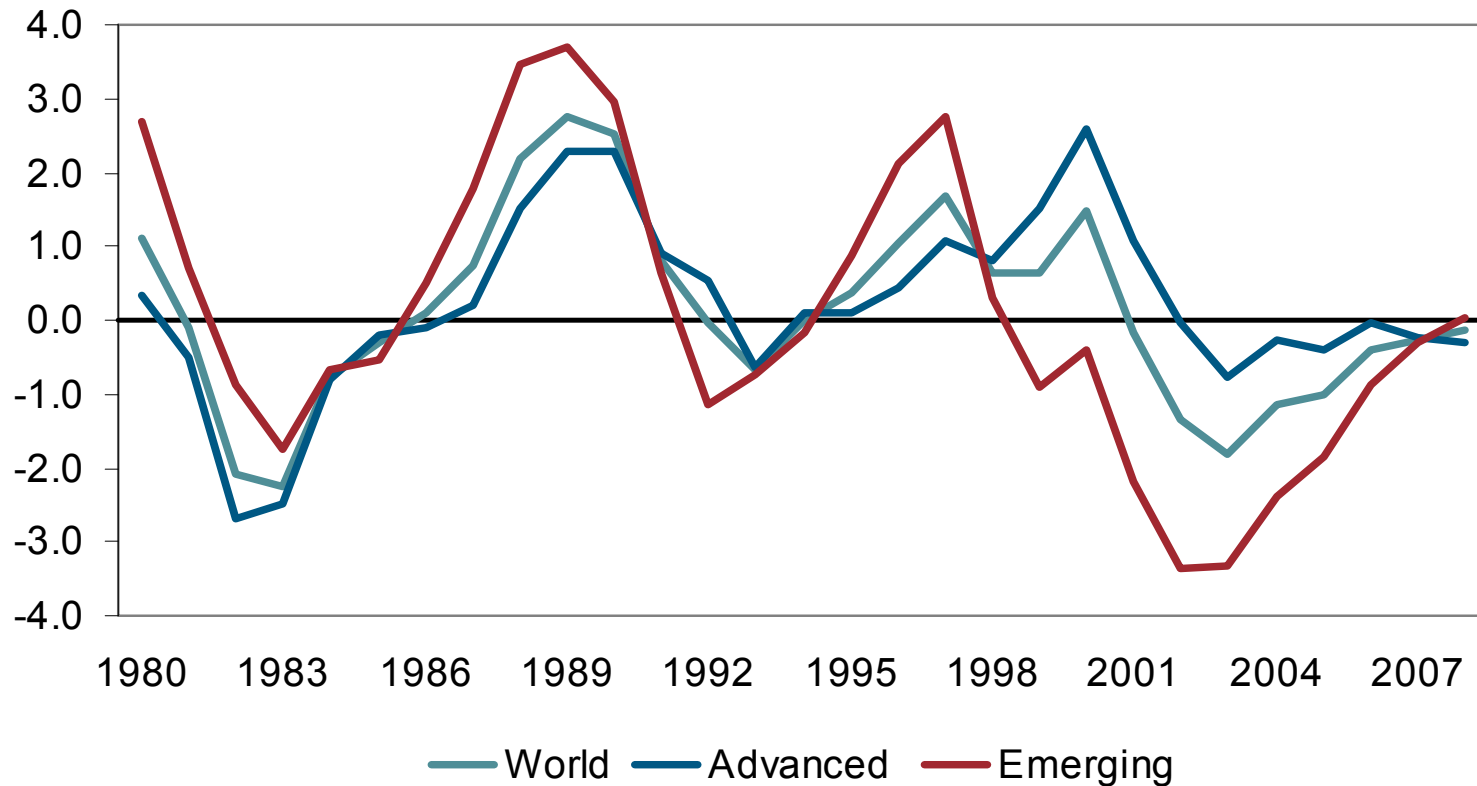
- ◆ Previous downturn bottomed out in 2001
- ◆ Growth should remain robust, but may decelerate a little
- ◆ Capacity utilisation has reached high level (output gap no longer negative)
- ◆ Inflation become more problematic (but not about to surge)

Global Growth: Robust but Stable

GDP Growth (% change)	2006	2007f	2008f
Developed	2.9	2.4	2.5
Emerging	7.9	7.5	7.1
World	5.4	5.0	4.9

Spare Capacity No Longer Exists

Output Gaps Have Closed (% GDP)



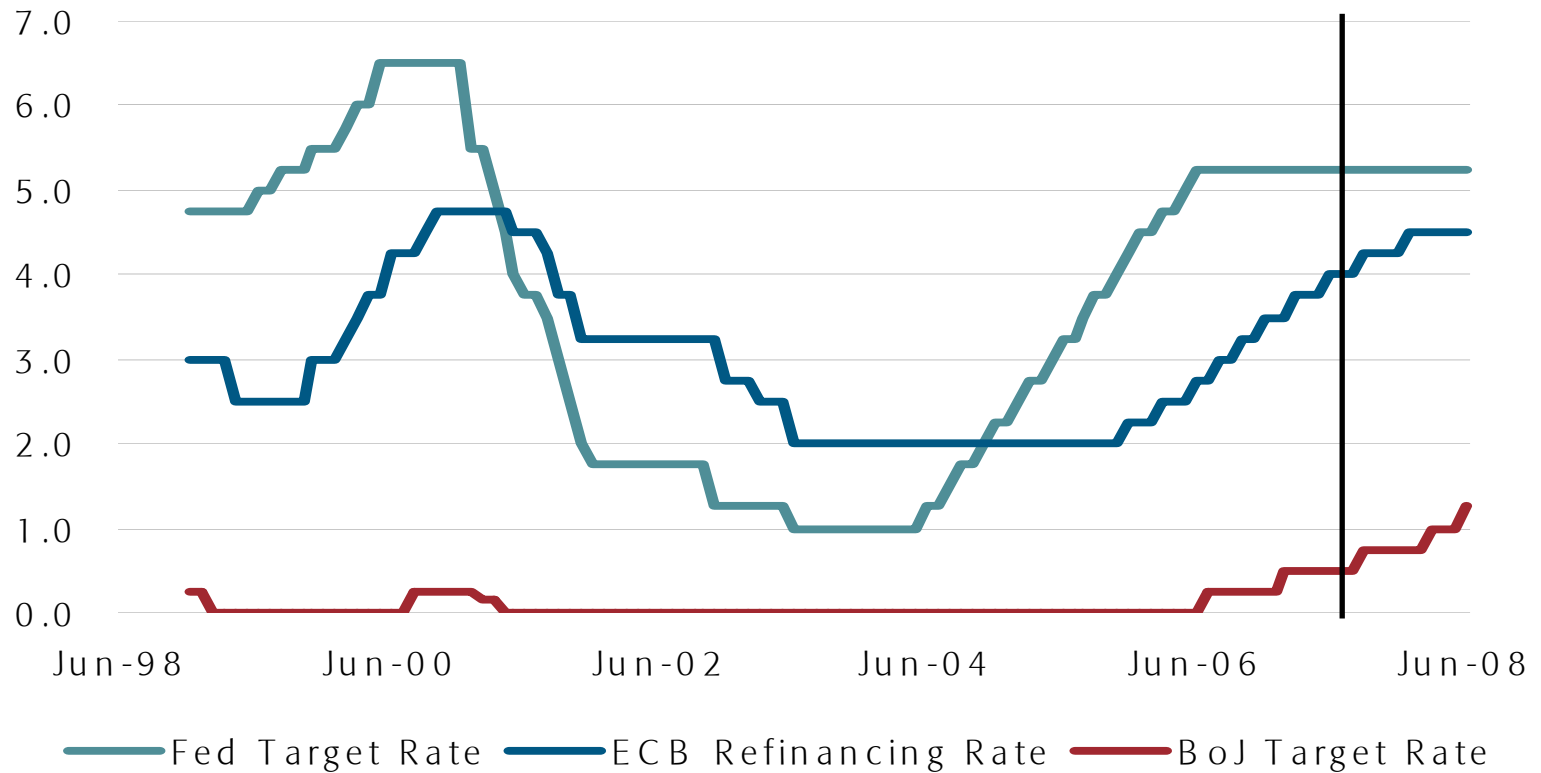
Central Banks Will Have To Be Vigilant to Contain Inflation

- ◆ Rate cuts no longer on agenda in US – Fed to remain on hold at 5.25%
- ◆ Peak of cycle not yet reached in eurozone – two more hikes to 4.50%
- ◆ Rate normalisation still has a long way to go in Japan
- ◆ No need for move to outright restrictive stance as inflationary pressures still quite low

Interest Rate Outlook

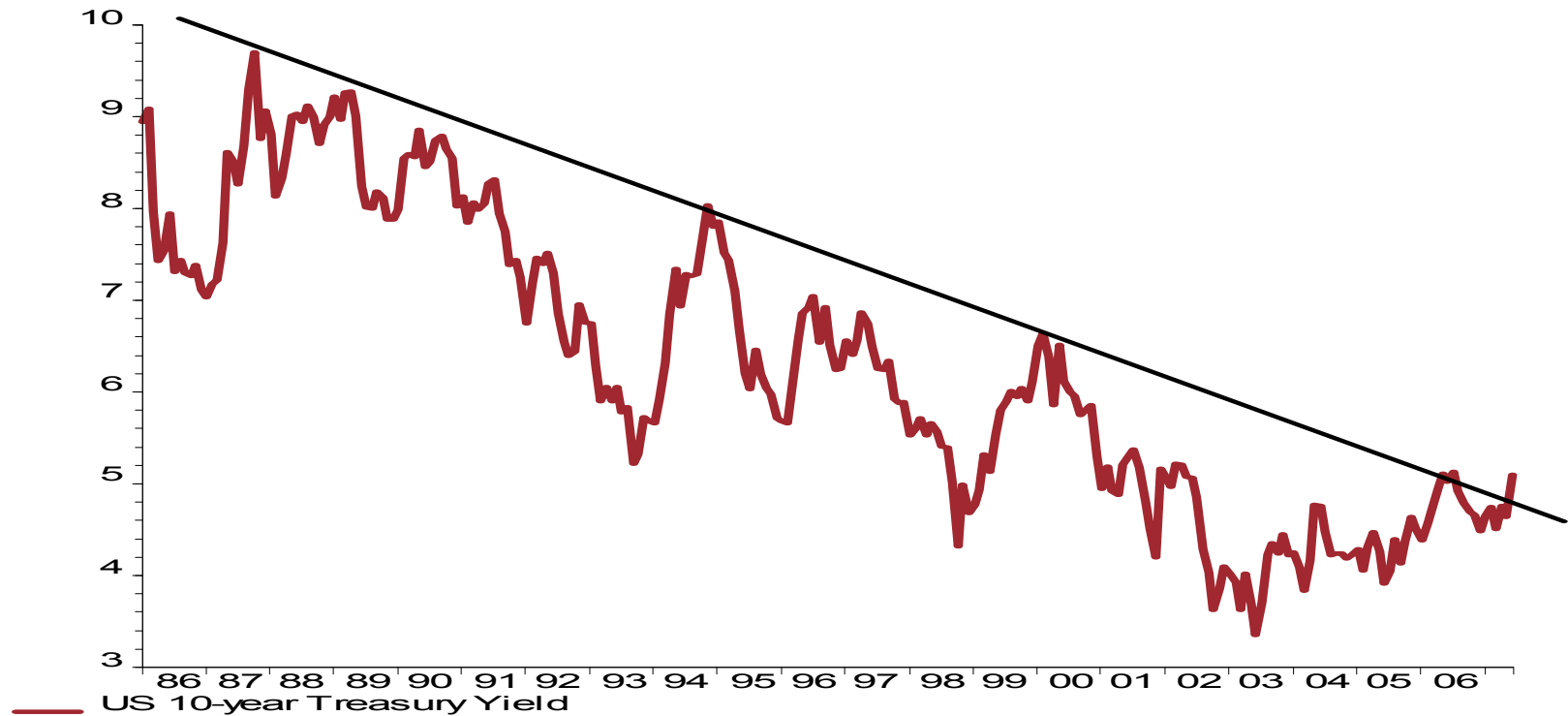
Forecast
→

Policy Rates (%)

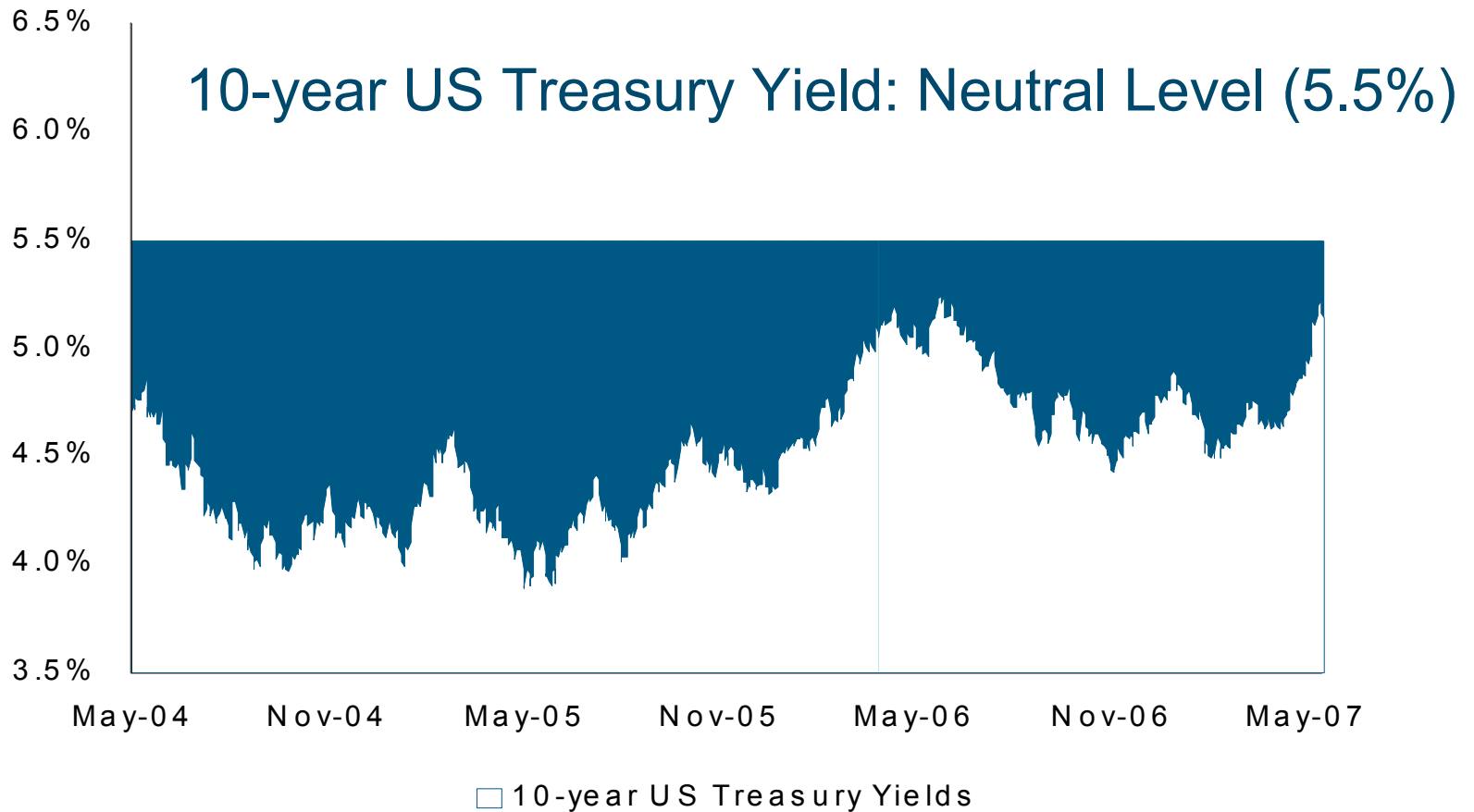


Global Liquidity: The Threat of Higher Bond Yields

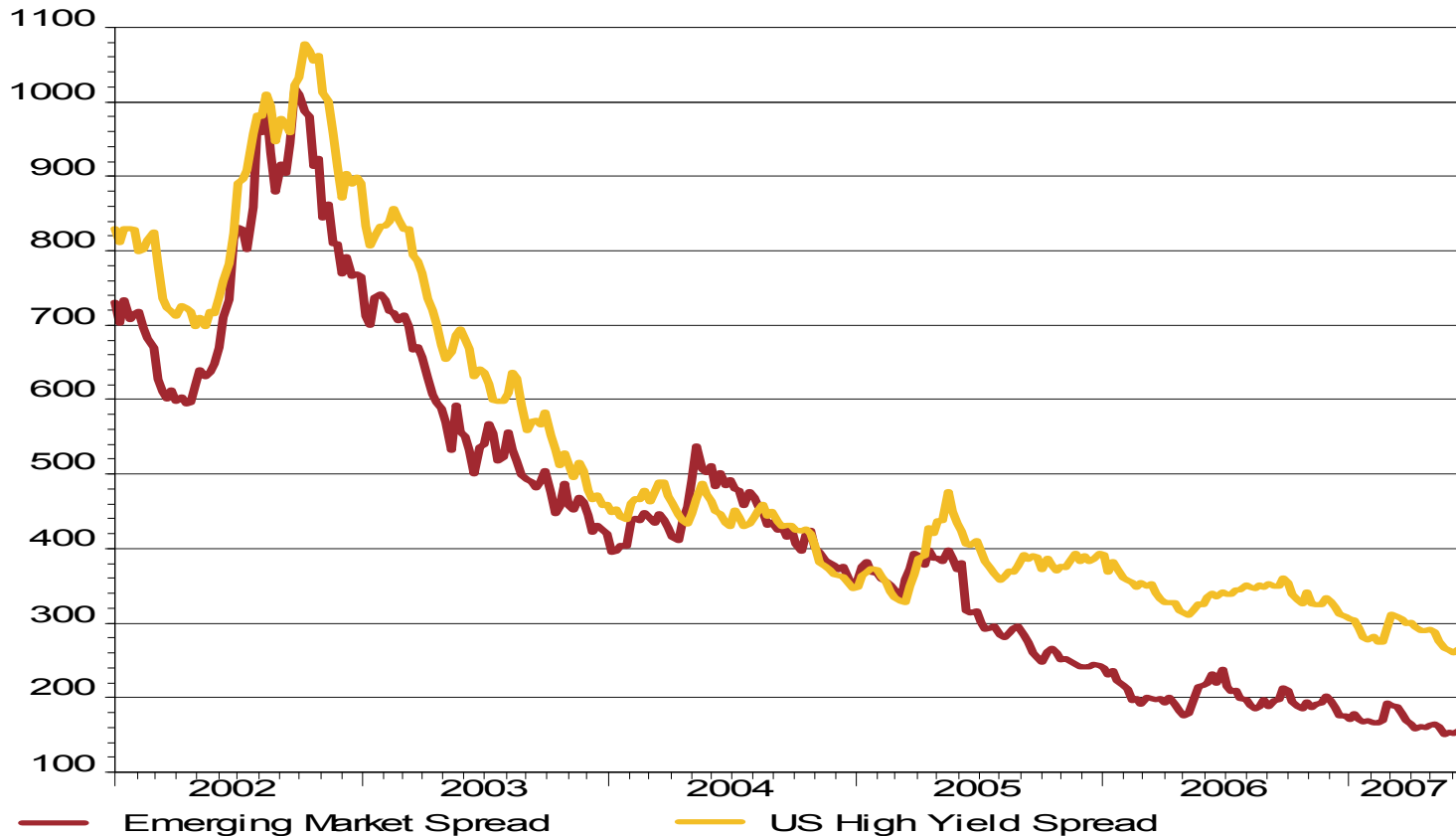
10-year US Treasury yield: 20-year trend (%)



Global Liquidity Conditions



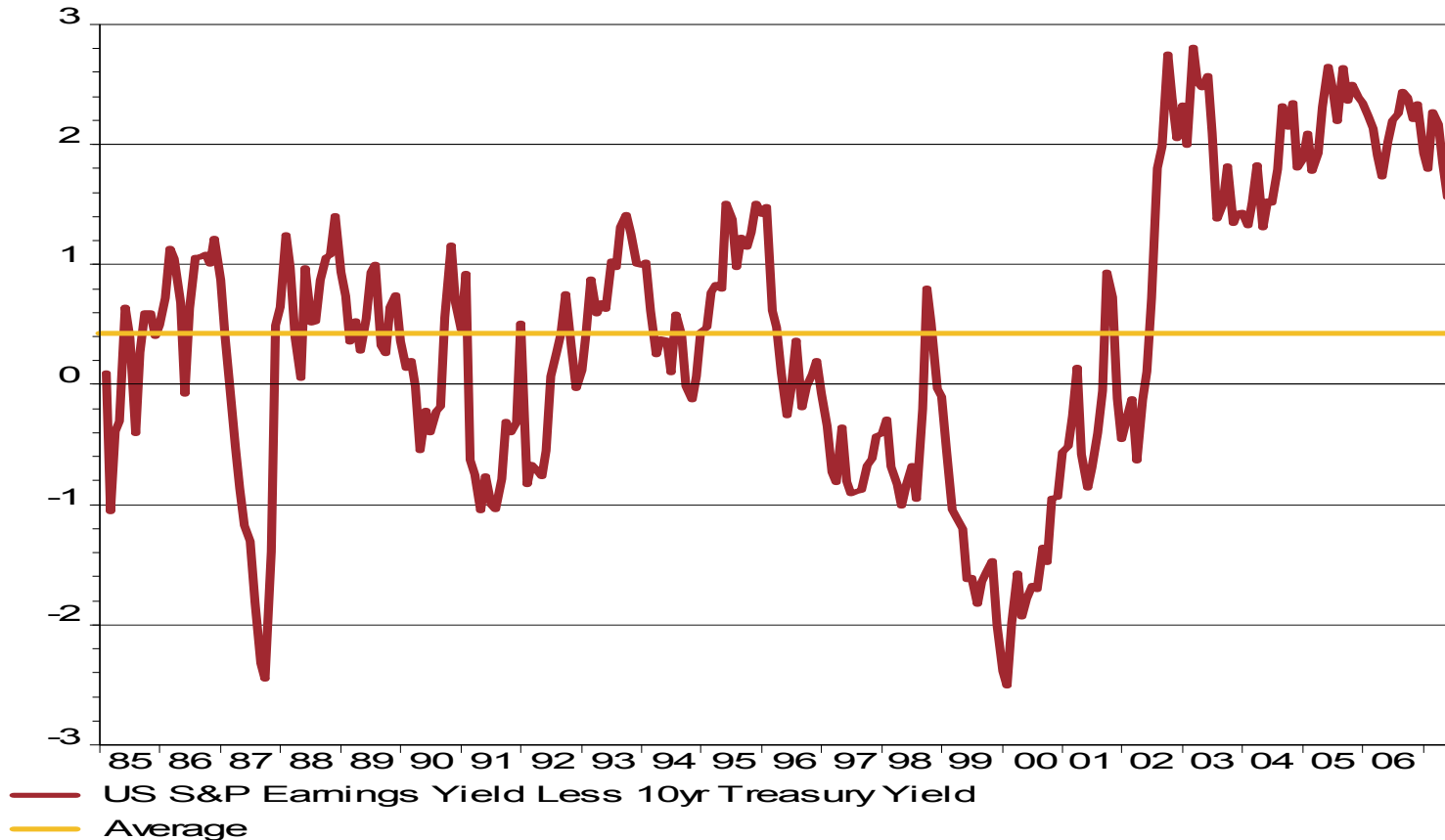
Credit and Emerging Market Spreads Remain Extremely Low



Liquidity Conditions Should Remain Relatively Benign

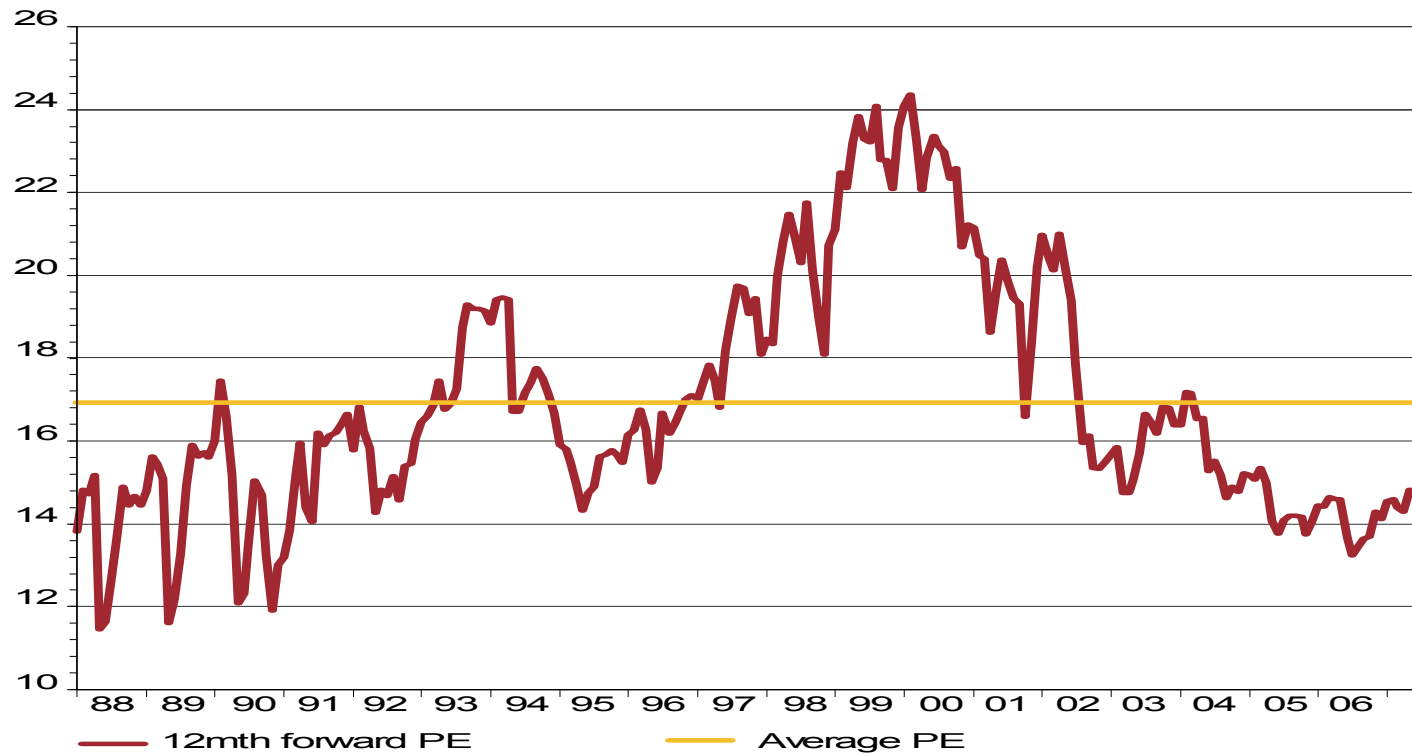
- ◆ Contained inflationary expectations will limit upward move in bond yields
- ◆ Robust economic growth will limit default risk, keeping credit spreads relatively low
- ◆ International reserves set to keep on rising in China, oil producers, other surplus countries

Valuations: Relative to Bonds, Equities Are Not Expensive

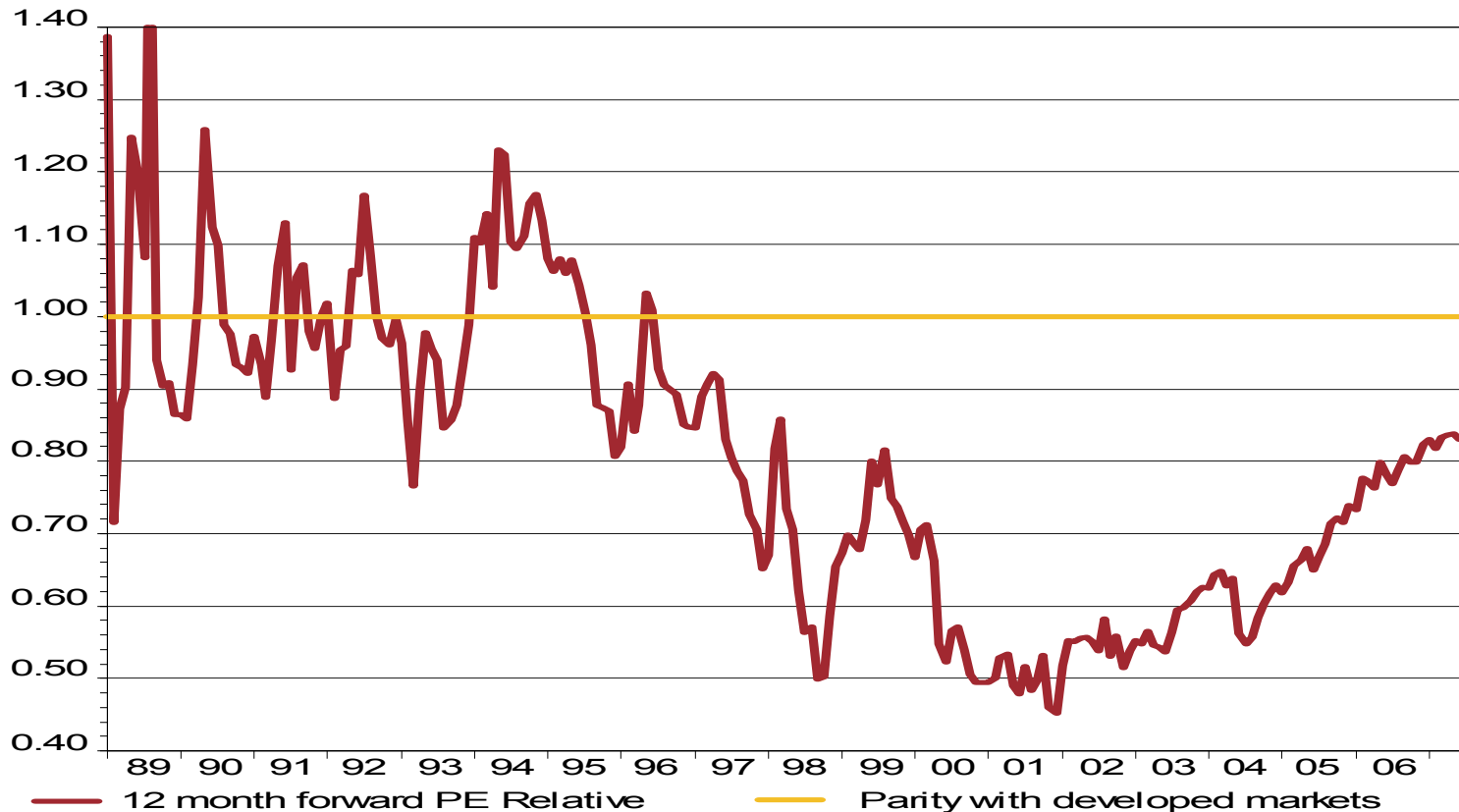


P/E Ratios Are Not Stretched

MSCI AC World 12mth Forward P/E Ratio



Emerging Markets Are Still Trading at a Discount to Developed Markets



Conclusion: Equity Bull Market Has Life in it Yet...

- ◆ Equity/bonds decision now more finely balanced, but we still favour equities
- ◆ Bond yields have moved up because growth prospects have improved
- ◆ Good for corporate earnings and equities
- ◆ Liquidity not about to dry up, but may not be as ample
- ◆ Valuations are far from stretched, although equities no longer cheap
- ◆ Emerging markets offer best long-term prospects

...But Over-Optimism a Potential Risk

- ◆ Long period of stability may contain seeds of own undoing
- ◆ Has encouraged build-up of leverage
- ◆ Financial markets linked by webs of debt and derivatives
- ◆ Could make reversals all the more powerful and sudden
- ◆ ‘Fat-tail’ risk (improbable but severe shock)
- ◆ Impossible to predict
- ◆ Always have an allocation to safe assets

...And Rally Has Entered a More Mature Phase

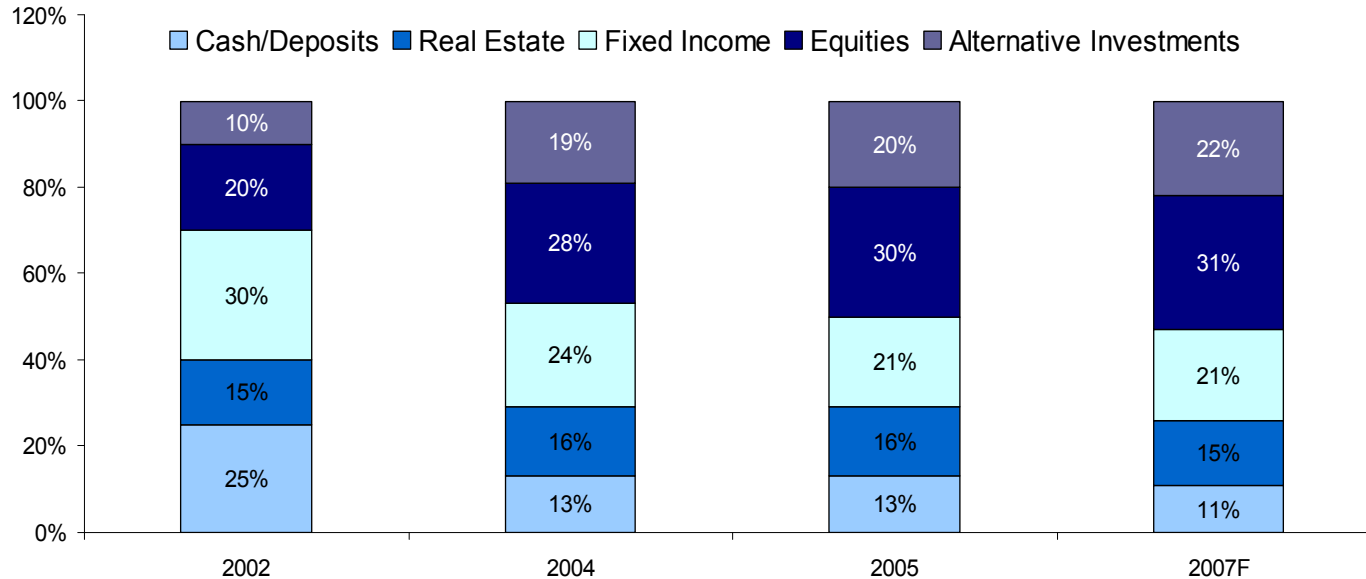
- ◆ Expect more modest returns (profits share reaching limits)
- ◆ Expect greater volatility
- ◆ Expect additional corrections
- ◆ But don't expect a bear market (yet!)

Portfolio Implementation

- ◆ “Traditional” Challenges, Opportunities and Process
- ◆ New Challenges and New Approaches
- ◆ Summary

Challenge/Opportunity: Proliferation of Asset Classes

GLOBAL HNWI*



“HNWIs are very sensitive to the economic environment, and reallocate their portfolios depending on current and impending economic conditions”

*Capgemini/Merrill Lynch, World
Wealth Report, 2006*

*Source: Capgemini, Merrill Lynch *World Wealth Report 2006* † HNWI hold at least USD\$1 million in financial assets.

Notes for Chart: Alternative Investments include structured products, hedge funds, managed funds, foreign currency, commodities (including precious metals), private equity and investments of passion. Real Estate includes direct real-estate investments and REITS.

Challenge/Opportunity: Growing Number of Funds/Managers



- ◆ How to pick the right fund to invest in ?
(Past performance – Advertising – Recommendations from family/friends?)
- ◆ When to buy it ? When to sell it?
- ◆ How many stocks are there in a world stock index?
2,100 stocks*
- ◆ How many funds invest in the world stock index?
135,000 funds**

Source, at the beginning of March 2006:
* Factset (FTSE World Index)
** Lipper All Mutual Funds

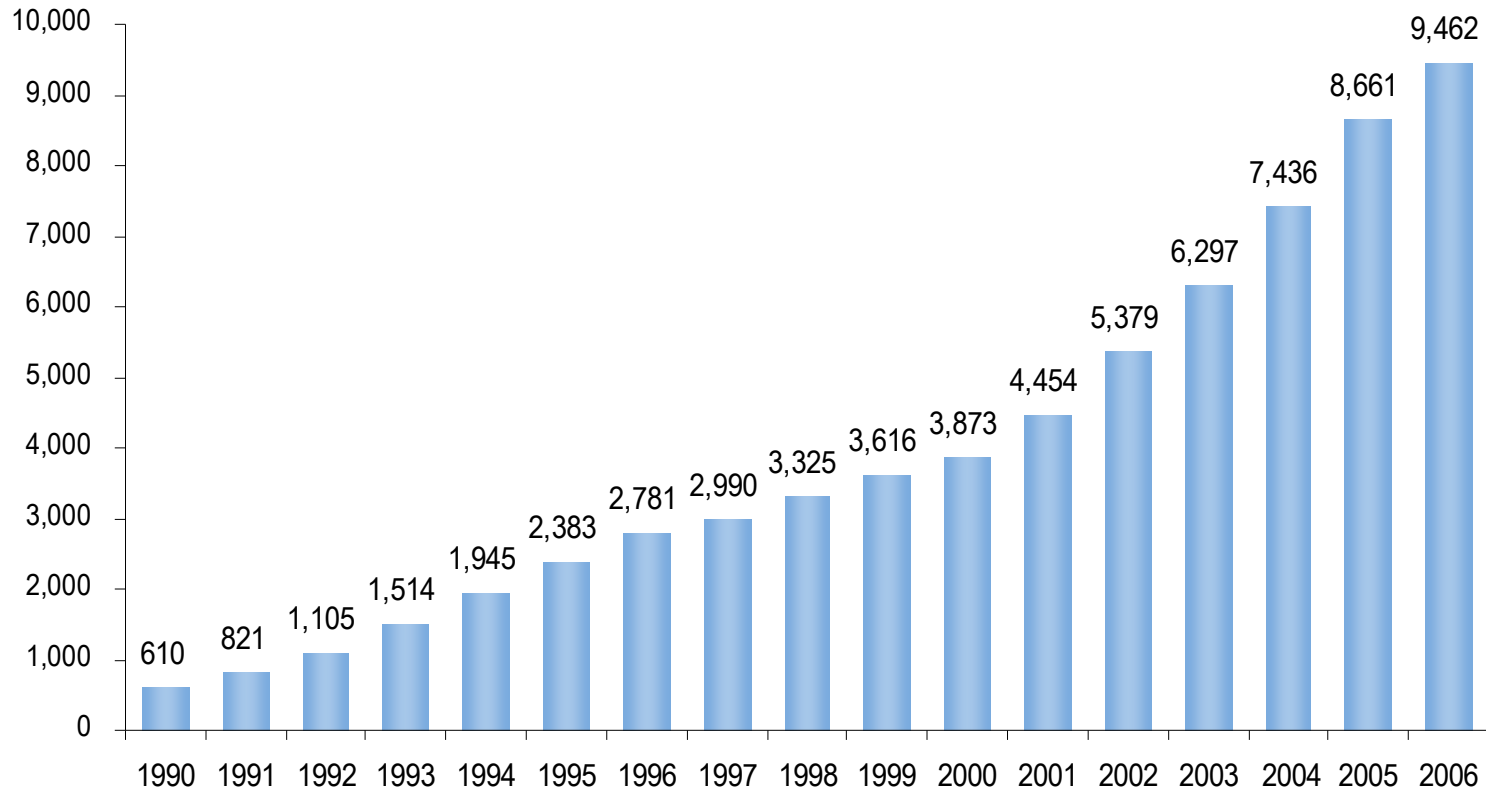


Asset Management

The Number of Hedge Funds is Growing...

HOW CAN INVESTORS CHOOSE ?

Estimated Number of Global Hedge Funds (1990 – 12/31/2006)

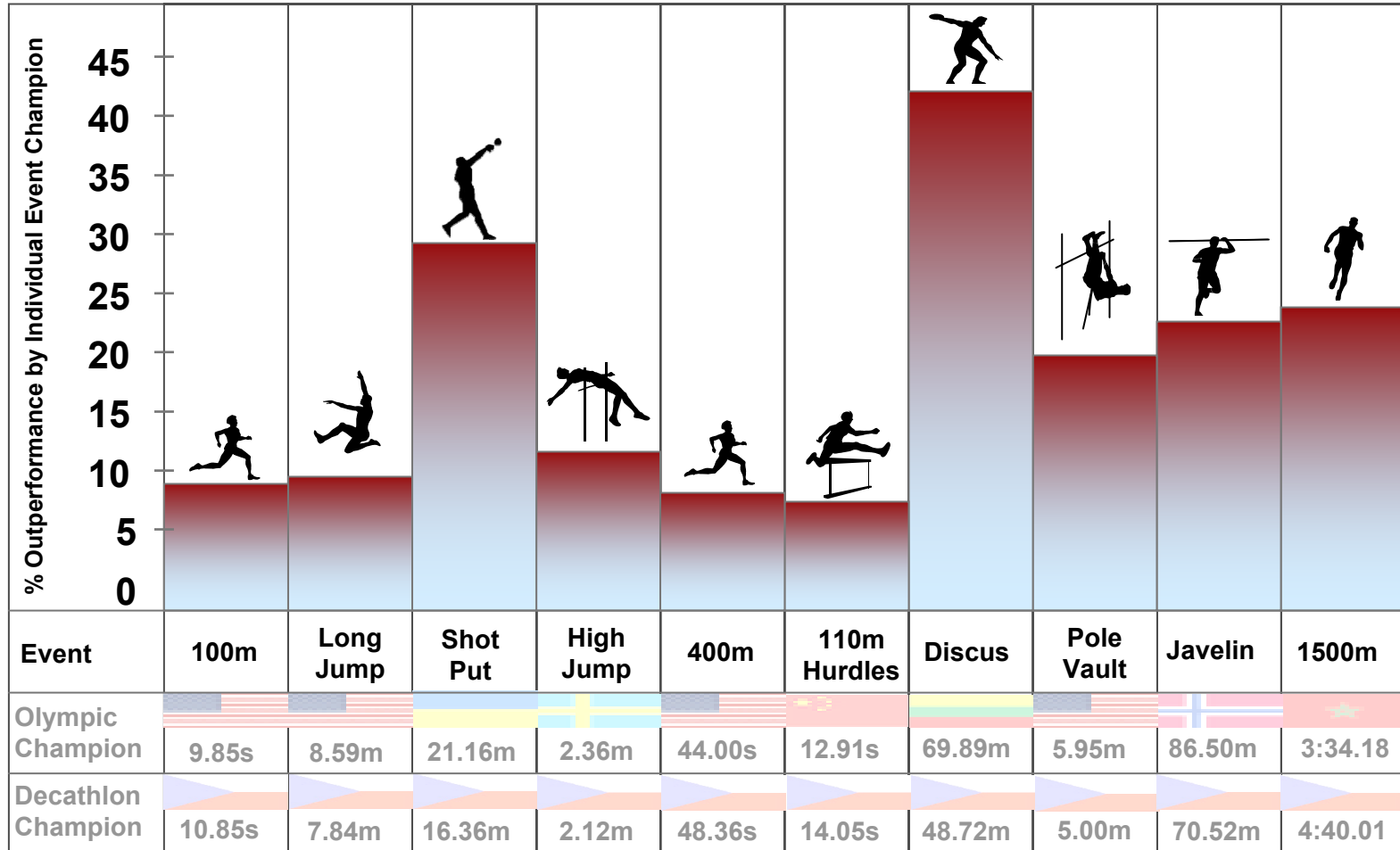


The largest 100 hedge funds hold 42% of the \$1.4Trn in assets. This compares to \$56.4Trn in Global AUM*

Source: Hedge Fund Research, Q4 2006 Industry Report

*Estimate of hedge fund assets and private equity funds; Sources: Courtesy of IMF (IFSL estimates based on Watson Wyatt, Bridgewater, Merrill Lynch, ICI, SwissRe Hennessee Group and Hennessee Group data)

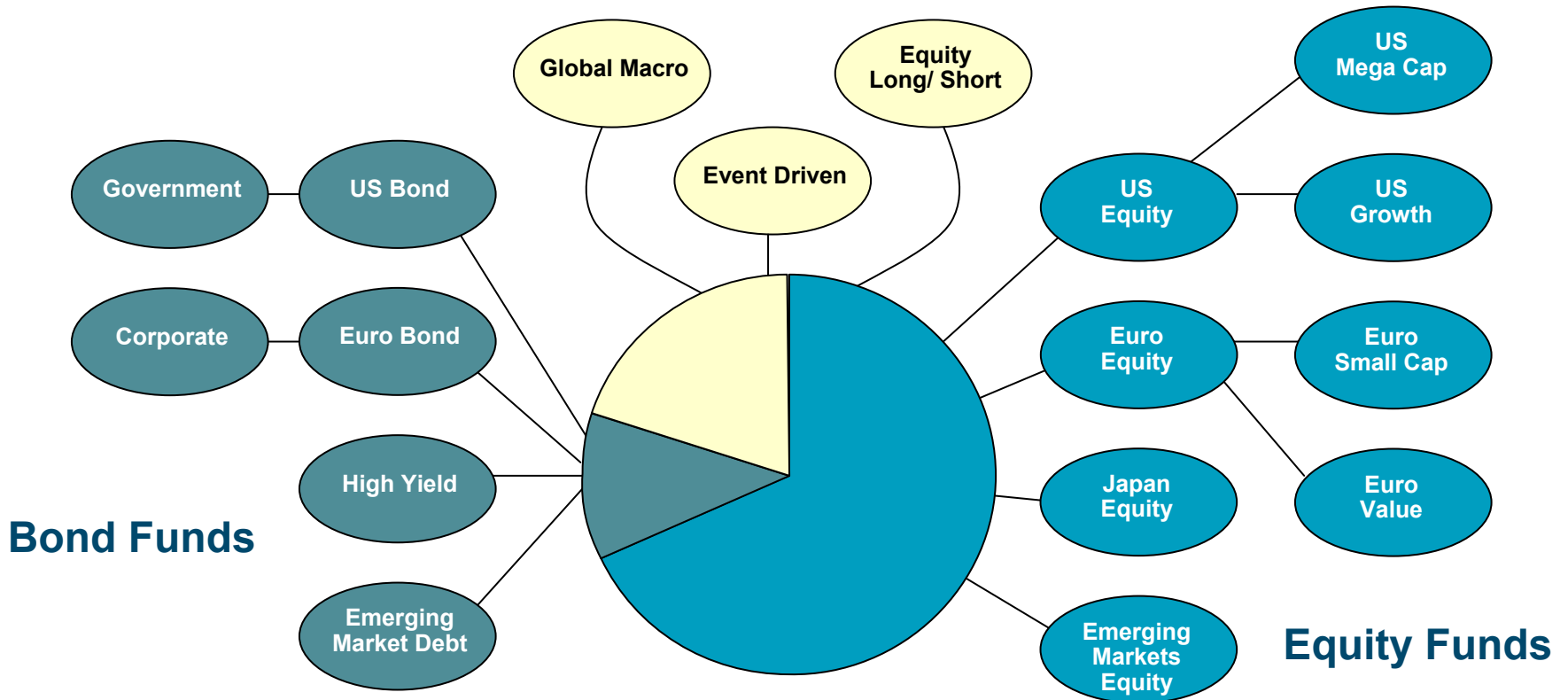
Challenge/Opportunity: Increased Specialization/Niches



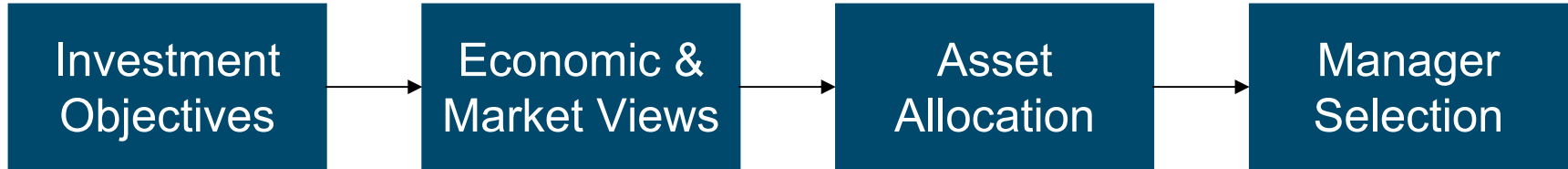
Source: Athens 2004 Olympic Games

Talented Asset Managers Focus on Key Regions, Sectors or Strategies

Hedge Funds



Professional Investment Process



Risk OR Return target

Time Horizon

Liquidity Requirements

Markets / Instruments

Cash

Fixed Income

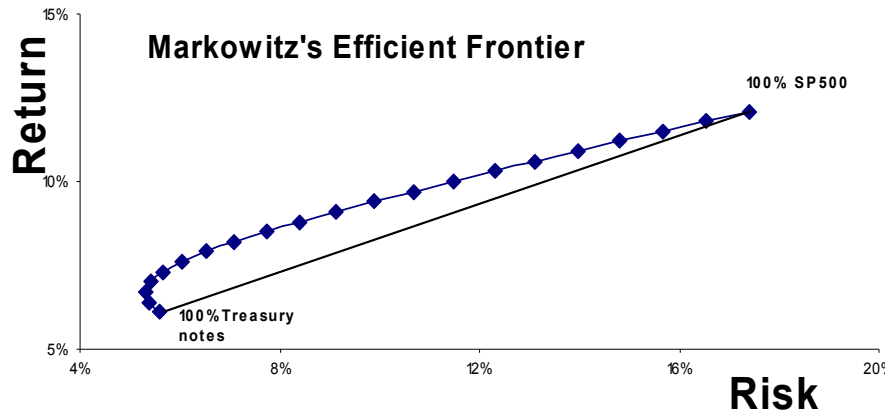
Equity

Portfolio Diversification & Optimization

Value Added, Alpha

Investment Process, Style, Consistency

Risk-adjusted Return, Info Ratio, Sharpe



Portfolio Implementation: New Challenges and New Approaches

New Challenges and New Approaches

New Challenges

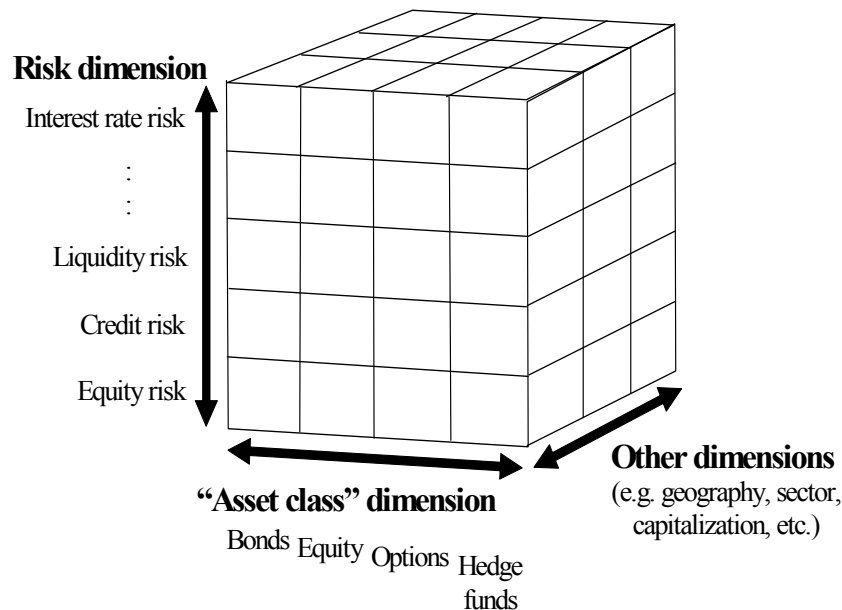
- ❑ Lower forecast returns
- ❑ Increasing volatility
- ❑ The search for “Alpha”
- ❑ Correlation questions

New Approaches

- Realistic expectations
- Enhanced Risk Metrics
- “Active” Managers
- More Frequent Oversight

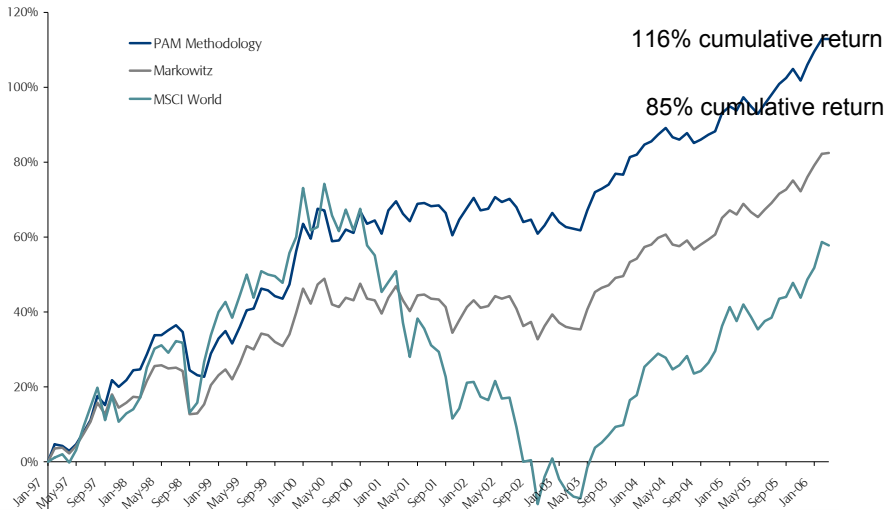
Portfolio Risks are More Complex

Sources of Risk and Return



- ◆ Innovation in hedge funds, derivatives, and other financial instruments enable investors to seize opportunities and manage risks
- ◆ While the potential rewards are attractive, the task of building a portfolio is more complex
- ◆ And the likelihood of unintended exposure to the same overlapping risk factors increases

Enhanced Risk Metrics: Measures of Downside Risk

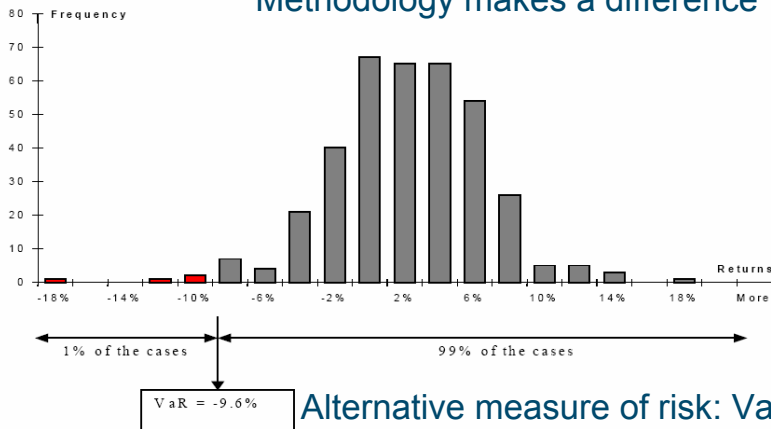


◆ Methods for analyzing risk are evolving

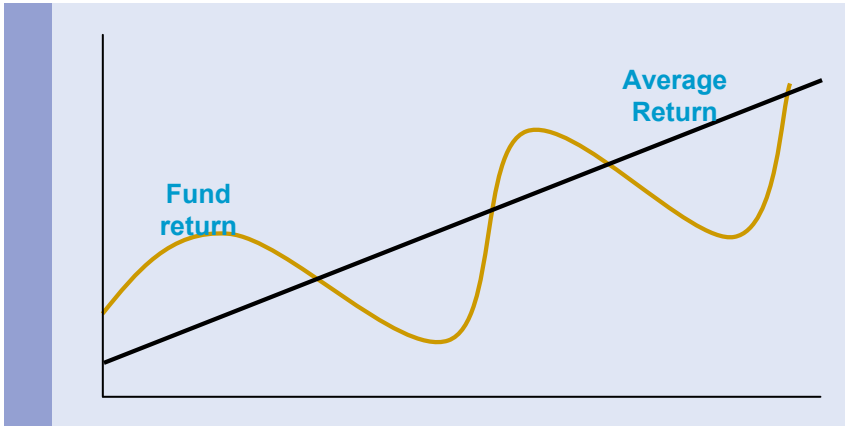
◆ Downside risk metrics complement measures of “general risk”

◆ Optimization techniques have been refined since the first days of Modern Portfolio Theory

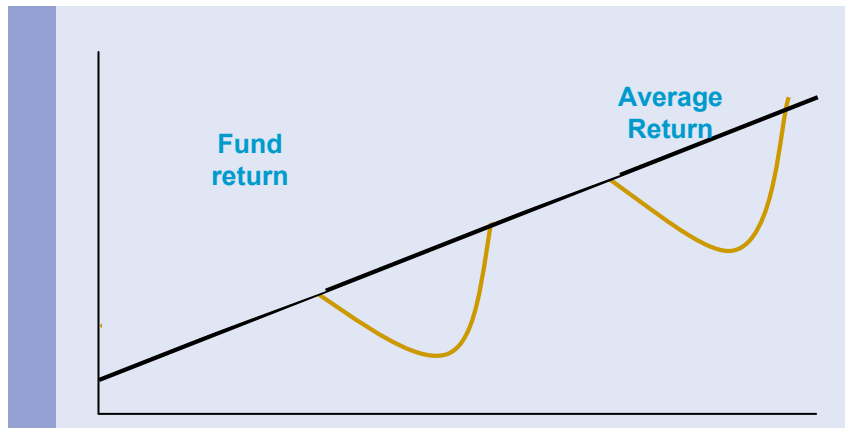
Methodology makes a difference



Risk Metrics: Standard Deviation & Downside Deviation



Standard deviation: Calculates the average deviation from the average return, considering both positive and negative returns.



Downside deviation: Calculates the average deviation from average return, considering only the negative returns.

The greater the divergence from the average return, the greater the deviation

Risk Metrics: Sortino Ratio

- ◆ Variation of the Sharpe Ratio which distinguishes between downside and general volatility by replacing standard deviation with downside deviation.
- ◆ Measures the excess return per unit of “bad” volatility.
- ◆ Large Sortino Ratio indicates a lower risk of large losses occurring.

$$\text{Sortino Ratio} = \frac{\text{Portfolio return} - \text{risk free rate}}{\text{Portfolio } \textit{downside deviation}}$$

$$\text{Sharpe Ratio} = \frac{\text{Portfolio return} - \text{risk free rate}}{\text{Portfolio } \textit{standard deviation}}$$

Risk Free Rate of Return – A theoretical interest rate that would be returned on an investment which was completely free of risk. Typically the T-bill rate is used as a proxy

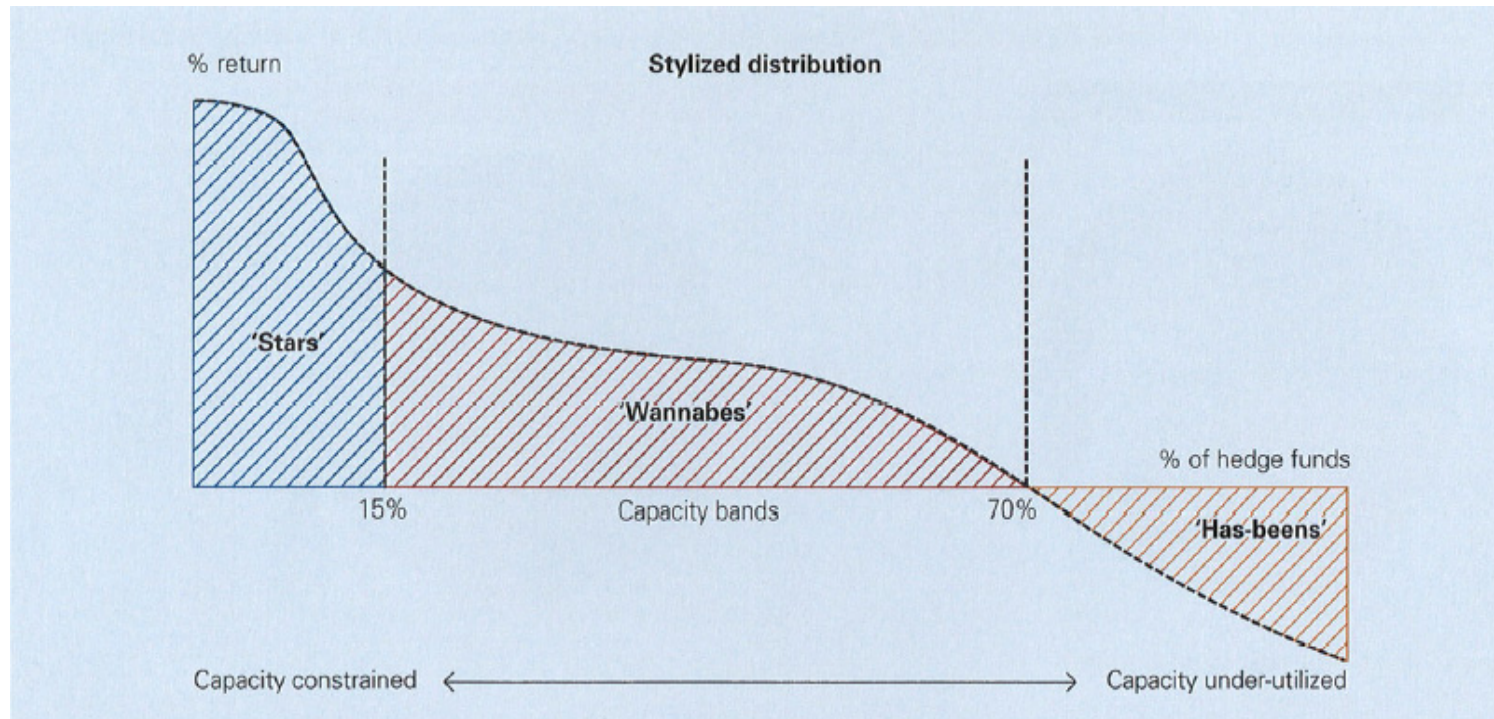
Analyzing Asset Managers is More Challenging

- ◆ Only a small percentage of asset managers add value
- ◆ Be careful to distinguish manager talent or “Alpha” from market risk or “Beta”
- ◆ “...Fund managers who run the most active portfolios are also those that add the most value”*

* Financial Times Feb 5, 2007 in review of “How active is your fund manager? A new measure that predicts performance” by M. Cremers and A. Petajisto, Yale School of Management, Jan 15, 2007

Quality of Hedge Fund Capacity

The hedge fund universe is perceived as having three groups of managers:

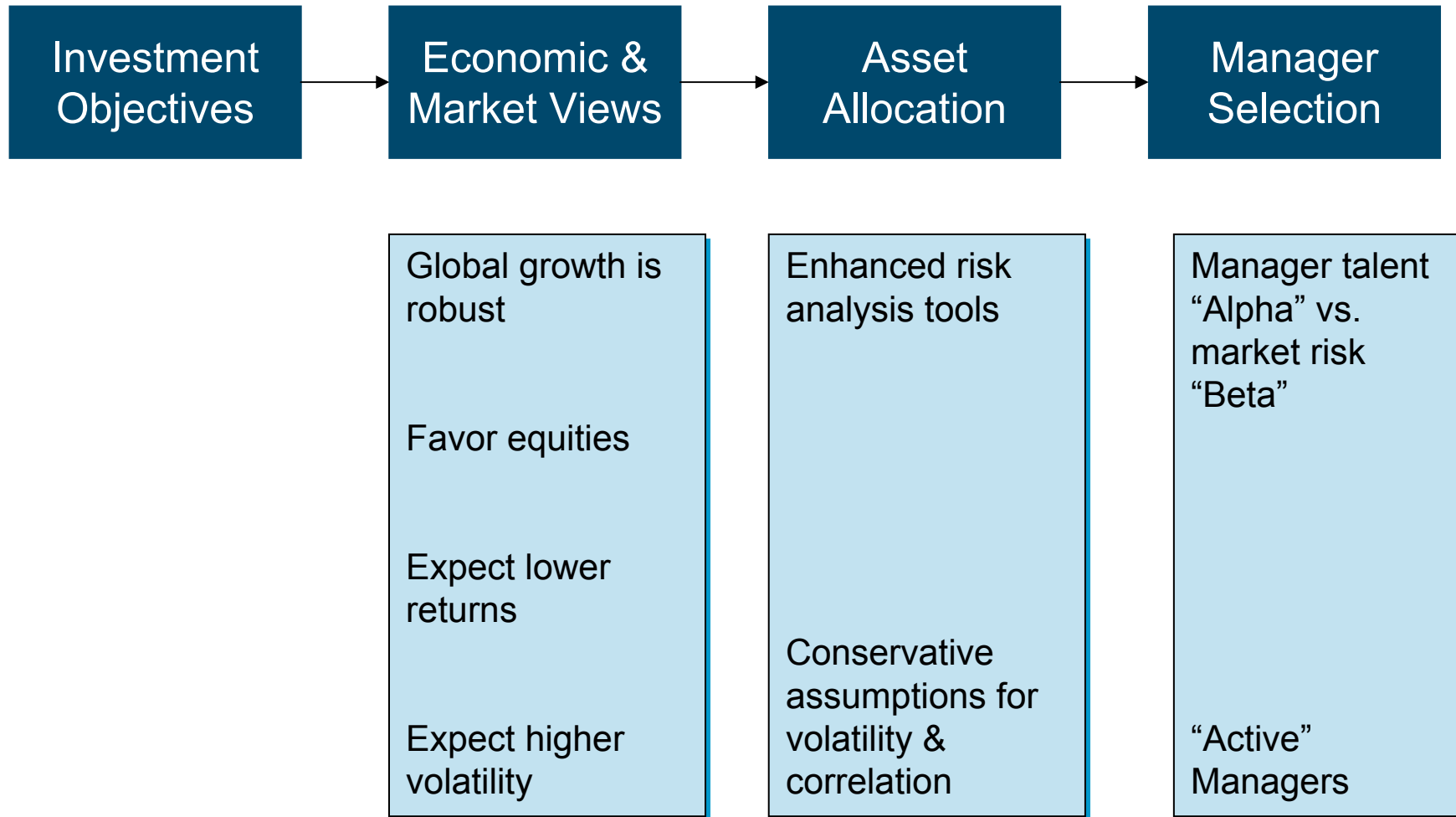


Around 15% of managers are clear *stars*: they provide the prime capacity that is capable of generating risk-return characteristics in line with client expectations. The majority are based in the U.S. A further 55% are *wannabees* who aspire to be stars before long. Many are based in Europe and also Asia/Pacific. The remaining 30% are *has-beens*.

Views on Correlation, a Key Factor in Portfolios, are Evolving as well

- ◆ Diversifying a portfolio among asset classes and manager styles with low correlation improves the overall risk/return profile
- ◆ However, correlations change over time, especially during periods of peak market movements
- ◆ And the inclusion of more active managers may increase or reduce diversification benefits
- ◆ Therefore frequent oversight is appropriate at all levels of the investment process

Enhanced Investment Process



Appendix

Michael Warszawski – Chief Executive Officer

- 19 years of industry experience
- Citigroup Private Bank, Cambridge Technology Partners
- MBA Columbia University, CFA Charterholder

Michael Ranis – Chief Investment Officer

- Head of the Discretionary Portfolio programme
- 20 years of industry experience including 10 years at Bank Hapoalim
- MBA NYU, PhD University of Chicago

Simon Blum - Chief Financial & Operations Officer

- Head of PAM financial and operations activities
- 17 years of industry experience including Deutsche Asset Management in London
- LLB honours degree in Law and qualified Chartered Accountant

Catherine Lemaitre – Deputy Chief Executive Officer

- Head of advisory services at PAM
- 13 years of industry experience, 5 years at PAM
- BA in Business Engineering, MA in Economics, University of Brussels

Dr. Peter West – Head of Research

- Head of economics/markets research
- 26 years of industry experience including BBVA and UN Economic Commission for Latin America
- MA, D Phil in Economics, Cambridge University

PAM Investment Platform

Client Objectives



Investment Strategy
Second Quarter 2007

Investment Strategy



poalim
Asset Management

Equity Funds

Fund	Invest	Total Fund	% of Assets	2007 Return (YTD)
Upper Meridien	100	100	100	100
Global Growth	100	100	100	100
Asia Pacific	100	100	100	100
Emerging Markets	100	100	100	100
Global Infrastructure	100	100	100	100
Global Healthcare	100	100	100	100
Global Technology	100	100	100	100
Global Consumer	100	100	100	100
Global Financial	100	100	100	100
Global Energy	100	100	100	100
Global Real Estate	100	100	100	100
Global Natural Resources	100	100	100	100
Global Infrastructure	100	100	100	100
Global Healthcare	100	100	100	100
Global Technology	100	100	100	100
Global Consumer	100	100	100	100
Global Financial	100	100	100	100
Global Energy	100	100	100	100
Global Real Estate	100	100	100	100
Global Natural Resources	100	100	100	100

Fund Focus List

What is a Structured Product?

Structured Products

Portfolio Allocation

Advisory Portfolios

An Introduction to the Dynamic Performance Portfolio Programme

Discretionary Portfolios

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