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Sent: Wednesday, September 17, 2008 11:57 AM
To: Stephanie Lord
Subject: Latest developments in the financial markets

In our continuing efforts to keep clients informed about the latest developments in the financial markets, we would like to share with you our thoughts on the financial landscape. We intend to send additional commentary as the strains of the markets continue over the coming days and weeks.

Please let us know if you have any questions.

(See attached file: Current Thoughts on the Financial Landscape.pdf)

Regards,
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MESSAGE TO CLIENTS

September 15, 2008, 1:00 p.m.

What is Loomis Sayles' exposure to Lehman Brothers?

The market value of Loomis Sayles' debt and preferred stock holdings in Lehman Brothers totaled less than 1.00% of our total fixed income assets under management. The allocation in each portfolio is dependent upon specific strategy and client guidelines.

What is the background on the current turmoil?

Initially, Lehman appeared to be weathering the credit crunch relatively well. They had not taken the sizeable write-downs against collateralized debt obligations (CDOs), subprime-related assets or leveraged loans that Morgan Stanley, Merrill Lynch and Bear Stearns were forced to take.

As 2008 wore on and the housing crisis deepened, Lehman began to suffer losses due to its significant exposure to US commercial and residential real estate. Despite repeated assurances by Lehman that they were de-leveraging their balance sheet and had sufficient capital, investors grew increasingly wary.

Fears came to a head last week when talks between Lehman and Korea Development Bank fell apart and the firm released a disappointing third-quarter earnings pre-announcement. Lehman laid out various plans to strengthen its position, including spinning off or selling assets and cutting the dividend; however, investors feared the firm would not be able to execute those ambitious plans quickly enough, and the stock price plunged.

Why did Loomis Sayles own Lehman Brothers debt?

Our view, based on our internal research effort, was that Lehman had sufficient liquidity and capital to survive the credit crunch. We recognized they had greater exposure to real-estate related assets than their competitors; however, we believed that exposure was diversified by both geography and product type. Lehman bonds offered significant yield advantage to their peers, sufficient in our view to compensate for the risks implied by this greater exposure to the housing downturn. After the fall of Bear Stearns, the Federal Reserve created new borrowing facilities to prop up liquidity at investment banks. Thus, if Lehman did need liquidity, the Fed stood ready to supply it. We believed valuations on Lehman's bonds would be among the most volatile this year, given their exposures, but we believed Lehman would be a survivor.

What changed to push Lehman into bankruptcy?

Financial firms can not survive when there is a significant loss of investor confidence. Following Lehman's announcement of strategic initiatives in the third quarter earnings release, investors worried that the firm had not moved quickly enough to clean up its balance sheet. This was particularly worrisome in the current environment, where the rating agencies appear to be taking a more aggressive stance in lowering ratings at a faster pace. If the rating agencies downgraded Lehman, its funding costs would rise, it would need to post additional collateral against borrowings, and it would lose its ability to act as counterparty in many financial transactions. Investors worried that Lehman had not acted quickly enough in raising capital, despite assurances from the firm that it had.

The Fed, the Treasury and the SEC held emergency meetings all weekend with leaders of some of the country's largest financial institutions. Speculation was rampant about various deals to buy all or

parts of Lehman. Ultimately, the government was unwilling to back stop any deal, and potential buyers feared that buying any part of Lehman's mortgage assets could cause them losses. Without government aid, buyers refused to step in.

Where do we stand today?

One of the biggest concerns in letting Lehman fail is the ripple that the firm's global reach and significant credit default swap (CDS) exposures may cause. Attempts to mitigate problems included an emergency trading session yesterday, where traders were encouraged to assess their exposure to Lehman and re-adjust positions as possible.

Going into the trading day on Monday, there remain significant unknowns as to how investors will react to the failure of Lehman, given the complex, intertwined nature of global markets. One factor helping to calm traders is that Bank of America has announced its intention to purchase Merrill Lynch. A big fear over the weekend was that Merrill would be the next to fall, in a cascade of financial failures. By putting Merrill on sound footing, there is hope that markets will settle down and focus more on fundamentals and less on fears. As part of our strategy to invest in financials, we also owned Merrill Lynch bonds. With the announcement that Merrill would be bought by a higher rated firm, valuations improved. Gains on our Merrill Lynch holdings partially offset the losses on our Lehman holdings.

There is not a large volume of trading today (9/15/08) and most quotes are just that— quotes. It's a fluid situation, and we will be assessing valuations and liquidity in determining how to best position portfolios ahead.

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CURRENT THOUGHTS ON THE FINANCIAL LANDSCAPE

September 16, 2008

The financial landscape is shifting with developments occurring at remarkable speed. It will take time to properly digest exactly what has changed as further events unfold. Today we want to present our current thoughts on the economy and the fixed income markets, with the expectation that in coming days we will communicate additional insight as our teams work together to refine their investment strategies.

The Economy

Our economist believes growth will be very weak over the next two quarters, but could gradually rebound in 2009 if the worst of the housing bust moves behind us. The government's takeover of Fannie Mae and Freddie Mac should boost the availability of mortgage credit and reduce its cost, which could lead to improved demand for housing. This won't happen quickly, but perhaps it's a glimmer of hope for the spring selling season. This is critical as anything that might reduce the price declines in housing can help reduce the risk of further damage to financial institutions and the broader economy.

However, recent events raise the risk of weaker economic growth. As financial institutions scramble to preserve their capital, credit availability (particularly outside of mortgages) can become scarcer. The Fed and Treasury are providing various lending facilities to help maintain liquidity, and the banks themselves have created a \$70 billion fund to help those banks who need it. But these measures are life preservers in a storm; you still need to get out of stormy waters and back on dry land. Until bank balance sheets are stronger, lending conditions will likely remain a concern for investors.

The Market

The weekend's events seemed to shock even veteran observers, judging by the interviews on CNBC and the observations of our own staff, many of whom have lived through difficult markets before. We are operating in an environment where a 158-year old firm can go from adequately capitalized to bankruptcy court in the span of five days. The rating agencies appear to be taking a more aggressive view toward downgrading credits, a factor exacerbating the situation.

With the demise of Lehman Brothers and the sale of Merrill Lynch to Bank of America, we are now down to just two independent dealers. Market liquidity was poor before this weekend; it just got a whole lot more challenging. Trading is more difficult, and probably more expensive, as bid/ask spreads are likely to remain wider than normal.

Risk appetites have diminished, as evidenced by the gains in US Treasuries. Many investors are leery that there may be more shoes to drop, and are either heading to relative safe havens or keeping their cash on the sidelines. Longer-term this can be a positive for the spread sectors when these funds are redeployed. However, at the moment, it is a drag on valuations.

We had been cautious regarding issue selection in high yield, expecting default rates to modestly rise. With potentially tighter credit conditions and a less friendly market environment, there is a potential for defaults to rise further than previously thought. Our strategy had been to focus on those credits with minimal refinancing risk over the next 12-18 months. We believe this strategy is more important now.

We had been optimistic on investment grade credit and financials in particular, believing the sector to be generally oversold (though clearly specific credits deserved their wide spreads). With recent events, it's necessary to reassess the financial landscape. Short-term, we expect to see further pain as the excesses of the housing boom works through the system. Longer-term, the structure of the financial world remains unclear. To survive, financial institutions need confidence and capital, something more easily achieved by the larger commercial banks due to their size, diversity, and the strength of their depositor base. We are looking at the sector with a new lens today. It's clear that we have a spectrum of banks, from the strongest institutions to those hampered by toxic assets, to every one in-between. Our credit analysts and securitized asset analysts continue to partner with our portfolio managers and traders to affirm or alter our investment strategies in the sector.

Illiquid markets, diminishing risk appetites, generational shifts in the financial sector and rising defaults add up to an unsettling investment environment. The easy answer is to retreat, lick your wounds, and wait for the air to clear. However, it is just these types of markets that can produce some of the best values for those investors willing and able to take advantage of them. "Willing" means having the time and patience to ride out what will likely continue to be a challenging environment. There are further losses ahead for financial institutions and others, and the economy is at a critical juncture. "Able" means having the liquidity to step in and buy, but only after doing your homework. We are closely watching the markets, judging opportunities and assessing valuations. No one can predict with certainty when the markets will hit bottom, but we can identify and purchase good investment opportunities when they present themselves. While we need to be cautious about buying credits too early, our job is to identify survivors and build positions to seek to capture the upside when the market turns. We expect to be very busy in the coming days.

AMERICAN INTERNATIONAL GROUP (AIG): A MESSAGE TO CLIENTS

September 17, 2008

What happened to AIG this week?

AIG is the one of the largest insurance companies in the world. Its subsidiaries are involved in life, property, casualty and reinsurance in the US and Asia. The company has several wholly-owned subsidiaries that operate in the finance industry. Additionally, it provides financial guarantees (credit default swaps or CDS) used in structured finance products. While their insurance and financial subsidiary operations are healthy, they have experienced large losses from the financial guarantee business. Due to rising concerns about those contracts, this week the rating agencies downgraded AIG from low AA to low A. This action resulted in large increases in collateral requirements associated with the financial guarantee business. The fear of rising collateral calls pushed the stock price down 90% over the past five weeks, making it difficult for AIG to raise capital quickly enough to meet the rating agencies' concerns. AIG tried in vain to secure a loan from several sources. With its back against the wall, it went to the government seeking support.

What did the government do?

The US federal government seized control of AIG, replacing its senior management. The government will loan AIG up to \$85 billion over the next two years, at a rate of LIBOR plus 8.5%. Further, the government will have a majority stake in AIG (79.9% of equity). This loan is secured by AIG's assets, providing some protection to taxpayers, in the event that the company is not able to pay the government back. This is not cheap money. At a high price, the government is giving AIG time to unwind.

Why did the government step in?

The government takeover was orchestrated for the same reason they helped facilitate the purchase of Bear Stearns, but this time on a significantly larger scale. AIG is an enormous company, deeply entrenched in the global financial system. It was feared that a bankruptcy by AIG would set off a domino reaction of financial institution failures. The primary concern related to its huge book of business in CDS. Those financial institutions that had exposure to the CDS would likely face significant write-downs or losses. Other possible concerns related to the broad universe of investors who owned various debt instruments of AIG and its subsidiaries. Those investors included banks, mutual funds, and more importantly perhaps, money market funds. Just yesterday a large money market fund reported that its NAV had fallen below \$1 due to losses from holding Lehman securities. The fallout from the collapse of the much larger AIG could lead to losses in other money market funds, a huge event for a sector designed to be a safe haven. Other concerns associated with the possibility of an AIG bankruptcy focused on its core insurance business, and the risk that regulators would have to step in and take it over. While policyholders would likely remain whole, the turmoil would be unprecedented.

How does this impact AIG?

The company now has time for an orderly unwind of its CDS business and time to sell off assets. It is a tough environment to sell assets, but we believe they are likely to receive better prices than they would have in a bankruptcy-induced fire sale. Those asset sales are expected to include their insurance subsidiaries (both life and P&C), American General Finance Co, International Lease Finance Corp

(ILFC) and other global assets. AIG, the holding company, will use the proceeds from those sales to pay off its obligations, including the loan from the government and their obligations under the CDS contracts.

How might this impact AIG securities?

Bondholders initially reacted positively to the news. However, because of the many uncertainties, trading is illiquid and quotes are volatile. We have instruments in AIG debt that include a small exposure to the holding company (AIG). Our primary exposure is to two of AIG's subsidiaries, American General Finance and ILFC. Importantly, all three of these entities continue to carry investment grade ratings; AIG carries a rating of A-, American General Finance is BBB and ILFC is A-.

For the debt at the holding company level, the outlook is uncertain at this time. We expect that proceeds from the sale of the subsidiaries will be used by the holding company to help pay off their obligations over time. For the subsidiaries (including those we own) we think the most likely scenario is that the debt will move along with the companies to their acquirers. Thus, the future value of that debt depends on the credit quality of the acquirer. For this business model to work, the subsidiaries need to be bought by an investment grade firm. We think this is the most likely scenario, which would have positive implications for our holdings.

This market outlook is for informational purposes only and it should not be construed as investment advice. We believe the information presented is reliable, but we cannot guarantee its accuracy. There can be no assurance that developments will transpire as stated. Opinions expressed reflect subjective judgments and will evolve as future events unfold.