ValueInvestor INSIGHT

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The Leading Authority on Value Investing

The Strong Get Stronger

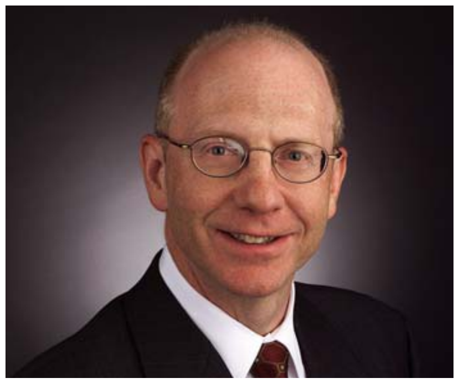
Finding unappreciated value in large-cap companies is only half the battle, says Jerry Senser, who's also proven adept at identifying the keys to unlock it.

Since joining Chicago's Institutional Capital as an economic analyst in 1986, Jerry Senser spent time on each of the firm's 14 industry research teams before being named CEO and CIO in 2007. "We've always valued the broader over the narrower view," he says.

Investors have been pleased with ICAP's approach. The firm now manages $15.5 billion, while its flagship mutual fund, the MainStay ICAP Select Equity Fund, has earned a net annualized 6.8% since its 1997 inception, vs. 2.7% for the S&P 500.

Concluding that the economic environment will favor "the strong getting stronger," Senser sees opportunity today in leading players in such areas as energy, pharmaceuticals, investment banking and diversified industrials. See page 2

INVESTOR INSIGHT



Jerry Senser
Institutional Capital LLC

Investment Focus: Seeks undervalued companies with at least one of five specific catalysts in place to bring that overlooked value out over the next 12 to 18 months.

Macro to Micro

Having spent the first 10 years of his career as an economic (rather than investment) analyst, Jerry Senser has always considered many investors' aversion to macroeconomics to be rather misguided. "Having a perspective on the economy doesn't in all cases add value to the investment analytical process," he says, "but if the past two years have taught us anything, that perspective can at times be extremely valuable. So many value investors in 2008 got trapped in stocks that appeared cheap but only got cheaper and cheaper – which was because the overall economic environment had dramatically changed."

What top-down advice might Senser offer today? "We do believe the global economy is moving into an expansionary phase, in all major regions of the world. The strongest growth will be in Asia, followed by Latin America, the United States, and then Europe clearly lagging behind. One basic insight from that is if you're looking for growth, you should be focused more on economies or companies tied to Asia. At the same time, you might want to be a bit more skeptical in formulating expectations for businesses focused on the U.S. or Europe."

Investor Insight: Jerry Senser

Jerry Senser of Chicago's Institutional Capital LLC describes the five catalysts that often accompany inefficiencies in large-cap stocks, the key triggers that can signal when it's time to sell, where he's investing in his own business, and what he thinks the market is missing in ConocoPhillips, Textron, Sanofi-Aventis and Credit Suisse.

ICAP manages some $15 billion in assets, equities only. How do you define your investment universe?

Jerry Senser: Our universe is roughly 900 companies worldwide with current market caps above $2 billion. As a first step in narrowing that down, our analysts determine what we consider to be the sustainable, through-the-cycle earnings power of the individual companies, and then also estimate the normalized multiple – relative to the current market multiple – at which the shares should trade. Using the resulting target prices, we screen out whatever doesn't have at least 15% potential upside from today's price.

The next step is to screen out companies for which consensus earnings estimates have recently declined. Here we're trying to avoid the trap of buying a cheap stock and watching it get cheaper and cheaper as the fundamentals erode. We've found historically that the combination of good valuation and stable to rising earnings expectations produces an attractive set of stocks to look at in more detail.

After those first two steps, we generally end up with a subset of stocks that's about 20% of our overall universe – a good point from which the analysts can do further old-fashioned stock research.

On what is your old-fashioned stock research focused?

JS: The focus is primarily on finding specific investment catalysts that can move stocks toward their warranted target prices over the next 12 to 18 months. We've identified five primary catalysts – management, restructuring, problem-fixing, new products, and pricing flexibility – that we believe can consistently take advantage of pockets of inefficiency in the market. Larger-cap stocks are usually priced relatively efficiently, but we've found this focus on catalysts helps us identify when they aren't.

Elaborate on the five catalysts and the inefficiencies that can accompany them.

JS: Management at even the largest companies can obviously make a significant difference in how well a company performs. We spend a lot of time trying to understand both new and existing top managers' track records, strategies, operating capabilities and motivations. As important as that is, we find investors can often be slow to recognize the potential for management to make things better.

One long-standing holding of ours is Hewlett-Packard [HP], which we initially bought when Mark Hurd became CEO. This is an example of how strong management can remain a catalyst for a long period of time. He initially focused on attacking H-P's bloated cost structure, but in recent years has also made what we feel have been the right strategic investments in expansion. Good management creates its own opportunities, and as long as the market isn't adequately recognizing that, we're happy to go along for the ride.

With respect to restructurings, we find that companies going through operating or financial change can also go into a bit of an information vacuum, which can provide a good entry point into a position. There's often uncertainty about the specific programs being instituted, management may be less apt to provide guidance and, because the change is ongoing, the results are by definition unclear.

Wells Fargo [WFC] is an example in our portfolio with both management and restructuring catalysts. Management tends to be remarkably stable and has a long history of generating better-than-expected returns and growth. At the same time, we believe the Wachovia acquisition significantly enhances Wells Fargo's ultimate earnings power. This certainly won't happen all at once, but if you apply to the legacy Wachovia bank branches the same cross-selling ratios of products and services that Wells' branches produce, that would increase the branch network's revenue by 25%. The synergies go the other way as well: the former Wachovia Securities, now Wells Fargo Securities, is the third-largest retail brokerage in the U.S., and there are certainly opportunities for selling brokerage products to Wells' bank customer base.

There are clearly concerns in the market about Wells' exposure to regulatory change underway in Washington and about the ultimate health of Wachovia's legacy loan book. In both cases, we're comfortable that we've conservatively built those risks into our normalized earnings estimates, and we still consider the upside in the stock to be substantial.

Are you finding plenty of "problem-fixing" catalysts out there today?

JS: Even good companies run into problems, and the combination of Wall Street's herd mentality and its ever-shorter time horizon can result in stocks selling off due to problems that will ultimately prove to be temporary. People have the attitude that if a problem isn't going to be fixed in less than a quarter, they'll go away and come back later. That often creates opportunities in individual companies.

We'll speak in more detail about it later, but Textron [TXT] is a company we own that has been working through significant problems at its finance unit, which prior to the financial crisis had started lending in a variety of asset classes – like timeshares and golf courses – that were well beyond the financing of its own products. While that nearly brought the company down, our feeling when we first bought the stock in August of last year was that a very strong management team was taking the right steps with the finance business and the worst was behind it. If you're early enough in making those calls – and, of course, they turn out to be right – there's usually a nice return to be made in a given stock.

Digressing for a moment, how early do you try to be in making such calls?

JS: You have to be reasonably early and we of course love to get in at the absolute bottom, but so long as our valuation work indicates enough upside and we're confident in management's ability to execute, we'll initiate a position even after a restructuring is well underway or a problem is already on its way to being fixed.

Describe the two remaining catalysts you seek, new products and pricing flexibility.

JS: The new-product catalyst is relatively straightforward: from time to time we find companies with growth prospects for new products or services that we think the market is underappreciating or doesn't understand. If the valuation based on our more-optimistic earnings estimates is compelling, we're likely to be interested. PepsiCo [PEP] is a large holding of ours that falls in this category, both because of its strong new-product focus and the opportunity Frito-Lay, in particular, has to expand in emerging markets.

Pricing flexibility can be a strong driver of earnings, but the supply-demand dynamics that make it possible in an industry may not always be fully recognized by Wall Street. Most companies don't have a great deal of pricing flexibility in the current environment, so if it exists, in can be a huge benefit to margins and returns. The stock has done well lately, but Viacom [VIA-B] is an example for us, given the continued strong growth in affiliate fees we expect going forward for access to their cable networks such as MTV, Nickelodeon and Comedy Central.

You started your career as an economic analyst. Are any macroeconomic-based themes evident in your portfolio today?

JS: We believe there's a broad-based global economic recovery underway, but we expect the extent of the rebound to be sub-par, particularly in the western developed economies, reflecting high levels of public and private debt. Given that environment, one theme we've had in place for some time we call "the strong will get stronger." In a sluggish economy, revenue growth will likely require taking share, and the firms most capable of doing that are those with the market positions, cash flows and balance sheets to take advantage of the distress of their competitors.

Last year you saw low-quality stocks do somewhat better than high-quality ones, largely because they had fallen so much further in 2008. But we expect this strong-getting-stronger theme to remain in place in our portfolios for some time.

ON THEMES:

Given the environment, one theme we expect to remain in place for some time we call "the strong will get stronger."

How concentrated do your portfolios tend to be?

JS: We have a variety of products with differing concentration levels, based on client demand. Our Select Equity strategy usually has 25 to 30 names. Our flagship domestic institutional product has 40 to 50, and the comparable international strategy has 30 to 50.

That's quite concentrated given the amount of money you manage.

JS: Our basic feeling is that there are not an infinite number of really good ideas. In addition, we want to understand the stocks in the portfolio in great detail, which is just impossible if you own hundreds of names. We consider being 100% on top of everything we own from the time of purchase to the time of sale to be a central element of risk control.

Do you follow any rules on individual-position or sector exposure?

JS: Position sizes can diverge quite a bit, with the largest ones generally reflecting higher potential upside and greater confidence in the catalysts. In our flagship domestic and international products we do not hold individual positions over 5% and will not have more than 30% in any one sector. Historically, whether it was energy in the 1980s, technology in the late 1990s or financials more recently, when a single sector approaches 30% of our portfolio or of the market, that signals the end rather than the beginning of great investment performance.

Given your focus on catalysts, does your time horizon tend to be fairly short?

JS: We think it's difficult to have a reliable view of events beyond 12 to 18 months. Also, because we have a limited number of names in the portfolio, we want to make sure each one is making progress toward its catalyst or catalysts and adding to portfolio performance. If it's not, we're quite disciplined about selling.

We constantly evaluate the key investment-case elements for each of our holdings and prepare an exception report each week that flags any number of issues. These include when there are material changes in the remaining upside to our target price, when earnings estimates are revised downward, when questions have arisen about any existing catalysts, when new risks appear, or when the stock has been significantly underperforming. We usually have a limited number of reasons for owning a stock, so if any of those reasons change, we want to recognize that early and move on.

Give an example of something you sold recently and why.

JS: We've been lucky, at least in the recent past, that a lot of the names that have come out of the portfolio have primarily been a function of their approaching or hitting target prices and our moving on to better alternatives.

One name we sold earlier this year that was more than that was Capital One [COF]. The original thesis for the stock was that their relatively strong capital position would allow them to benefit disproportionately from an improvement in the economy and credit-market conditions. As that started to play out and the stock rebounded, we started to get concerned about how changes in the regulatory environment might prove to be more negative to credit-card issuers than we originally expected. Given that the discount to our target price had narrowed, the potential risks were high enough that we exited the position.

What's your typical annual turnover?

JS: It averages about 100%, which is consistent with our time horizon. That's not to say, however, that we won't hold on to something as long as the elements of the investment case remain intact, even if they're slow to develop.

One example of that would be Pfizer [PFE], whose stock hasn't been a ball of fire for us, but which is a restructuring situation we believe will pay off. We think the market underestimates the company's earnings power as the Wyeth acquisition is fully integrated and Pfizer continues to diversify away from dependence on U.S. blockbuster drugs and toward emerging markets and off-patent products. The latest worry appears to be about additional downward pressure on healthcare costs and difficulties in Europe, both of which we believe are more than discounted by the current stock price. The catalysts are still in place, so there's been no reason for us to adjust our position.

Describe the case for another restructuring idea, ConocoPhillips [COP].

JS: This is a stock we avoided subsequent to their buying Burlington Resources in late 2005, a deal that kicked off an ill-conceived and ill-timed global asset-gathering period for the company. We bought a new position in March and the story today is that management has changed its orientation and is now focused on improving returns on capital by reducing capital spending and selling low-return assets. The plan is to sell $10 billion in assets over the next two years as well as half their stake in Lukoil, which is worth $5 billion at current prices. That would raise $15 billion to pay down debt and to increase shareholder returns. The operating goal is to significantly increase the company's return on capital, to 13%.

Given the same management pursued a very different strategy until recently, we understand why the market has been skeptical about the restructuring. We were as well, but we now believe they're serious and have instituted an aggressive program, the success of which is not reflected in the stock price today.

Is there evidence the plan is on track?

JS: Yes. In separate announcements, the company said recently it wasn't proceeding with investments in the Yanbu refinery project in Saudi Arabia or the Shah natural-gas project in Abu Dhabi. In addition, they announced the sale of their 9% stake in oil-sands producer Syncrude

INVESTMENT SNAPSHOT

ConocoPhillips
(NYSE: COP)

Business: Based on market capitalization and volume of oil and gas reserves, third-largest U.S. integrated global energy company. Operates in more than 30 countries.

Share Information
(@6/29/10):

Price	**49.84**
52-Week Range	38.62 – 60.53
Dividend Yield	4.2%
Market Cap	$74.18 billion

Financials (TTM):

Revenue	$149.94 billion
Operating Profit Margin	6.9%
Net Profit Margin	4.1%

Valuation Metrics
(@6/29/10):

	COP	S&P 500
Trailing P/E	12.1	17.8
Forward P/E Est.	8.2	13.1

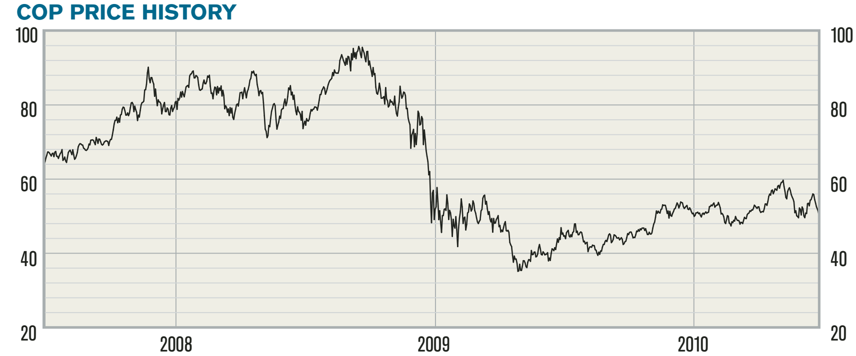
Largest Institutional Owners
(@3/31/10):

Company	% Owned
Capital Research Global Inv	4.9%
BlackRock	4.1%
State Street Corp	3.6%
Vanguard Group	3.4%
Berkshire Hathaway	2.3%

Short Interest (as of 6/15/10):

Shares Short/Float	1.0%

COP PRICE HISTORY



THE BOTTOM LINE

The market appears unconvinced that the company's broad-based restructuring efforts to lift its return on capital will be sustained, says Jerry Senser. If it reaches his 12% return-on-capital expectation, assuming $70-per-barrel oil, he arrives at a $70 target price for the shares – 10x his normalized earnings estimate of $7 per share.

Sources: Company reports, other publicly available information

Canada for about $4 billion after-tax, well above what people anticipated.

Do BP's problems in the Gulf impact the investment case for Conoco at all?

JS: We've thought a lot about that. If the deepwater drilling moratorium in the Gulf extends well beyond six months, it could begin to negatively impact global supply, which would put upward pressure on energy prices over time. More specifically to Conoco, it doesn't have much of its resource base in the deepwater Gulf, relying far more on onshore positions in Alaska and Canada. One could argue that those assets will be more valuable as production costs go up in the deepwater Gulf.

That said, we haven't built incrementally higher energy prices or asset values due to the Gulf situation into our valuation of Conoco. There's just too much uncertainty around that.

What upside do you see in Conoco shares, now trading at just under $50?

JS: Assuming $70-per-barrel oil, $7-per-Mcf natural gas and that the company can get its return on capital to about 12%, we arrive at a normalized earnings estimate of around $7 per share. At the 10x earnings multiple we consider reasonable, that gives us a target stock price of around $70. That's obviously sensitive to the price of oil, but we're comfortable that the $70 per-barrel price we're using for crude has at least as good a chance of turning out too low than too high.

What do you think the market is still missing about Textron?

JS: Textron is both a management and a problem-fixing story. The CEO, Scott Donnelly, joined the company as COO in mid-2008 from General Electric, where he had run the aviation business and had an excellent operating track record. He was named CEO in late 2009 and we think the team now in place – including the new CFO, Frank Connor, hired last August from Goldman Sachs – is the best it's ever been at the company, which will be key to driving a successful turnaround.

The company operates in four main businesses: Cessna aircraft, Bell helicopters, defense systems and an industrial business that is anchored by Kautex, an automotive supplier. Cessna and Bell each account for around 30% of normalized profits, with the other two businesses at roughly 20% each. All those businesses have been challenged by the downturn and the company has responded with a comprehensive operating overhaul. At Cessna, for example, they've cut the workforce by 50% and are working to reduce and reconfigure the manufacturing footprint. That's happening in all the businesses, partly due to reduced demand, but in many cases they're just making hard decisions that had been avoided in the past.

The result of all that should be significant improvements in operating costs and ultimately in margins as Textron's businesses – most of which have very strong market positions – recover. Some early evidence of that came in the first quarter, in which margins at the industrial division were nearly double what the market anticipated as the automotive business started to improve. That's an excellent example of the operating leverage we

INVESTMENT SNAPSHOT

Textron
(NYSE: TXT)

Business: Diversified aircraft, defense and industrial manufacturer, with key brands including Bell helicopters, Cessna aircraft and E-Z-GO golf carts.

Share Information
(@6/29/10):

Price	**16.80**
52-Week Range	8.51 – 25.30
Dividend Yield	0.4%
Market Cap	$4.59 billion

Financials (TTM):

Revenue	$10.18 billion
Operating Profit Margin	4.0%
Net Profit Margin	(-1.2%)

Valuation Metrics
(@6/29/10):

	TXT	S&P 500
Trailing P/E	n/a	17.8
Forward P/E Est.	32.9	13.1

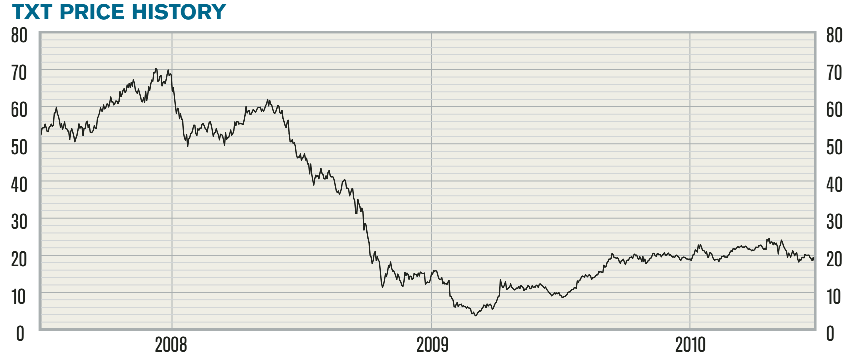
Largest Institutional Owners
(@3/31/10):

Company	% Owned
Fidelity Mgmt & Research	9.7%
Vanguard Group	4.6%
Wellington Mgmt	4.5%
Bank of NY Mellon	4.0%
T. Rowe Price	3.8%

Short Interest (as of 6/15/10):

Shares Short/Float	9.8%

TXT PRICE HISTORY



THE BOTTOM LINE

In making many hard operating decisions that had been avoided in the past, new company management is building into all parts of the business excellent operating leverage as the economy rebounds, says Jerry Senser. At 11-12x his normalized earnings estimate of $2.30 per share, his target price for the shares is around $27.

Sources: Company reports, other publicly available information

believe management is building into all parts of the business.

Is the finance division out of the woods?

JS: They have already liquidated about half the "non-captive" receivables from areas outside their own businesses, getting roughly 95 cents on the dollar for the sold receivables. That has improved their liquidity profile, and they've also reduced rollover risk by repurchasing near-term debt maturities and issuing longer-term ones. In April of this year they paid down $250 million of a bank credit line, which was a sign of financial strength. All in all, they've made significant progress on the finance front and we don't expect any big negative surprises going forward.

With the shares at a recent $16.80, how are you looking at valuation?

JS: Making what we believe are conservative assumptions about how far the various businesses can come back, we estimate normalized earnings at around $2.30 per share. At Cessna, for example, our normal earnings estimate assumes legacy jet deliveries come in at about 55% of 2008's peak level, while we assume operating margins of 10%, versus management's ultimate goal of around 15%. At the other businesses we assume margins that are closer to the company's goals, but still conservative.

Based on where Textron's shares and the shares of its peers typically trade, we're assuming a normal multiple of 11-12x earnings, which gives us upside in the stock to around $27.

Is the biggest risk the overall health of the economy?

JS: That's the primary one. Cessna's jet orders, for example, have been very weak as a result of the downturn. We have seen some improvement in the U.S. in things like business-jet usage and inventory levels, which might suggest we're closer to the bottom of the order cycle. The extent to which that is true will become clearer in the second half of the year.

There are also concerns about defense spending, which in general we expect to be under pressure for a number of years. Textron should not be overly sensitive to that, primarily because there seems to be strong strategic support for developing the military's helicopter capabilities. Bell appears particularly well-positioned in that context.

You mentioned Pfizer as a restructuring play. Is the story similar for Sanofi-Aventis [SNY]?

JS: In many respects, yes. As with many big pharmaceutical companies, Sanofi has key drugs – representing 20% of sales and about one-third of profits – going off-patent in the next couple of years. Our basic thesis is that management will be able to successfully reinvest the company's €9 billion in annual free cash flow (after capital spending) in non-pharma and new geographic markets to offset that. That's not priced into the shares today.

The CEO, Chris Viehbacher, took over in late 2008 after heading Glaxo's U.S. business, and he's restructuring the company in two fundamental ways. The first is in expanding in areas without traditional generic pressure. Sanofi is already strong in areas like vaccines,

INVESTMENT SNAPSHOT

Sanofi-Aventis
(NYSE ADR: SNY)

Business: Paris-based global pharmaceutical company with broad product portfolio of branded prescription drugs, vaccines and consumer healthcare products.

Share Information
(@6/29/10):

Price	**29.75**
52-Week Range	28.01 – 41.59
Dividend Yield	4.2%
Market Cap	$77.90 billion

Financials (TTM):

Revenue	$38.50 billion
Operating Profit Margin	24.1%
Net Profit Margin	17.4%

Valuation Metrics
(@6/29/10):

	SNY	S&P 500
Trailing P/E	11.6	17.8
Forward P/E Est.	6.8	13.1

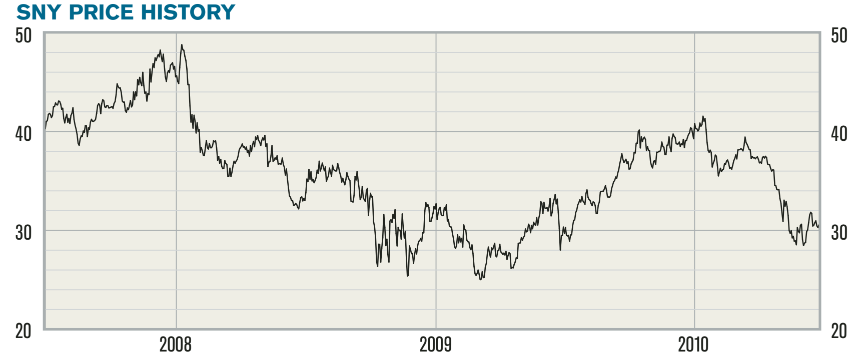
Largest Institutional Owners
(@3/31/10):

Company	% Owned
Dodge & Cox	1.3%
Institutional Capital	0.5%
NWQ Inv Mgmt	0.4%
Tradewinds Global Inv	0.3%
Brandes Inv Partners	0.3%

Short Interest (as of 6/15/10):

Shares Short/Float	n/a

SNY PRICE HISTORY



THE BOTTOM LINE

Jerry Senser believes management's plan for reducing the company's dependence on patent-protected "small-molecule" pharmaceuticals and on aggressively cutting costs will result in a more sustainable and more highly valued business mix. At 10x his $4-per-share estimate of normalized earnings, the shares would trade at $40.

Sources: Company reports, other publicly available information

consumer health and animal health, where product cycles can be longer and there's less reliance on patent protection. They have a disciplined acquisition strategy and have already made a variety of what we believe are smart deals. One example is the nearly $2 billion purchase of Chattem, which gives Sanofi a $500 million consumer healthcare business in the U.S. and provides them a platform to launch an over-the-counter version of the Allegra allergy drug, which could reach $400 to $500 million in annual sales. By 2013, we estimate that 75% of revenues will come from things other than small-molecule drugs, up from 50% today.

The second part of the restructuring is an aggressive cost-cutting program. They're killing previously sacred R&D projects. They're streamlining administrative and sales staffs, reducing the number of organizational layers within the company from 11 to 6. Overall, management's goal in restructuring the business mix and cutting costs is to keep earnings essentially flat between now and 2013.

Is your assessment of the company's drug pipeline important to the thesis?

JS: It's clearly part of the overall analysis process, but the reality is that this is not really a new-product story. Our finding the shares of a Sanofi or a Pfizer attractive has very little to do with our evaluations of potential blockbuster products. For better or worse, that's really not where most of the industry players are at this point.

How cheap do you consider Sanofi's ADR at a recent price of $29.75, close to its 52-week low?

JS: As I mentioned, the company should generate around €9 billion in annual free cash flow over the next couple of years. On a market capitalization of about €65 billion, that's a remarkably high free cash flow yield of 14%. The earnings multiple on our estimated normal earnings of around $4 per share is just over 7x.

If they successfully execute their program, they will dramatically change the company's business mix to one that is more sustainable and we'd argue should warrant a higher multiple. We believe 10x is reasonable, resulting in a target price of around $40 for the ADR. On top of that potential capital appreciation, we're getting a better than 4% dividend yield.

At today's price, the market seems to be assuming all the cash flow currently generated is going to be frittered away by management. We don't think that will at all be the case.

Turning to another European stalwart with issues, describe your interest in Credit Suisse [CS].

JS: Credit Suisse is one of the few global banks that didn't take any government capital or funding support in the crisis, and we think they've emerged from the crisis stronger today than they were going in. That's a testament to the quality of the management, led by Brady Dougan, who took over the investment banking division in 2004 and became CEO in mid-2007.

So it's a management story that also fits into our "strong get stronger" theme.

INVESTMENT SNAPSHOT

Credit Suisse
(NYSE ADR: CS)

Business: Global financial services holding company headquartered in Zurich, with primary operations in private banking, investment banking and asset management.

Share Information
(@6/29/10):

Price	**37.48**
52-Week Range	36.36 – 60.08
Dividend Yield	3.0%
Market Cap	$43.29 billion

Financials (TTM):

Revenue	$31.05 billion
Operating Profit Margin	29.0%
Net Profit Margin	20.0%

Valuation Metrics
(@6/29/10):

	CS	S&P 500
Trailing P/E	7.9	17.8
Forward P/E Est.	7.5	13.1

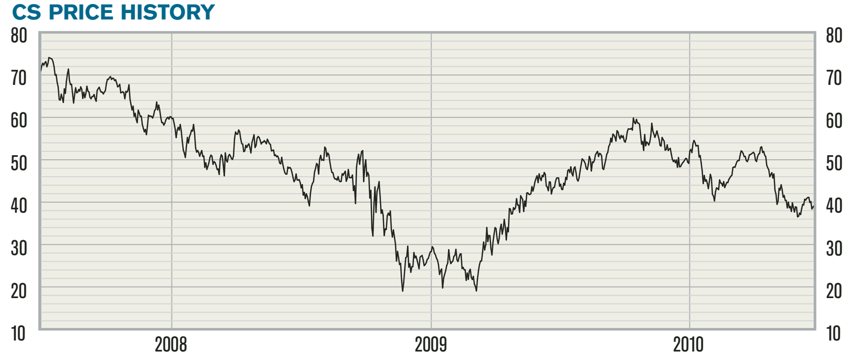
Largest Institutional Owners
(@3/31/10):

Company	% Owned
Fisher Inv	0.9%
AllianceBernstein	0.4%
Janus Capital	0.3%
Sound Shore Mgmt	0.3%
Dodge & Cox	0.3%

Short Interest (as of 6/15/10):

Shares Short/Float	n/a

CS PRICE HISTORY



THE BOTTOM LINE

European economic weakness and concern about the pace and scope of investment banking activity have weighed on the stock, says Jerry Senser, who expects the well-capitalized company to go from "strength to strength" as key competitors struggle. His target price for the firm's ADRs is around $60, more than 50% above today's level.

Sources: Company reports, other publicly available information

The company's basic business is roughly 60% investment banking and 40% private banking and asset management. Their strong capital position has allowed them to stay more focused on operations and they've taken share across business lines. They've particularly enhanced their positions in Asia, where long-term growth prospects are excellent. As damaged competitors continue to scale back, we see Credit Suisse likely going from strength to strength.

How are you viewing the regulatory risks, both of new financial regulations as well the continued breakdown of Swiss secrecy laws?

JS: One of the key things Brady Dougan started years ago at the investment bank was to deemphasize proprietary trading, so they're much better prepared than their competitors for any limits on that. I also come back again to the strong capital position, reflected in a total Tier 1 capital ratio of over 16%. To the extent new regulations require higher capital reserves, they're already well prepared for that and shouldn't need to raise additional capital.

In the wealth management business last year they did see some money flow out of Switzerland as the secrecy laws started being dismantled. Our view is that in the end the key issues are service and product capabilities, not secrecy. That's largely been borne out in the numbers. Net new money came into the wealth-management business at a 6.5% rate in the first quarter, so that total invested assets are now down only about 8% from the end of 2007. Despite the environment, they've done an excellent job retaining assets.

The stock has been quite weak so far this year. What upside do you see from the recent ADR price of around $37.50?

JS: The weakness in Europe and renewed concern about the pace and scope of investment banking and M&A revenues have certainly weighed on the stock, as it has with other investment banks. Our feeling is that the investment banking business will be fine, especially as restructuring activity picks up in the global economy, and that Credit Suisse will capture an increasing share of that activity. All in all, we estimate normal earnings at about $6 per share.

Assigning different relative multiples for the bank business and wealth/asset management, we put the current overall normal multiple at around 10x earnings. Our target ADR price is $60, more than 50% above the current price.

Speaking generally again, are there particular economic indicators to which you're paying primary attention in handicapping the U.S. economy's prospects?

JS: This isn't particularly unique to us, but clearly the level of initial unemployment claims is a leading indicator of U.S. employment trends, which will need to improve if consumer spending is going to help the economy rebound. I'm also watching closely what happens to gasoline prices, given that energy prices have a big impact on people's real income and thus their discretionary spending.

The business side of the economy right now looks pretty good, whether reflected in increased capital spending or still-low inventory levels. But any reasonably paced expansion won't happen without some positive news on the consumer-spending front.

Have the past two years caused you to rethink any aspects of your investment process?

JS: We still very much believe our process is a competitive advantage, and nothing in recent times has changed that. In terms of where we're investing in our business, I would say that our global perspective and capabilities are going to expand. We have always thought you can't invest in the large-cap arena without analyzing industries on a global basis, but over the next three to five years the role of developing countries in the global economy and in global financial markets is going to significantly expand. If you want to be in front of the trends and the companies that are going to make a difference, you can't do that by focusing primarily on the United States.

This is not going to be a typical economic recovery, which can make for a difficult environment for investors. But economic uncertainty is creating pretty attractive valuations – especially against fixed-income alternatives – which I find somewhat encouraging. There are opportunities out there as long as you focus on companies that can thrive in a difficult environment – and avoid at all costs those that would be hobbled by one. VII

MainStay ICAP Select Equity Fund Average Annual Total Returns **Period ended 6/30/10**

Class (Inception)		1 Year	3 Years	5 Years	10 Years	Since Inception
Class A (8/31/06)	*(NAV)*	15.63%	-9.04%	1.02%	3.50%	6.12%
	(max 5.5% load)	9.27	-10.74	-0.12	2.91	5.64
Class I (12/31/97)	*(no load)*	15.94	-8.78	1.30	3.77	6.40

Performance data quoted represents past performance. Past performance is no guarantee of future results. Due to market volatility, current performance may be less or higher than the figures shown. Investment return and principal value will fluctuate so that upon redemption, shares may be worth more or less than their original cost. Performance figures reflect fee waiver and/or expense limitation agreements, without which total returns may have been lower. The agreement for Class A and Class I shares is in effect through 2/28/11, and may be modified or terminated only with Board approval. For performance information current to the most recent month-end, please visit our web site at mainstayinvestments.com.

Total annual operating expenses are: Class A: 1.28%. Total annual operating expenses after recoupments, waivers, and/or reimbursements are: Class A: 1.18%, Class I: 0.90%

Average annual total returns shown include the change in share price and reinvestment of dividends and capital gain distributions. Effective 8/31/06, ICAP Select Equity Fund was renamed MainStay ICAP Select Equity Fund. At that time, the Fund's existing no-load shares were redesignated Class I shares. Performance for Class A shares, first offered 8/31/06, includes the historical performance of Class I shares from inception (12/31/97) through 8/30/06, adjusted to reflect the applicable sales charge and fees and expenses for such shares.

The matters discussed herein may constitute forward-looking statements made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995. These include any predictions, assessments, analyses or outlooks for individual securities, industries, market sectors and/or markets. These statements involve risks and uncertainties. A complete listing of all ICAP's investment selections for the past 12 months is available upon request. The opinions expressed are those of ICAP (Institutional Capital LLC) as of the date of this report and are subject to change. This is no guarantee that any forecast made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment. Institutional Capital LLC is a federally registered advisor and an affiliate of New York Life Investment Management LLC. Institutional Capital LLC subadvises MainStay ICAP Select Equity Fund.

All holdings and sector weightings are as of June 30, 2010, and are not indicative of future holdings or weightings, and may change daily. MainStay ICAP Select Equity Fund's top ten holdings were as follows: **Pepsi Co., Inc.** (6.1%), **Merck & Co., Inc./NJ** (5.3%), **Conoco Phillips** (5.2%), **Sanofi-Aventis**, ADR (5.0%), **Newmont Mining Corp.** (4.4%), **Marathon Oil Corp.** (4.3%), **Pfizer Inc.** (4.1%), **Lowe's Companies, Inc.** (4.0%), **Wells Fargo & Co.** (3.8%), **Coca-Cola Co.** (3.8%). The information provided in this article reprint should not be construed as a recommendation to buy, sell or hold any particular security. There is no assurance that any of the securities discussed herein will remain in any account's portfolio at the time you receive this report or that securities sold have not been repurchased. Inclusion of references to individual holdings is intended to illustrate contributors to recent performance or market trends and to provide examples of thematic or issuer-specific catalysts identified by ICAP's investment team as part of its investment process. References to specific securities should not be viewed as representative of an entire portfolio, nor should the performance of any particular security be viewed as representative of the performance experienced by any other security or portfolio. It should not be assumed that future recommendations will be profitable. Past performance is no guarantee of future results.

Before You Invest

The Funds may invest in derivatives, which may increase the volatility of the Funds' net asset value and may result in a loss to the Funds. Liquidity risk is the risk that certain securities may be difficult or impossible to sell at the time that the seller would like or at the price that the seller believes the security is currently worth. Foreign securities may be subject to greater risks than U.S. investments, including currency fluctuations, less liquid trading markets, greater price volatility, political and economic instability, less publicly available information, and changes in tax or currency laws or monetary policy. These risks are likely to be greater for emerging markets than for less developed markets. The Funds may experience a portfolio turnover rate of over 100% and may generate short-term capital gains which are taxable to the shareholder. The Funds' use of securities lending presents the risk of default by the borrower, which may result in a loss to the Fund. Mid-capitalization companies are generally less established and their stocks may be more volatile and less liquid than the securities of larger companies. Growth stocks may be more volatile than other stocks because they are generally more sensitive to investor perceptions and market moves. During periods of growth stock underperformance, a fund's performance may suffer. The principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value.

The S&P 500® Index is widely regarded as the standard for measuring large-cap U.S. stock market performance. LIBOR, London Interbank Offered Rate, is the rate of interest at which banks offer to lend money to one another in the wholesale money markets in London. An investment cannot be made directly into an index.

For more information about MainStay Funds, call 800-MAINSTAY (624-6782) for a prospectus. Investors are asked to consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus contains this and other information about the investment company. Please read the prospectus carefully before investing.

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