

What's New at Arrowstreet?

We hope this issue of the Arrowstreet Journal finds you enjoying the start of fall. This edition of the Journal features a white paper by Tuomo Vuolteenaho and Greg Ingolia on the link between GDP growth and stock returns.

Q3 2009 Review:

Investment Performance Attribution:
Global equity markets extended the gains made in the second quarter through the third quarter of 2009 on growing evidence that the recession was less extreme than originally feared.

Business Growth:

During the third quarter, Arrowstreet's firm-wide assets under management increased to \$21 billion and we have reached our Emerging Markets product capacity for separate accounts.

Team Members:

In this edition of the Journal, we profile Robert Roderick and Joe Tiano, who joined Arrowstreet's portfolio management team in 2006 and 2008, respectively. Please turn to page 3 of the Journal to learn more about Robert and Joe.

As always, we are interested in your views and encourage your feedback. Please email your thoughts to us at:

info@arrowstreetcapital.com

How Tight Is The Link Between GDP Growth and Stock Returns?

*Tuomo Vuolteenaho, Ph.D., Partner,
Co-Head of Research*

Greg Ingolia, Manager, Research

Growth is often viewed as the Holy Grail of successful investing, and justifiably so. Assuming a discount rate of 5%, a perpetuity growing at 3% has twice the present value of a perpetuity growing at 1%. This power of growth to drive present values has lead investors to look for growth everywhere they go.

Countries with high GDP growth are natural places to look for companies that deliver value added growth to their investors. Care must be taken, however, not to equate high GDP growth with high growth of cash flows to investors. The four main reasons why investors' wealth might not enjoy similar growth to the country's GDP are the following:

- First, the growth may be accompanied by a shift of pay-offs from capital to labor.
- Second, the GDP growth may not be coming from the existing companies but instead from new companies.
- Third, even if the growth is coming from the existing companies, this growth may require large investment and lead to associated dilution.
- Fourth, it is important to remember that even if the high GDP growth translates to high per-share cash flow growth, the returns earned by the existing shareholders may be ordinary or even disappointing if the equities are priced to fully reflect this future growth.

To what extent GDP growth "trickles down" to existing shareholders is an empirical question. To answer this question, Tuomo and Greg assembled a large, annual panel of stock returns and GDP growth rates.

For a complete version of this article, please visit:
http://www.arrowstreetcapital.com/research_whitepaper.htm

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September 2009 Investment Outlook

Global/International Equity Strategy

Developed Markets Overview: 3rd Quarter 2009

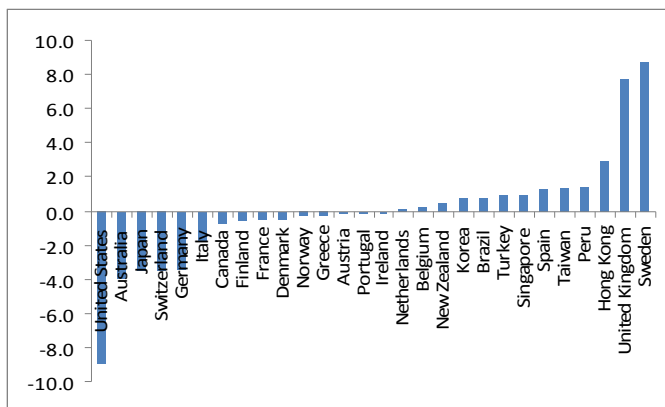
Global equity markets extended the gains made in the second quarter through the third quarter of 2009 on growing evidence that the recession was less extreme than originally feared. The MSCI EAFE index returned 14.9% in local currency terms during the quarter, following the second quarter's large gains. US home prices began showing signs of recovery, rising the most in four years during the month of July as low borrowing costs, government tax credits and depressed prices encouraged buyers. US Consumer confidence also began a recovery and jobless claims fell slightly during the quarter. Confidence also continued to recover in Europe as government spending flowed into the economy and the European Central Bank kept interest rates at record low levels. Despite the encouraging data, economists cautioned that the drop in unemployment rates and a return to economic strength would not be rapid because of the severity of the downturn.

The US Dollar continued to weaken during the quarter and commodities strengthened. Gold climbed to over \$1,000 per ounce and the Japanese Yen strengthened to 90 Yen per US Dollar. Chinese Premier Wen Jiabao fueled speculation over the world's central banks' plans to move investments away from the US Dollar when he said China was "worried" about the safety of its investments in US debt. Subsequently, it has been speculated that a number of Arab states are contemplating a similar move.

Among developed countries, the Netherlands was the best performing developed market country during the third quarter, in local currency terms. The market index rallied 26% over the past three months. Netherlands Financials were the best performing group within the market, rising 56% on the quarter. The worst performing developed country was Japan, whose market index was the only negative performer amongst developed nations, losing 1% for the quarter. The Japanese Financials sector, in particular, was hardest hit; down 14% over the period.

Every sector in the developed world posted positive returns in the third quarter. Financial stocks were the best performers amongst developed countries. After soaring more than 30% in Q2, the sector gained 22% in the last three months. As fears of the severity of the recession have softened, financial names have led the market's recovery. Goldman Sachs, Bank of America, JP Morgan, and other large financial institutions announced better-than-expected earnings, bolstering banking sector performance for the quarter. The Utilities sector was the worst performer in the third quarter amongst developed nations, returning 8.47%, as defensive stocks lagged their sector peers. In a similar fashion, the Health Care sector also underperformed the broad market, finishing up only 10.95% for the quarter.

September 2009 Active Country Weights (%)
(MSCI World)



Developed Markets Strategy Performance Attribution

Two country/sector baskets that impacted the performance of Arrowstreet's developed markets portfolios during the quarter are described here:

United States Information Technology - Seagate Technology, the world's largest maker of hard-disk drives, saw share prices rise after the company raised revenue guidance for the third quarter. The CEO Steve Luczo made a substantial purchase of the company's stock which also bolstered investor confidence in the company. Our overweight position in Seagate was held for cheap valuations and attractive momentum signals.

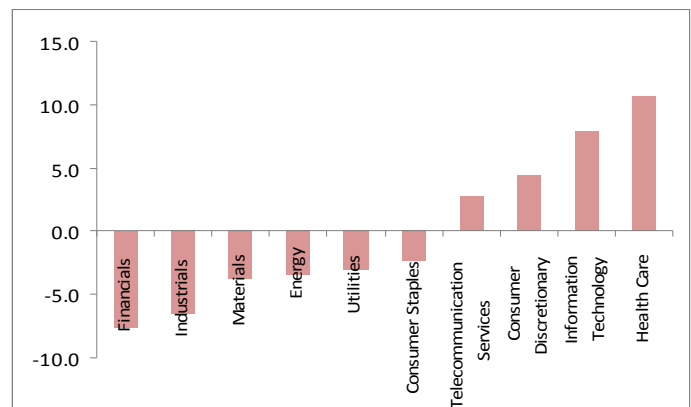
Sweden Consumer Discretionary - Shares of Swedish appliance manufacturer, Electrolux AB, soared 48% in the third quarter, after rallying 67% in the previous three-month period. Electrolux shares surged in early July after the company announced its second quarter profits increased six-fold, thanks to cost cuts in a period where demand for home appliances faltered. The stock continued its upward trend through September after the stock was upgraded to "overweight" by an equity analyst at HSBC.

Specific opportunities that we believe will offer attractive return potential include:

Western Digital (United States Information Technology): Western Digital, a leading computer hard drive maker, saw its shares rise over 37% in the third quarter. The company is expected to benefit from the Windows operating system upgrade cycle as companies finally start moving away from Windows XP. Earnings are also expected to increase as the holiday season approaches. Our overweight positioning in the stock is motivated by Basket level momentum and County level macroeconomic terms.

Nordea AB (Sweden Financials): Nordea Bank AB, the Nordic regions largest lender, was up 14% last quarter. The CEO stated that the economic deterioration in the Baltic countries had stopped and there would not be further loan losses at the bank. The bank has also been working to expand its footprint by acquiring smaller rivals. Attractive Stock level momentum and Stock level high frequency signals drive our overweight position in the stock.

September 2009 Active Sector Weights (%)
(MSCI World)



Data provided above is for Arrowstreet's longest standing representative portfolio for the Global Equity strategy as of the end of September.

September 2009 Investment Outlook Emerging Markets Equity Strategy

Emerging Markets Overview: 1st Quarter 2009

The MSCI Emerging Markets index returned 21% in US dollar terms during the quarter, following the second quarter's large gains. Optimism about economic recovery, rising domestic demand in China, and rising commodity prices fueled emerging market gains.

Peru was the best performing emerging markets country. The gains were driven by the rising price of commodities. Prices for copper and lead, major Peruvian exports, rose 24% and 35% respectively during the quarter as the outlook for global economic growth and demand for raw materials improved. China's equity markets lagged the broader emerging market index returns in the third quarter after rising steadily during the second quarter. Investors grew concerned that the sharp recovery in Chinese stocks became over-heated during the third quarter and that Chinese banks would tighten lending practices.

Information Technology was the best performing sector in the emerging markets. Electronics manufacturers benefited from strengthening demand for components for laptops and smaller net-books. The worst performing sector in the emerging markets was Health Care. Israeli generic drug-maker Teva Pharmaceutical underperformed during the quarter as US regulators accepted a rival's application for one of Teva's best selling medicines. Teva constitutes a large percentage of the market capitalization of the emerging Market's Health Care sector.

Emerging Markets Strategy Performance Attribution

Two country/sector baskets that impacted the performance of Arrowstreet's emerging markets portfolios during the quarter are described here:

Turkey Industrials - Turk Hava Yollari, the national airline of Tur-

key, rose 66% in the third quarter. The Prime Minister of Turkey announced the country needs one or two more major airports to handle the increasing traffic into and out of Istanbul. The company has been working throughout the year to also expand its fleet to capitalize on increasing demand. Our overweight position in this stock was based on stock level earnings and value signals.

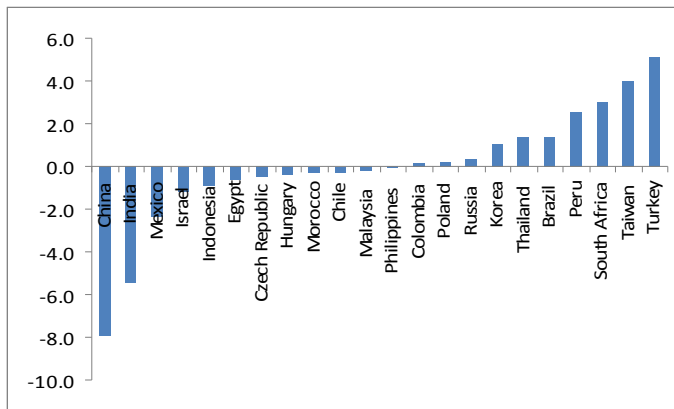
China Information Technology - Tencent Holdings has several different online offerings in China including instant messaging, online payments and video games. The stock was up 39% on large profit reports due to their online social networking venture. Our overweight positioning was based on Indirect Momentum and stock level value terms.

Specific opportunities that we believe will offer attractive return potential include:

Tencent Holdings (China Information Technology): Basket level value and Country level macroeconomic terms are the motivation behind overweight positions in Chinese internet company Tencent Holdings. Tencent operates China's largest internet-chat service, in addition to online gaming and other services. Growth in revenue generated by the company's online advertising and online commerce services has helped the company. Tencent is also succeeding in controlling costs as it grows and exploiting economies of scale as it grows with rapidly expanding internet use in China.

Cia de Bebidas das Americas (AmBev) (Brazil Consumer Staples): Latin America's largest brewer Cia de Bebidas das Americas, widely known as AmBev, is a stock we expect to outperform the broad market going forward. The company's rising share of the Brazilian beer market along with the strengthening recovery in Brazilian consumer spending will boost AmBev's revenues. Ambev shares are attractive based on Basket level Value and Stock level momentum terms.

**September 2009 Active Country Weights (%)
(MSCI EM Index)**



**September 2009 Active Sector Weights (%)
(MSCI EM Index)**



Employee Profiles



Robert Roderick
Associate, Portfolio Management
Robert works with the portfolio management team and is responsible for many of the day to day functions and trade support for our investment process. Prior to joining Arrowstreet, he worked as a Research Analyst for SAC Capital Management and for DTAP Capital Advisors. Rob graduated from New York University with a B.S. in Finance and Economics in 2004.

Joe Tiano
Associate, Portfolio Management
Joe works with the portfolio management team and is responsible for many of the day to day functions and trade support for our investment process. Prior to joining Arrowstreet Joe was a consultant with Factset. He received his BS in Economics-Finance from Bentley College in 2006.

