Financial Markets: Is "after the crisis" just "ahead of the crisis"?

NOVEMBER 17, 2010

Presented by:

Karsten Jeske, Ph.D., CFA
Investment Research
Mellon Capital Management

Disclaimer

This presentation reflects the opinion of the author as of the date noted and is subject to change without notice. The information in this presentation has been developed internally and/or obtained from sources we believe to be reliable; however, Mellon Capital does not guarantee the accuracy or completeness of such information. This presentation is provided for informational purposes only and is not provided as a sales or advertising communication nor does it constitute investment advice or a recommendation for any particular investment product or strategy for any particular investor. Economic forecasts and estimated data reflect subjective judgments and assumptions and unexpected events may occur. Therefore, there can be no assurance that developments will transpire as forecasted in this presentation.

Outline

- About BNY Mellon / Mellon Capital

- Financial Markets, current conditions and outlook
  - Equities
  - Bonds
  - Commodities

- Conclusion

About BNY Mellon/Mellon Capital

Bank of New York Mellon

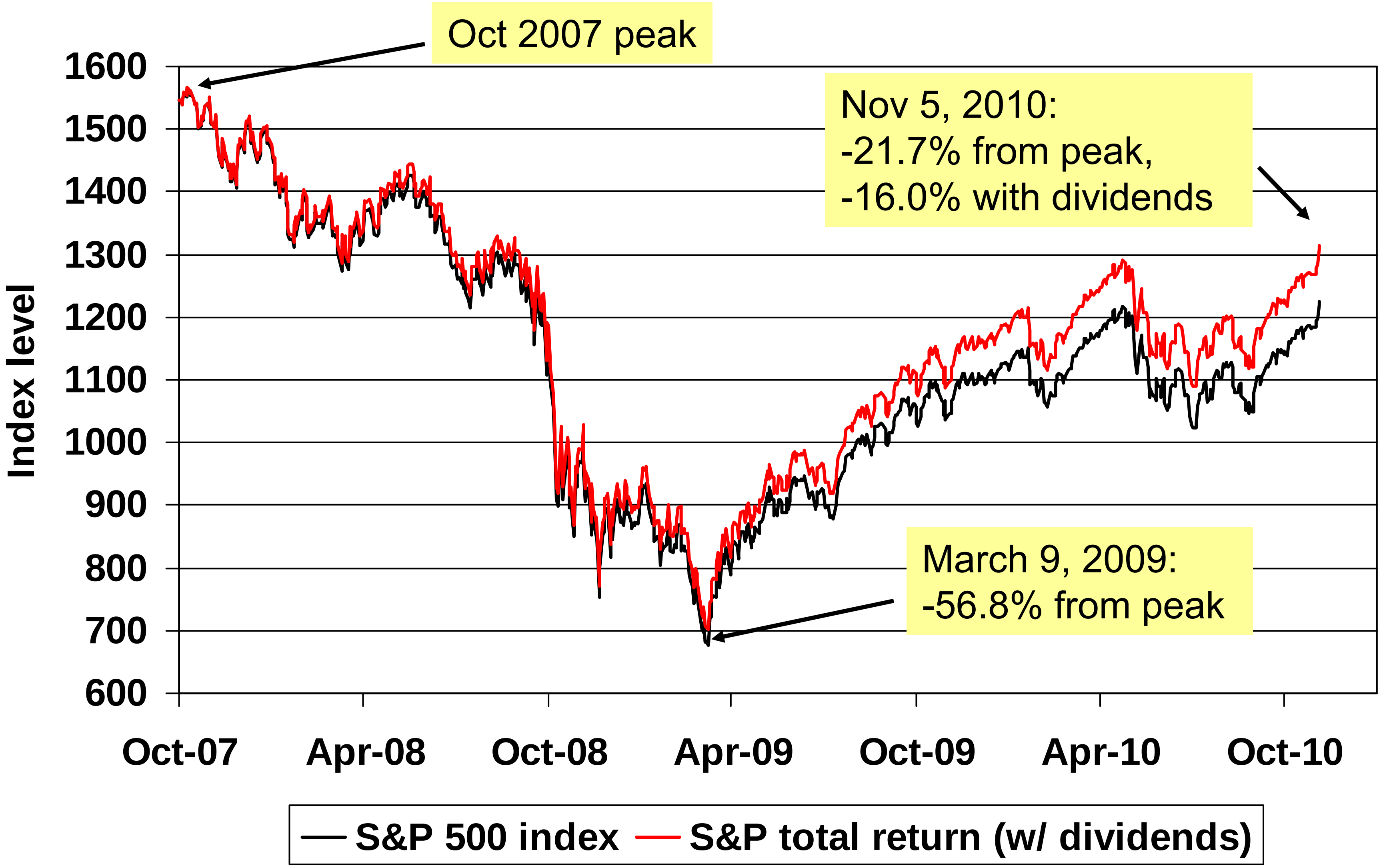
- Bank of New York founded in 1784 by Alexander Hamilton. Mellon Bank founded in 1869. Merger in 2007
- Headquartered in New York
- 47,700 employees (Oct 2010)
- 10th largest financial institution in the U.S. by market cap (11/08/2010)
- Custodial services: >$20t under custody (Oct. 2010)
- Asset Management
  - $>1t under management (Oct. 2010)
  - Distributed over a dozen boutique asset management companies

Mellon Capital Management

- Founded in 1983
- Headquarters in San Francisco
- $196b under management (Oct. 2010)
- Mostly institutional clients
- Variety of active and passive strategies
- Founded by innovators in indexing

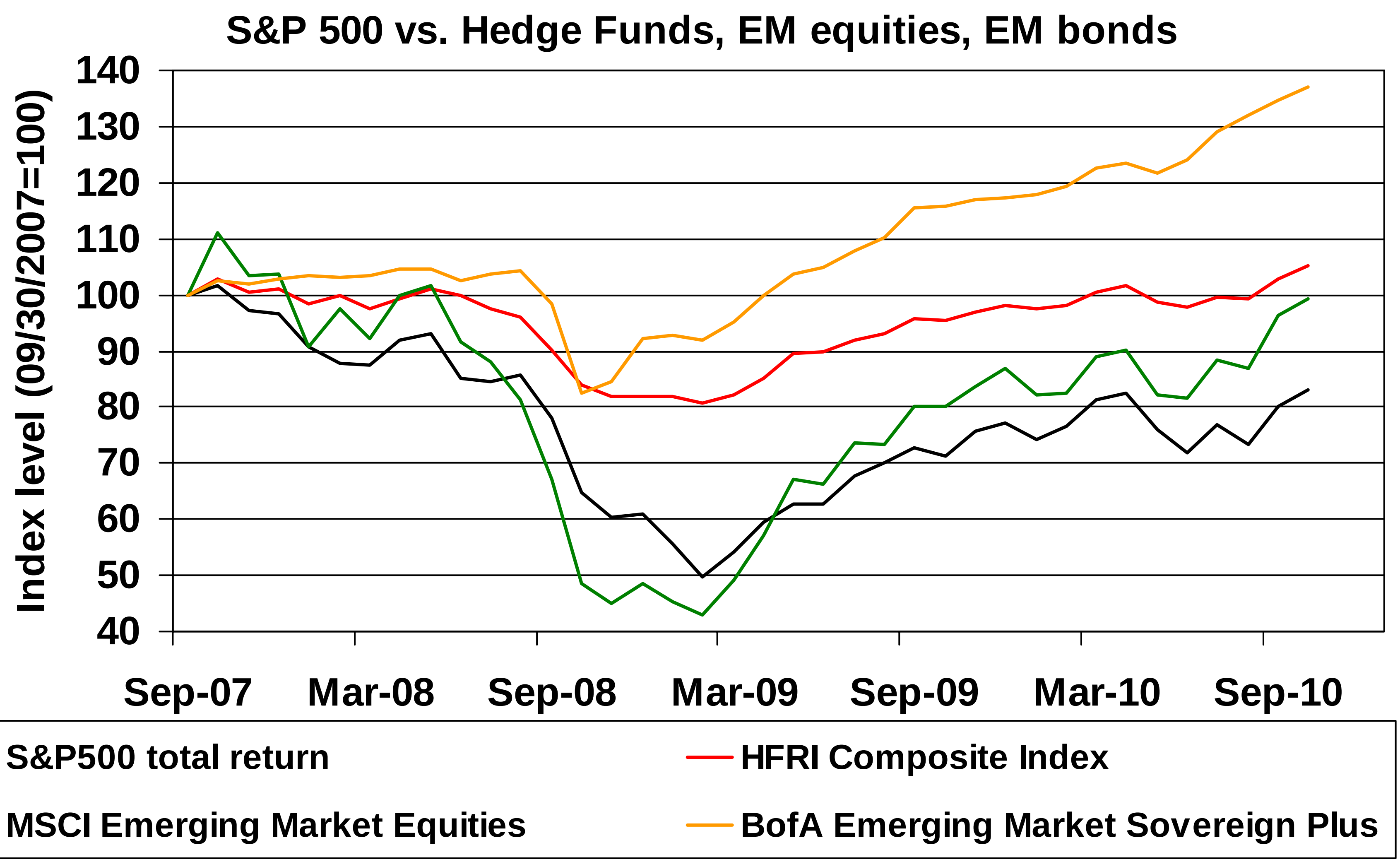
Additional information in Disclosure Statements at the end of this presentation

Here we go again: the S&P500® has recovered 84% of its drawdown



Source: Datastream

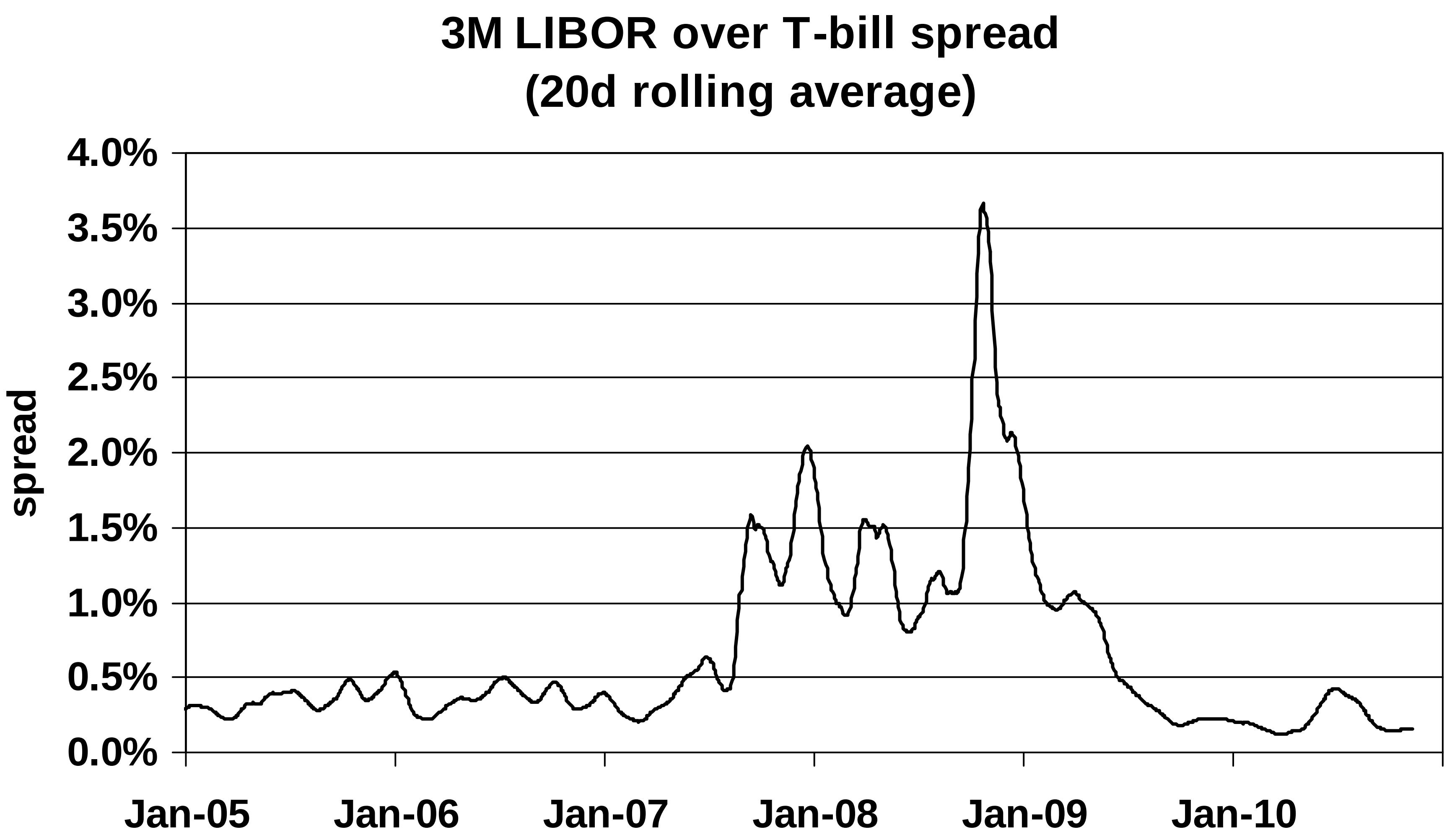
Hedge funds and emerging market stocks/bonds fared even better!



Source: Datastream and Mellon Capital Management

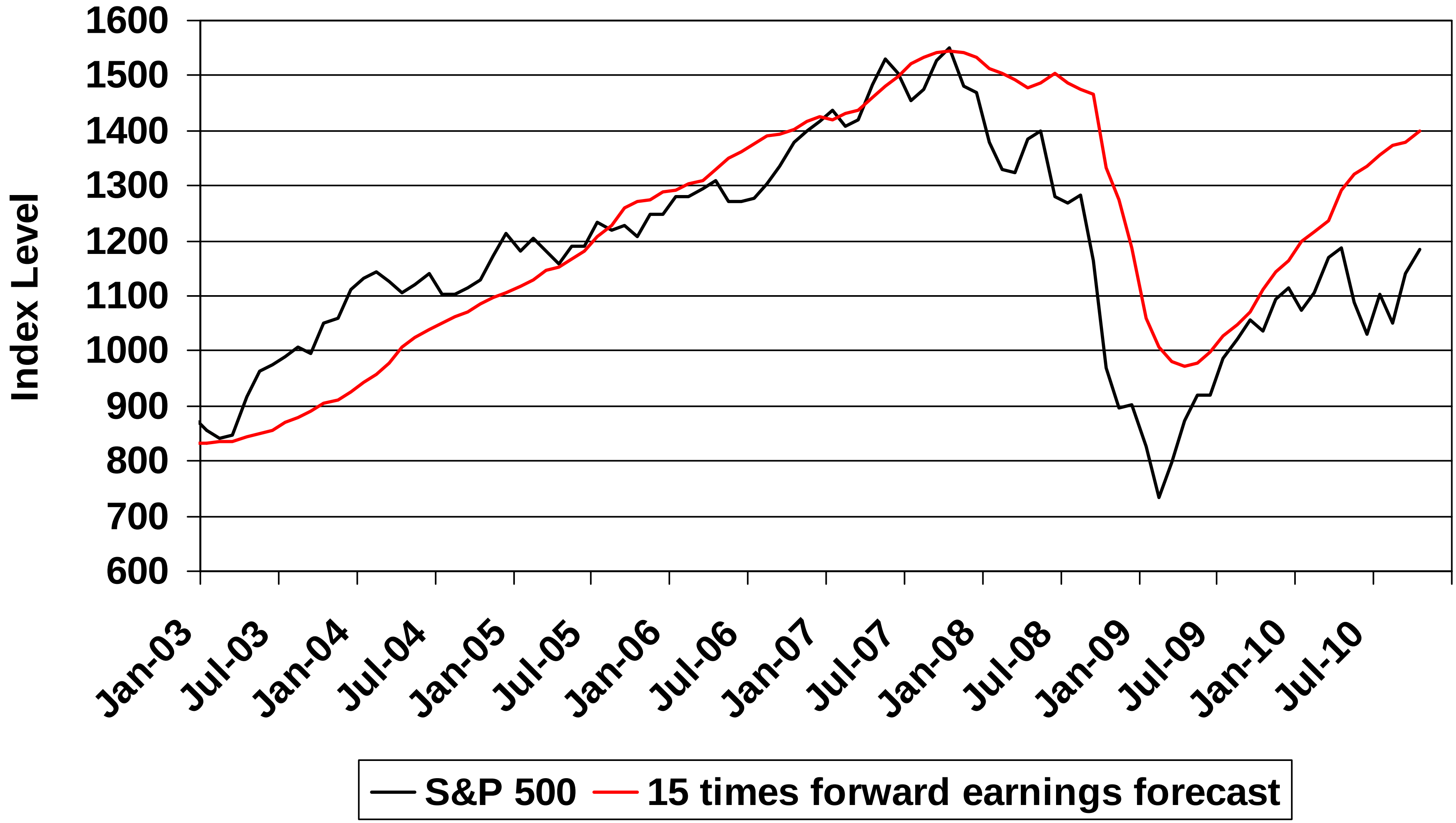
Additional information in Disclosure Statements at the end of this presentation

TED Spread: back to pre-crisis levels, hardly moved in mid 2010 crisis



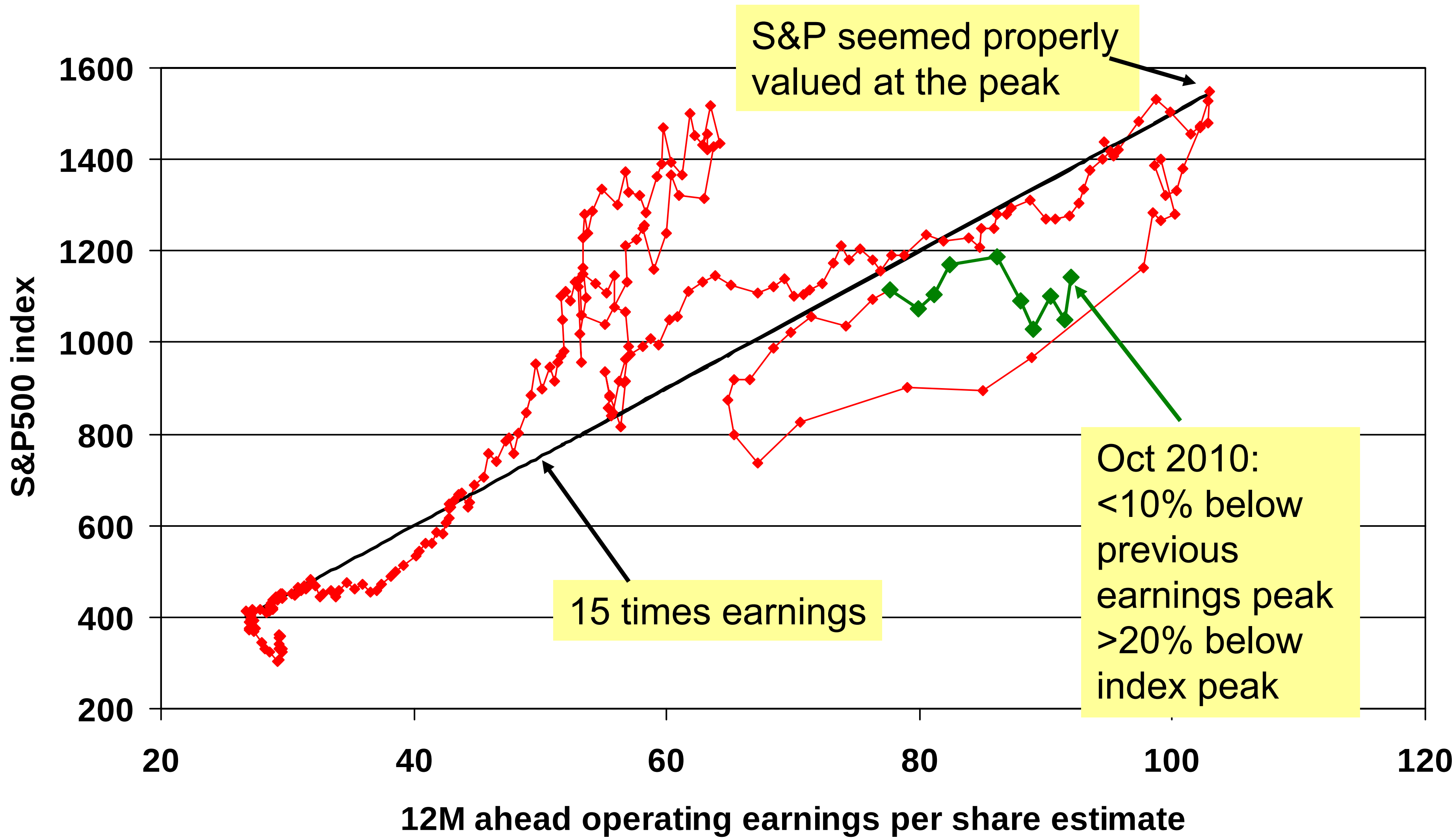
Source: Datastream and Mellon Capital Management

Relative to earnings, the S&P500® is still properly valued, by historical comparison



Source: Datastream and Mellon Capital Management

Earnings vs. S&P500® index: 1990-current



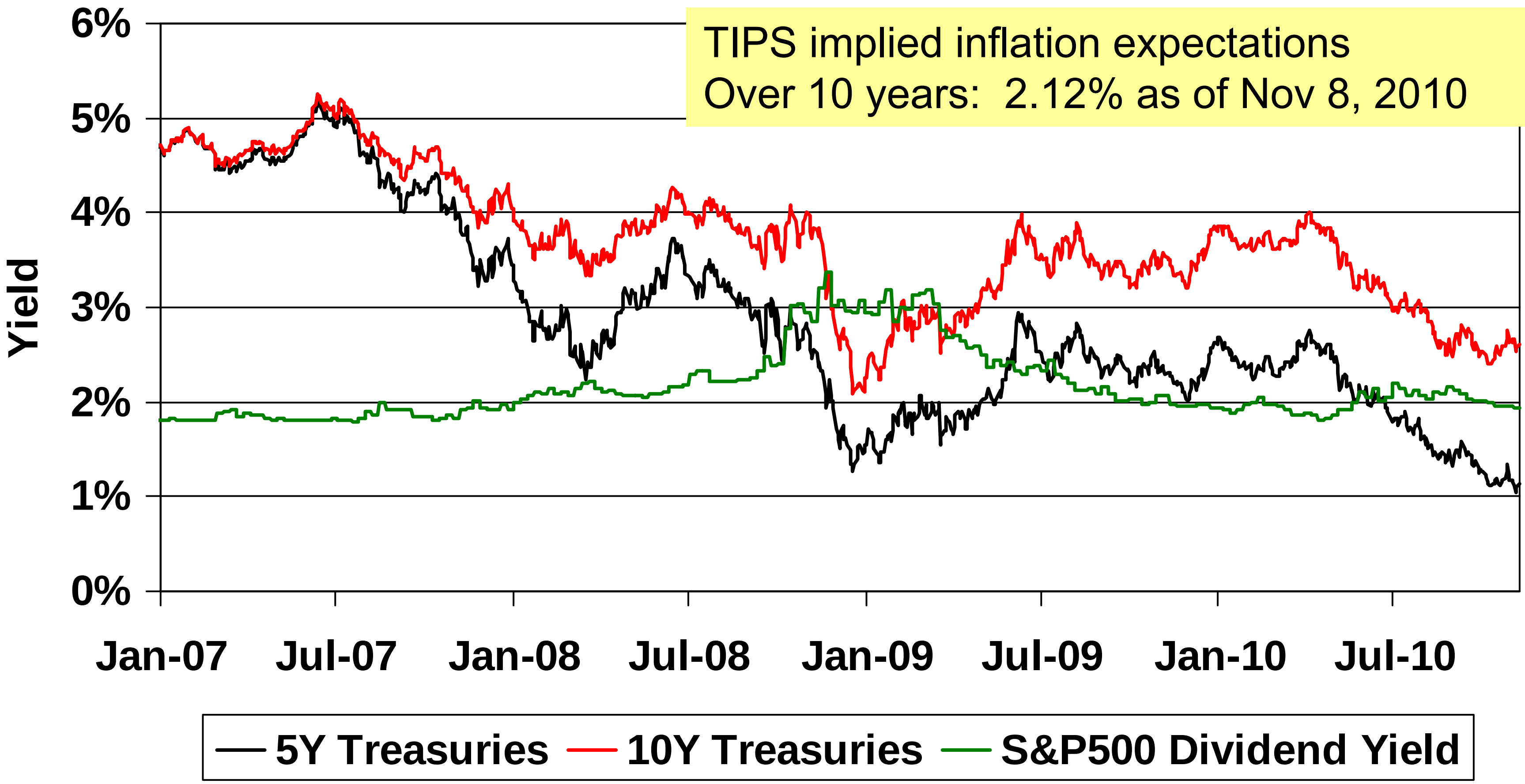
Source: Datastream and Mellon Capital Management

Bonds: the next bubble?

- Bonds yields are at or close to record-low levels
- Large deficits, especially in developed economies
- Inflation risk

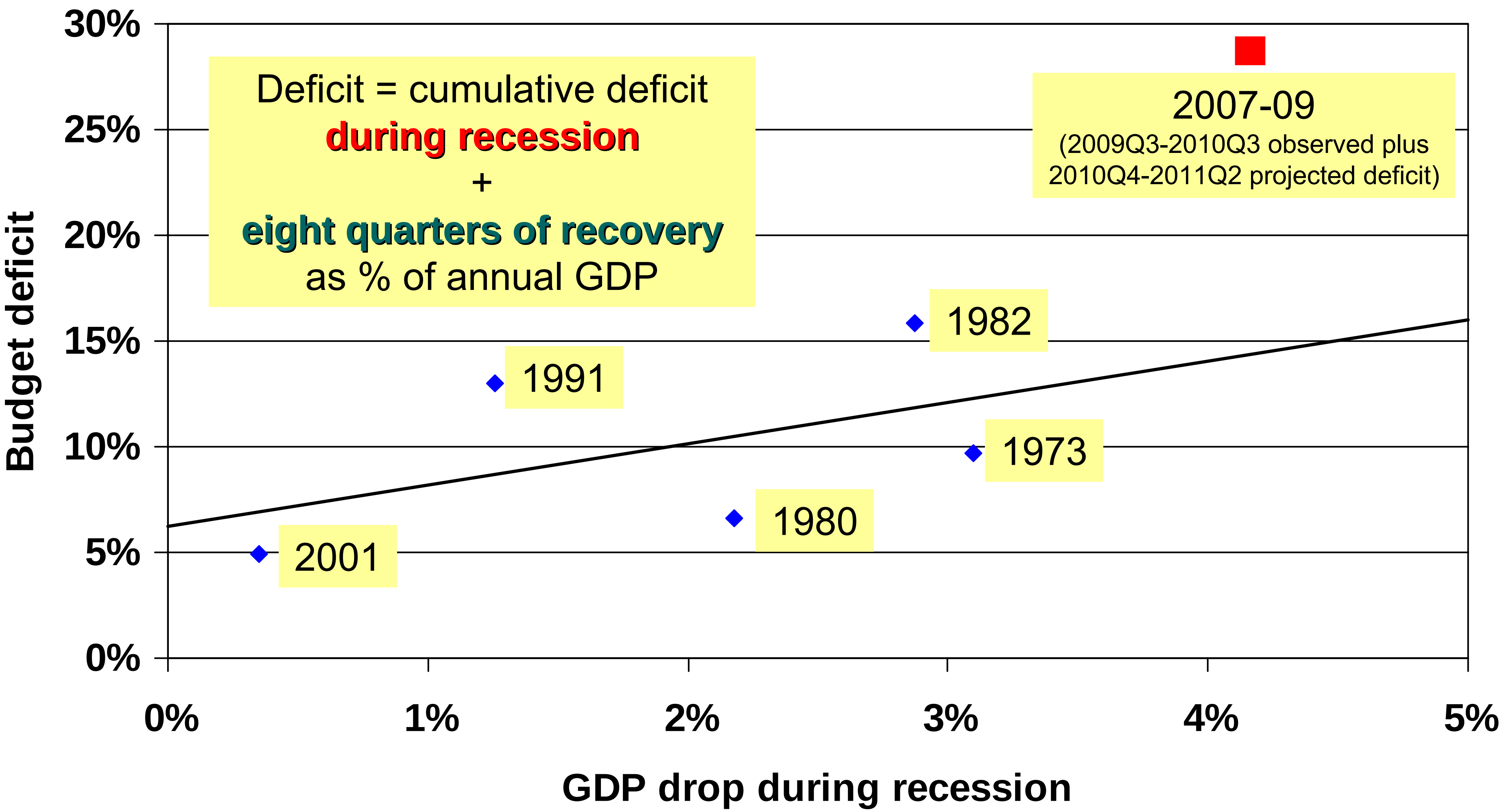
5 year yields at all time low,
10 year yields close to 2008 lows

5Y and 10Y Treasury yields vs. S&P 500 dividend yield



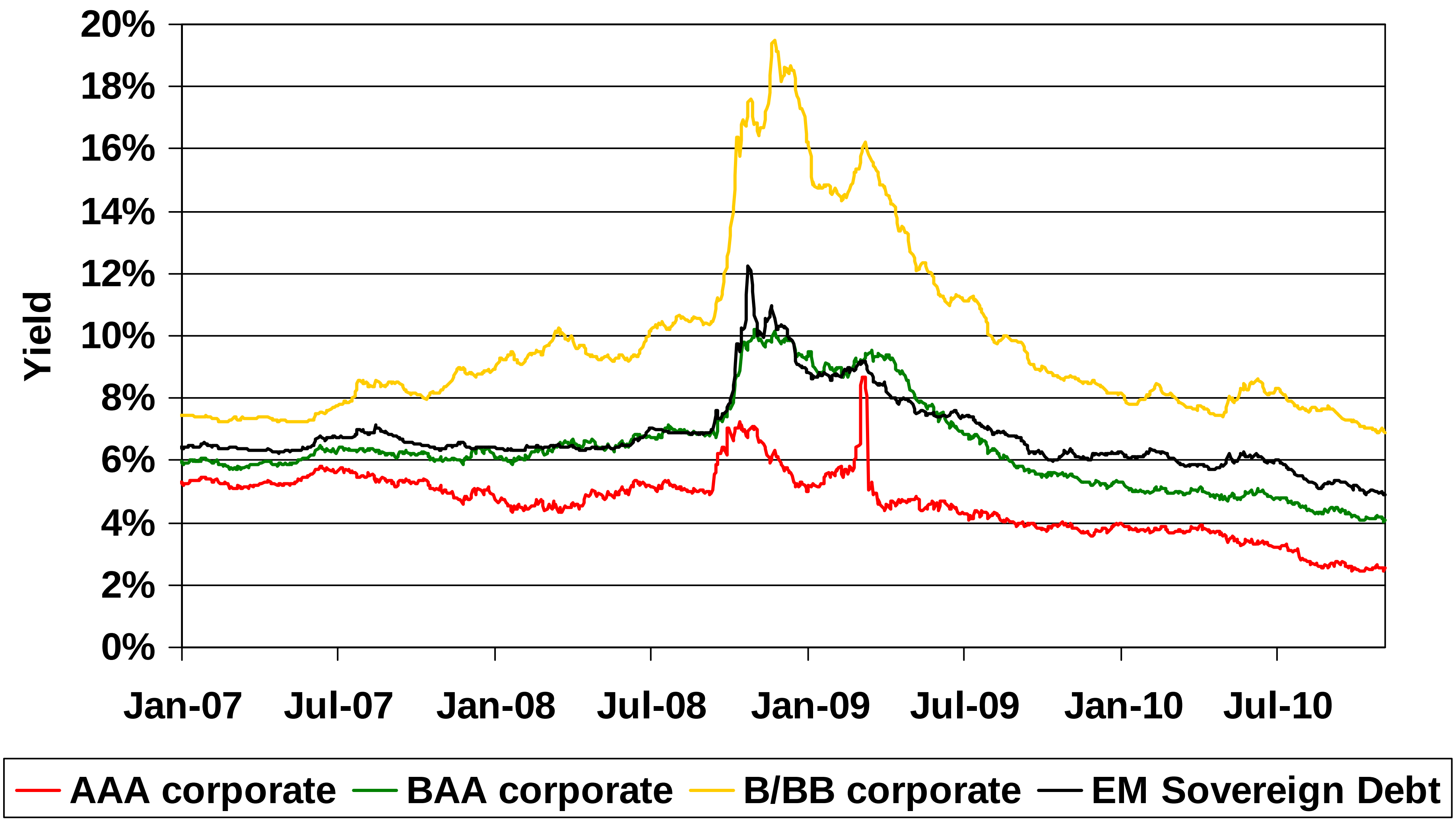
Source: Datastream and Mellon Capital Management

Severity of recession vs. U.S. budget deficit



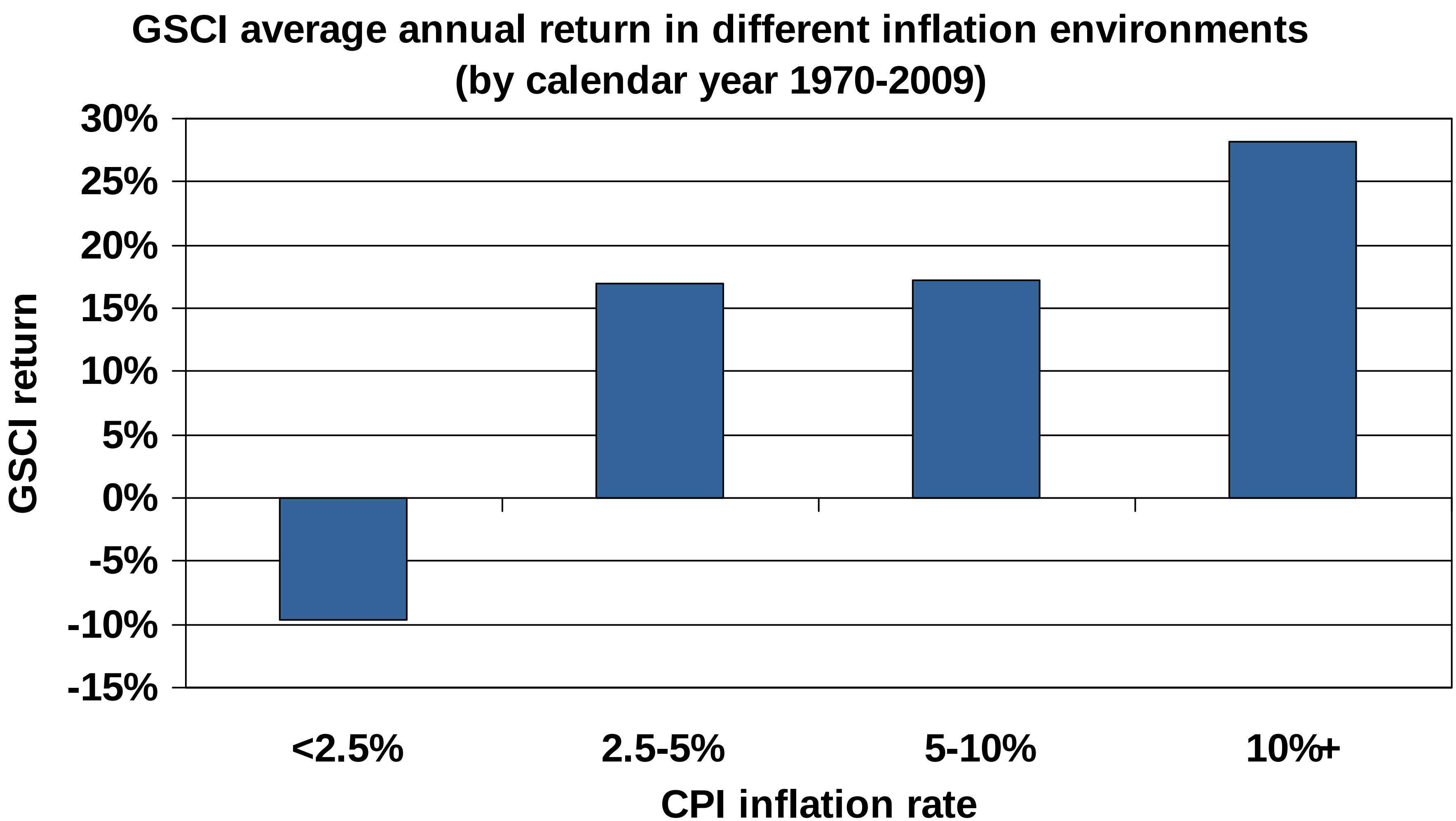
Source: Datastream, Bureau of Economic Analysis, Mellon Capital Management

Chasing yields: risky bonds yields are at or close to all-time lows



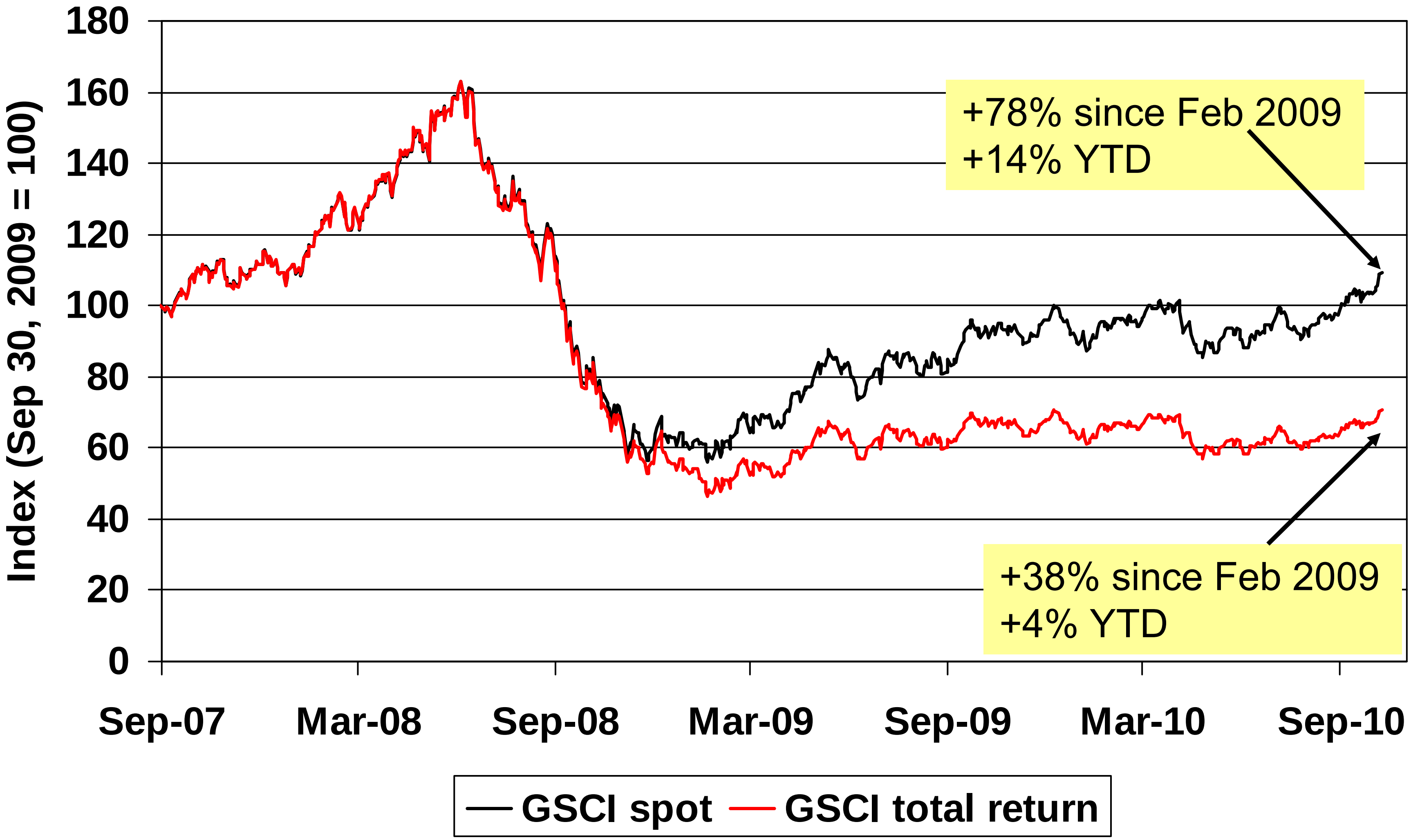
Source: Datastream, Barclays and Bank of America

Commodities may hedge against inflation



Source: Bureau of Labor Statistics and Mellon Capital Management

Caveat: since 2009 actual commodity returns lagged spot returns



Source: Datastream and Mellon Capital Management

Additional information in Disclosure Statements at the end of this presentation

Why commodity total returns have underperformed spot returns in 2009/10

Example: Commodity fund/ETF

- Hold December 2010 WTI crude oil contract:
- Investor never wants to take delivery of oil, thus before Dec 1:
  - ▶ has to sell December contract
  - ▶ buys January 2011 (or later) contract
- Nov 9, 2010 futures prices are in contango (from Bloomberg)
  - ▶ $86.77 for December 2010 contract
  - ▶ $87.36 for January 2011 contract (0.7% premium over Dec)
  - ▶ $87.85 for February 2011 contract (1.2% premium over Dec)
  - ▶ $88.37 for March contract (1.8% premium over Dec)

  => Sell cheaper contract, buy expensive contract
- Negative “roll yield” reduces returns by about 0.6-0.7% per month!

Conclusion

- Unlike rest of the economy, financial markets are in full swing again
- Equities seem adequately valued
- Bonds seem expensive
- Commodities bound to continue their rally, but beware of negative roll yields

Disclosure Statements

Mellon Capital Management Corporation ("Mellon Capital") is an investment adviser registered with the Securities and Exchange Commission ("SEC") under the Investment Advisers Act of 1940. Any collective investment funds presented are maintained by The Bank of New York Mellon and Mellon Capital provides non-discretionary investment advisory services to those collective investment funds. The firm is defined as Mellon Capital and includes assets managed as dual officers of The Bank of New York Mellon and as dual employees of The Dreyfus Corporation. AUM, client and employee count are as of September 30, 2010 unless noted otherwise. Mellon Capital's AUM includes assets managed in overlay strategies ($9.2 billion) as of September 30, 2010. BNY Mellon Asset Management is the umbrella organization for The Bank of New York Mellon Corporation's affiliated investment management firms and global distribution companies. Mellon Capital is a wholly-owned subsidiary of The Bank of New York Mellon Corporation. Any collective investment funds presented are not deposits of, and are not insured or guaranteed by, any bank, the FDIC or any other government agency. Please refer to the fund's Schedule A for important additional information.

This presentation does not constitute an offer or solicitation to any person in any jurisdiction in which such offer or solicitation is not authorized or to any person to whom it would be unlawful to make such offer or solicitation. This material (or any portion thereof) may not be copied or distributed without Mellon Capital's prior written approval. Statements are current as of the date of the material only.

The following provides a simplified example of the cumulative effect of management fees on investment performance: An annual management fee of 0.80% applied over a five-year period to a $100 million portfolio with an annualized gross return of 10% would reduce the value of the portfolio from $161,051,000 to $154,783,041. The actual management fee that applies to a client's portfolio will vary and performance fees may be available. The standard fee schedules for Mellon Capital's strategies are shown in Part II of Mellon Capital's Form ADV.

No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Past results are not indicative of future performance and are no guarantee that losses will not occur in the future. Future returns are not guaranteed and a loss of principal may occur. Performance is expressed in U.S. dollars unless noted otherwise. Performance results for one year and less are not annualized. Many factors affect performance including changes in market conditions and interest rates and in response to other economic, political, or financial developments. The active risk targets and information ratio targets shown in this presentation are the long run ex-ante targets. The active risk levels and information ratios may be higher or lower at any time. There is no guarantee that the active risk targets and information ratio targets will be achieved.

The information provided in this presentation should not be considered a recommendation to purchase or sell a particular security. Any specific securities identified do not represent all of the securities purchased, sold or recommended for advisory clients, and may be only a small percentage of the entire portfolio and may not remain in the portfolio at the time you receive this report. You should not assume that investment decisions we make in the future will be profitable or will equal the investment performance of the past.

Charts and graphs herein are provided as illustrations only and are not meant to be guarantees of any return. The illustrations are based upon certain assumptions that may or may not turn out to be true.

Please note that this presentation does not comply with all of the disclosure requirements for an ERISA "section 404(c) plan," as described in the Department of Labor regulations under section 404(c). Plan sponsors intending to comply with those regulations will need to provide the plan participants with additional information. The information provided in this presentation does not constitute individual investment advice for a participant or investor, is only informational in nature and should not be used by a participant or investor as a primary basis for making an investment decision.

The providers of the indices referred to herein are not affiliated with Mellon Capital, do not endorse, sponsor, sell or promote the investment strategies or products mentioned herein and they make no representation regarding the advisability of investing in the products and strategies described herein.

"Standard & Poor's®", "S&P®", "S&P 500® Index", "Standard & Poor's 500®", S&P Small Cap 600® Index, and "S&P Mid Cap 400® Index" are trademarks of McGraw-Hill, Inc., and have been licensed for use by BNY Mellon (together with its affiliates and subsidiaries).

"Dow Jones", "Dow Jones U.S. Total Stock Market Index℠", and "Dow Jones U.S. Completion Total Stock Market Index℠", are service marks of Dow Jones & Company, Inc. and has been licensed for use for certain purposes by Mellon Capital Management Corporation and The Bank of New York Mellon Corporation. The Bank of New York Mellon's EB Daily Valued U.S. Equity Market Fund based on the Dow Jones U.S. Total Stock Market Index℠, EB Daily Liquidity Market Completion Fund based on the Dow Jones U.S. Completion Total Stock Market Index℠, and EB Daily Valued Market Completion Fund based on the Dow Jones U.S. Completion Total Stock Market Index℠ are not sponsored, endorsed, sold or promoted by Dow Jones and Dow Jones does not make any representation regarding the advisability of investing in such products.

Russell Investments is the owner of the trademarks and copyrights relating to the Russell 1000® Index, the Russell 2000® Index, the Russell 2500™ Index, the Russell 3000® Index, the Russell Midcap® Growth Index, and the Russell Midcap® Value Index.

Any funds or securities referred to herein are not sponsored, endorsed or promoted by MSCI, and MSCI bears no liability with respect to any such funds or securities or any index on which such funds or securities are based.

The Dow Jones-UBS Commodity Indexes are calculated, distributed and marketed by CME Group Index Services, LLC ("CME Indexes") pursuant to an agreement with UBS Securities, LLC and have been licensed for use. All content of the Dow Jones-UBS Commodity Indexes © CME Group Index Services, LLC and UBS Securities, LLC 2010. "Dow Jones®" is a registered trademark of Dow Jones Trademark Holdings LLC and has been licensed for use by CME Indexes. "UBS®" is a registered trademark of UBS AG.

Australian prospects and clients, please note the following: If this document is used or distributed in Australia, it is issued by BNY Mellon Asset Management Australia Limited ("BNY AMI Australia") (ABN 56 102 482 815, AFS License No. 227865) located at Level 6, Macquarie Place, Sydney, NSW 2000. BNY AMI Australia holds an Australian Financial Services Licence authorising it to provide financial services in Australia. BNY AMI Australia also introduces the capabilities of BNY Mellon affiliated United States asset managers or investment advisers, such as Mellon Capital Management Corporation, in Australia. Mellon Capital is exempt from the requirement to hold an Australian Financial Services Licence under the Corporations Act 2001 in respect of financial services provided in Australia. Mellon Capital, and any financial services that may be provided by Mellon Capital, are regulated by the SEC under United States laws, which differ from Australian laws.

Japanese prospects and clients, please note the following: BNY Mellon Asset Management Japan Limited ("BNY AMI Japan") provides information about the investment advisory skills and products of BNY Mellon's investment management firms in Japan. Mellon Capital provides subadvisory services to BNY AMI Japan. The presentation is not an invitation of subscription and provides information only. BNY AMI Japan is not responsible for the accuracy and completeness of the information contained in this presentation. Past performance and simulated performance are not a guarantee of future performance or principle and returns. The information may be amended or revoked at any time without notice.

If this document is used or distributed in Hong Kong, it is issued by BNY Mellon Asset Management Hong Kong Limited, whose business address is Unit 1501-1503, 15/F Vicwood Plaza, 199 Des Voeux Road, Central, Hong Kong. BNY Mellon Asset Management Hong Kong Limited is regulated by the Hong Kong Securities and Futures Commission and its registered office is at 6th floor, Alexandra House, 18 Chater Road, Central, Hong Kong

BNY Mellon Asset Management International Limited. BNY Mellon Asset Management International Limited, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No. 1118580. Authorized and regulated by the Financial Services Authority.