

The Market Environment and Outlook of our Chief Investment Officer, Horacio A. Valeiras, CFA**ECONOMIC ENVIRONMENT – Uneven global rebound**

The U.S. will likely experience a muted economic rebound relative to past recessions. Some developed countries should recover faster, but real global growth is expected to remain subpar. Economic data will likely be mixed and below trend for some time. Deleveraging in developed economies should continue for years. Growth in the most stable emerging countries has bounced back strongly, and we are starting to see a rebalance from exports to domestic demand. This will be healthy in the long run.

EARNINGS / VALUATIONS / CREDITS – U.S. equities starting to look expensive, rotate toward Asia

Stock valuations and corporate bonds have risen as share prices rallied. Asian shares should benefit from strength in China and surrounding economies; therefore, we favor Asian equities from an asset allocation perspective. With regard to credit, we believe there are still attractive total return opportunities in corporate debt. Spreads have narrowed since reaching record levels last year, and we expect continued narrowing into 2010 as corporate earnings recover. High yield investors experienced strong positive returns when spreads were at comparable levels in the early 1990s and 2000s.

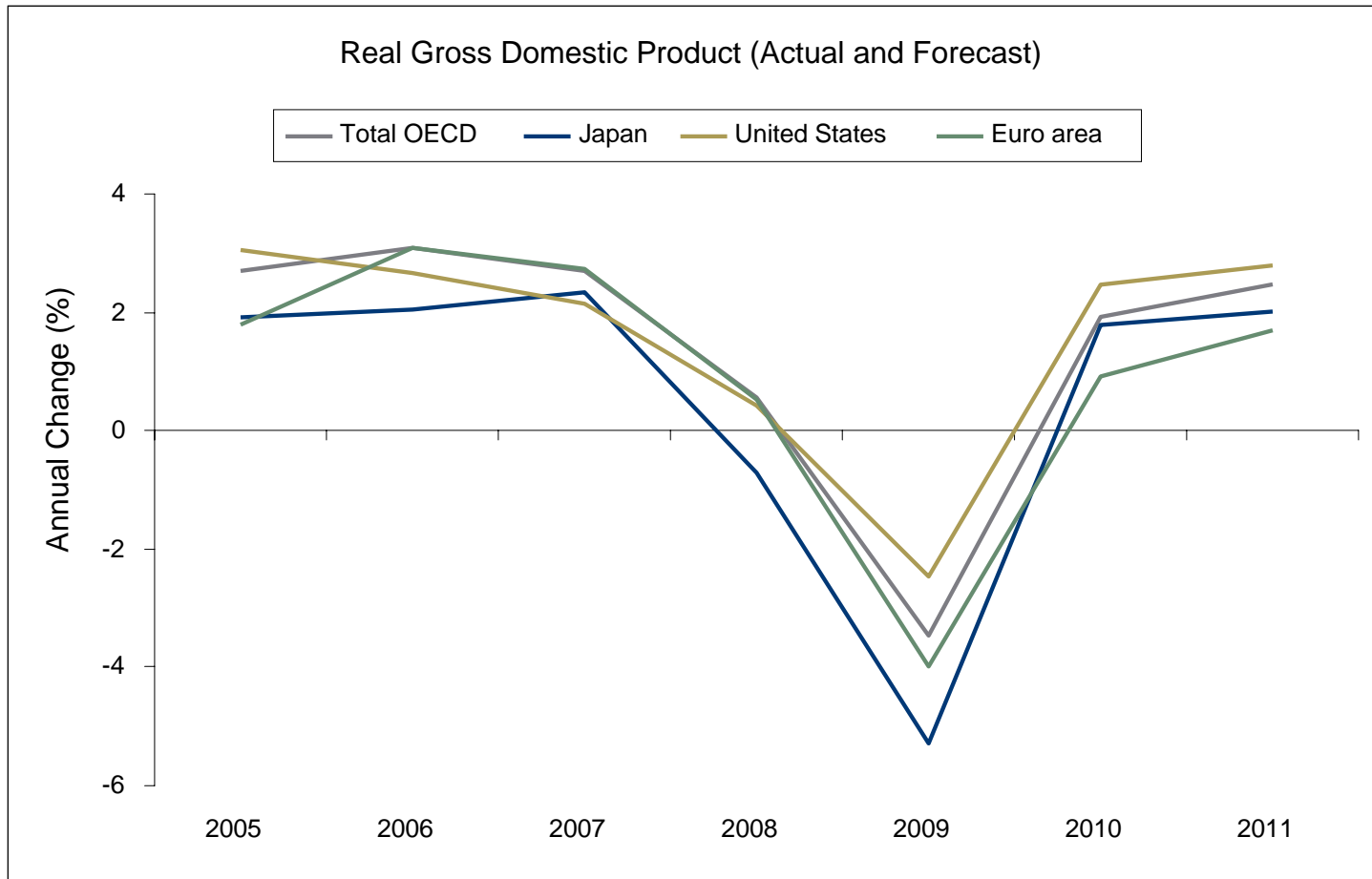
CURRENCIES / INTEREST RATES – Short rates should start to rise, yield curves steepen, dollar weak

The Federal Reserve has stated that interest rates in the U.S. will remain exceptionally low for an "extended period." However, we believe U.S. short-term rates will start rising in 2010 as inflation returns to the American economy. Some foreign central banks, notably China and Australia, have already embarked on post-crisis tightening. We expect this trend to spread. Combined with heavy Treasury issuance, low short-term rates in the U.S. should result in continuing downward pressure on the dollar relative to emerging market currencies. Global yield curves should steepen even more from here.

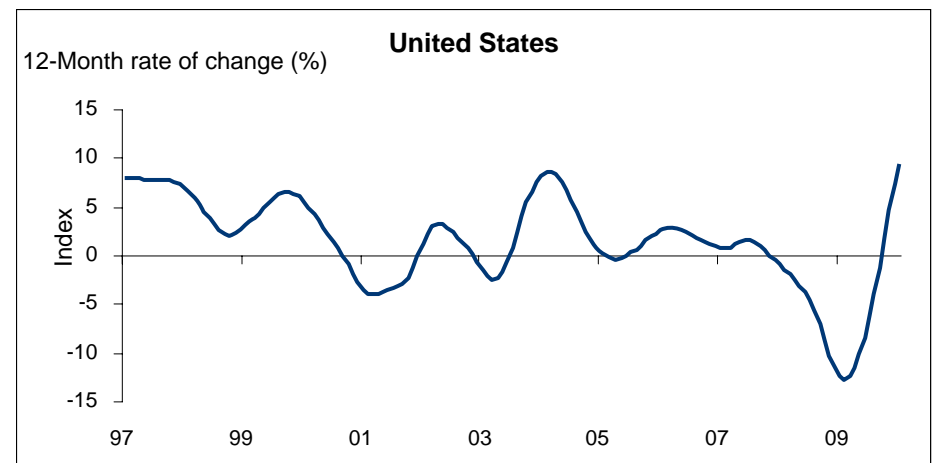
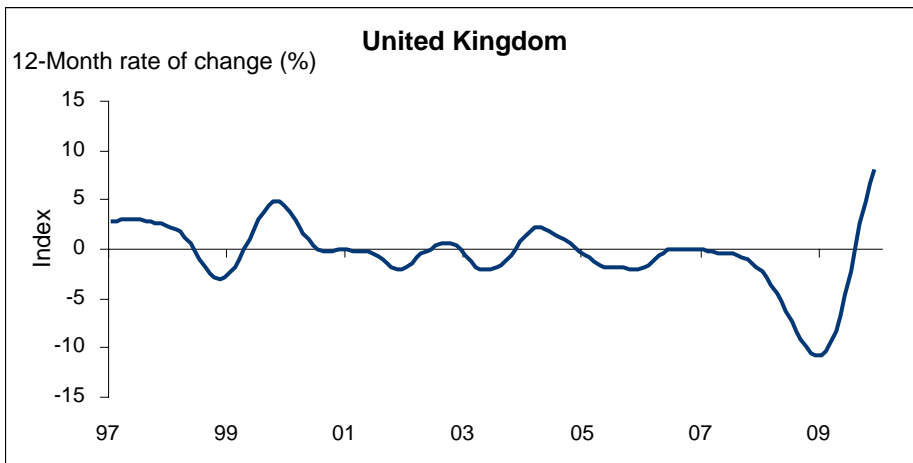
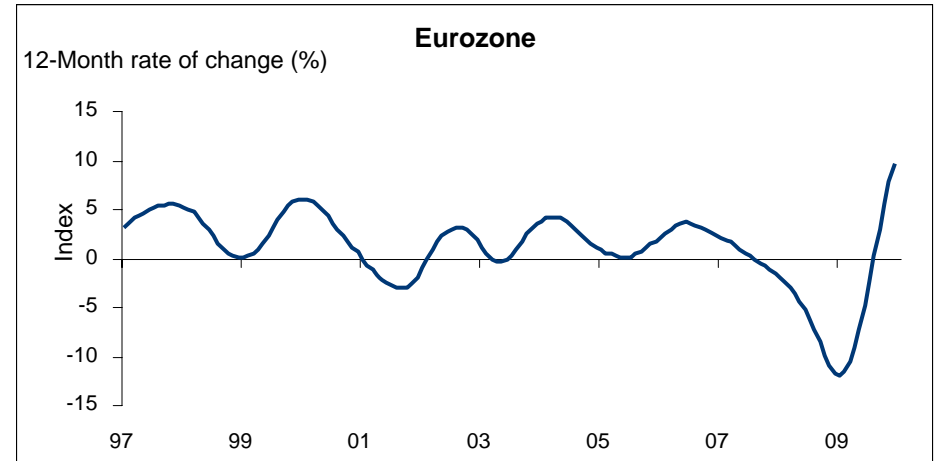
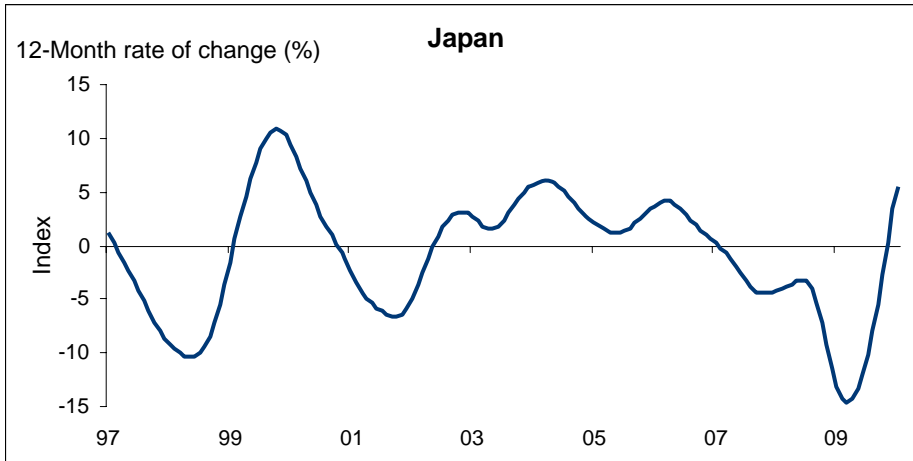
STYLE / SIZE / SECTORS – Continue to favor small caps and foreign equities

Styles, sizes, and sectors must be considered in light of low U.S. short-term interest rates, steepening yield curves and the return of inflation. We would continue to accumulate small-cap and foreign stocks in this environment.

The Organisation for Economic Co-operation and Development (OECD) predicts member economies will grow 1.9% in 2010. OECD unemployment is forecast to rise in 2010 before receding again in 2011. Europe lags in the OECD estimates, with below average 2010 economic growth and joblessness rising through 2011.



Compared against deeply depressed year-ago levels, leading indicators are showing strong improvement. At least six to twelve months of additional gains are needed to recover pre-recession levels of output in most developed countries.

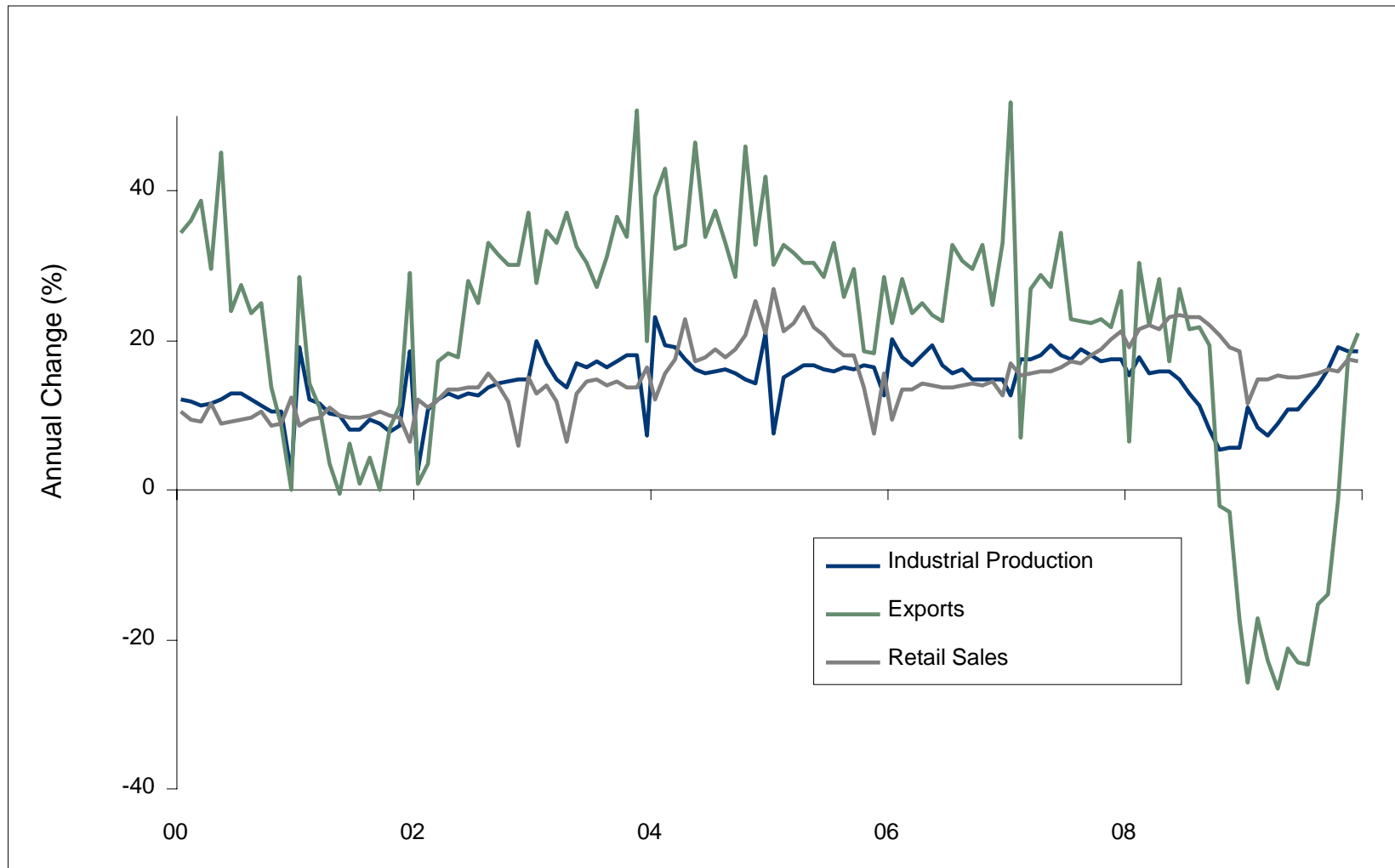


Note: Eurozone and U.K. through 31-Dec-09; Japan and U.S. through 31-Jan-10

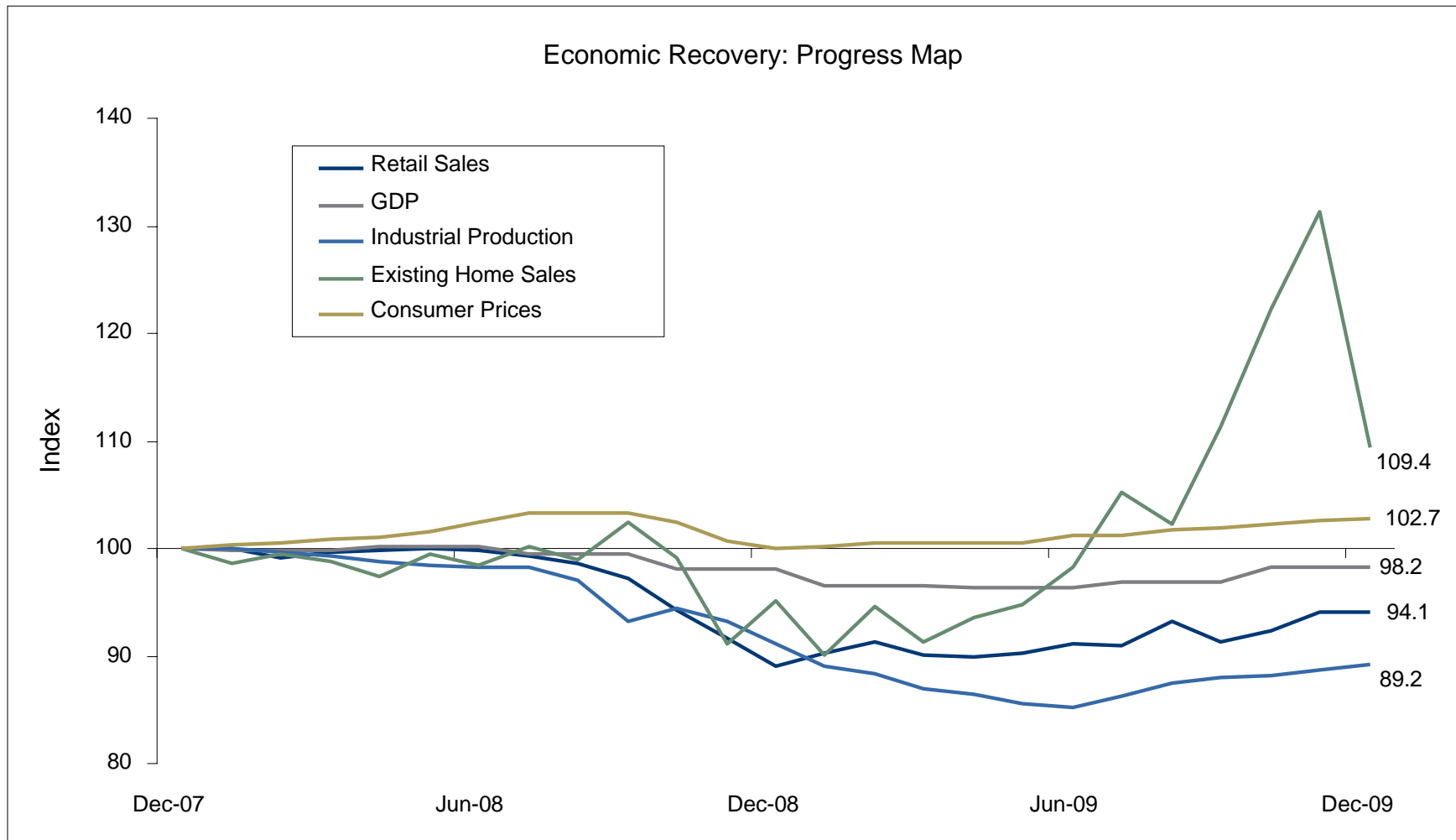
Source: Organisation for Economic Co-operation and Development (OECD); Nicholas-Applegate; see additional disclosure

Updated: 31-Jan-10

China's economy avoided much of the destruction caused by the financial crisis. Investors may react negatively as the country's authorities withdraw stimuli and tighten policy in 2010.



Economic indicators, including home sales, inflation and retail sales are growing again on a year-over-year basis. At least six to twelve additional months of growth are required to get us back to pre-crisis levels.

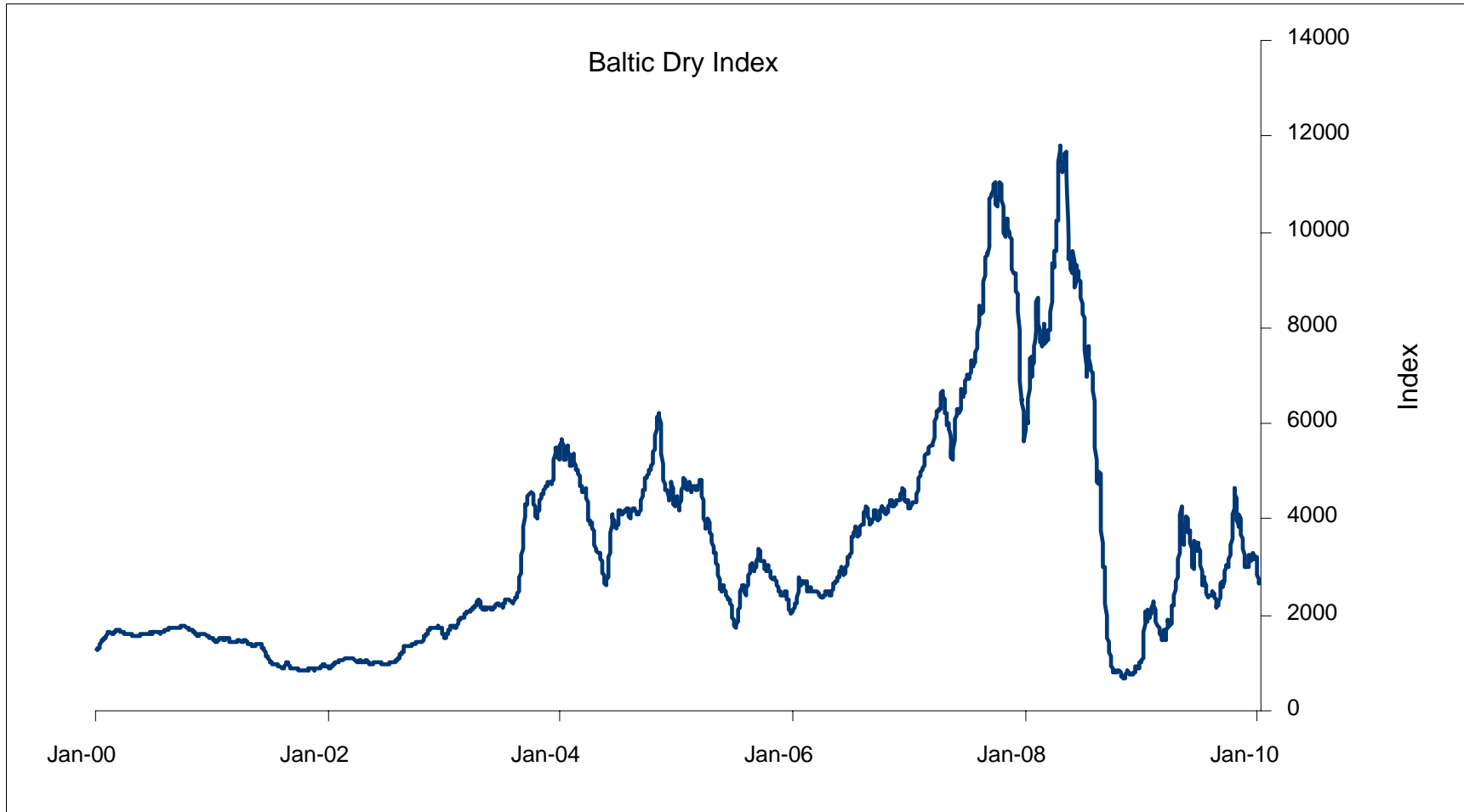


Note: Data indexed to 100 on 31-Dec-07

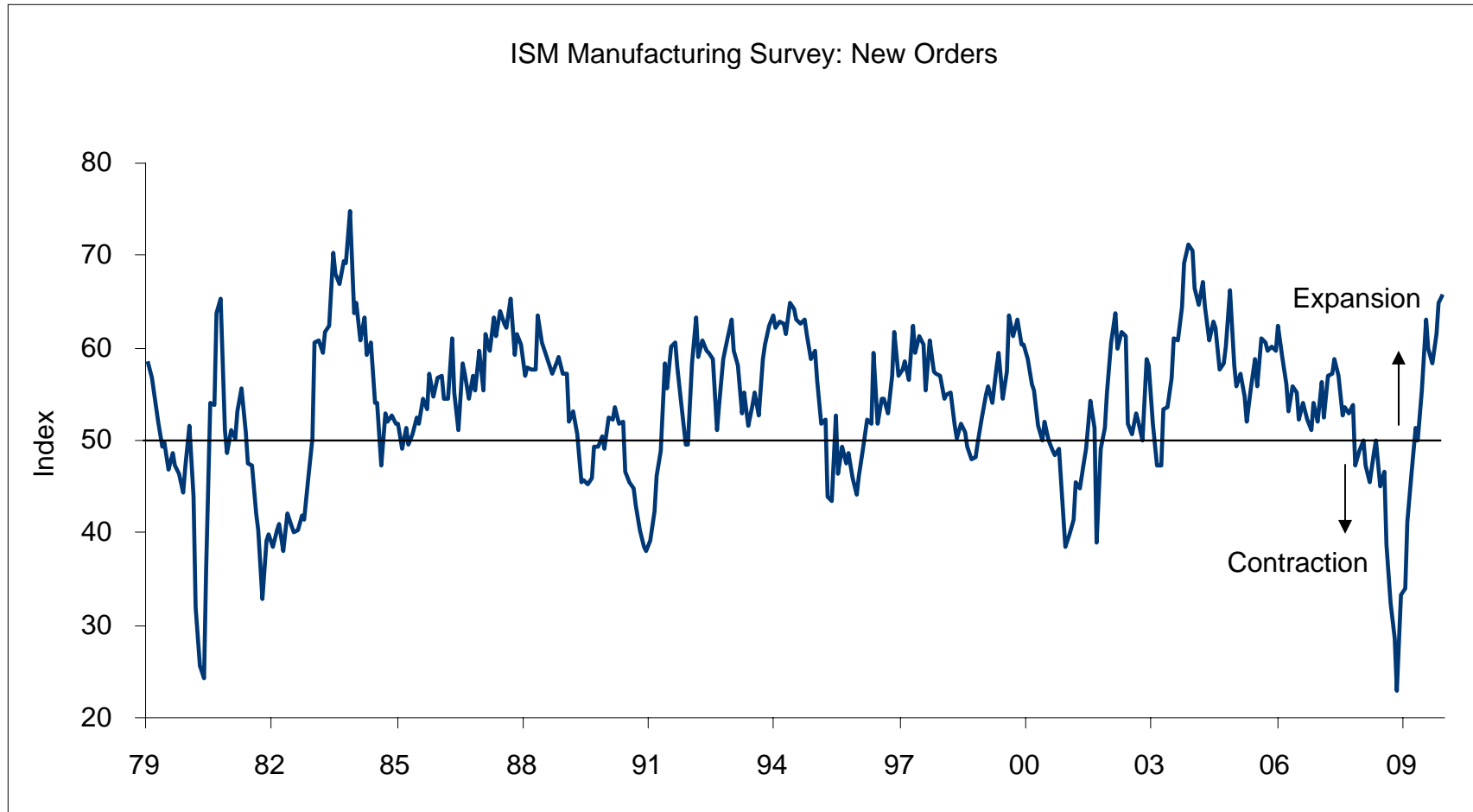
Source: National Association of Realtors; U.S. Federal Reserve; U.S. Census Bureau; U.S. Bureau of Economic Analysis; U.S. Department of Labor; Nicholas-Applegate; see additional disclosure

Updated: 31-Dec-09

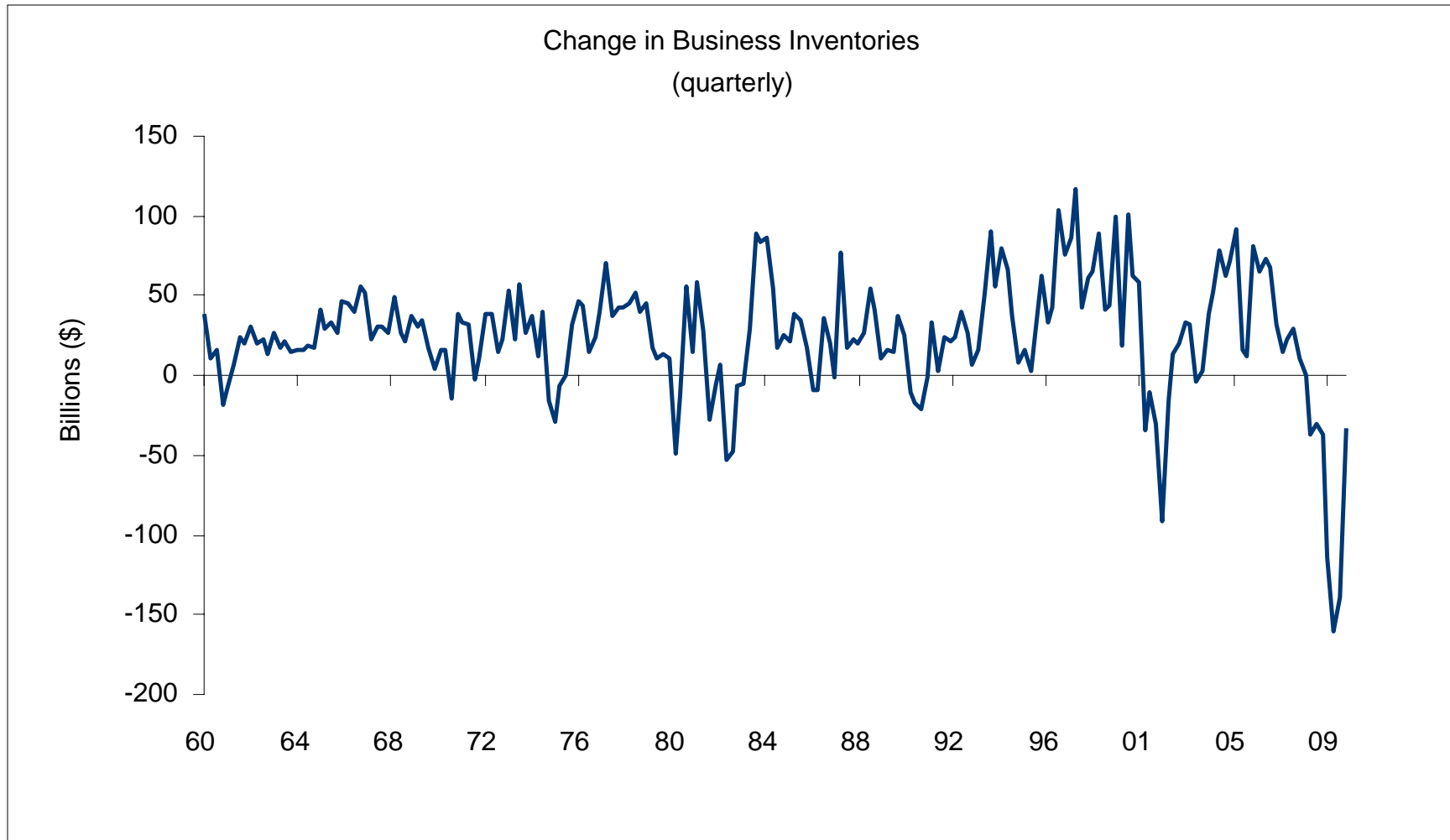
Dry bulk shipping rates are on a rising trend as global trade stabilizes and emerging market demand increases.



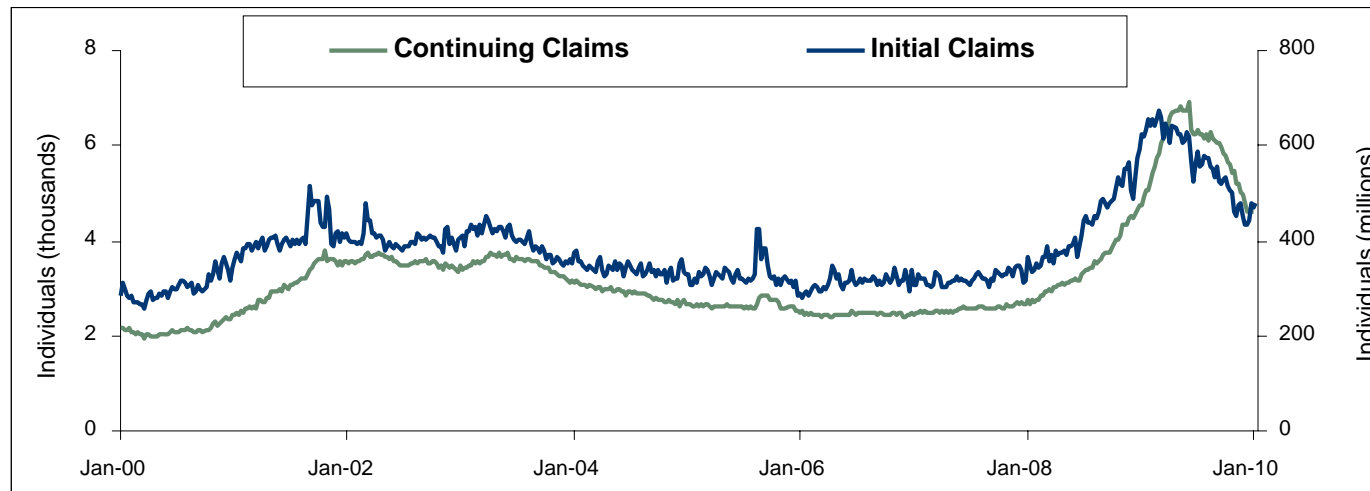
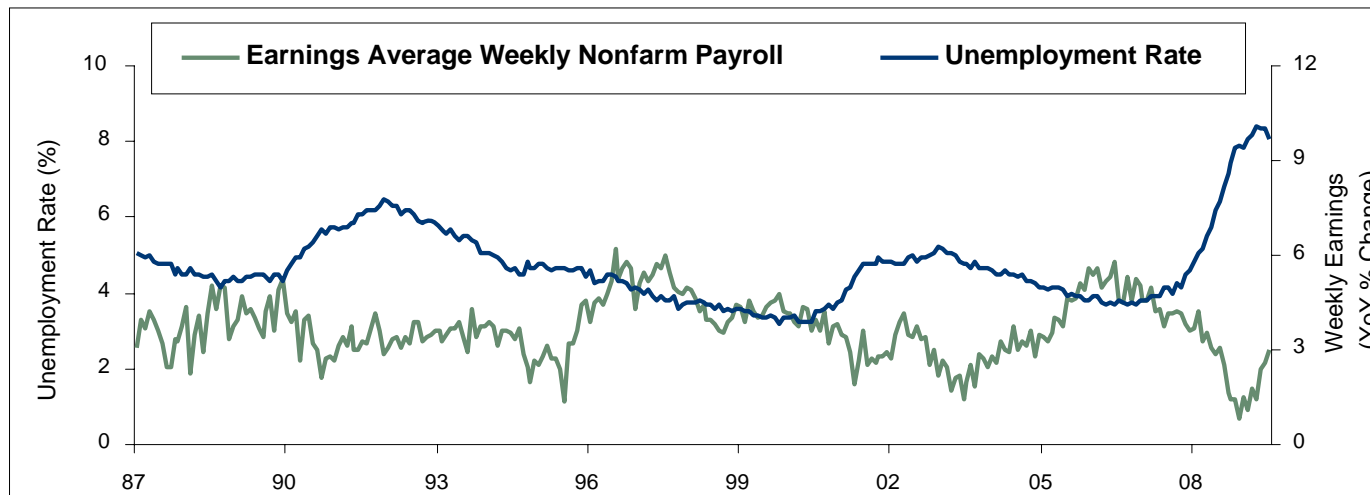
New orders, the most forward-looking component of the ISM manufacturing survey, bottomed in December 2008 and has been in expansion since July 2009.



Last year's record inventory drawdown is ending. De-stocking continued in 3Q09 and 4Q09, but at a much slower pace than the first half of the year. The reversal has provided a significant, but short-term, boost to GDP.



The recent stabilization in wages and jobless claims is encouraging, but overall conditions remain weak. Employers should begin adding jobs in 2010, but probably not in sufficient numbers to bring unemployment back below 9%.

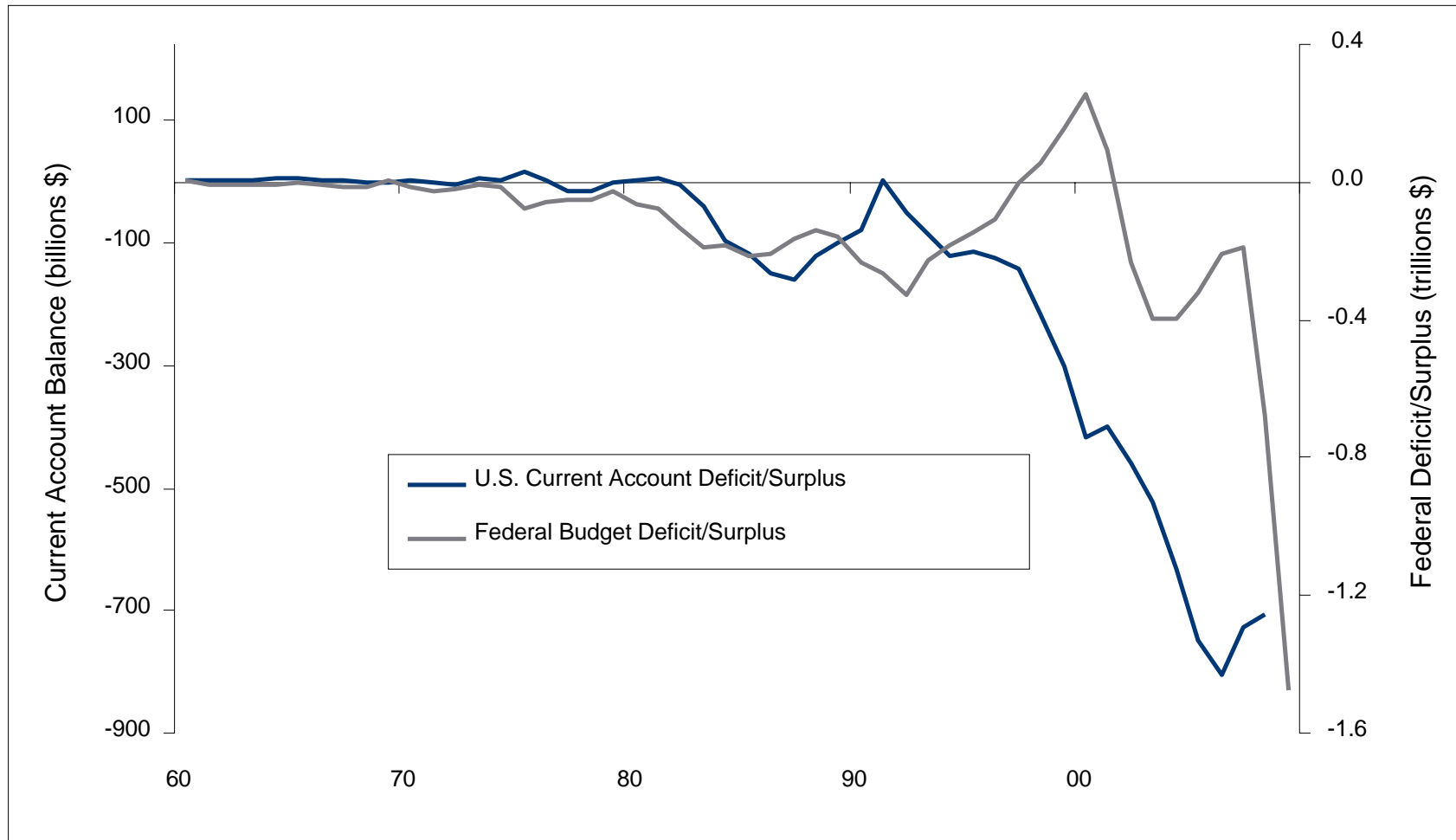


Note: Initial claims through 29-Jan-10; continuing claims through 22-Jan-10; all other figures through 31-Jan-10

Source: U.S. Department of Labor; Nicholas-Applegate; see additional disclosure

Updated: 31-Jan-10

America's federal budget and current account deficits constitute economic risk. These gaps are not sustainable in the long-term.

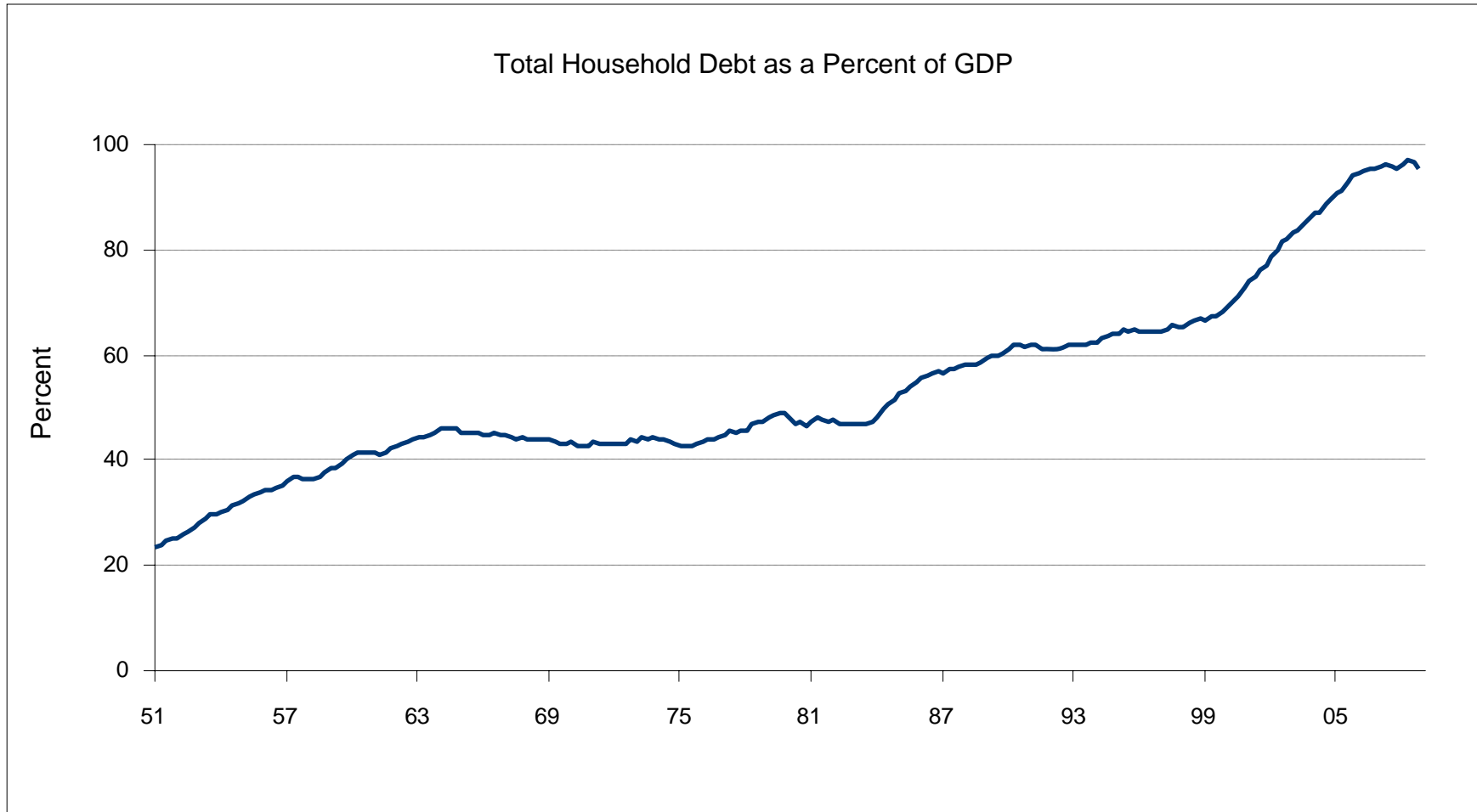


Note: Current account data through 31-Dec-08; federal budget data through 31-Dec-09

Source: U.S. Treasury; U.S. Bureau of Economic Analysis; Nicholas-Applegate; see additional disclosure

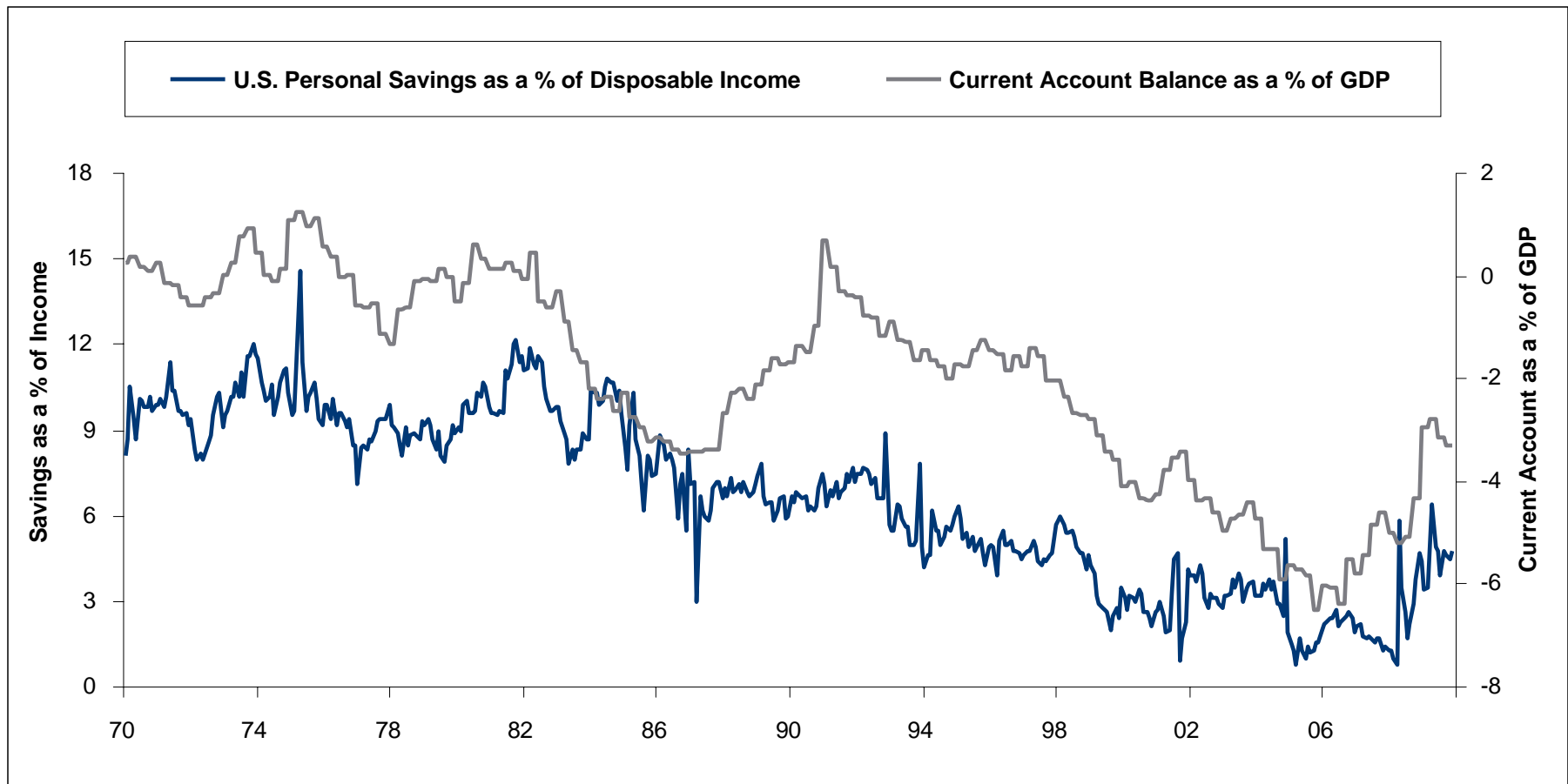
Updated: 31-Dec-09

The historic rise in household debt during the past decade reduces consumers' capacity for new borrowing.



U.S. Personal Savings and Current Account Balance

The U.S. personal savings rate may top 8% in the coming quarters, further pressuring consumer spending. This shift should help rebalance America's current account deficit.

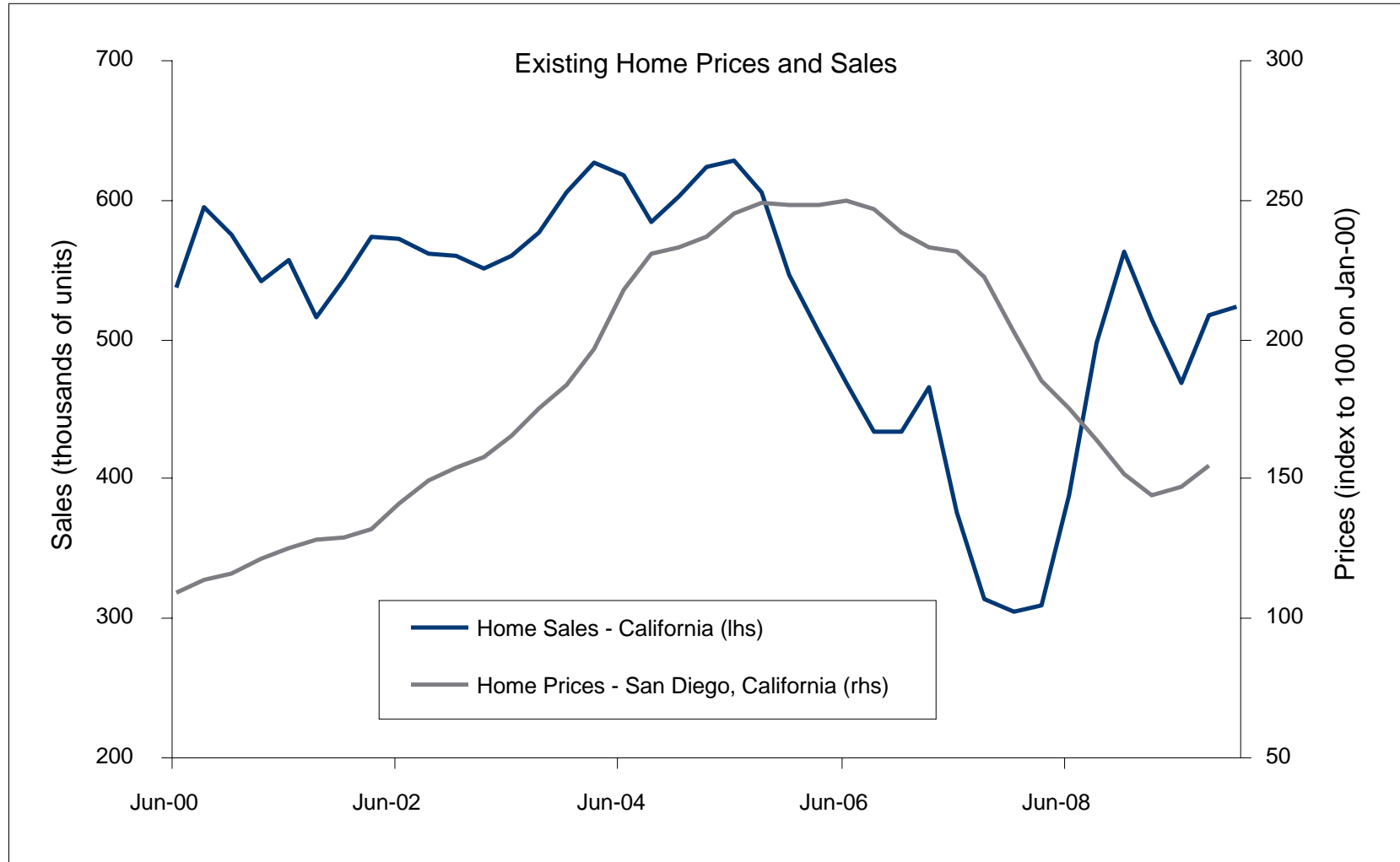


Note: Current account figures are quarterly, savings figures are monthly

Source: U.S. Bureau of Economic Analysis; Organisation for Economic Co-operation and Development (OECD); Nicholas-Applegate; see additional disclosure

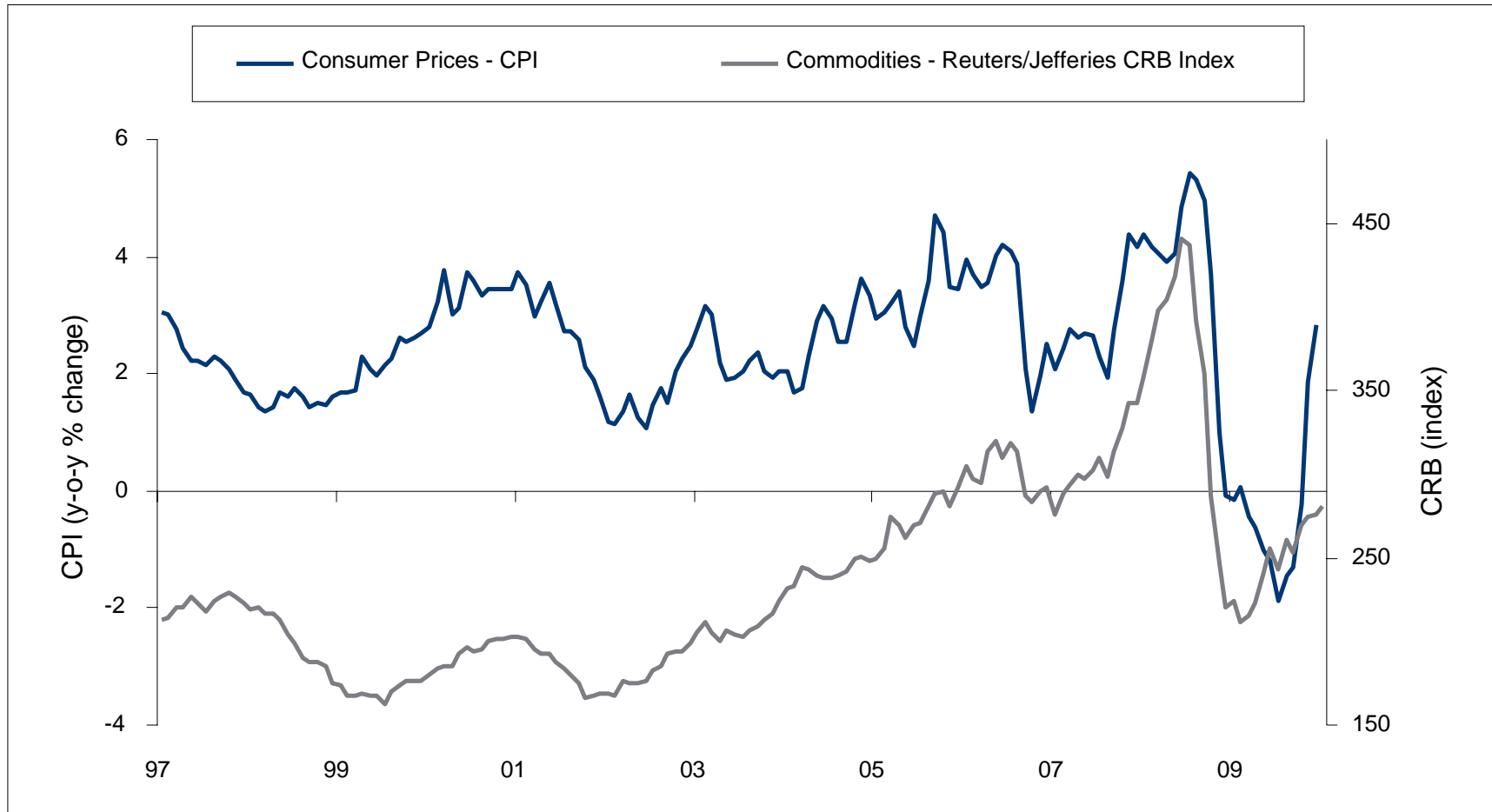
Updated: 31-Dec-09

Housing prices have stabilized as sales tick higher and lending standards ease. Foreclosures remain problematic.



Note: Home Prices through 30-Sep-09; Sales through 31-Dec-09
 Source: S&P/Case-Shiller; National Association of Realtors; Nicholas-Applegate; see additional disclosure

Commodity prices have recovered from crisis-level lows, helping spur the return of inflation. Falling at a 1.9% annual rate in July, U.S. consumer prices exited deflation in November, and rose 2.8% in December (year-over-year).

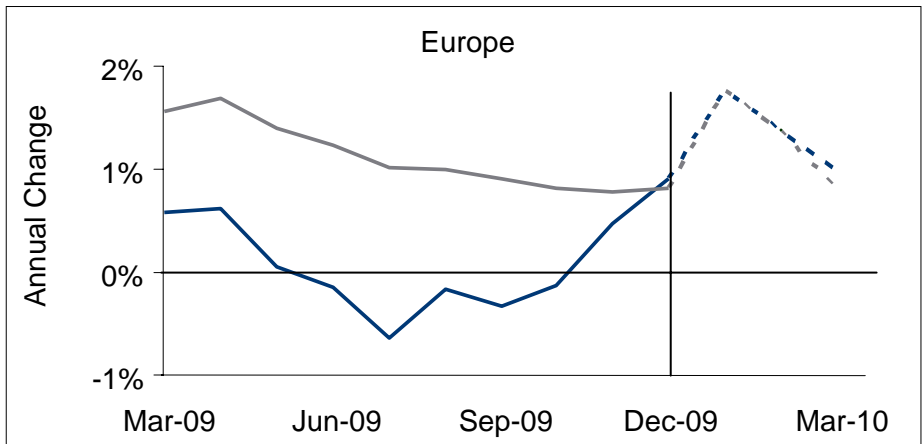
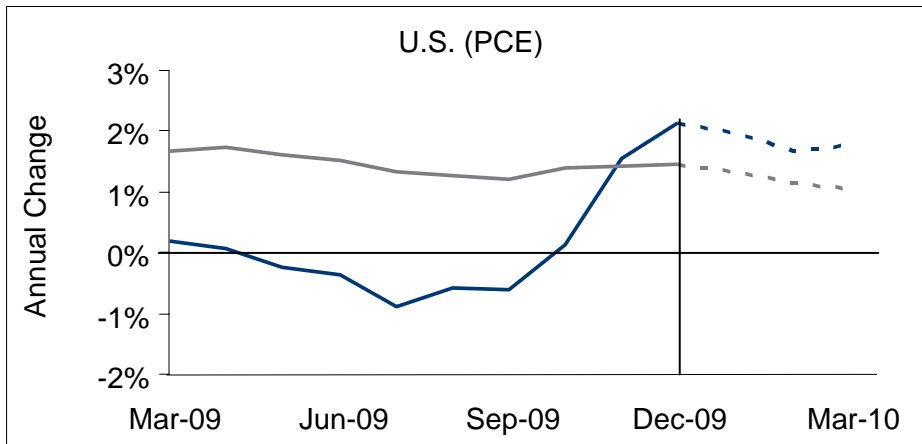
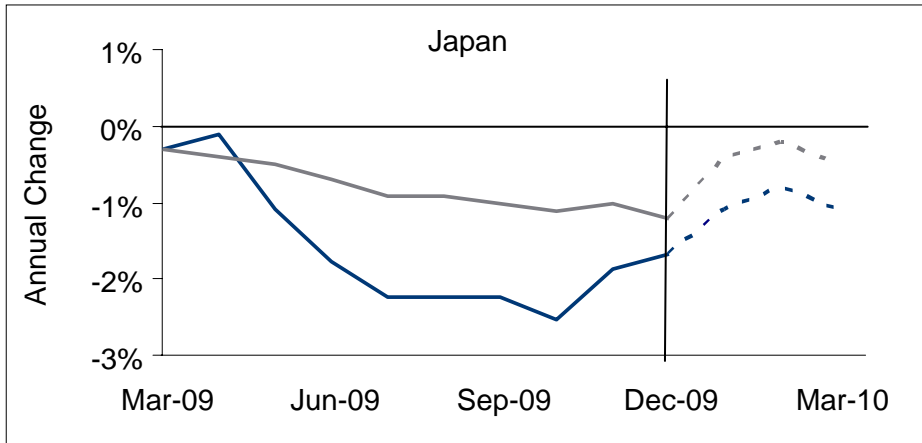
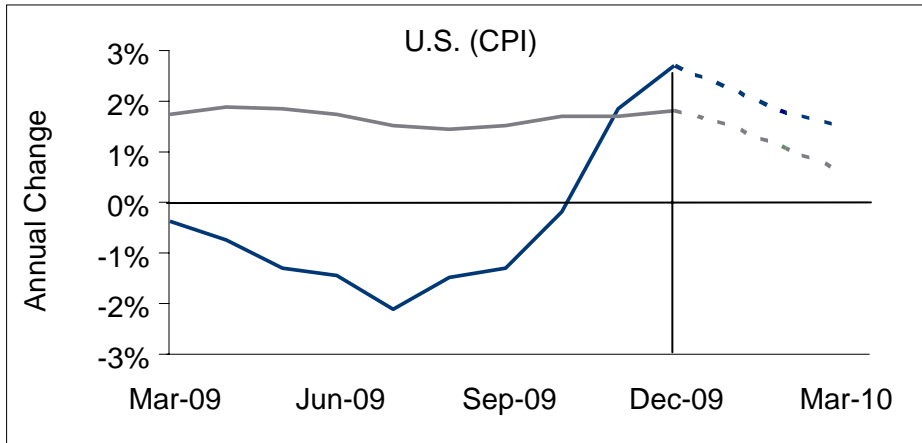


Note: CPI through 31-Dec-09; CRB through 31-Jan-10

Source: U.S. Department of Labor; Thomson Reuters; Nicholas-Applegate; see additional disclosure

Updated: 31-Jan-10

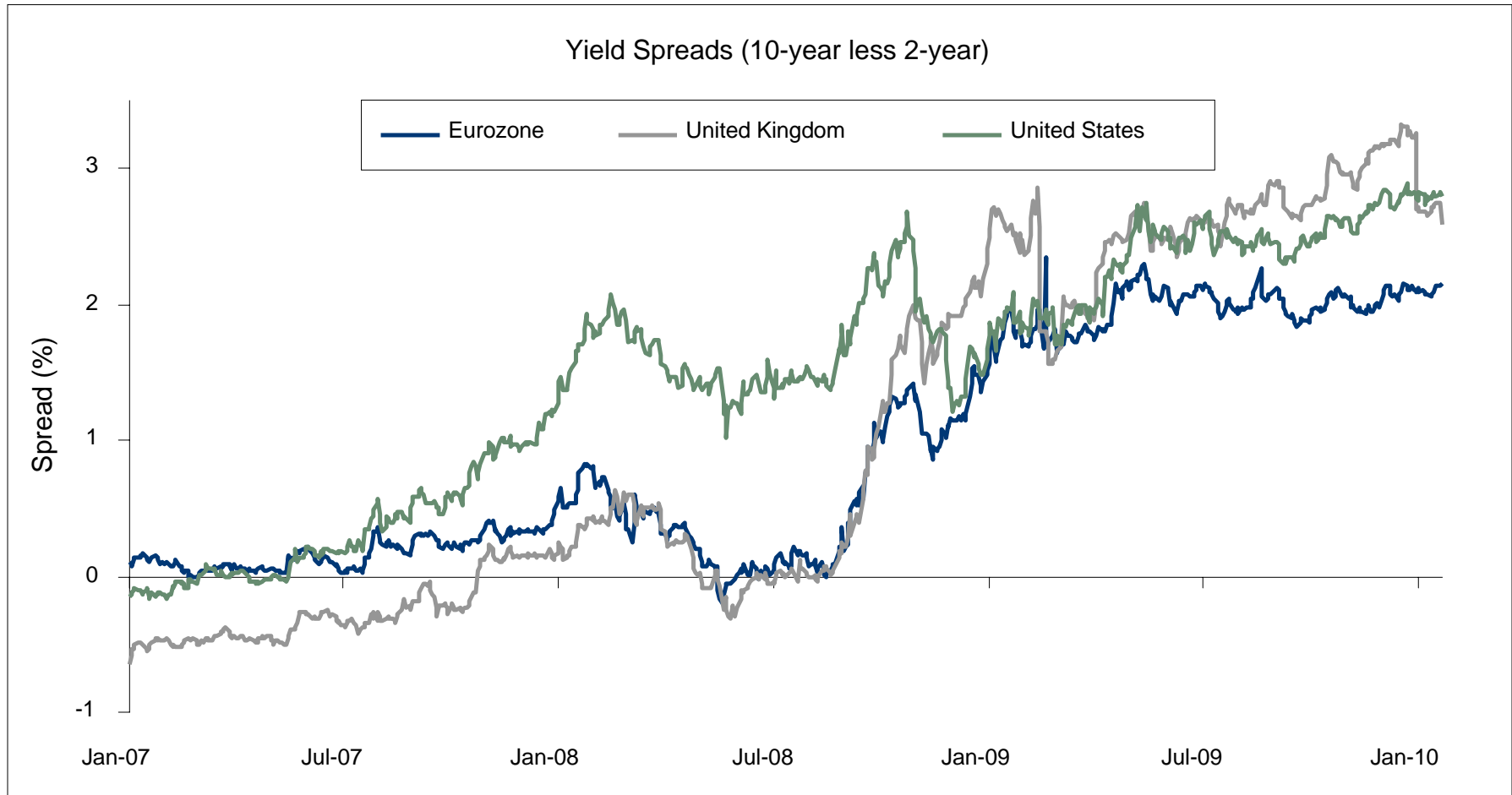
Price pressures have increased, pulling the U.S. and Europe out from deflation. Gains should moderate in the near-term, but before 2010 ends, we expect renewed upward pressure.*



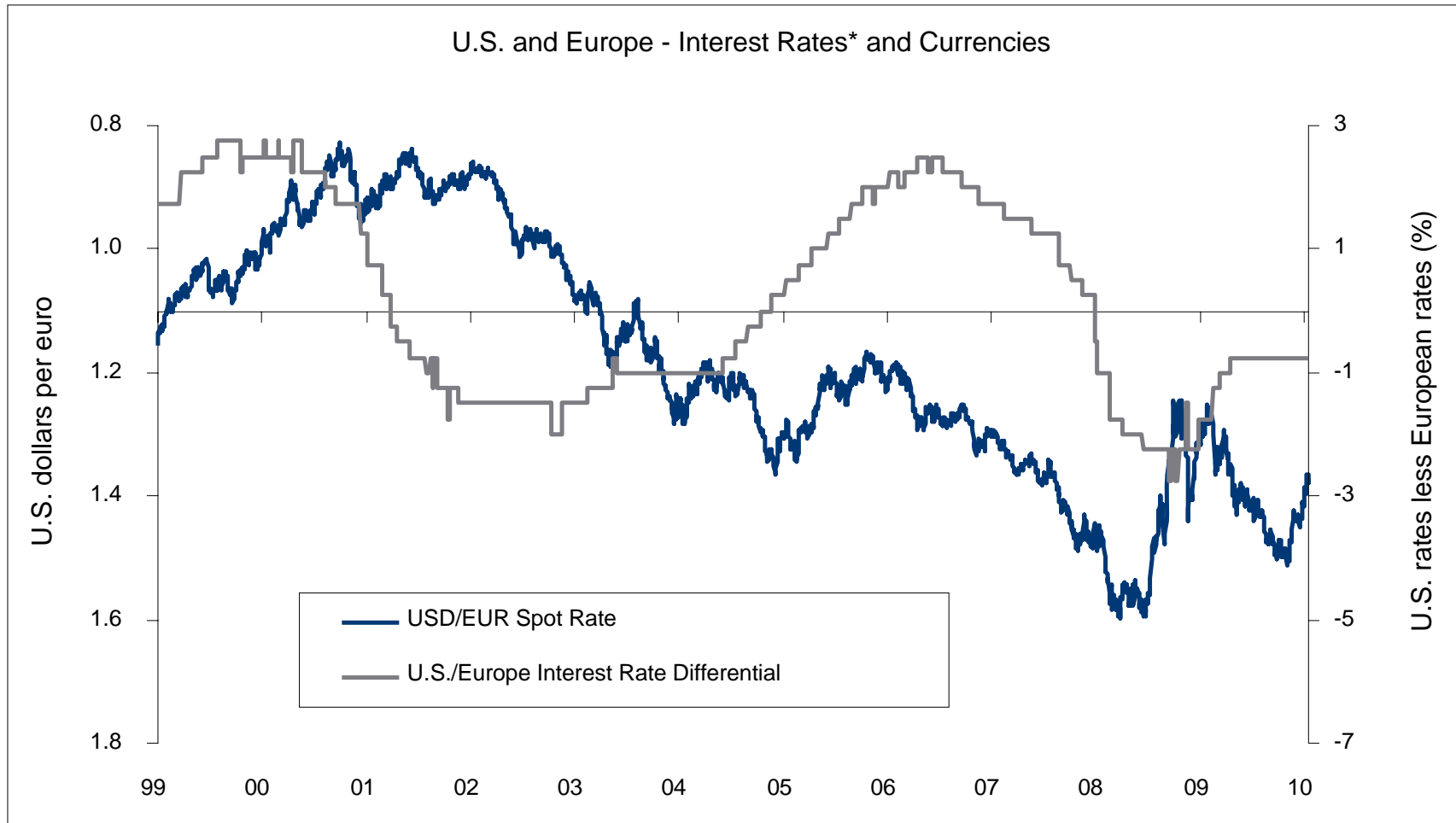
*Actual figures through 31-Dec-09; projections based on stable forward prices

Source: U.S. Department of Labor; Eurostat; Japan Ministry of Internal Affairs and Communications; U.S. Bureau of Economic Analysis; Nicholas-Applegate; see additional disclosure

Aggressive monetary easing has helped draw steeper yield curves in the U.S. and abroad. In the U.S., excess supply and long-term inflation concerns should lead to further steepening.



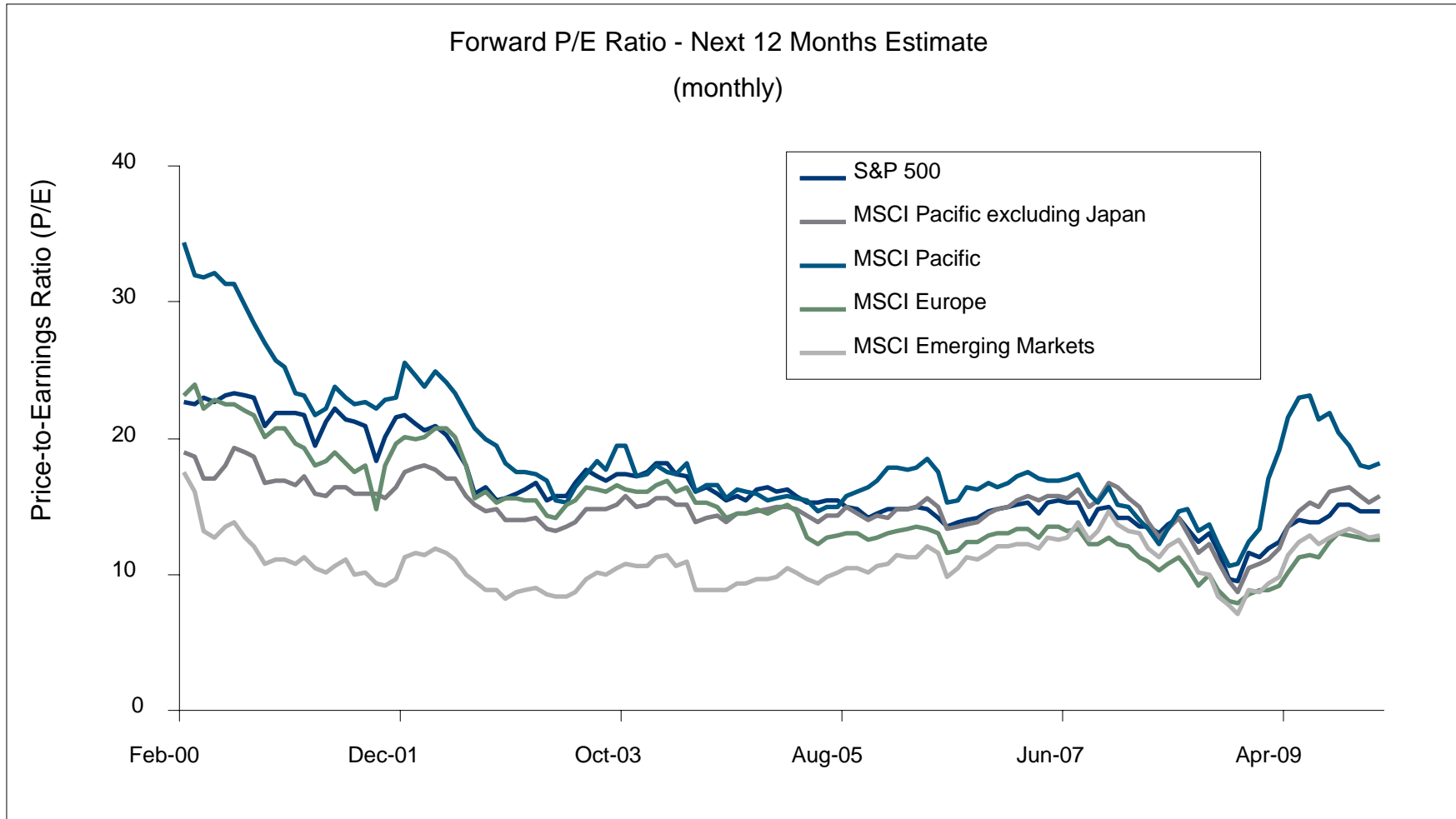
The U.S. dollar may strengthen against the euro over the next twelve months, as country-specific challenges weigh on Europe and the Federal Reserve gears toward policy tightening.



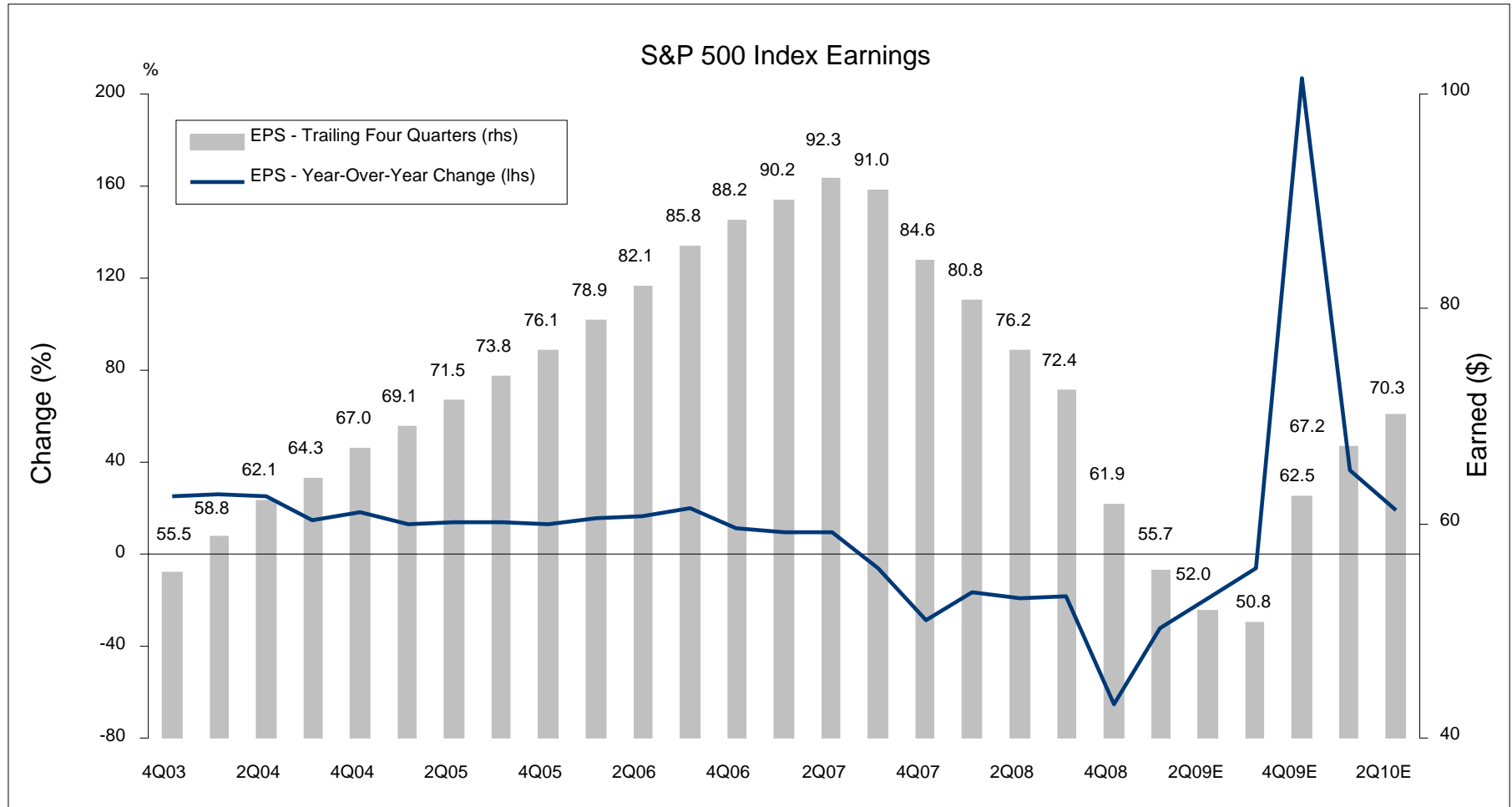
*U.S. short-term rates minus European constant short-term rates

Source: Bloomberg; FactSet; Nicholas-Applegate; see additional disclosure

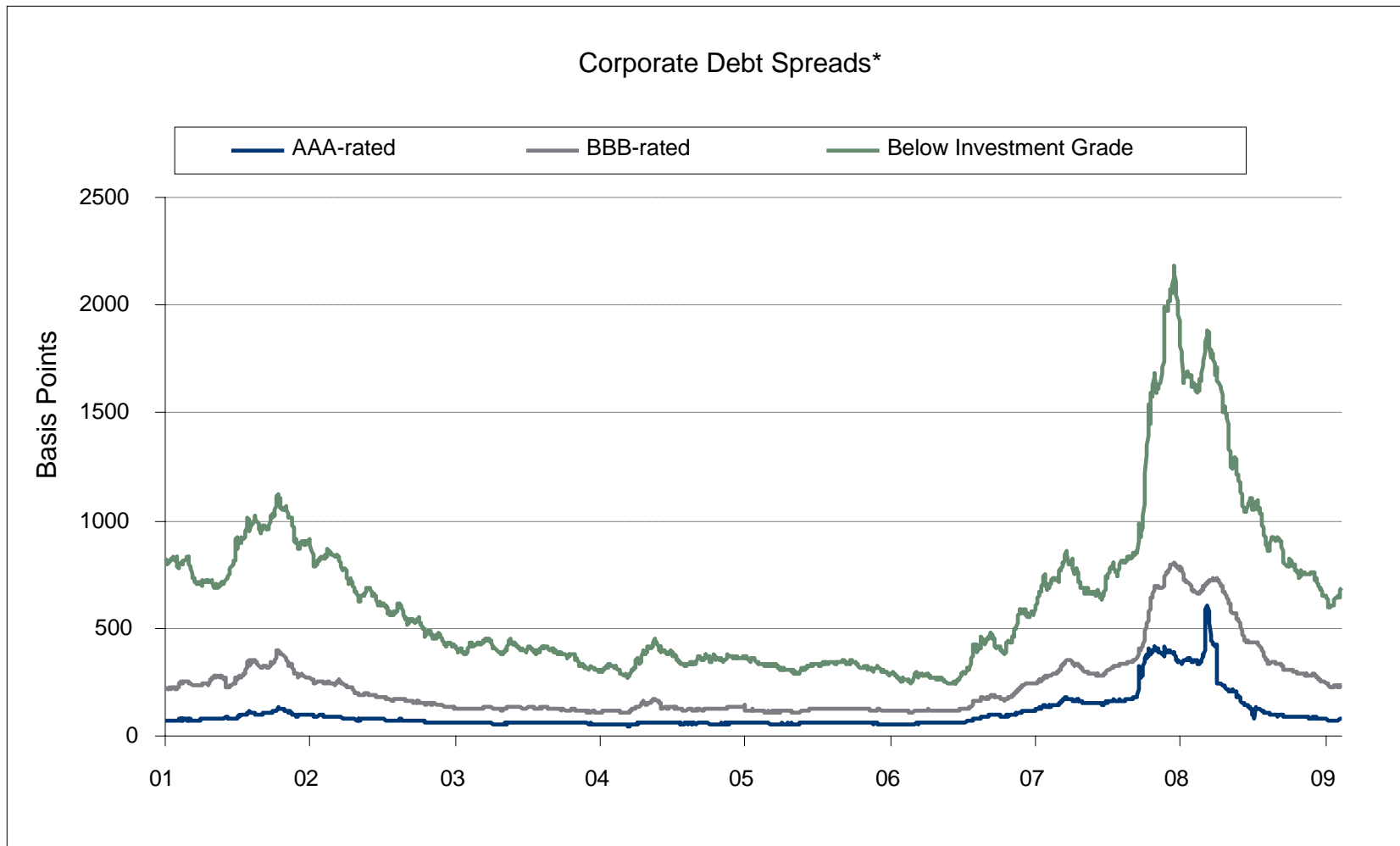
Despite the 2009 rally, equity valuations aren't unreasonable. Through January, P/E ratios in Asia, Europe and the U.S. were below both last year's highs and ten-year averages. Emerging market stocks are an exception, trading at P/Es that are higher than their ten-year average.



S&P 500 profits are predicted to rise more than 200% during the fourth quarter, largely because year-over-year comparables are dismal. Early estimates for calendar year 2010 indicate profit growth in the mid-20s range.



Spreads have tightened substantially from historic levels, but remain elevated. When spreads reached comparable levels in the early 1990s and 2000s, high yield investors experienced positive returns.



*Debt spreads are equal to yield-to-worst less comparable U.S. Treasuries

Source: Bank of America - Merrill Lynch; Nicholas-Applegate; see additional disclosure

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