

Investment Insights

Winter 2009



BNY MELLON
WEALTH MANAGEMENT

A LOOK INSIDE

Letter from Our Chief Investment Officer	1
A Fresh Look at Asset Allocation	3
Economic Outlook	7
Positioning Portfolios for a Sustained Recovery.....	10
Reframing the Dialogue around Risk and Objectives	14
Uncovering Opportunities in Equities	17

Letter from Our Chief Investment Officer, Leo P. Grohowski

What a difference a year makes.

Last fall, the financial crisis intensified as Lehman Brothers filed for bankruptcy, credit markets virtually froze and the stock market began its plummet. Many envisioned that we would slip into a depression. Instead, as a result of massive and unprecedented global policy response, the recession has ended and bright spots are beginning to emerge. Functioning credit markets, favorable leading economic indicators and strong stock market momentum have helped to facilitate growth during the third quarter. Although we expect the recovery to take longer than previous recessions and consumer consumption to remain tepid, we believe opportunities exist and will continue to surface to help position client portfolios for a global economic recovery.

In our spring issue of *Investment Insights*, we discussed how the changing financial landscape called for new strategies that complement our disciplined investment approach. To this end, we are focusing on three areas:

- evolving our asset allocation process
- expanding our solutions-based investment options
- aligning allocations to better meet client objectives

We already have taken steps to make our asset allocation process more dynamic by incorporating shorter-term market opportunities and have added new sources of diversification which we believe will add value over time.

The changing financial landscape calls for new strategies that complement our disciplined investment approach.

Equally important is how we define risk and apply our investment thinking to client portfolios. Through an enriched dialogue, we can assist clients in gaining a clearer understanding of what they want to accomplish with their wealth and how they view risk. By considering each client's wealth in two general categories — what they need to maintain their lifestyle and what they would like to bestow to future generations or causes — we can help ensure that critical needs are met while helping other assets to grow. Treating these categories separately and considering the contribution each investment makes to a portfolio will help to ensure that investments are aligned with each client's end objectives.

I am excited about what we are doing and confident these enrichments will help us all successfully achieve our clients' goals. This issue of *Investment Insights* highlights these new strategies and how they apply to our clients. We explore the following topics:

- A fresh look at asset allocation
- Our economic outlook and current investment recommendations
- An enhanced perspective about risk and client objectives
- Opportunities within the equity market

As I look back a year later, I realize that many of us, including me, have never witnessed such a multifaceted, complex market environment. I am proud that our organization has weathered the storm well and I thank you for your continued trust. In the coming year, we will continue to share new market perspectives in the management of your wealth and in an effort to best serve your needs.

A handwritten signature in black ink, appearing to read "Leo P. Grohowski". The signature is fluid and cursive, with a large initial "L" and "G".

Leo P. Grohowski
Chief Investment Officer
BNY Mellon Wealth Management

A Fresh Look at Asset Allocation

Given the degree to which almost every asset class fell together in 2008, it is understandable for many to question the benefits of asset allocation. Based on modern portfolio theory, the concept suggests that portfolios benefit from combining asset classes in ways that, while not always intuitive, serve to balance risk and reward across multiple asset classes. During the financial crisis, however, investors suffered losses regardless of the degree to which they spread money across different investments. Quantitative models failed to foresee the severity of the crisis, normally non-correlated asset classes moved in tandem, and risks associated with some types of investments were not readily apparent.

As a result of these perceived inadequacies, a debate has emerged regarding the effectiveness of asset allocation. Because it is the basis upon which most investment portfolios today are constructed, the contention that the asset allocation process has failed, if true, has serious implications. After significant consideration and analysis, we believe that diversification and asset allocation will continue to serve investors well. However, some changes are necessary.

The Benefits of Diversification

We have all heard the phrase, “Don’t put all your eggs in one basket.” With respect to investing this saying is particularly true. The premise behind diversification is that asset classes do not move up or down at the same time, or at least by the same degree. Thus, by spreading investments in a portfolio across different asset classes, one can smooth out returns, protect against considerable losses in a single investment and reduce overall risk.

Correlation specifies how the performance of one asset class varies in relation to another and can range between 1 and -1. A correlation of 1 indicates that two asset classes move together, while a correlation of -1 indicates that they move in opposite directions. Combining asset classes with negative correlations (those that move in the opposite directions) can

reduce the overall level of risk. If assets are properly combined, the riskiness of an entire portfolio is less than that of the average of each separate investment. A process called mean-variance optimization determines the appropriate allocation that is expected to be most efficient — or that provides the potential for highest return for an assumed level of risk (this is known as variability or how far prices move from their average), based on an analysis of historical data.

As reflected in Exhibit A, different asset classes will outperform others in any given time period. For example, small capitalization stocks were the best performing asset class from 2001 to 2004, while large capitalization stocks lagged. From 2005 to 2008, however, taxable fixed income outperformed other asset classes. In 2008, virtually every asset class declined in tandem, except the safest investments, such as cash and Treasury securities. Last year, a diversified approach to asset allocation was not as effective an investment strategy because traditional correlations between many asset classes broke down and tightened significantly.

Exhibit A

Why Diversify?

Developed International Equities 43.4%	Large Cap U.S. Equities 15.7%	Large Cap U.S. Equities 17.2%	Large Cap U.S. Equities 17.2%	Small Cap U.S. Equities 11.5%	Taxable Fixed Income 4.7%
Large Cap U.S. Equities 17.7%	Small Cap U.S. Equities 11.8%	Small Cap U.S. Equities 15.6%	Small Cap U.S. Equities 11.7%	Taxable Fixed Income 6.8%	Developed International Equities -2.5%
Taxable Fixed Income 11.8%	Taxable Fixed Income 11.7%	Developed International Equities 13.9%	Developed International Equities 7.4%	Developed International Equities 2.4%	Small Cap U.S. Equities -3.9%
Small Cap U.S. Equities 9.0%	Developed International Equities -4.5	Taxable Fixed Income 6.9%	Taxable Fixed Income 7.2%	Large Cap U.S. Equities -0.5%	Large Cap U.S. Equities -5.2%
1985 - 1988	1989 - 1992	1993 - 1996	1997 - 2000	2001 - 2004	2005 - 2008

The Barclays Capital U.S. Aggregate Bond Index was formerly known as the Lehman Brothers U.S. Aggregate Bond Index. The returns presented are annualized returns for each index for each four year time period. The returns were calculated using the S&P 500 Total Return Index, S&P 600 Small Cap Total Return Index, MSCI EAFE (with net dividends reinvested) Index, and the Barclays Capital U.S. Aggregate Bond Index. Developed International is represented by MSCI EAFE. Large Cap is represented by S&P 500. Small Cap is represented by S&P 600. Taxable Fixed Income is represented by Barclays Aggregate. There can be significant volatility in the prices of the securities included in an index for any time period and therefore, the rankings could be different if different time periods were used.

Why Correlation Estimates Were Off the Mark

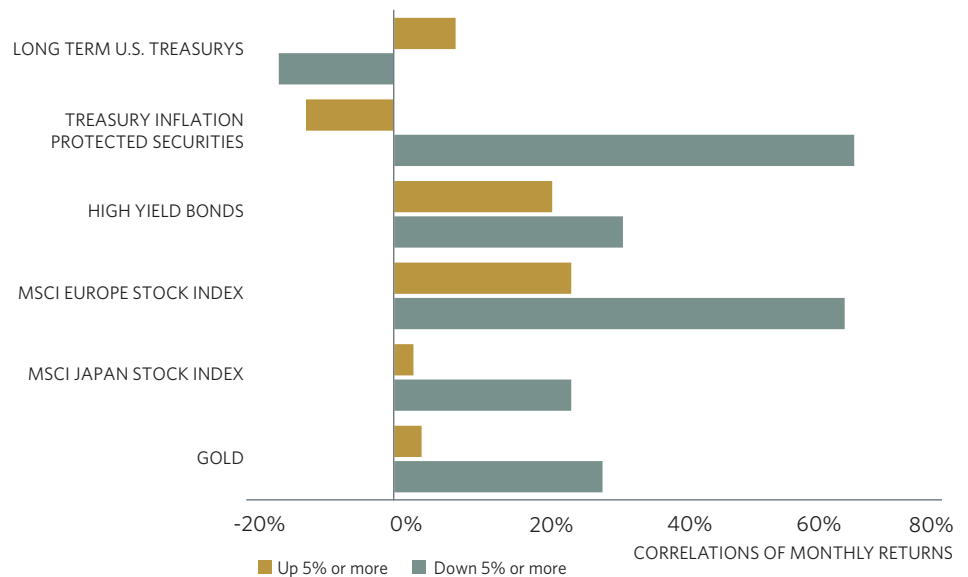
A recent Ibbotson and Associates study of correlations between asset classes from 1973 through June 2009 showed that asset classes tend to become more correlated in bear markets. Exhibit B shows the correlations of returns of various asset classes compared to the S&P 500 in up months (+5% or more) and down months (-5% or steeper). As indicated in the chart, with the exception of Treasuries, asset classes are more likely to track U.S. stocks in down months compared to up months. The correlation between the MSCI Europe and S&P 500 indices, for example, was more than double in down months as in up months.

Of course, the above analysis covers an extended period. During the recent financial crisis, as investors fled risky assets, about the only places that offered a safe haven were Treasuries and cash. As a result, traditional investment considerations — fundamentals, valuations, etc. — mattered little. Differences between large caps, small caps, and international equities seemed like minor nuances. Because investors wanted the protection of Treasuries, they sold virtually everything else, without a lot of discrimination. As a result, *all* asset classes with perceived risk fell dramatically, and short-term correlations converged towards 1.

To compound the problem, some large investors employed high amounts of leverage, which amplified returns when assets were rising, but caused asset prices to fall precipitously as positions

Exhibit B

Asset Class Correlations to the S&P 500 Increase in Down Markets



Source: Ibbotson Associates. Correlation of returns between asset returns and S&P 500 in months from 1973 through June 2009. Analysis looked at those months when the S&P 500 returned 5% or more as well as months the index declined 5% or more. Prices of various assets are more likely to track U.S. stocks, as measured by the S&P 500, in down markets than in up markets.

were liquidated. Additionally, leveraged investors needed to make margin calls, but found that they often could not sell illiquid securities. As a result, the liquid assets that were easier to sell bore the brunt of the sell-off.

Correlations appear to be returning to more historic levels. However, this experience emphasizes the need to incorporate shorter-term forecasts into models that typically are built with historic long-term returns in mind. Quantitative models are important guides, but should be modified to account for expected market realities. More importantly, models cannot replace qualitative judgment, and thus it is important to incorporate experience continually into one's thinking.

Benefiting from a More Nimble Approach

We historically have been advocates of a long-term view of asset classes while recognizing the importance of evaluating market inefficiencies and making changes in anticipation of market events. However, we believe the rapidly changing global marketplace requires an even more nimble approach in order to further protect our clients' portfolios and enhance long-term results.

Our dynamic asset allocation process begins with a long-term view of asset class performance expectations. This view is based on an extensive understanding of, and expert insights on, historical performance and long-term market expectations with regard to return, risk, yield and valuation. Based on these projections, we establish a range for each asset class and then determine the strategic mix of asset classes for a given level of risk.

Our investment strategy views will continue to be guided by this strategic perspective, which is framed by a 7-10 year horizon. However, we now also seek to add further value by incorporating a shorter-term view of asset class relationships over a 1-3 year horizon. We may, for instance, implement a change due to a shift in relative value between asset classes or introduce a new source of diversification that can provide additional return to portfolios without disrupting long-term asset allocation plans.

Putting Theory Into Practice

As illustrated in Exhibit C, over the course of 2009, we continued to identify new sources of diversification and opportunities to capitalize on specific short-term asset class mispricings. In early 2009, for example, we recommended an allocation to commodities due to their price correction from previous highs and our belief that demand would begin to increase in late 2009 and early 2010. In anticipation of a global recovery, we expected the demand for energy to increase as well. We therefore selected a broad-based commodities solution that provided a greater focus on energy. We also considered commodities' historically high correlation with inflation

and low correlation to other traditional asset classes when evaluating opportunities to hedge inflation. Thus, we identified a favorable entry point and recommended exposure to commodities as a hedge against inflation and a diversifier.

Exhibit C

Our Approach at Work

TIME PERIOD	MARKET OBSERVATIONS	ACTIONS AND BENEFITS
4Q08	Investors flocked to the safety of Treasuries; relative value within municipal bonds.	Introduced a new source of diversification within municipal bonds to provide potential for enhanced returns.
1Q09	Historically low Treasury yields resulted in extreme spreads.	Recommended increased diversification through high yield allocation in taxable bond portfolios.
	Extreme mispricings in equity market; fundamentals not moving price.	Introduced a concentrated portfolio of our best ideas in large cap space offering an opportunity for enhanced returns.
2Q09	Riskier equities increasingly attractive as risk aversion diminished.	Recommended increased exposure to emerging markets as potential source of increased diversification.
	Pullback in commodity prices created attractive entry point.	Introduced exposure to commodities as source of incremental diversification and inflation protection.
3Q09	Relative valuations of emerging markets attractive; stronger economic recovery and weaker dollar benefits this market versus domestic large cap.	Recommended increased exposure to emerging markets, decreased domestic large caps.

Data provided as of 10/31/09. No investment strategy or risk management technique can guarantee returns in any market environment. Past performance is no guarantee of future results.

This experience emphasizes the need to incorporate shorter-term forecasts into models that typically are built with historic long-term returns in mind.

Last spring, extreme market volatility and deflated stock prices created an opportune time to introduce a concentrated portfolio of actively managed U.S. large capitalization equities. This investment strategy provides the potential for incremental capital appreciation and added diversification, but it also may incur greater volatility than our more diversified equity strategies. For this reason, it may be appropriate as a complement to an existing diversified equity portfolio in cases where a client's long-term timeframe and goals suggest such volatility can be weathered.

New Thinking about Asset Classes

Historically, investments that behave similarly in varying market cycles have been grouped into asset classes (i.e., stocks, bonds and cash). Portfolios were often derived by determining the optimal combination of asset classes based on forecasts of risk, reward and correlations — assuming correlations would remain stable over time. However, even prior to the recent crisis, asset class correlations that were previously low were rising, which reduces the benefit of diversification. While correlations may again fall over time, we also believe in having a framework that accounts for short-term correlation anomalies. By considering the expected contribution of each asset class and sub-asset class, we can better analyze, select and implement investment solutions that will be additive to the risk/reward tradeoff. This approach also will help us better demonstrate the purpose various investments play in achieving client objectives, whether it is saving for retirement or starting a foundation for a favorite cause.

We continue to forecast how traditional asset classes will behave in a given market environment when determining our allocation recommendations. However, we also consider the expected contribution each investment solution will play in clients' portfolios. We believe the investment purpose of asset classes, as illustrated in Exhibit D, can be best described by the following categories:

- Preservation and Income
- Inflation Protection
- Capital Appreciation
- Incremental Diversification
- Enhanced Return

Exhibit D

Additional Framework for Asset Classes

INVESTMENT PURPOSE	EXPECTED ROLE IN A PORTFOLIO
Preservation and Income	Investments may provide stability, liquidity and/or income <i>Cash, Core Fixed Income, Structured Products</i>
Inflation Protection	Investments provide hedge against inflation <i>TIPS, Commodities, Real Estate</i>
Capital Appreciation	Broad market investments that seek capital growth <i>Domestic Equities, International Equities, Absolute Return Strategies</i>
Incremental Diversification	Investment for opportunistic diversification <i>International Fixed Income, Long/short Strategies, High Yield Bonds, REITs</i>
Enhanced Return	Focused and opportunistic investments for capital growth <i>Value/Growth Equity Styles, 130/30 Equity Strategies, Private Equity</i>

For example, investors saving for retirement are concerned about maintaining the purchasing power of their assets. Therefore, investments that provide income preservation, such as Treasury Inflation Protection Securities (TIPS), would be beneficial in a portfolio tailored to this objective. By mapping asset classes and sub-asset classes in terms of their investment purpose, we can better ensure that the assembly of investments will not only perform well together in varying market conditions, but will best align with the end purpose.

Asset Allocation Works, but It Needs to Be More Dynamic

Given the scope of the recent financial meltdown and the interconnectedness of the global economy, it is understandable in retrospect why virtually all asset classes declined together and became unusually correlated. However, diversification did not fail — it still safeguarded investors from further losses. We do not reject the theory behind asset allocation, but believe that we have developed a more effective application. The dynamic approach that we have been employing as a result of recent market lessons has enabled us to take advantage of opportunities created by this crisis while still controlling risk. We always have believed that investors should look beyond a static view of asset allocation, and we have continuously reviewed our strategic mix of assets throughout the years as markets have changed. This approach is even more critical in today's environment. We are confident this approach provides the best foundation for clients to reach their long-term goals.

Economic Outlook

Growing signs of economic recovery have confirmed our view that the worst recession since the Great Depression has ended. We have a markedly better environment than we did just six months ago: credit spreads have narrowed, leading economic indicators have hit bottom, housing inventories have dropped and sales have risen, and consumer confidence, while still fragile, has increased from its historic low. Growing sentiment that the economy is on the road to recovery has helped fuel the equity market rally since last spring, with all indices reaching new highs for the year. Although we anticipate some bumps along the way, we believe global economic growth is sustainable, albeit at a slow pace.

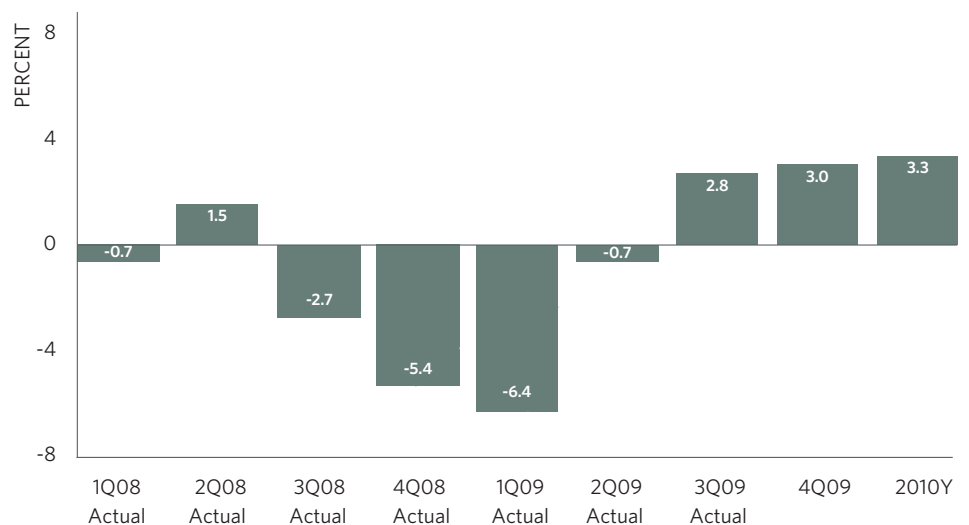
On Our Way

Leading economic indicators typically forecast economic trends 6 to 9 months in advance. These indicators now have risen for seven consecutive months, a turnaround since their extended slide began in July of 2007. Meanwhile, domestic manufacturing activity grew for the fourth time since January of 2008, driven by new customer orders and increased production.

The latest data from the Federal Reserve confirms that economic activity is either stabilizing or modestly improving in most markets, although it acknowledges that consumer spending and employment are lagging. The Fed also verified that it would maintain low rates and wind down its debt repurchase program, signaling increased confidence that the economy is on the way to recovery. As illustrated in Exhibit E, we expect modest growth for the remainder of 2009 and 2010, with positive activity in areas such as auto sales, inventory and exports.

Exhibit E

BNY Mellon Wealth Management GDP Forecast



Source: BNY Mellon Wealth Management, November 2009

Not Necessarily a Smooth Ride

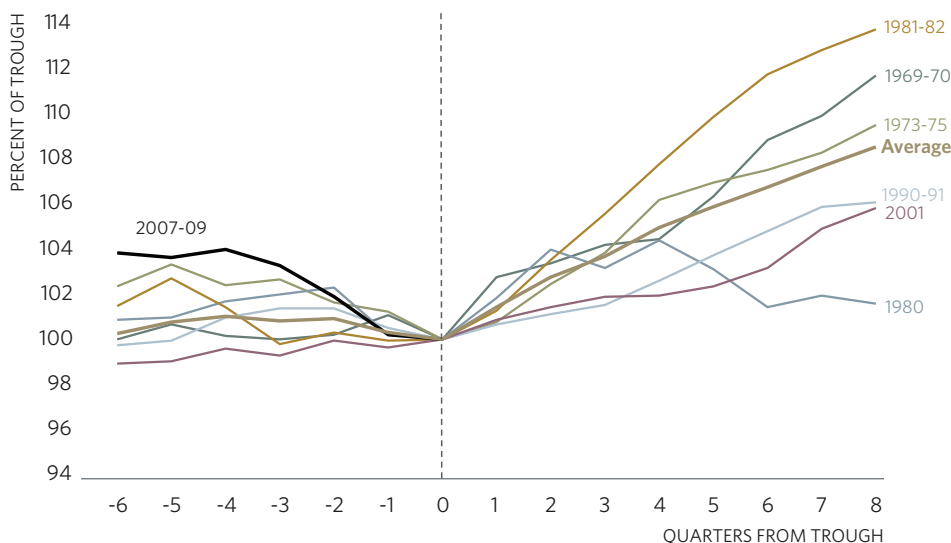
Past experience suggests that balance sheet recessions such as the current downturn are long, and that subsequent recoveries generally are weak. As illustrated in Exhibit F, we expect a slower improvement than the average 8.5% cumulative rate of real growth following the trough of the last six recessions. We anticipate that a combination of consumers' reluctance to spend, growing unemployment and housing market uncertainty will contribute to a less than robust recovery.

Although consumer confidence has improved from its low in February 2009, as illustrated in Exhibit G, consumers remain cautious. After experiencing an average decline of 33% in home values and staggering stock market losses, this is not surprising. In past recoveries, lower interest rates encouraged people to add more debt to household balance sheets. Instead, in this recession consumers were forced to reshape their finances by increasing savings and paying off debt accumulated over the past decade. The deleveraging process, however, has been slow. Household indebtedness, which peaked at the end of 2007 at 132%, has only fallen to 125%, suggesting that it may take time before consumers resume their historic spending rates.

High unemployment, which stands at 10% as of November 2009, also will slow the pace of recovery as it puts downward pressure on wages. Even as cyclical conditions improve, companies will remain reluctant to hire. As a result, we expect unemployment to stay elevated for the next year or so.

Exhibit F

Real GDP — Percent of Trough



Source: Calculated from U.S. Bureau of Economic Analysis data.

Exhibit G

Consumer Confidence Cautiously Rebounds



As of 11/24/09. Source: The Conference Board, Haver Analytics

While recent trends in housing are promising, home prices in some markets still may have some room to fall. Since home equity is down to 2001 levels, almost all of the increase from the most recent housing boom has been lost. Thus, many consumers will not be able to tap into home equity loans for residential expenditures or personal consumption. Low rates, a one-time tax credit of \$8,000, and lower home prices (which have declined, on average, one-third from peak levels reached in 2006) have helped to attract new home buyers. As a result, lower inventory levels and slowing price declines have helped to rebalance the housing market. However, as long as unemployment remains high, the foreclosure rate also will remain relatively high at 2 million homes this year. Additional stabilization in housing will be necessary to strengthen consumers' balance sheets and encourage spending, and this stabilization still may be months away.

Inflation and the Dollar

The Federal Reserve's actions to restore the credit markets and help stimulate the economy have kept the Fed funds rate near zero. In early summer, following a better than expected jobs report, yields on the 10-year Treasury note hit their highest level, briefly nearing 4%. The movement was precipitated by an incremental increase in investors' appetite for risk and fears of rising inflation, given the growing U.S. deficit.

We believe the increase in longer-term rates is part of the normal cyclical rebound and anticipate that the 10-year Treasury note will remain within a range of 100 basis points (one percent) of its current rate of 3.35% over the coming quarters. We are not concerned about near-term inflation, as an overhang of unemployed workers will keep downward pressure on wages. Additional factors contributing to the extended recovery — such as excess global capacity, a tighter credit market and a higher consumer savings rate — suggest that it could be several years before inflation becomes a pressing issue, although that possibility cannot be dismissed.

One result of the easy U.S. monetary policy has been a weakened dollar. Although the dollar's decline has been orderly, the ballooning federal deficit and several central banks' expressed desire to diversify away from the dollar have caused additional unease about its decline. For the time being, low short-term interest rates along with continued economic weakness imply that the dollar may face downward pressure in the months ahead.

Outlook

The U.S. economy is in a much better position than a year ago. We are confident that the U.S. has emerged from this global recession and that third quarter GDP will mark the turning point towards sustainable growth. Improved credit markets, cost cutting and increased demand from emerging economies will help position U.S. corporations for stronger earnings moving forward. Nevertheless, numerous challenges still remain. The massive global policy response that helped end the recession may lead to rising interest rates and higher inflation. We expect the Fed will maintain low interest rates into 2010 and then begin to take appropriate actions to prevent an acceleration of inflation while continuing to stimulate economic growth.

Positioning Portfolios for a Sustained Recovery

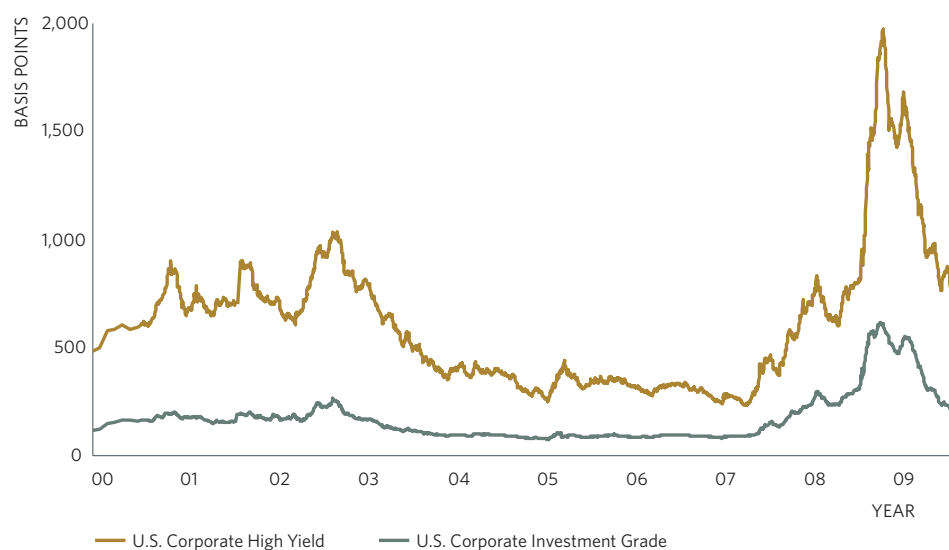
The economy now appears to be on the path to recovery. Although we recognize that a full recovery will take time, given the job market, lackluster consumer spending and a challenging housing market, we do see opportunities for investors. As mentioned in our asset allocation article, we continuously review our longer-term view of asset classes to identify short-term mispricings that may offer added value. During this period of subdued growth, we advocate maintaining a diversified portfolio while taking advantage of opportunities in equities and certain spread strategies. Equally important is our defensive positioning to help protect portfolios from rising interest rates and potentially higher inflation.

Improved Credit Markets Limit Fixed Income Opportunities

After virtually shutting down a year ago, the credit markets are functioning again. The desire for safety, which drove Treasury yields to zero, has subsided as investors recognized the worst was behind us and incrementally embraced riskier investments. The contraction in spread relative to Treasuries, as illustrated in Exhibit H, has made debt more affordable and stimulated corporate borrowing. We do not think that spread products will produce as much excess return in the coming quarters as compared to earlier this year. However, high yield bonds still may provide high single-digit yields. Investment grade corporate bonds could register mid-single-digit total returns. The selection of individual issues will be critical, as more downgrades than upgrades in credit ratings may occur in the quarters ahead.

Exhibit H

Corporate Bonds Yield Spreads Contract



As of 11/20/09. Source: Barclays Capital

The relative yield ratio between municipal bonds and Treasuries also has narrowed significantly. Although not as compelling as earlier this year, municipal bonds still present an attractive opportunity for income seeking investors, particularly in light of possibly higher future taxes. The fiscal strains some municipalities are facing likely will continue for several quarters. We are confident, however, that ample opportunity for value can be uncovered during this recovery period. Again, issue selection will be of paramount importance.

Equities Offer Longer-term Promise

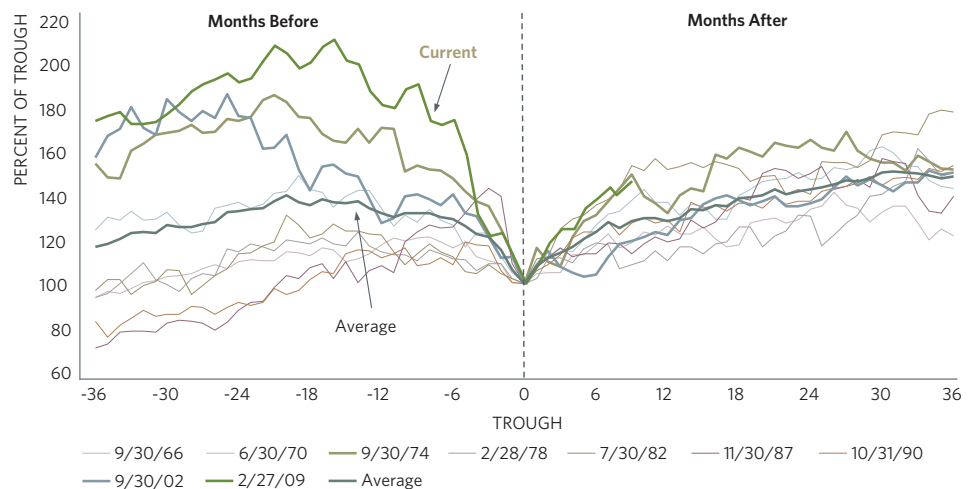
A combination of improved economic conditions and better than expected corporate earnings has fueled steadily rising stock prices since the spring of 2009. As Exhibit I illustrates, the market also has rebounded more strongly than in past recessions. Although we do not expect to see the degree of gains realized to date, we believe that equities do not fully reflect the growth this recovery may yield.

We recognize that top-line revenue growth may still be challenging, but are encouraged by better than expected third quarter earnings and improved sales. A weaker dollar also has made U.S. exports less expensive and may continue to benefit multinational corporations that rely on revenue from abroad. We anticipate that 2010 corporate earnings improvement will be generated from better global economic conditions, previous expense reductions and improved revenue growth.

We are balancing our more positive long-term outlook for equities with the recognition that markets have moved so far and so quickly. We may continue to see modest pullbacks and increased volatility until additional evidence of positive growth emerges. Due to the abundance of cash still on the sidelines, as evidenced by money market fund levels of \$3.3 trillion, we do not anticipate any major corrections. Future pullbacks, on the other hand, may present opportunities for clients to rebalance to long-term targets or gradually shift back into equities.

Exhibit I

Percent of Trough in S&P 500



Source: Standard & Poor's

Value Remains in Alternative Investments

After a challenging 2008, many of the headwinds facing hedge funds, such as industry consolidation, tight credit and record requests for redemptions, have improved. Last year, hedge fund assets shrank by 50%, with more than 1,500 funds closing. While the pace has slowed in 2009, consolidation is ultimately positive for the industry. This has allowed the most stable and experienced managers to capitalize on current market opportunities. Additionally, as the rate of investor redemptions has eased, hedge funds have been able to reduce their high levels of cash and increase their market exposure.

Positive performance year to date by many of the surviving funds has encouraged new investors to commit money to this asset class. Hedge fund flows moved into positive territory by the end of the third quarter, with approximately \$1.1 billion of new assets. A rising equity market and a fifth straight month of net inflows pushed hedge fund assets close to \$1.5 trillion as of the end of September. Hedge funds will continue to play an important role in portfolio diversification and we expect to see further asset growth in the years ahead.

We are seeing some signs of improvement in real estate, but remain cautious. Real estate typically lags the broader economy by 12-18 months and will be negatively impacted by increased vacancy rates and debt refinancing over the next few years. Public REITs have been able to take advantage of the strong equity markets and raise funds; this has put them in a positive position for select buying opportunities. The FTSE NAREIT Equity REIT Index reflects some of these positive developments, having risen over 19% year to date. We have more concern about private REITs, because they have less access to funding due to the ongoing problems in the commercial mortgage-backed securities market.

Historically, private equity investments made during periods of economic downturn have generated strong returns, due to depressed valuations. Looking across sectors, we see value in lower and middle market buyouts where operational improvements and attractively priced opportunities are available. Early stage ventures remain attractive due to lower valuations and favorable credit terms. Although we are cautious as a result of the current absence of an initial public offering (IPO) market, the slowdown may be beneficial for later stage ventures, enabling them to secure additional financing. Currently, our private equity partners are increasingly optimistic. They are forecasting a stronger interest in companies going public and expect increased merger and acquisition activity which bodes well for the asset class moving forward.

Investment Strategy

At the beginning of the year, we identified several opportunities to add incremental value to portfolios, depending on each client's unique situation. When fear gripped the market in 2008, we recognized that Treasuries were extremely overpriced relative to spread products and reduced our exposure to Treasuries. We also increased our exposure to high yield when credit spreads were at historic highs and launched a municipal opportunities strategy. Although spreads have tightened dramatically, we continue to think corporate and municipal bonds hold potential for clients for whom the associated risk is appropriate.

Earlier in the year, given our view that inflation risk was not being properly priced, we recommended several allocation changes to asset classes we felt could offer some protection from future inflation. We overweighted Treasury Inflation Protected Securities (TIPS) — inflation protection that was extremely inexpensive at the time. In addition, we took advantage of a price correction and added commodities to our strategic asset allocation.

In summary, a few high level views form our investment strategy for the remainder of 2009 and early 2010. We believe that:

- we reached the recession trough this summer
- earnings growth will increase by 20-30% in 2010
- the Fed will continue to keep rates low
- the near-term risk of rising inflation is minimal
- cautious consumer spending will contribute to slower economic growth
- the dollar will remain relatively weak unless we see a change in investor sentiment or monetary tightening sooner than expected

With that in mind, short-term opportunities exist, as reflected in our investment strategy for the next 12-18 months (Exhibit J). It is equally important, however, to protect portfolios against the possible risks of rising interest rates and higher inflation over the next 3-5 years. While the investment environment remains challenging, we believe our proactive approach will enable us to deliver added value through all market cycles while enabling clients to meet their unique long-term objectives.

Exhibit J

Investment Strategy

ASSET CLASS	CURRENT THINKING
Treasury Bonds	We are not overly bearish on Treasury rates now that they are closer to global rates, but we remain underweighted in favor of certain spread products.
Corporate Bonds	To protect portfolios against any significant interest rate movement, we have a more defensive positioning of high quality, short-to-intermediate corporate bonds.
High Yield Bonds	Although spreads to Treasuries (rate differentials) have tightened considerably, yields on high yield bonds can add income to portfolios for those comfortable with the associated risk.
Municipal Bonds	For tax-sensitive investors, municipal securities are still attractive relative to Treasuries. However, states and municipalities will face budgetary challenges over the next several years. Credit analysis remains extremely important in identifying quality municipal bonds that offer long-term value for tax-sensitive client portfolios.
Treasury Inflation Protection Securities	In order to hedge against inflationary pressures, TIPS still provide relatively inexpensive insurance.
Domestic Equity	Within our equity allocation, we favor companies that may benefit from economic recovery, although we continue to believe that broad sector diversification will be advantageous.
International Equity	We are emphasizing a globally diversified equity allocation, having increased our exposure to emerging markets several times this year. These markets appear to have preceded the U.S. into recovery and thus may offer incremental value over developed markets.
Commodities	This global recovery likely will put upward pressure on commodity prices. Thus, while commodities can provide unique inflationary benefits within a diversified portfolio, we are cautious on the entry point given the recent rally in prices.
Real Estate	Challenges remain over the next 12-18 months due to higher vacancy and increased borrowing cost. Public REITs with strong balance sheets will be well positioned to take advantage of deep discounts and high value properties. Private REITs may encounter more difficulty in this environment where there is limited access to credit markets. Thus, for those investors with limited exposure to public REITs, select buying opportunities may exist.
Hedge Funds	Hedge funds have turned around and some strategies are delivering the best year-to-date returns in more than a decade. We continue to stress the important role that lower correlated strategies can add in diversifying portfolios.
Private Equity	For those investors able to take advantage of lower valuations, adding private equity exposure across sectors, strategies, stages and vintage years may be the best approach for incremental returns over the long term.

Source: BNY Mellon Wealth Management. As of November 2009.

Reframing the Dialogue around Risk and Objectives

As behavioral economics suggests, investors often fear financial losses more than they desire gains. In bear markets such as the most recent one, it is not surprising that some investors reacted to drastic market fluctuations and exited the market. As is often the case, many investors equate volatility with permanent or longer-term losses and realize that they are not as tolerant of risk as they thought. Unfortunately, reacting to market events can prove costly and impede investors from reaching their goals.

At BNY Mellon Wealth Management, our goal is to help clients maintain a long-term investment perspective and successfully attain their desired personal and financial objectives. Toward this end, it is important that we have a clear dialogue about what clients want to accomplish with their wealth and what risk means to them. By helping investors think about their needs in two simple categories — what they need for their lifestyle and what they may want to leave to future generations or causes — we can more easily link the appropriate level of risk to each portfolio and its end objective.

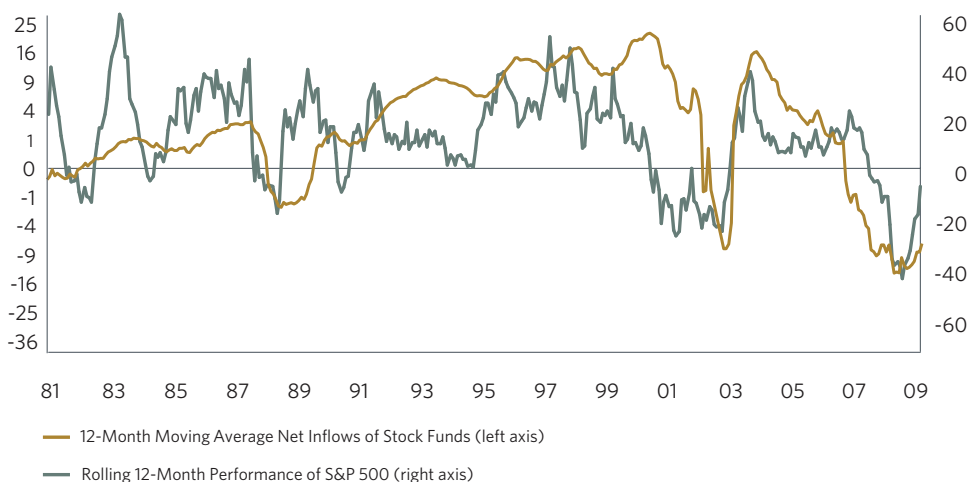
Incorporating Investor Behavior into the Equation

Understanding the psychology of investing has been gaining attention, as behavioral economists try to comprehend the role of psychology in market bubbles and economic decision making. A number of studies show how cognitive and perceptual errors and emotional biases tend to influence investment decisions. For example, studies show that when making decisions, individuals often tend to become too confident, incorrectly assume that recent trends will continue and place more credence on recent information. These feelings can quickly translate into poor investment logic when a trend reverses course. As illustrated in Exhibit K, during this recent market crisis investment loss caused some investors to exit the stock market at just the wrong time. As a result, many investors today find themselves further from achieving their goals than if they had stayed with their investment strategy.

Exhibit K

Investors Panic In Face of Declines

Rolling 12-Month Average Net Inflows of Stock Funds vs. Rolling 12-Month Performance of S&P 500



Monthly Data 2/29/1980 - 10/30/2009
Source: Investment Company Institute, Morningstar Direct

Emotional Decision Making Can Prove Costly

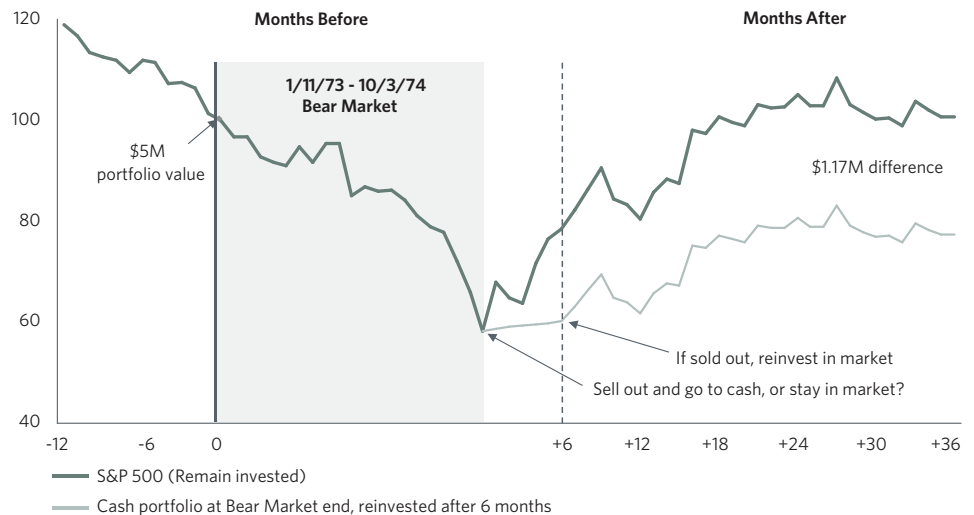
Making emotional decisions and trying to time the market can negatively impact an investor's wealth. Investors would be better off resisting the temptation to time short-term swings and instead adhere to long-term investment plans. Exhibit L highlights the value of a \$5 million investment at the beginning of the 1973 bear market and three years after the bear market bottom. The top line reflects the investment balance if an investor had remained invested in the market for the entire period. The bottom line illustrates the performance of an investor who exits the market at the bottom and reinvests into the market six months later. The impact on a portfolio's recovery is significant — \$1.17 million more over a three-year period for the investor who remained invested. Although each market recovery yields different results, resisting the urge to abandon a well thought out investment plan pays off in the long run.

A Closer Look at Defining Risk

A closer look at risk shows that investors and investment managers define risk differently. Portfolio risk often is described by managers as those factors that will negatively impact return, such as market, interest rate and currency risk. Each type of risk can cause variability in expected returns, leading to a financial loss within a portfolio. However, investors typically do not think in terms of how various types of risks will impact their portfolio or what their level of comfort is with those outcomes. Rather than thinking about

Exhibit L

Danger of Throwing in the Towel



Shaded area represents 1/11/73 - 10/3/74 Bear Market. Indexed to 100 (\$5M portfolio) at start of Bear Market (solid vertical line at 0). Cash proceeds are reinvested in S&P 500 six months after Bear Market end (dashed vertical line at +6). Performance calculated monthly.

industry concepts like 'standard deviation,' 'beta,' or 'kurtosis,' investors are more concerned with the impact a loss may have on their ability to accomplish a specific objective.

We believe there is an opportunity for investment managers to speak in more meaningful terms with their clients. By doing so, managers can gain a better appreciation of investors' goals (and their relative importance) and their views on wealth. This approach — which incorporates elements of objective-driven investing — considers a client's objectives (retirement, charitable giving, wealth transfer, etc.), cash flows (both in and out), assets and liabilities, and then structures an investment portfolio to meet those circumstances.

Compartmentalizing Wealth

We believe that investors' unique objectives generally can be compartmentalized into two broad categories: lifestyle and wealth transfer. Lifestyle needs are those required to maintain one's standard of living, both current and future. For example, lifestyle needs may include the ability to supplement income following the sale of a business or to amass a certain amount of income for retirement. Depending on a client's specific lifestyle needs, cash inflows and expenditures, a portfolio can be constructed to serve different purposes. Understanding lifestyle objectives and aligning a portfolio accordingly can help to ensure that an investor has adequate wealth for his or her lifetime, regardless of market dynamics. Having this assurance will make it more likely for the investor to avoid emotion-based behavior that hinders achieving his or her goals.

Wealth transfer needs should address client objectives for future generations. Some examples include leaving money to grandchildren or ensuring that philanthropic goals are achieved. Investors often are more willing to assume additional risk with assets needed for future generations because the longer time horizon allows for the ability to sustain shorter-term value fluctuations and volatility. A portfolio constructed for wealth transfer may focus on growing capital and providing excess returns without concern for liquidity and current income.

A Thoughtful Approach to Aligning Portfolios and Client Objectives

To illustrate the benefits of compartmentalizing wealth within an overall strategy, let's consider a middle-aged couple in their 50s with two children in college. Recently, this couple sold a family-owned business to a private equity firm and received a 10% ownership interest in the newly created entity as well as cash proceeds from the sale. The couple plans on working for the new entity and collecting a salary for three years, after which they will retire.

During retirement, the couple would like to maintain their lifestyle and do some traveling. Assets from the sale of the business will be used to fund a portfolio established to address their lifestyle needs. The lifestyle portfolio will be invested mostly in fixed income, but also will include a small exposure to equities and commodities to provide modest growth and inflation protection. By setting aside assets to meet lifestyle expenses, the couple can be confident that the combination of investments within this portfolio will provide sufficient income and inflation protection for their retirement.

By helping investors think about their needs in two simple categories — what they need for their lives and what they may want to leave to future generations or causes — we can construct portfolios that best achieve these objectives.

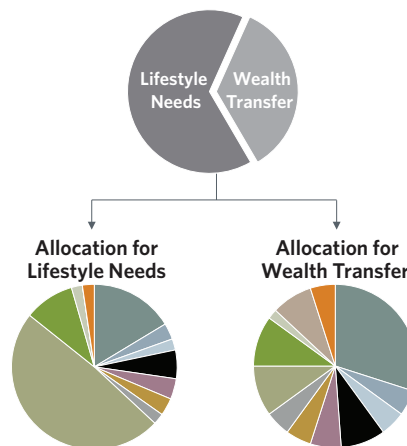
The couple also desires to leave assets to their children and minimize estate taxes. This portion of their assets will comprise their wealth transfer portfolio, which will be invested mostly in domestic and international equities as well as alternative investments to generate capital appreciation and growth for the next generation. A combination of estate planning transfer techniques may also be implemented to minimize estate taxes (i.e., different types of trusts and transfer vehicles). As Exhibit M illustrates, the underlying investments are aligned with each portfolio's distinct objective which together meet the client's broad range of goals.

Exhibit M

Aligning Portfolios with Client Objectives

Lifestyle Needs

- Greater allocation to preservation and income strategies
- Larger cash allocation for funding multi-year living expenses and to meet liquidity needs
- More emphasis on inflation protection investments to protect against decline in real purchasing power.



Wealth Transfer

- Greater allocation to capital appreciation and enhanced return strategies
- More emphasis on incremental diversifiers as investable capital increases
- Incremental appreciation achieved from exploiting manager skill

Large Cap
 High Yield
 Mid Cap
 Fixed Income
 Small Cap
 Long/Short Strategies
 Emerging Markets
 Absolute Return Strategies
 Developed International
 Private Equity
 Commodities
 Real Estate

Source: BNY Mellon Wealth Management

No investment strategy or risk management technique can guarantee returns in any market environment. Allocations are shown for illustrative purposes only and do not necessarily reflect current allocation recommendations.

Focus on Long-term Success

We are committed to helping our clients achieve their long-term wealth objectives and believe that by better defining risk from our clients' perspectives, we can obtain a more comprehensive picture of their needs and objectives. By integrating this knowledge and developing distinct investment portfolios to accomplish both lifestyle and wealth transfer goals, we can better align investments with each client's goals and simultaneously enhance results and control volatility. In the end, clients can have the confidence that their objectives are being met in a way that makes the most sense to them, and avoid the deviations from strategy that can damage a portfolio's full investment potential.

Uncovering Opportunities in Equities

The stock market has made an impressive rally since its March lows, primarily fueled by an improved economic outlook. Despite renewed interest in equities, many believe the market's easiest gains have been realized and question its sustainability. In the face of these divergent views, we believe that there is more upside potential for equities and that the asset class offers investors long-term opportunities for capital appreciation and diversification. We have gathered some of our equity experts to share their views on where they see opportunities in today's market.

Roundtable participants include: Christopher Sheldon, Director of Investment Strategy, BNY Mellon Wealth Management; Irene O'Neill, Managing Director, Large Cap U.S. Equities, BNY Mellon Wealth Management; William Adams, Portfolio Strategist, The Boston Company; Ciarán Spillane, Head of U.S. Business, Newton Capital Management; Dr. Kenneth Lyall, Chairman, Walter Scott; Andy Gibson, Health Care Analyst, BNY Mellon Wealth Management.

Beginning in the spring, we felt that investors had a good entry point for increased investment in equities after what had been one of the weakest markets for this asset class. If we look at rolling 10-year returns through November 30, 2009 (illustrated in Exhibit N) equities had their worst performance since the early 1940s. Although we have seen an impressive rally from its lows, we believe the market (S&P 500) is fairly valued. Currently, the price-to-earnings ratio, based on 2010 operating earnings for the S&P 500, is roughly 15. Although this is not cheap, it is important to note that higher earnings multiples are common in recessionary times when earnings are at depressed levels. We do not believe that equities fully reflect the improvement in earnings that this recovery may yield. We expect positive earnings growth in 2010 will be delivered by corporate cost cutting, strength in emerging markets and a weak dollar. It would not be realistic, however, to expect gains of the magnitude we have seen to date. We expect more modest gains into 2010.

What is the basis for your favorable equity outlook?

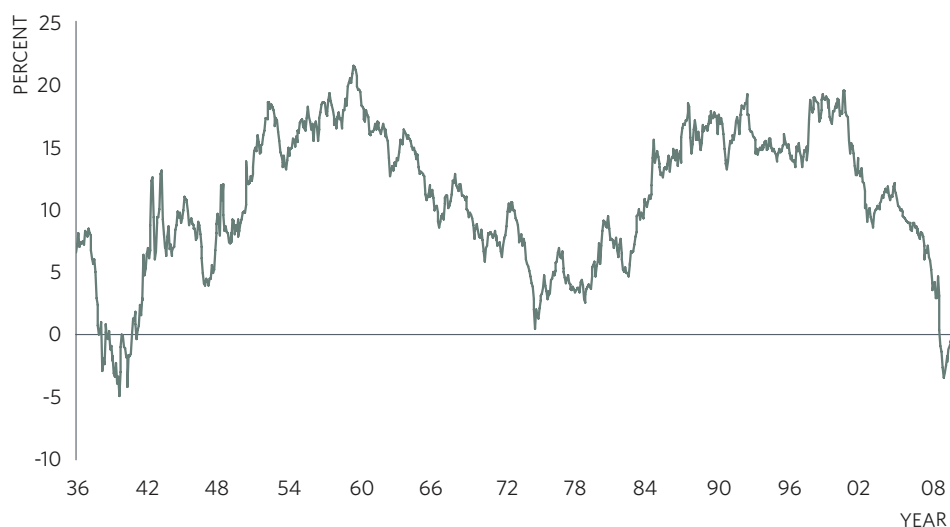
Christopher Sheldon

The market rebound from March's low has been fast and significant, with the S&P 500 up approximately 62% and emerging markets, as measured by the MSCI Emerging Markets Index, up roughly 70% through the end of November. Near term, we expect that the equity market may stall for a bit or consolidate modestly until investors see clearer signs of sustainable positive economic activity.

Exhibit N

Weak Equity Market Creates Opportunity

S&P 500 Rolling 10-Year Returns



As of November 30, 2009. Source: Standard & Poor's

Given expectations for slower recoveries in the U.S. and developed markets, where do you see opportunities?

Irene O'Neill

We expect emerging markets to recover more quickly than many developed markets, given their timely response to the financial crisis, strong fiscal conditions and growing consumer base. Thus, U.S.-based multinational companies with established businesses in emerging markets likely will experience above average earnings growth. Consumer staples companies, for example, which sell packaged foods, beverages and personal care products, are among the first to benefit as emerging market consumers buy products to improve their quality of life. Additional sectors that will benefit from emerging markets growth include industrials, materials and energy. Expanding infrastructure, auto sales, and home and office construction will drive demand in these sectors.

William Adams

The short-to-medium term outlook favors emerging markets versus the developed markets. However, the relative year-to-date outperformance has created a premium for emerging markets as opposed to EAFE and U.S. markets. At the moment, the market is pricing in a more imminent earnings recovery and stronger growth trajectory for emerging markets. Investors still are more cautious and negative about recovery prospects in the U.K., Europe and Japan, which could create interesting valuation opportunities in these regions in the near term.

Which emerging markets look attractive and what is driving growth in those markets?

Ciarán Spillane

There are varying degrees of attractiveness within emerging markets. For example, Brazil, India and China are far stronger economies at present than those of Eastern Europe. A number of emerging economies should benefit from their accumulation of foreign exchange reserves in recent years, as this will help cushion the declining demand from the developed world. In Latin America, perhaps most notably, large currency reserves, vast natural resources and sizeable consumer markets bode well for the region's future prospects.

It will be imperative to evaluate investments in emerging markets on a country-specific basis. Brazil, for example, is likely to generate a number of attractive investment opportunities given its sizeable foreign exchange reserves, large consumer market and considerable natural resources. Russia, by comparison, may require a highly selective approach in light of its significant political risk and fragile banking system.

Do you think the Asia-Pacific markets represent a good investment opportunity in the near term?

William Adams

On a year-to-date basis, the region has outperformed the broader emerging markets and, as a result, Asia-Pacific stocks appear more expensive compared to the broader emerging market index. That said, Asia-Pacific historically outperforms in the early stages of an economic recovery due to its early cyclical exposure to industries such as technology. Additionally, Asia-Pacific markets are, in general, importers of raw material, rather than exporters like many emerging markets in Latin America. Thus, Asia-Pacific companies typically benefit from lower raw material costs. While the near-term relative outperformance and higher prices may pose some risk, we continue to identify compelling value candidates in these markets which have been left behind in the rally.

We see more upside potential for equities and believe this asset class offers investors long-term opportunities for capital appreciation and diversification.

Dr. Kenneth Lyall

Over the last 10 to 15 years economic activity in the Asia-Pacific markets has increased dramatically. Much of this has been export oriented, but more policies are being geared towards substituting domestic growth for trade-based growth, like in China. Additionally, increasing per capita income and populations with relatively young consumers are providing additional profit sources for companies.

What challenges does Europe face in restoring economic growth?

William Adams

In some respects, the challenges facing both the U.K. and continental Europe in terms of economic recovery and growth are similar to those for the U.S. While rates have been low in the Eurozone, the fiscal stimulus packages have been uneven and less generous than in the U.S. and China. France and Germany have implemented car scrappage schemes that have worked. Our belief, though, is that they have merely brought forward sales that would have occurred in 2010, and thus, are experiencing short-term blips in economic activity versus a sustainable trend. Countries such as Spain and Ireland continue to be constrained by housing busts, and Italy faces a significant fiscal and trade deficit as demographic trends continue to deteriorate.

Although this backdrop may paint a dire outlook for economic growth, it can create compelling value opportunities for patient investors. For example, while expectations have increased substantially for earnings recovery and growth in emerging markets (now reflected in premium valuations), even very modest improvement within Europe could deliver better than expected GDP growth and corporate earnings.

Are there some opportunities in green energy investments?

Irene O'Neill

While alternative energy, such as wind, solar and biofuels, may play a significant role in the growth of "green" energy longer term, expensive production costs often inhibit profitable corporate business models that do not have the benefit of government subsidies. We believe energy efficiency is a more investable theme. Bringing more energy efficient technologies to American homes and businesses is a faster and more cost effective way to reduce energy consumption, energy costs and, ultimately, carbon production. According to the Energy Information Administration, commercial energy demand, which is primarily from office buildings, accounts for about 40% of total electricity consumed in the U.S. By reducing energy consumption through the application of energy efficient technology in lighting, heating and air conditioning, businesses can become "greener." In fact, \$30 billion of the U.S. government's stimulus package is being spent to improve energy efficiency in government buildings. Thus, companies that provide services and equipment to boost energy efficiency offer attractive earnings growth potential.

What impact do you think the proposed financial regulation reform will have on financial stocks?

Irene O'Neill

The proposed financial reform will most likely curb innovation, reduce financial service industry returns on capital, and create more barriers to entry. While all of that may sound negative, the actual net effect on stocks is difficult to predict. The industry also will be less risky and have more predictable earnings. The single largest change in the reform is the creation of a Consumer Protection Agency, which will regulate financial products and ensure that consumers are not being misled. While this regulatory agency likely will raise the barriers to entry for potential competitors by slowing down innovation and making it more difficult to market new products, this could be a net benefit to larger institutions that can more easily shoulder the regulatory burden.

We expect higher capital requirements for most institutions, but even more so for the larger institutions in order to deal with the "Too Big to Fail" problem. We should expect to see more stringent regulation and more standardization of derivatives and other financial products such as mortgage-backed securities. Winners from the reform should be more traditional institutions, such as regional banks that have seen their market share eroded by upstarts and more aggressive competitors and exchanges that may benefit from standardization of derivatives contracts.

As the Obama administration looks for ways to insure more Americans, where do you see opportunities in healthcare stocks?

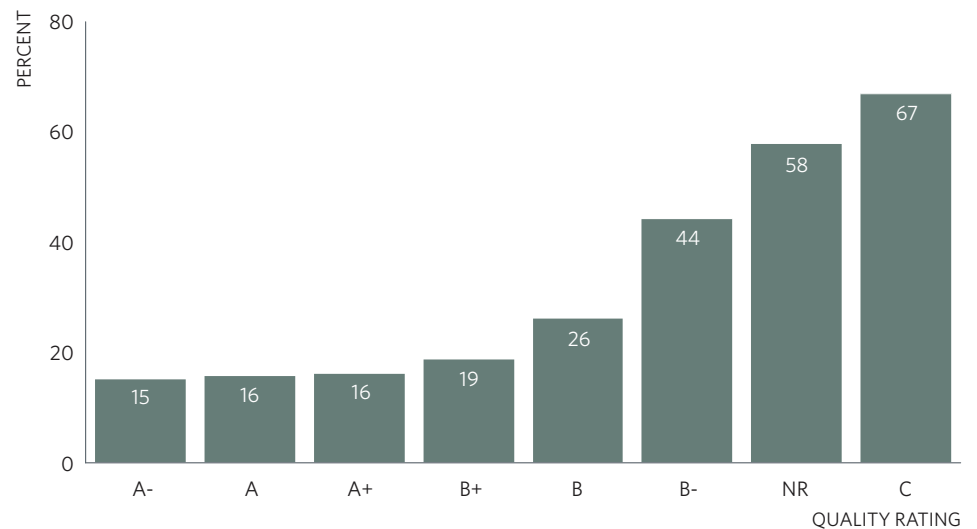
Andy Gibson

Likely beneficiaries of having more people insured are hospitals, companies that offer products that save the health care system money and, possibly, managed care companies. Hospitals would experience a reduction in bad debt expense and an increase in patients, due to there being more insured individuals. In exchange for this benefit, hospitals have offered to reduce spending costs by \$155 billion over a 10-year period. Comparative analysis of health care treatments will become increasingly important as more people are insured. In an effort to contain costs, companies with differentiated products or services that save the system money will benefit, and both innovative and low cost producer companies can offer comparative value. Good examples of this would be biotechnology and generic drug companies.

Depending on size and role of the public option (government health care plan), managed care companies could be beneficiaries of having more people insured. If the public option is not part of the insurance offerings or is offered only as a potential threat to keep insurance companies honest, managed care companies would benefit. Managed care companies would welcome more customers particularly, since a good portion of the uninsured are “young” and “invincible” — the desirable risk pool.

Exhibit O

Higher Quality Stocks Have Underperformed



As of 9/30/09. Source: Vestek

Do you have any closing thoughts?

Christopher Sheldon

We continue to believe that clients will benefit from a globally diversified equity allocation that provides exposure across market capitalizations, geographies and sectors. As discussed here, we are seeing broad consensus for improved corporate earnings in 2010 and believe equities offer long-term diversification and capital appreciation benefits. The equity market decline and ongoing volatility have created a range of valuations and attractive opportunities. Thus far this year, (as illustrated in Exhibit O) quality and performance have been inversely related (i.e., lower quality = better performance). Thus, higher quality names that have favorable fundamentals as well as appealing dividends, in some cases, can be bought at attractive valuations. Picking the right companies will be rewarded in this type of market and we believe our equity managers can uncover value through their disciplined and active management approaches.



Leo P. Grohowski
Chief Investment Officer
BNY Mellon Wealth Management

Leo Grohowski is chief investment officer of BNY Mellon Wealth Management. He leads all investment strategy and investment management functions for the wealth management organization. In addition, Mr. Grohowski is a member of BNY Mellon's Operating Committee and its Benefits Investment Committee.

Mr. Grohowski joined The Bank of New York Mellon in 2007 and has more than 25 years of industry experience. Previously, he was with US Trust, Bank of America, where he was chief investment officer, responsible for investment solutions and the end-to-end investment process, including portfolio management and investment strategy for Private Wealth Management clients. Prior to his role at US Trust, he was the chief investment officer for Deutsche Bank in the Americas, overseeing more than \$250 billion in assets. From 1999 to 2002, Mr. Grohowski was chief investment officer of Deutsche Bank Private Banking, serving as chairman of the Global Markets Strategy Committee and Domestic Investment Strategy group, and head of Investment Products and Services for the DB Alex Brown unit. In 1996, Mr. Grohowski joined Bankers Trust where he served as a senior trust investment officer of the Private Bank and head of the U.S. Investment Strategy group. He was with HSBC Asset Management from 1988 to 1996 and was named chief investment officer in 1993, after heading the U.S. Equities group from 1988 to 1993.

Mr. Grohowski earned a bachelor's degree in economics from Drew University, and a master of business administration from New York University's Stern School of Business. He has served on the Board of Trustees at Drew University for 12 years and has chaired its Investment Committee. He is a Trustee of the Far Hills Country Day School in New Jersey and serves as chair of its Audit Committee.

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