Betwixt Scylla and Charybdis

Navigating the Seas of High Uncertainty and Low Return

Sintercafe 2012

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Betwixt Scylla and Charybdis

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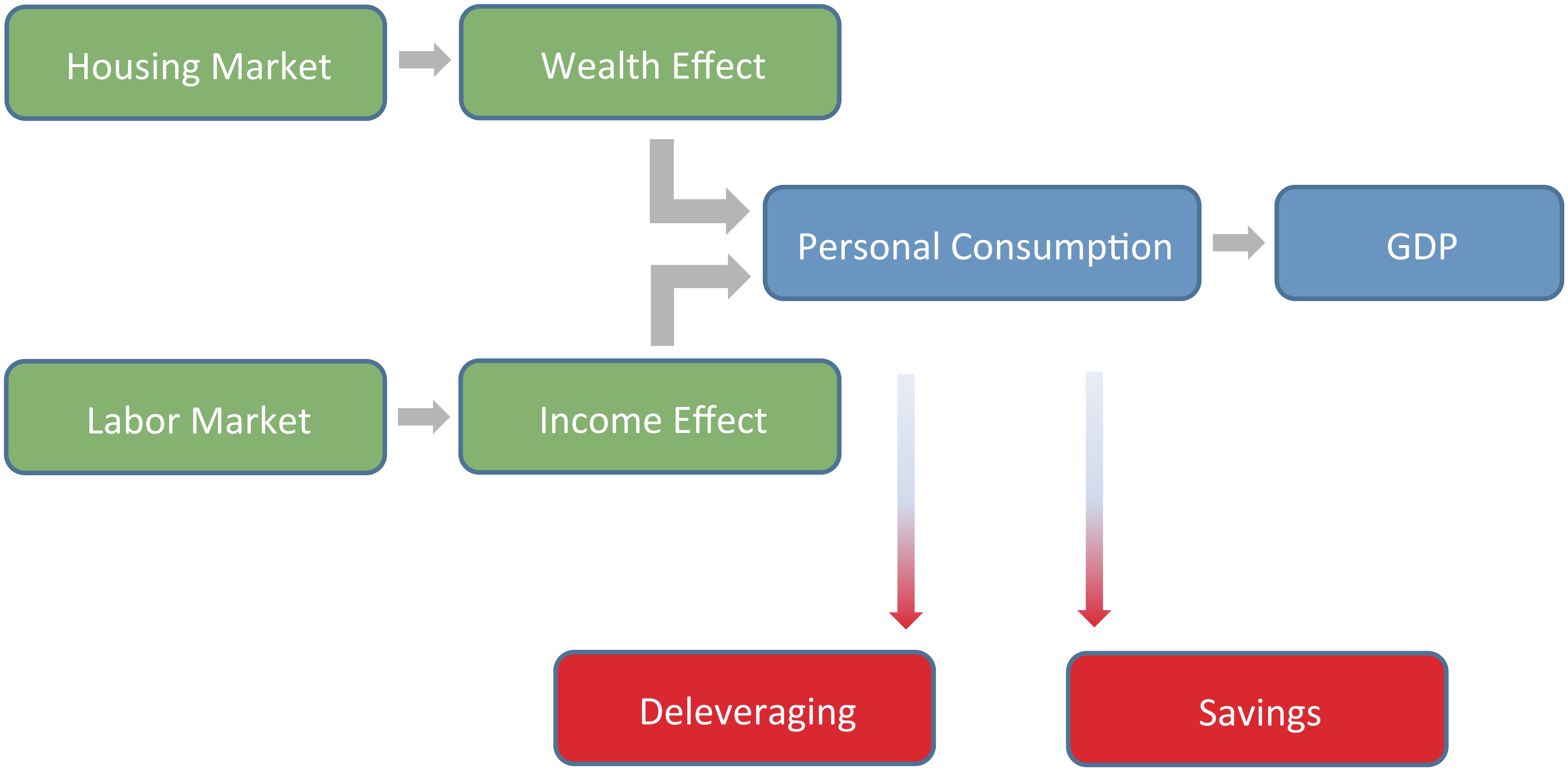
Roadmap of the Domestic Economy



Housing Market

Signs of Meaningful Improvement

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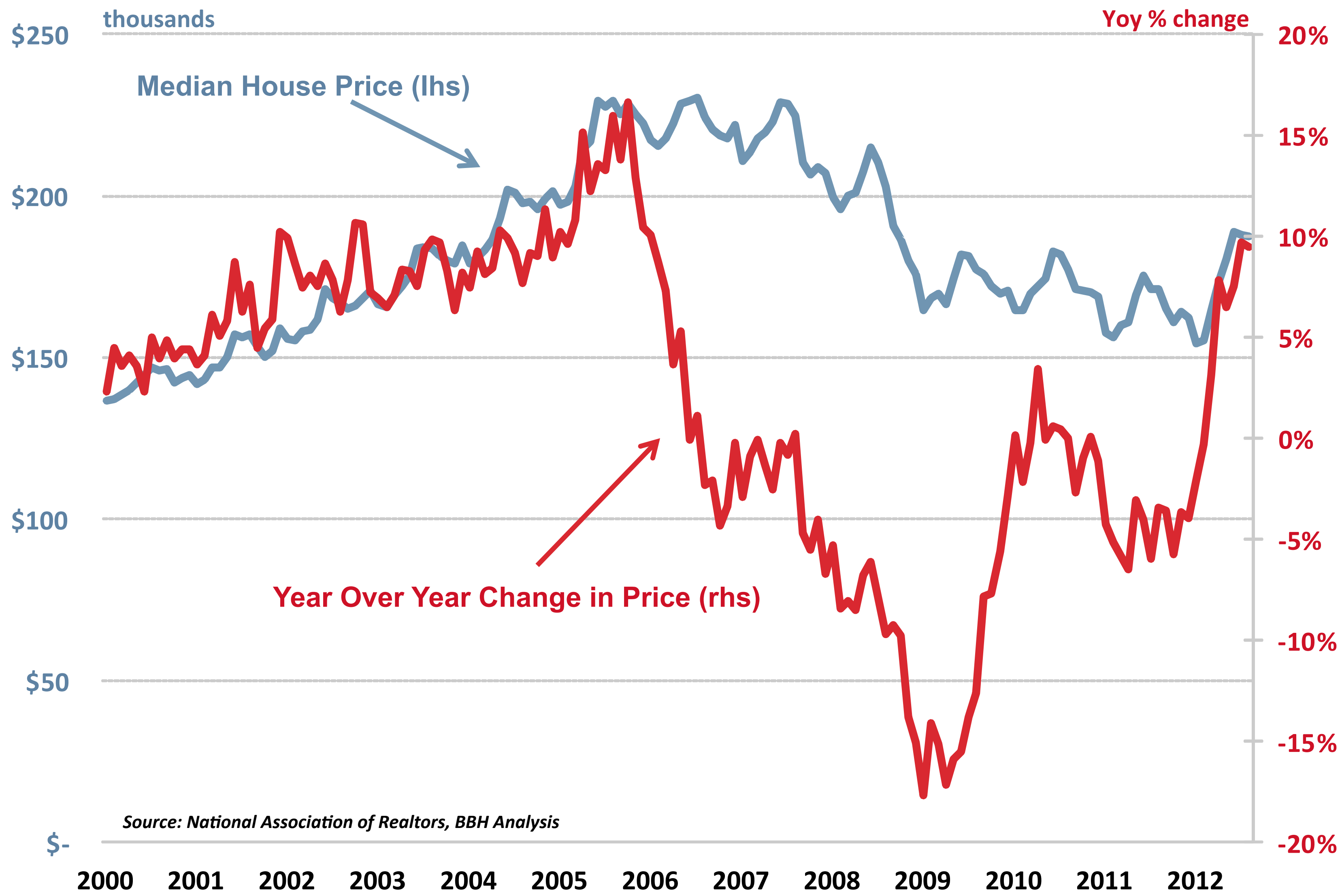
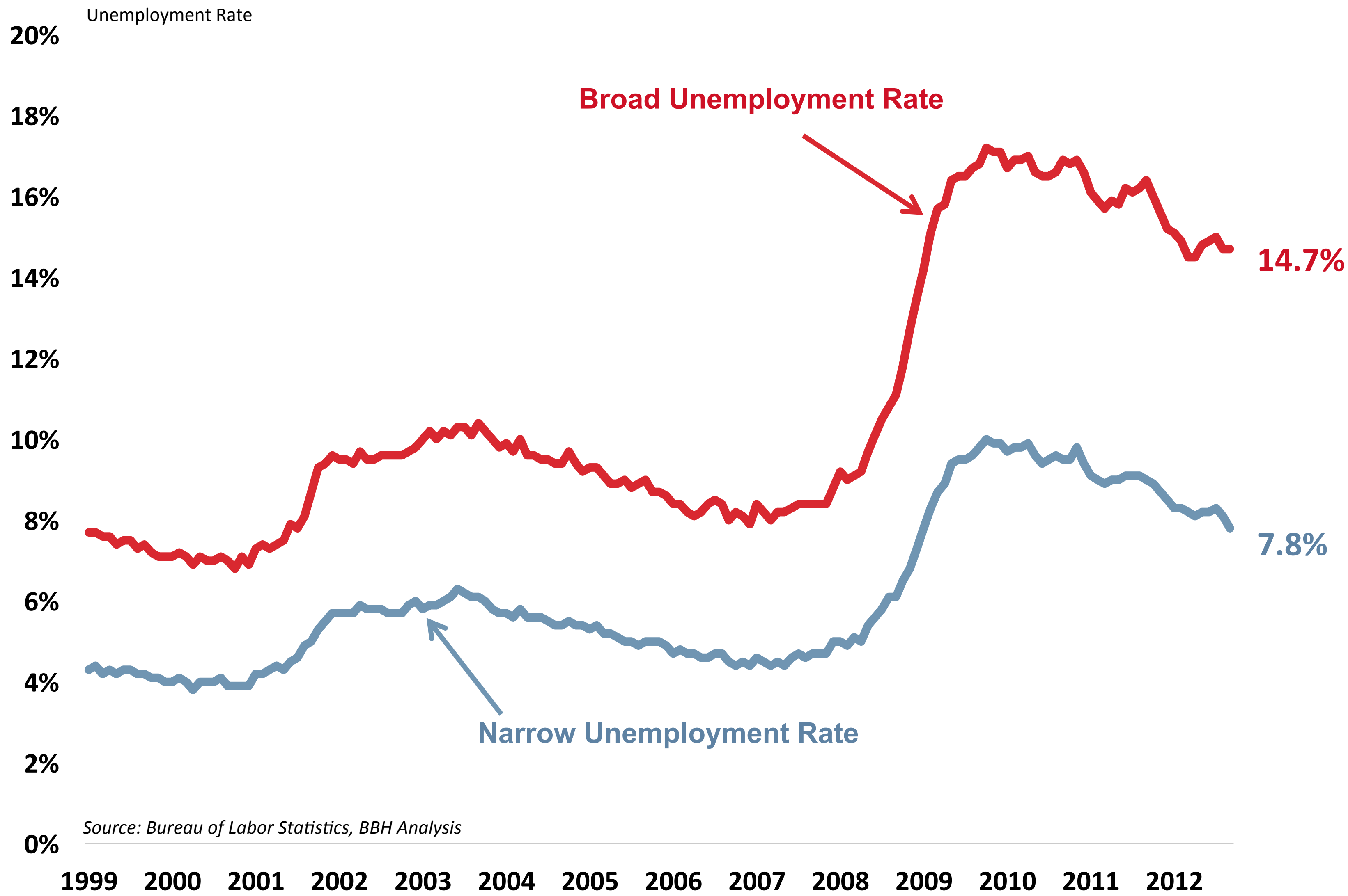


Source: National Association of Realtors, BBH Analysis

Unemployment Rates

Gradual Improvement?



Source: Bureau of Labor Statistics, BBH Analysis

Gross Domestic Product

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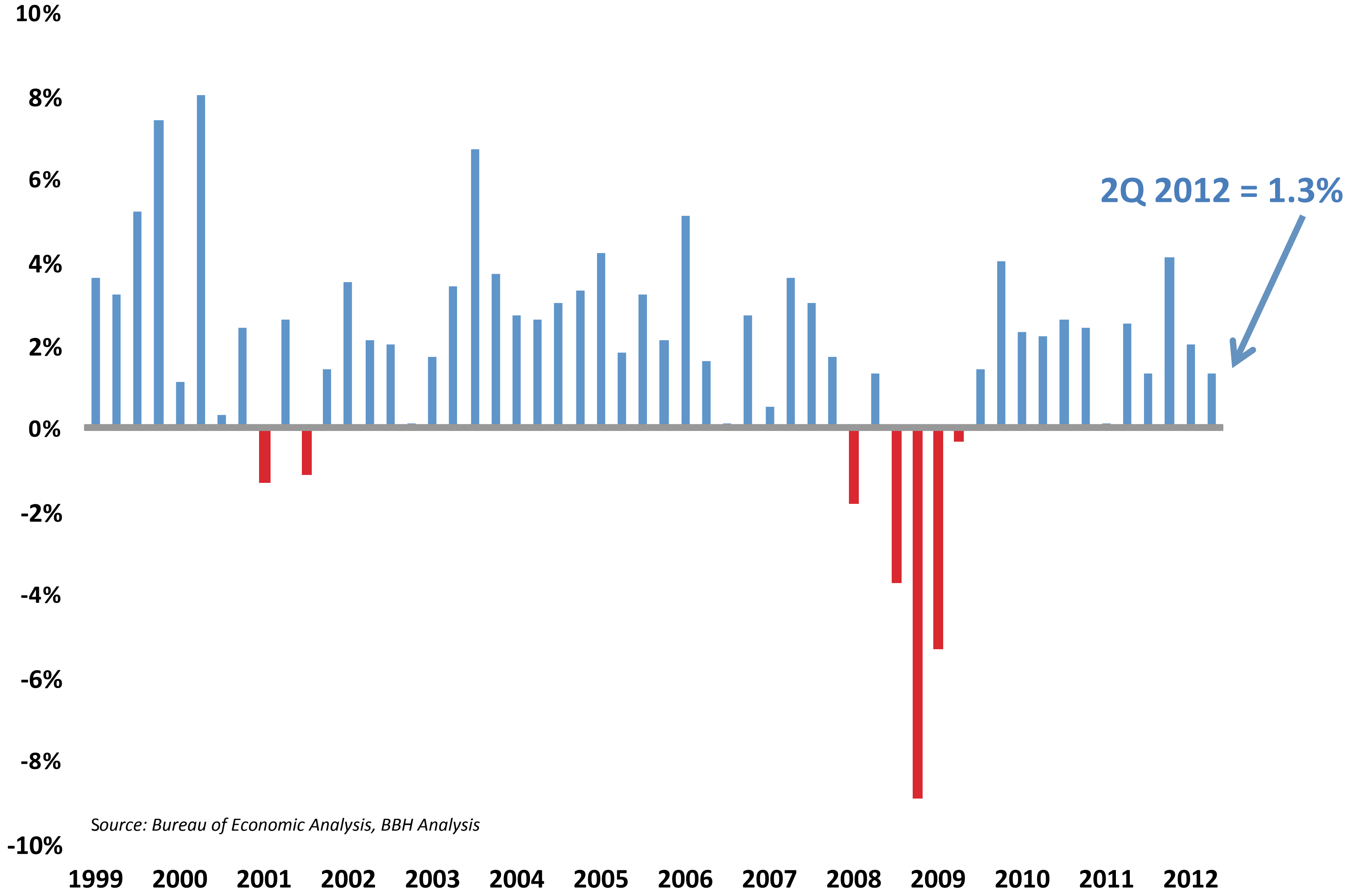

Source: Bureau of Economic Analysis, BBH Analysis

The Fiscal Cliff

Changes from Fiscal Year 2012 to Fiscal Year 2013	$ billions	% of GDP
Changes in Specified Revenue Policies		
Expiration of certain income tax and estate and gift tax provisions scheduled to expire on December 31, 2012, and of indexing the AMT for inflation	221	1.4%
Expiration of the reduction in the employee's portion of the payroll tax	95	0.6%
Other expiring provisions	65	0.4%
Taxes included in the Affordable Care Act	18	0.1%
Subtotal	399	2.6%
Changes in Specified Spending Policies		
Effects of the automatic enforcement procedures specified in the Budget Control Act	65	0.4%
Expiration of eligibility to start receiving emergency unemployment benefits	26	0.2%
Reduction in Medicare payment rates to physicians	11	0.1%
Subtotal	102	0.7%
Other Changes in Revenue and Spending	105	0.7%
Total Changes in Deficit Without Effects of Economic Feedback	607	3.9%
Effects of Economic Feedback	-47	-0.3%
Total Change	560	3.6%

Source: Congressional Budget Office, *Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013* (May 2012)

The Fiscal Cliff

Key Questions for Investors

- How likely are we to sail off the fiscal cliff?

The Fiscal Cliff

Month-over-Month Change in Durable Goods Orders

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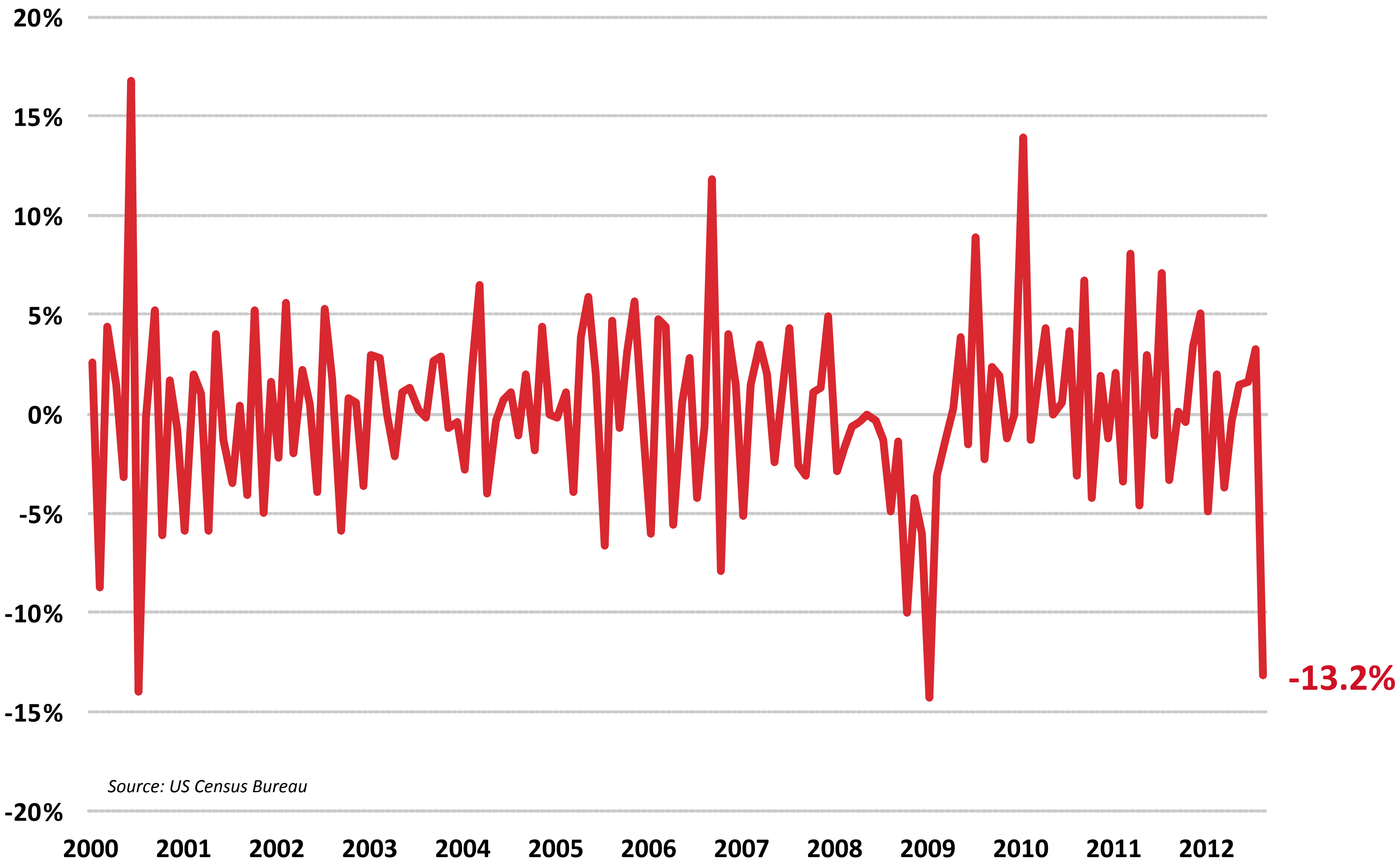

Source: US Census Bureau

The Fiscal Cliff

Manufacturing Purchasing Managers Index

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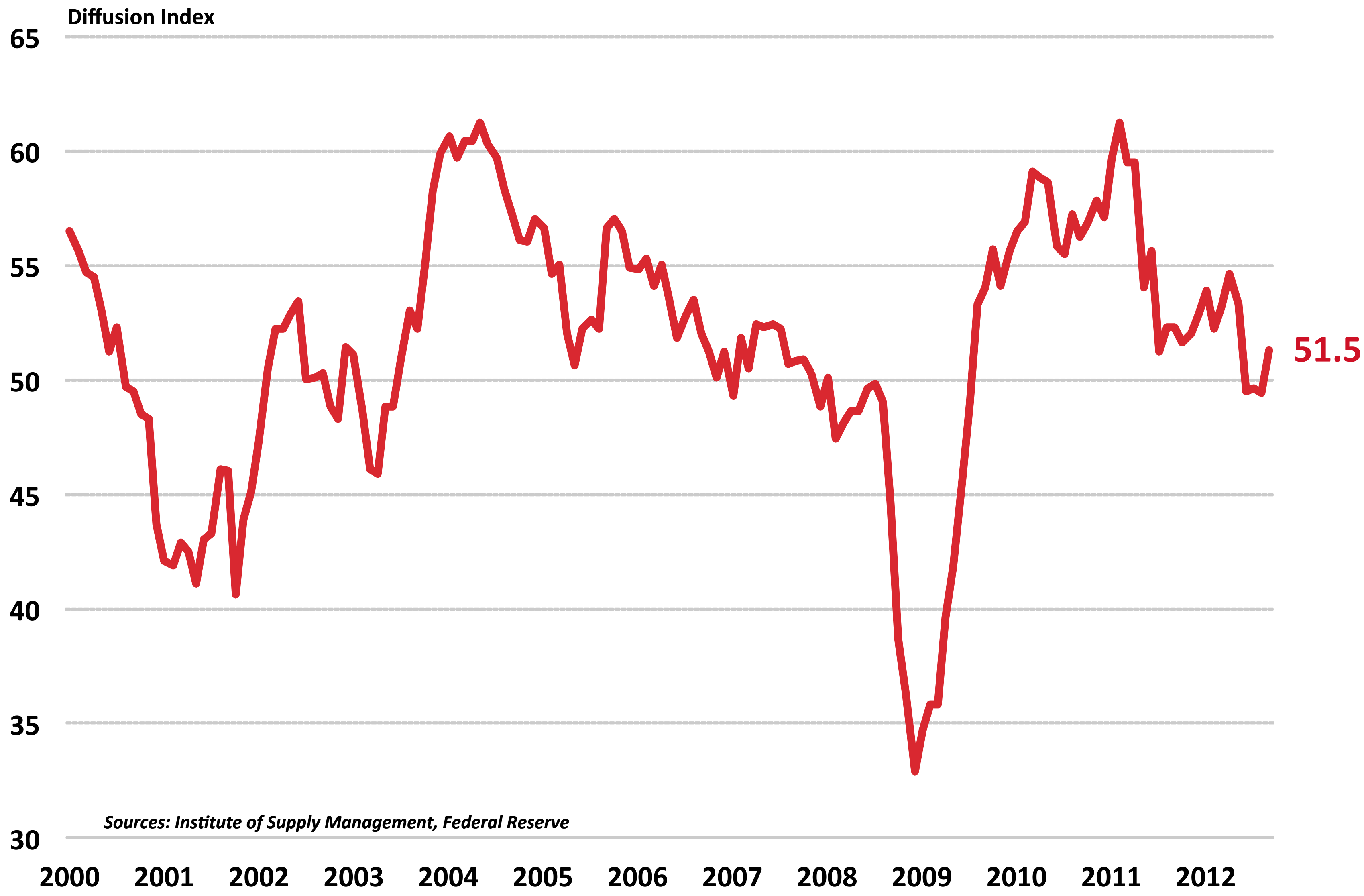

The Fiscal Cliff

Key Questions for Investors

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- How likely are we to sail off the fiscal cliff?

- What are the implications of higher taxes on dividends and capital gains?
  - Little evidence that capital markets respond to changes in tax policy.
  - Could alter the way individual companies handle cash flow.

- What are the implications of higher taxes and/or lower exemptions on estates and gifts?
  - $10 million lifetime exemption on gifts set to expire.
  - Accelerate philanthropy?

Assets of the Federal Reserve

Including Pro-Forma QEx Assumptions

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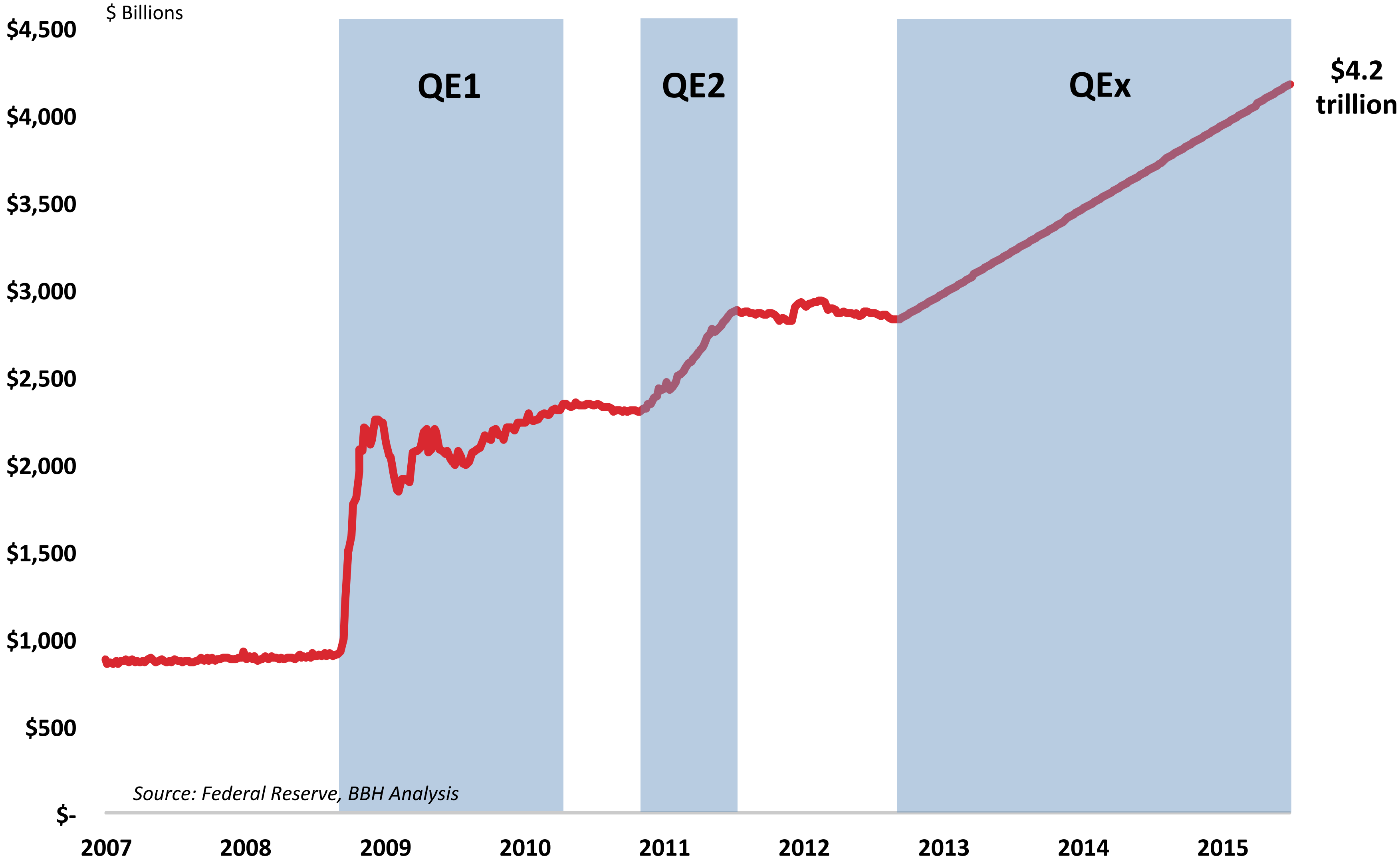

Fed Funds Rate

And Futures Market Implications

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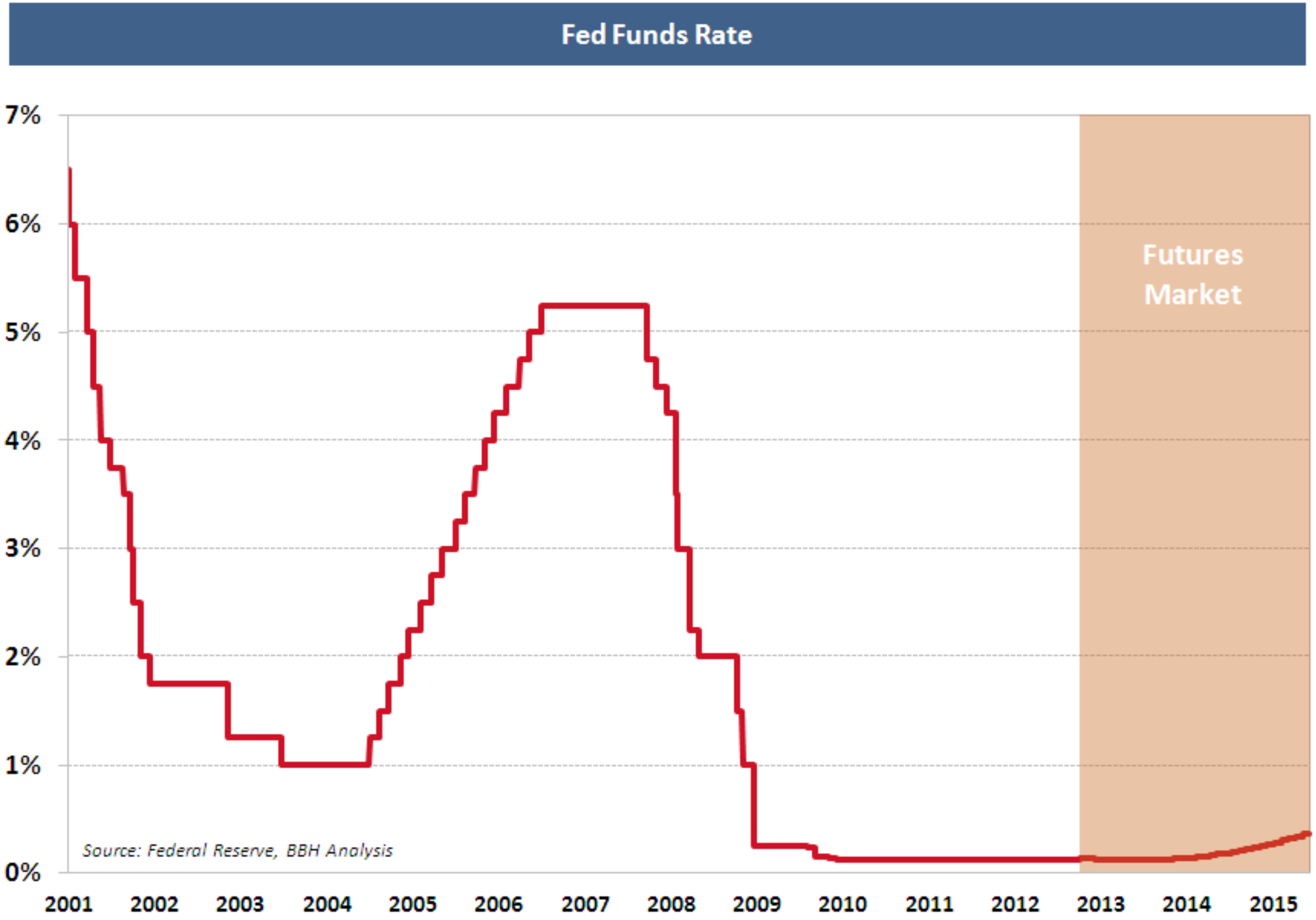

Treasury Yield Curves

Inflation Risk

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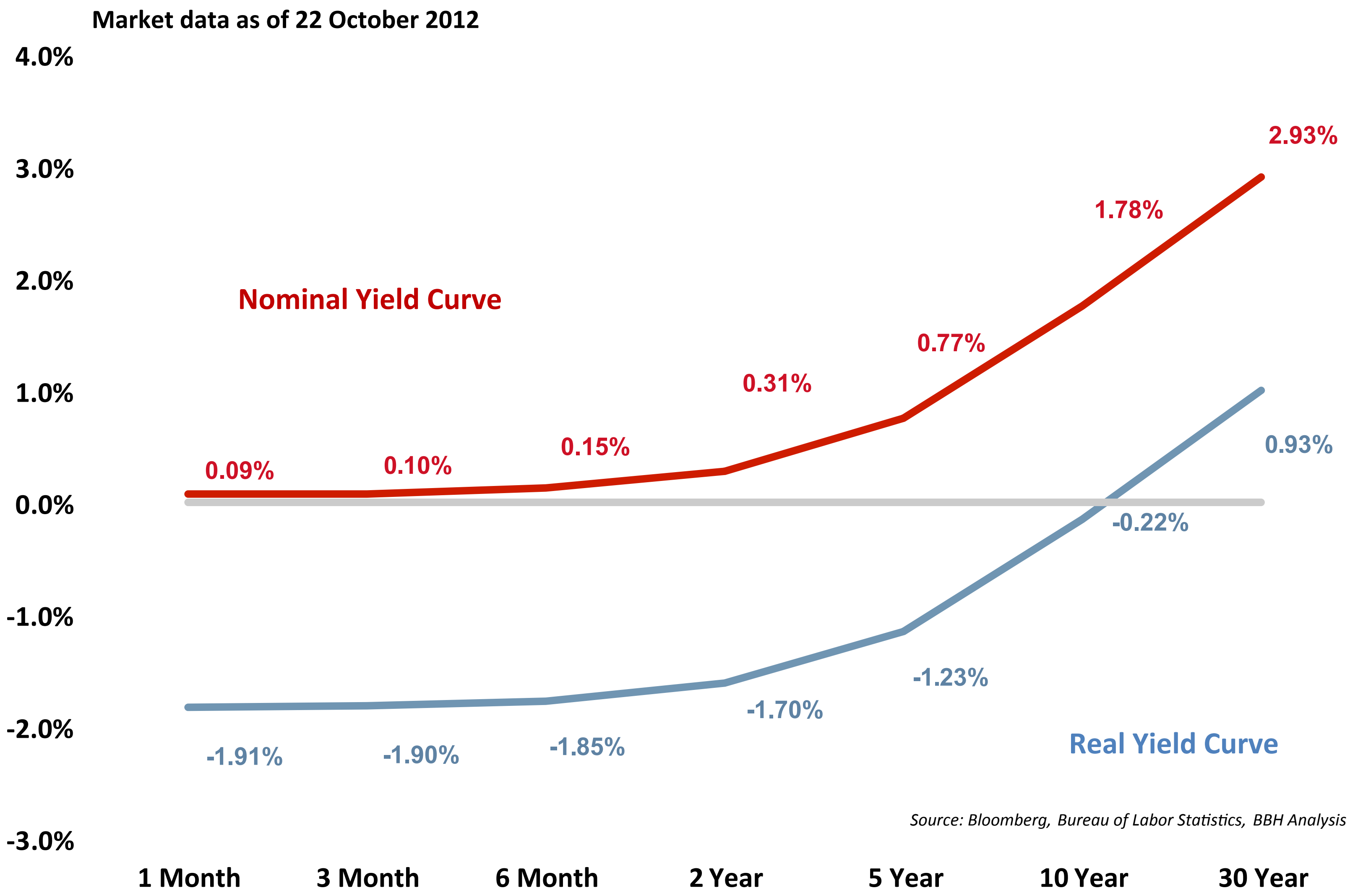

Treasury Yield Curves

Price Risk

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One-year total return of single maturity bond portfolios under various interest rate assumptions

As of October 22, 2012

Scenario 1	2-Year Portfolio	5-Year Portfolio	10-Year Portfolio	30-Year Portfolio
No change in interest rates	0.30%	0.77%	1.78%	2.93%

Scenario 2	2-Year Portfolio	5-Year Portfolio	10-Year Portfolio	30-Year Portfolio
Interest rates increase by 50 basis points	-0.16%	-1.15%	-2.21%	-6.32%

Scenario 3	2-Year Portfolio	5-Year Portfolio	10-Year Portfolio	30-Year Portfolio
Interest rates increase by 100 basis points	-0.62%	-3.04%	-6.10%	-14.88%

Scenario 4	2-Year Portfolio	5-Year Portfolio	10-Year Portfolio	30-Year Portfolio
Interest rates increase by 200 basis points	-1.54%	-6.77%	-13.59%	-30.09%

** Scenarios are illustrative of potential outcomes, and not intended to guarantee results.*

The Role of Fixed Income

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Asset Class	Portfolio Benefits		
	Yield	Liquidity	Price Stability
Treasuries and Municipals	Very little in the current environment. Negative real yields.	Markets remain deep and liquid.	Good, but beware sensitivity to rising rates.
Corporate Bonds	Better yields, but still low in an absolute sense.	Less liquidity than traditional fixed income.	Similar sensitivity to rising rates at longer maturities.
High Yield Bonds	Attractive yields, both relative to treasuries and absolute.	Decent liquidity in fund structure, but markets can become thin in times of stress.	Prices have volatility more similar to equities than traditional fixed income.
Commercial Real Estate	Attractive yields, both relative to treasuries and absolute.	Illiquid.	Prices appear more stable by virtue of illiquidity. Better inflation protection.

The Case for Equities

S&P 500 Price-to-Earnings Ratio

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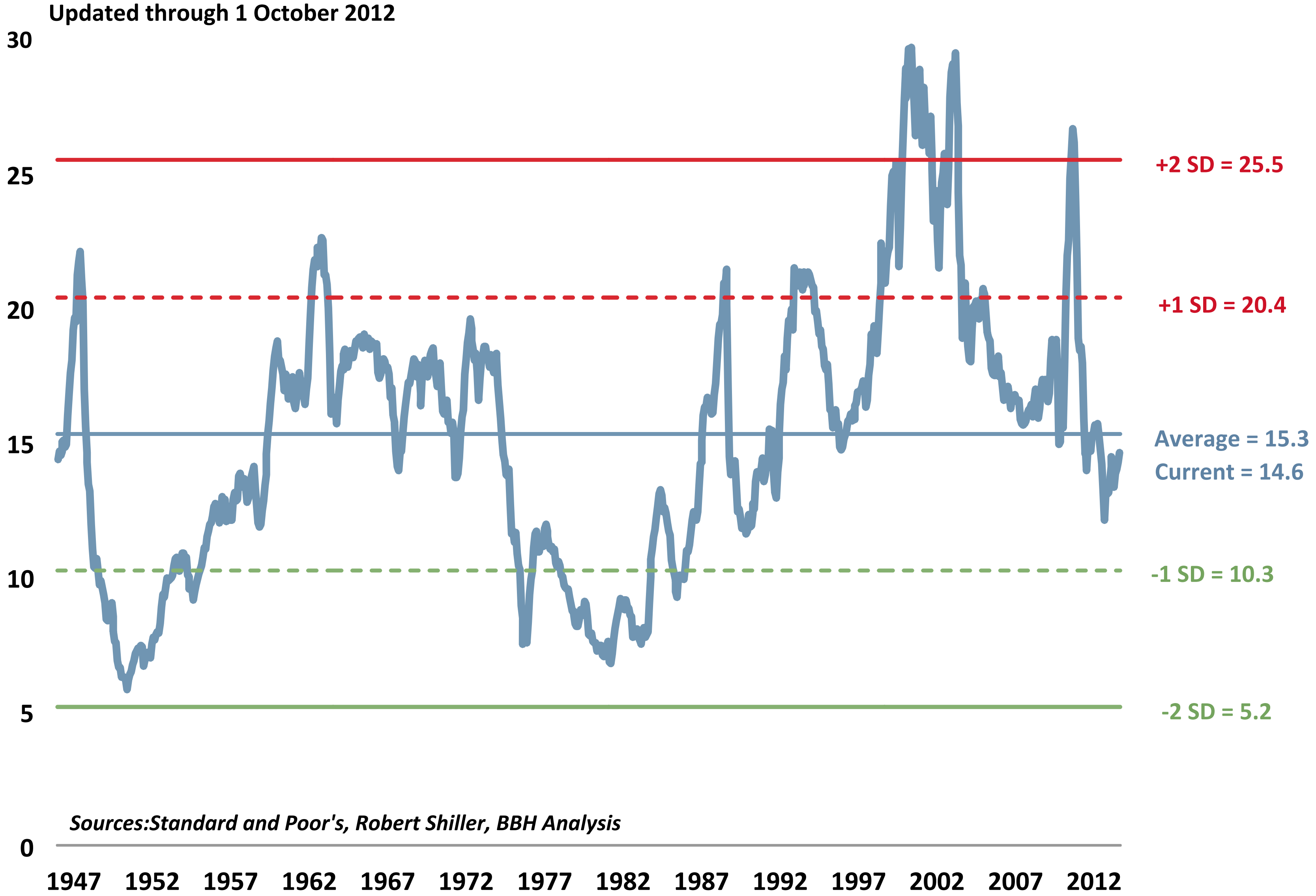

Equities as a Competitive Source of Yield

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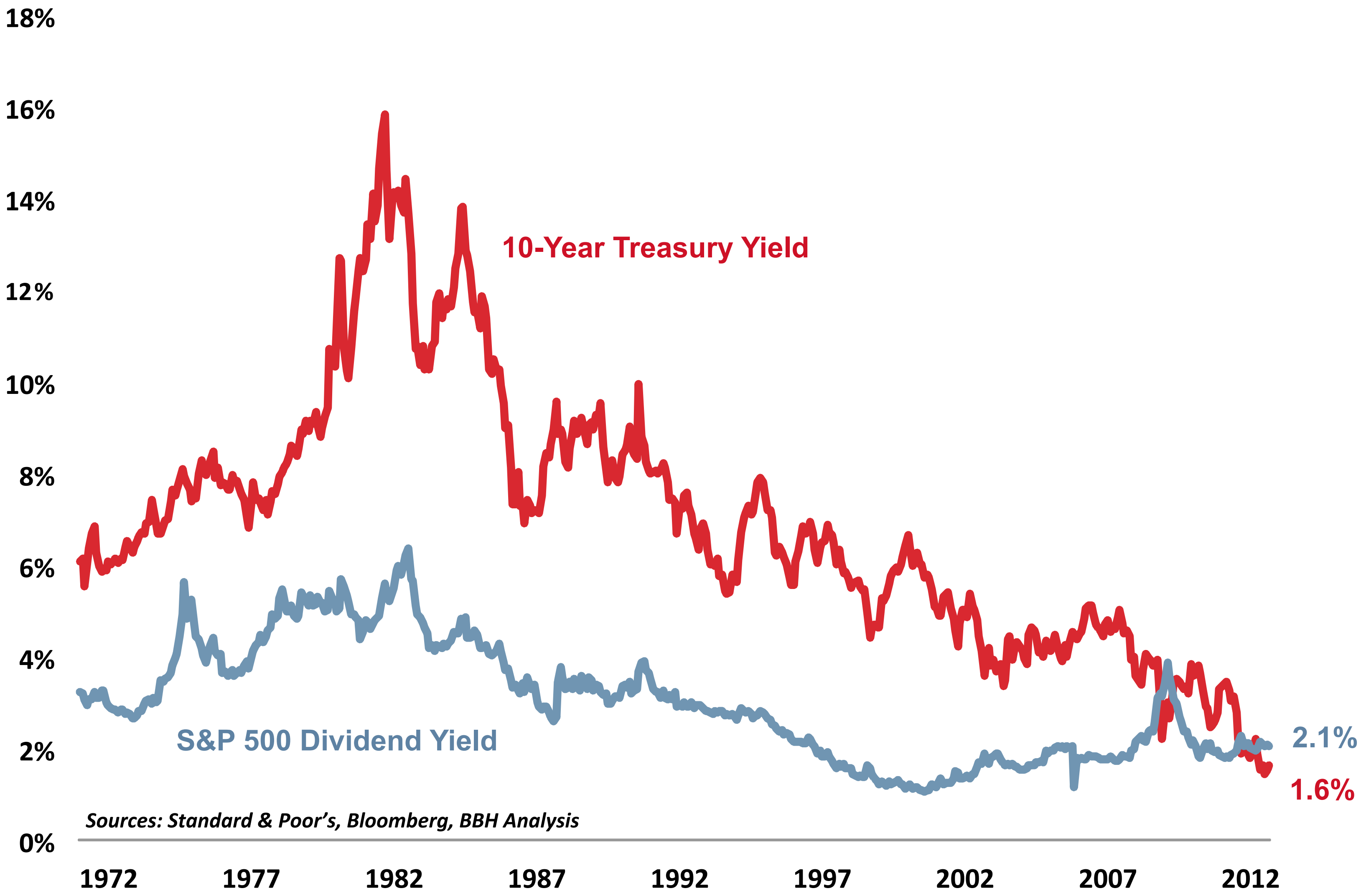

Economic Conclusions

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- A slow improvement in the housing and labor markets is supporting modest growth in personal income, which in turn is allowing for lethargic economic growth even as households pay down debt.

- Yet this balance of spending, saving and deleveraging is fragile, and could be upended by the fiscal cliff.

- Fragility plus uncertainty indicates that monetary policy is likely to remain very accommodative for the foreseeable future.

- The Obama administration will need to address secular issues that extend beyond the scope of any one or two terms of office.

Investment Conclusions

- Traditional fixed income assets in the current environment present inflation risk (even in an environment of modest inflation), and price risk if and when interest rates begin to rise.
  - Assets held for liquidity and price stability should remain high quality and short duration.
  - Assets held for yield should have a margin of safety and be well diversified.

- Although our enthusiasm for equities as an asset class has waned as the market has rallied, we still find the best tradeoff of risk and return in carefully chosen companies that …
  - Provide essential products and services
  - Posses financial strength
  - Can be bought at a discount to their intrinsic value

- Diversification is important, but the best risk management tool is knowing what you own, and owning it at the right price.

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