Investment MATTERS

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A changing U.S. market landscape:

The new "re"-ality

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The global financial meltdown slowed economic progress, generated massive corporate and employment losses and changed people's lives. It reoriented the structural dynamics of how companies make decisions and investments. Nonetheless, the U.S. economy has stabilized and corporate profits are expanding quickly from post-downturn lows. After a substantial rally, the stock market is no longer "cheap" and that has encouraged us to consider what might make good investments in the U.S. market going forward. In general, we expect the best investments to be in companies which best prepare themselves for relatively slow growth and for some headwinds following the initial stages of the economic recovery.

As investment managers at Aberdeen, we meet the management teams of hundreds of companies from every sector of the U.S. economy each year. Many of those managers see the downturn as the most meaningful catalyst for corporate productivity improvement since the 1990s technology revolution. It forced them to reduce exposure to marginal projects and cut costs to operate and thrive with less revenue than they enjoyed during the cyclical peak years of 2006 and 2007. Many companies have taken the re-engineering much further and have sought ways to leverage the already-robust structural benefits of solid infrastructure, a well-educated labor force and strong rule of law that historically made the U.S. an economic powerhouse.

> Solid investments in the U.S. seem to fall into two distinct themes: The consistent leaders, and those which fit the "re" theme–re-engineering, restructuring and reducing–for what will come next.

Clearly, the case for optimism isn't based on hope for a remarkably rapid economic recovery. After all, U.S. unemployment recently surpassed 10% and will likely remain at high levels through 2010. Income growth has stalled and, we believe, may not exceed 3% in 2010, and top-line revenue growth for most companies will not get closer to 2007 levels for at least a few years. In our view, it looks and feels like a long and difficult battle to reach real economic growth. Wildly high federal deficits have weighed on the value of the U.S. dollar, and most consumers and businessmen are preparing for higher taxes, which will be needed to fund the federal deficit in the future.

Prospecting for solid companies and growth opportunities in the U.S. could be a very difficult task given the obstacles noted and, of course, the very strong recent rally which has made stocks "less cheap" than they were in the depths of the financial crisis in March 2009. Therefore, solid investments in the U.S. seem to fall into two distinct themes: The consistent leaders, companies which have maintained an element of global superiority in their respective industries and where company behavior isn't materially affected by the economic slowdown; and those which fit the "re" theme–re-engineering, restructuring and reducing–for what will come next.

American companies are among the consistent leaders in global business

Consistent leaders have scalable business models–that is, they are able to maintain and improve their levels of performance during an increase in their business without making significant fixed-cost investments–and company-specific drivers of success,

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and have shown the ability to perform fundamentally throughout entire business cycles. Many U.S. companies fit this bill, including several notable technological innovators as well as other companies in the biotechnology, medical devices, and software engineering industries. These companies have a technological product advantage over their peers, and therefore have the benefit of running better and more predictable businesses, the flexibility to invest when others are retrenching, and the ability to attract top-tier employee talent.

In addition, excellent management teams of many consumer staples producers and diversified industrial companies provide consistent leadership status to their organizations, making them the companies which find it easiest to improve while others panic, and for which these improvements are most apt to create significant changes in company operations.

Re-engineering, restructuring and reducing are keys to corporate profitability

We believe that some non-financial U.S. companies may see increases in operating margins over the next couple of years as a result of their re-engineering efforts. Since nearly everyone recognized the barriers to robust revenue growth, companies took unprecedented steps through the spring and summer of 2009 to reduce capacity and employee headcount. The significant reduction in U.S. manufacturing employment probably will never be regained as many of the jobs will be exported to offshore contract manufacturers which have lower costs, or they will just be eliminated as part of the cost of efficiency improvement. Additionally, there have been many plant closures which are likely to be permanent, reducing excess capacity in many industries, including automobile manufacturing, where we feel that production rates should run below 75% of their recent peaks for several years.

Our company meetings provide tremendous insights into the economy as a whole and give us confidence that, although opinions remain sharply divided about the shape of the economic recovery, most companies have already restructured in anticipation of slow growth. Whether those management teams believe in a "V-shaped" rebound, as the stock market predicts, or an "L-shaped" period of very slow and choppy growth, most of them have devised a plan for achieving profit margin stability at the slow end and for passing along operating leverage with any acceleration in growth. In short, our discussions with company managers suggest to us that the reactionary phase of the restructuring is past.

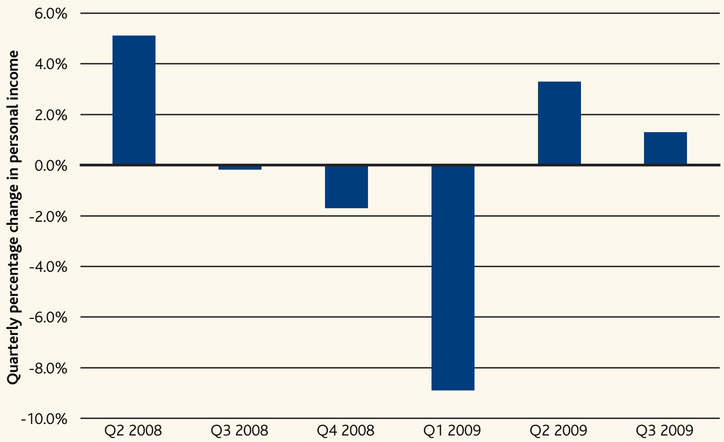
While these meetings have enhanced our confidence about earnings growth in the near future, we are still searching for evidence that revenues will accelerate as fast as current consensus thinking believes. Our quest for investments continues as we seek the proper fit of companies offering robust and differentiated business models–the consistent leaders–and those which took the opportunity to improve their companies' financial positions throughout the course of the downturn.

Important information

Will higher incomes lead to "hire" expectations?

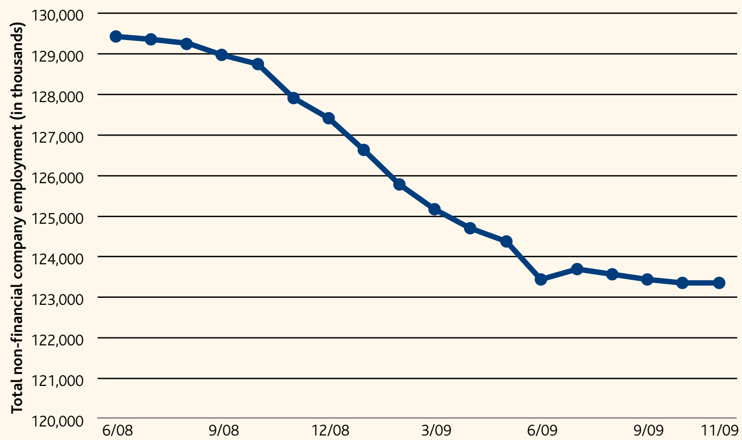
A substantial portion of the potential for operating margin improvement in 2010 is a result of the sharp reduction in employment and personal income seen since mid-2008. Historically, employment has lagged a recovery in corporate earnings and GDP growth, and we feel that personal income may begin rising before employers make the much larger commitment of adding new hires.

Change in U.S. Personal Income
Q2 2008 to Q3 2009



Source: U.S. Department of Commerce, Bureau of Economic Analysis, November 2009.

Total Employment in Non-financial U.S. Companies
June 2008 to November 2009



Source: U.S. Department of Labor, Bureau of Labor Statistics, December 2009.