JUNE 2010

CAUSEWAY CAPITAL MANAGEMENT LLC
NEWSLETTER

Emerging Markets Equity Allocation:

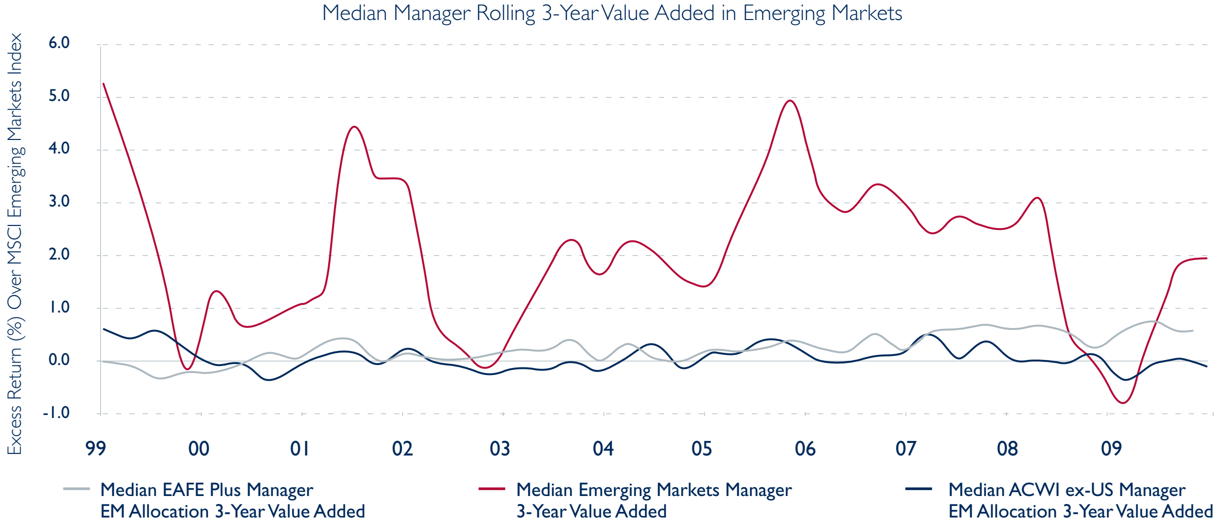
Run For Cover – or Bring it On?

What method leads to the optimal amount of emerging markets equity in a global portfolio? We argue strongly that a pragmatic, factor-based allocation model makes a lot more sense than allocating 50/50, or tracking index weights, or any other arbitrary or backward-looking guideline. A primary focus on stock selection has served our clients well in markets where equity cultures have established themselves over several decades. In contrast, investing in emerging markets typically requires measurement and understanding of both top-down (country/region) and stock-specific factors. We may have entered a period where top-down risks plague some of the developed European markets, but that situation hasn't taken the primary focus from stock selection and company-specific fundamentals. Emerging markets stocks, by comparison, are domiciled in countries where shareholder protections have less history, legal systems remain less reliable, and often unpredictable government policy can impede a company's progress. That minefield needs careful navigation. We recently discussed our emerging markets allocation strategy with Causeway's emerging markets portfolio managers, Arjun Jayaraman and Duff Kuhnert, and our president and head of fundamental research, Harry Hartford.

> "We believe that for many clients, it makes sense to give us, the investment manager, discretion to buy the most attractive combination of stocks, wherever they are located."

Dedicated Emerging Markets Managers Have Been More Successful Adding Value

Median Manager Rolling 3-Year Value Added in Emerging Markets



Source: InterSec Research

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Run For Cover – or Bring it On? continued

Q: Why should clients have a separate portfolio of emerging markets stocks that you combine with an international or global equity portfolio? In fact, why make any distinction between emerging and developed equities?

AJ: After years of participating in Causeway's fundamental research meetings, I understand how stock selection drives superior performance in developed world stocks. In contrast, the valuations of emerging markets equities are more sensitive to country, political, and regulatory uncertainty. Emerging markets stocks respond to a set of factors that typically are much less important in the developed world. We combine two different approaches for optimal results. Quantitatively, we construct a well-diversified portfolio of emerging markets stocks (with a broad range of market capitalizations), and combine that with our concentrated fundamental portfolio of developed markets stocks. Blending the two has become a critical component of the overall success of the strategy. We call this strategy International Opportunities. We believe that for many clients, it makes sense to give us, the investment manager, discretion to buy the most attractive combination of stocks, wherever they are located.

> "In our analysis of historical investor behavior, rising risk aversion often precedes outperformance from emerging markets."

Q: Why not simply buy a few emerging markets stocks in your typical 60-stock developed markets portfolio?

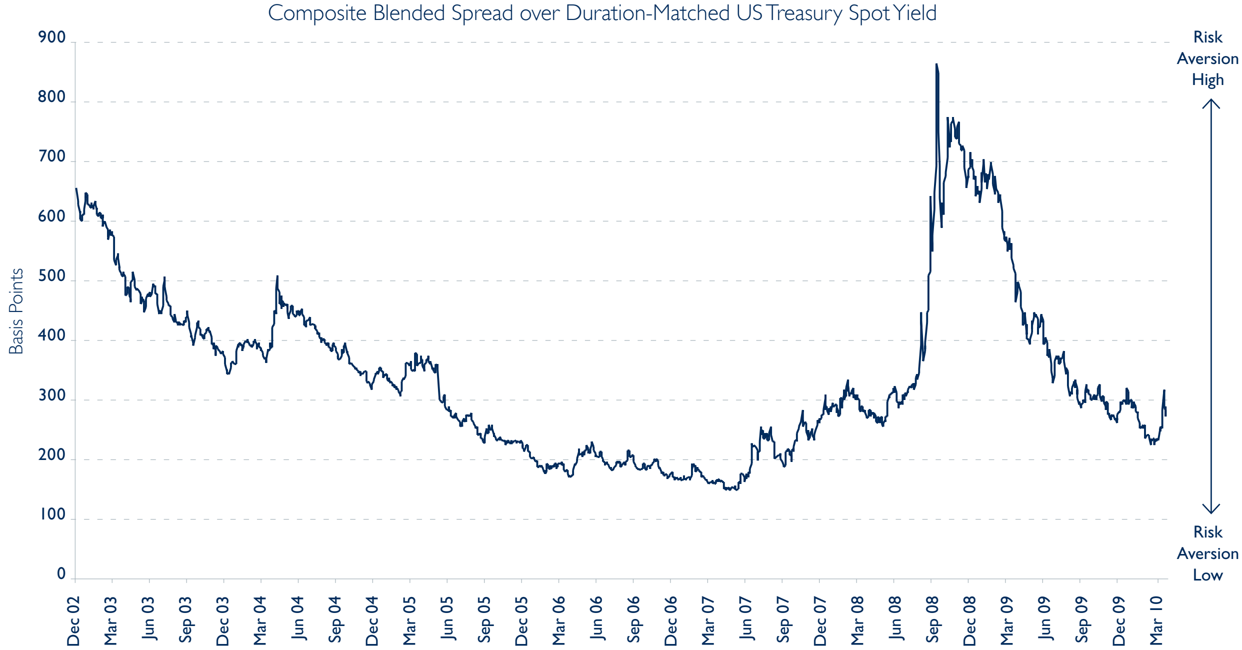
DK: Many managers add only a few emerging markets holdings to their developed market portfolios, rather than dynamically combine an emerging markets strategy with a developed markets strategy. According to InterSec Research, managers with an MSCI All-Country World Index ex-United States (ACWI ex-US) mandate historically have been underweight the emerging markets allocation of their benchmark. Given their tendency to hold fewer emerging markets securities than in a stand alone emerging markets portfolio, these managers have accentuated the volatility of their emerging markets holding. Dedicated emerging markets managers have been more successful adding value, outperforming, on average, the emerging markets allocation of ACWI ex-US and EAFE Plus (developed international markets plus a maximum of 15% in emerging markets) managers' returns. Since inception April 30, 2007 through March 31, 2010, the performance of the Causeway Emerging Markets Equity Composite has been strong, and in excess of most dedicated emerging markets managers.

Q: Why use a tactical approach rather than a fixed allocation to emerging versus developed weights?

HH: If the world were static, that would be an ideal method. However, risk factors change, and we must ensure that our allocation reflects our tested criteria. A dynamic allocation model allows us to take greater advantage of

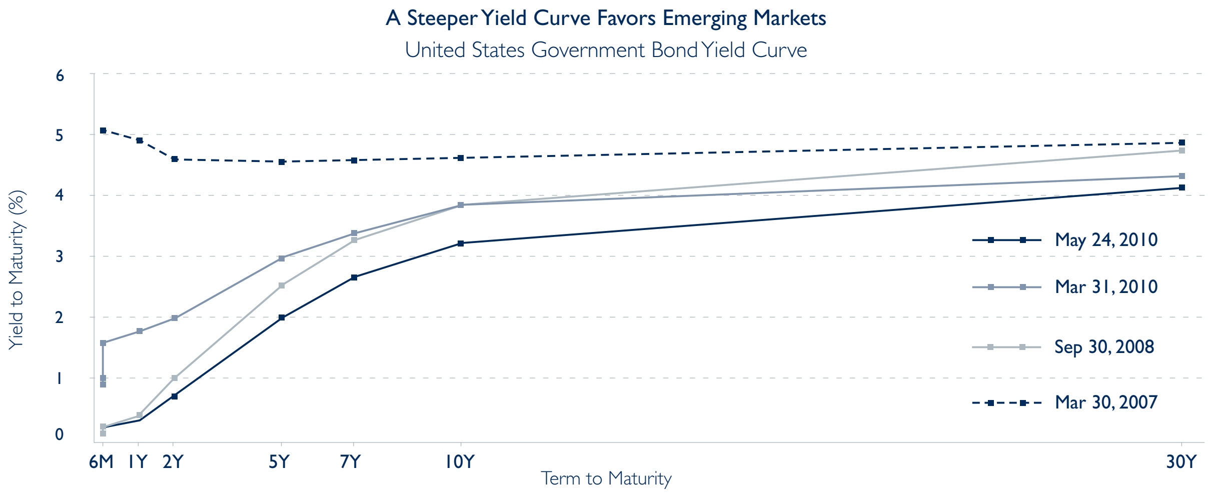
Investor Risk Aversion Typically Precedes Emerging Markets Outperformance

Emerging Markets Bond Index Global (EMBI):
Composite Blended Spread over Duration-Matched US Treasury Spot Yield



Source: JP Morgan, Global Insights

Run For Cover – or Bring it On? continued



Source: U.S. Department of the Treasury

emerging markets opportunities, or scale back our exposure when emerging markets appear overvalued and high risk.

Q: What exactly is in Causeway's quantitative allocation model?

DK: We build the model and we maintain it, keeping full control over the mechanics and its efficacy through a multitude of iterations, using historical data. We identified five primary factors as most indicative of the ideal allocation target. The five factors are:

- Macroeconomic
- Risk Aversion
- Earnings Growth
- Valuation
- Financial Strength

This week, for example, our allocation model recommended another 50 basis point increase in the allocation to our emerging markets portfolio. One of the most important components of the macroeconomic factor is the slope of the US yield curve (a steeper yield curve indicates looser monetary conditions and typically a favorable environment for higher-risk equities). The risk aversion factor and its constituents have also turned in favor of emerging markets from readings in the prior week. Both the emerging markets bond yield spread over US Treasuries as well as the VIX (or volatility) index indicate that investors have recently become more risk averse. In our analysis of historical investor behavior, rising risk aversion often precedes outperformance from emerging markets. Not all the factors are presently tipped in favor of emerging markets. Most importantly, the earnings growth factor currently suggests more upward earnings revisions in developed markets, albeit by a slim margin. With lowered expectations of global growth, research analysts may have tempered earnings estimates for emerging markets stocks in the near term, although we are convinced that those companies still have a growth advantage over their developed markets peers in the longer term.

Q: Under what conditions does your model perform best? What are the greatest challenges to the allocation model?

AJ: The model performs best in "normal" market conditions where volatility and liquidity are not at 20-year extremes, and where valuation and earnings growth are important drivers of stock prices. When these conditions do not apply, as was the case in late 2008, it can pose a challenge for the allocation model because it means that factors outside the model, often irrational, are driving asset prices. Investors became overly risk averse in 2008, and wanted to minimize their exposure to risky assets such as emerging markets, regardless of the fundamentals. This was an environment that was unprecedented during our back-test period, which ran from 1995-2006. In practice, aside from 2008, the model has performed well for our clients.

Q: How often do portfolio managers implement the allocation model's recommendations?

HH: Each week, all seven of Causeway's portfolio managers meet to review the allocation model and discuss both the macroeconomic environment as well as information gleaned from company management about business activity in all regions. In addition to discussing risk factors and individual security weights across each strategy, our quantitative portfolio managers review the current allocation model recommendations. In general, equity markets tend to move in concert over short time frames. However, over a more intermediate (several months) to long-term time frame (years), markets can behave quite differently. It is these more pronounced changes that we seek to exploit. As a result, Causeway's portfolio managers are more likely to implement changes over several weeks rather than each week.

Q: What is your weighting recommendation for Causeway's emerging markets allocation versus your

Run For Cover – or Bring it On? continued

developed portfolio currently, and how has that changed over time?

DK: Our emerging markets portfolio currently comprises about 23% of the total value of our clients' International Opportunities portfolios. We are currently marginally overweight emerging markets relative to the ACWI ex-US benchmark, mainly because the US yield curve is steep and liquidity is plentiful. Our allocation decreased from its peak in 2009, as we were overweight for most of the year given that our yield curve, risk aversion, and earnings growth factors pointed towards emerging markets outperformance. This is in contrast to the underweight position that we held in 2008, when, given the unusual circumstances in global financial markets, we decided to override the model's preference for emerging markets. Since inception of the International Opportunities strategy, we have navigated some extraordinary markets and delivered a small positive overall allocation effect for our clients, including positive contributions in calendar years 2008 and 2009, and year-to-date 2010. Over a full market cycle, we seek to provide up to 50 basis points of annualized performance above a passive combination of our underlying strategies—this is the level of incremental alpha (excess return) reflected in our back-test and simulation work.

> "In an environment of historically high volatility, we believe that agility makes us an attractive choice for clients seeking managers to invest and allocate assets to equities across all regions globally."

Q: What sort of alpha, beta (market sensitivity), and tracking error (difference between Index and portfolio volatility) does your International Opportunities strategy target?

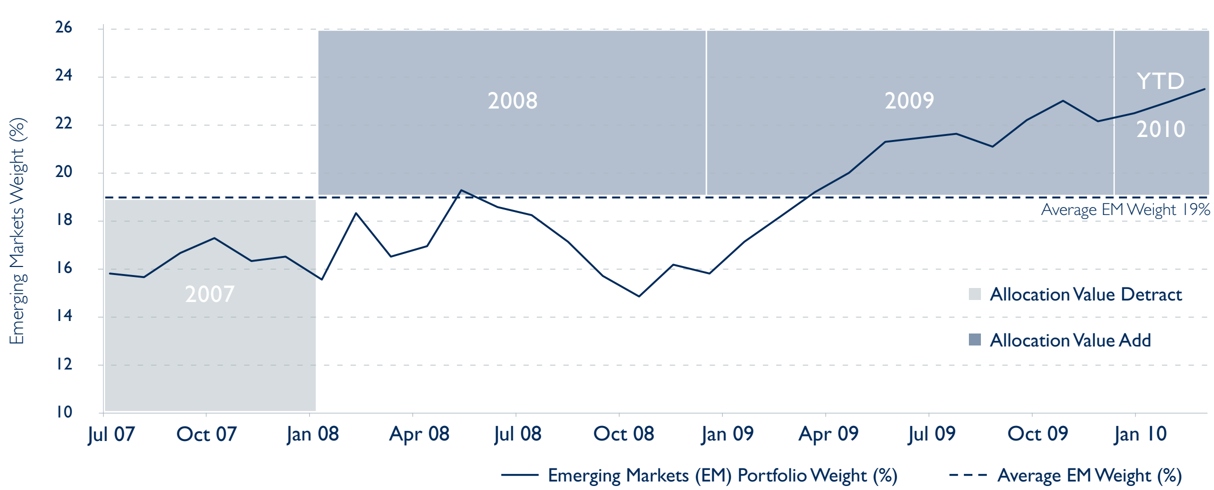
AJ: While we can't guarantee performance, the International Opportunities strategy targets an alpha of 3-5% per annum. The strategy does not target a specific beta, but we do monitor the expected beta of the portfolio to make sure it does not stray too far from market (i.e., 1). We are willing to add beta to our fundamental developed portfolio if we experience market selling such that upside risk dominates downside risk. The emerging markets portion of the portfolio has a tracking error target of 5%, while the developed markets portion targets volatility to be lower than benchmark volatility. Since inception of our International Opportunities composite on June 30, 2007, the strategy has produced a tracking error of just over 4%.

Q: Causeway has made its ACWI ex-US strategy, International Opportunities, available to mutual fund investors. Do you plan on launching any additional strategies?

HH: We are working on a Global Opportunities strategy that would invest in developed markets, including the US, and emerging markets. We believe the Global Opportunities strategy will offer investors a blend of our best skill sets. For investing in the developed world, this means intensive fundamental research implemented using a disciplined value approach. For investing in the emerging world, this translates to a quantitative strategy tailored to the unique growth, momentum, and risk characteristics of developing markets. With access to timely data, we use quantitative analysis that is designed to gauge the relative attractiveness of developed versus emerging markets and assist the portfolio management team to make the appropriate allocation decision. Our team can move quickly, if needed, to rebalance weightings. In an environment of historically high volatility, we believe that agility makes us an attractive choice for clients seeking managers to invest and allocate assets to equities across all regions globally.

Causeway's Allocation Has Added Value

Causeway International Opportunities Emerging Markets Allocation



Source: Causeway Analytics

Important Disclosures

The market commentary expresses the portfolio managers' views as of 5/28/10 and should not be relied on as research or investment advice regarding any stock. These views and portfolio holdings and characteristics are subject to change. There is no guarantee that any forecasts made will come to pass. Any portfolio securities identified and described do not represent all of the securities purchased, sold, or recommended for client accounts. The reader should not assume that an investment in the securities identified was or will be profitable.