

What's New at Arrowstreet?

We hope that 2010 is off to a great start for you. This edition of the Journal features a white paper which reviews three powerful arguments commonly made against active extension strategies.

Q4 2009 Review:

Investment Performance Attribution:
Global equity markets continued their ascent during the fourth quarter of 2009 as positive economic news led to reduced fears of a double dip recession..

Business Growth:

During the fourth quarter, Arrowstreet's firm-wide assets under management increased to \$23 billion.

Team Members:

In this edition of the Journal, we profile Erica Monroe and Neil Garceau, who joined Arrowstreet's business development team in 2008 and 2010, respectively. Please turn to page 3 of the Journal to learn more about Erica and Neil.

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

Active Extension Strategies: A Response to the Skeptics

For the better part of the 2000s, active extension strategies were heralded with great fanfare as a step into the future of active management. Managers using active extension strategies such as 130/30, holding 130% of invested capital in long positions and 30% in short positions, can express not only their positive outlooks for individual securities by over-weighting them in the portfolio, but also their negative outlooks via short sale positions. For boosters of active extension strategies, this relaxation of short sales constraints is an unambiguously good thing.

During the last few years, plan sponsors have grown skeptical of active extension strategies. This is understandable given that they experienced both systemic risk exposure during the global financial crisis and subpar investment performance by many managers in this space. In this note we discuss the main criticisms of active extension strategies advanced by their growing chorus of detractors. Are these criticisms valid, or is active extension still underutilized in investor portfolios?

Three powerful arguments are commonly made against active extension strategies:

- 1) Counterparty exposure to prime brokers is unacceptably high and should not be delegated to the active extension manager.
- 2) Early results for active extension strategies have fallen short of the benchmark in many cases.
- 3) Active managers lack sufficient understanding of short-sale candidate securities to overcome the additional costs imposed by borrowing fees.

In this paper, we review each of these arguments in turn.

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

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December 2009 Investment Outlook Global/International Equity Strategy

Developed Markets Overview: 4th Quarter 2009

Global equity markets continued their ascent during the fourth quarter of 2009 as positive economic news led to reduced fears of a double dip recession. With industrial production climbing 0.8 percent and unemployment falling by 0.2 percent in the US in November, the world's largest economy is recovering as we enter 2010, when stimulus spending will reach its peak. While the Federal Reserve continues to indicate a commitment to low interest rates, talk has been mixed between embarking on a second round of quantitative easing and planning around an 'exit strategy' from their nontraditional asset purchases.

European nations also showed signs of growth as the Eurozone consumer confidence index rose to its highest levels since September 2008, indicating that stimulus programs were working and the recovery is gathering strength. Despite initial signs of an economic turnaround, anger at the financial system remains high as elevated unemployment lingers. The United Kingdom implemented a one time 50 percent surtax on bonuses in an effort to raise government revenues and fix the short term incentives believed to have contributed to the crisis.

Concerns about a state owned Dubai World default brought a fresh wave of speculation about sovereign solvency when the company attempted to delay debt payments in November. Dubai and the company were ultimately bailed out by Abu Dhabi, their United Arab Emirates neighbor, ensuring they could make timely payments on their debt obligations. The worst of spillover effects was suffered by Greece, whose deficit, at 12.7 percent of GDP, will be the highest in the European Union.

Among developed countries, Norway was the best performing country in local currency terms during the fourth quarter. The country index advanced 14% over the three-month period. Norwegian Materials were the best performer in the region, gaining 37% on the quarter. The worst performing developed country was Greece, with the MSCI Greece Index declining more than 20% in the 4th quarter after a 5% drop in December. Greek Financials were the worst performer, dropping 26% in the fourth quarter, followed by Materials, which declined more than 13% over the same time period.

Seven of the ten sectors in the EAFE index posted positive performance for the 4th quarter. The Materials sectors posted the largest gain of over 13%. Some of the best performing stocks in this sector were Vedanta Resources and Anglo American, two large metal mining companies. The commodities rally was sparked by a strengthening recovery and successive increases in demand from various countries. The Financials sector was the worst performing sector in the developed markets during the fourth quarter, after registering strong gains during the second and third quarters. Bank stocks around the world fell as investors grew concerned that banks may lack sufficient capital to meet the tightening standards of regulators and rating agencies. Apprehension over the strength of economic recovery also weighed on Financials' share prices.

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 - Our overweight position in computer drive manufacturer Western Digital was motivated by favorable stock level value and momentum terms. Western Digital shares benefitted from an analyst upgrade at Wedbush Morgan, predicting earnings growth and share price appreciation. During the quarter, Western Digital announced plans to enter into the enterprise Hard Disk Drive (HDD) segment. This market is expected to lead to substantial revenue growth and increased competitiveness with rivals Seagate and Hitachi. Western Digital shares rose 21% in the fourth quarter.

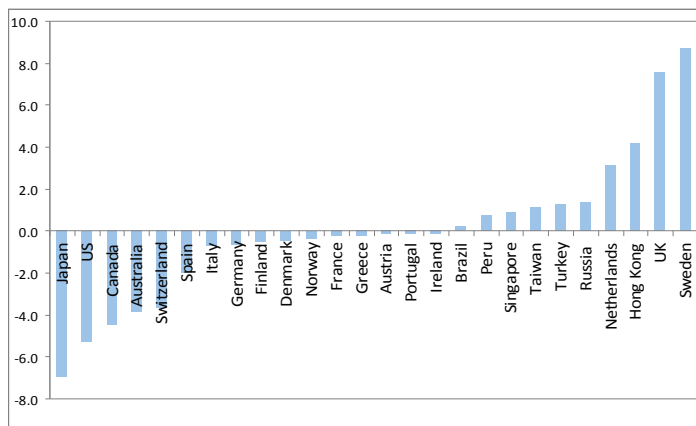
French Health Care - Our overweight position in Sanofi-Aventis, France's largest drugmaker, was based on attractive basket and stock level value signals. Shares of Sanofi gained 10% in the fourth quarter after rising 19% in the previous quarter. Sanofi continued to benefit from its development and distribution of H1N1 influenza vaccines. New contracts were signed with European nations and the company also announced it was on pace to achieve its goal of delivering seventy-five million doses of the vaccine by the end of 2009. Looking ahead, Sanofi intends to keep its pipeline strong by continuing investment partnerships with biotechnology firms, evidenced by its contract extension with Regeneron in November.

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

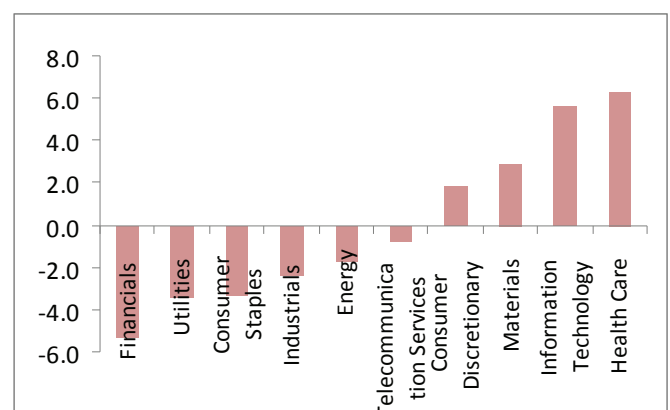
Koninklijke Philips Electronics (Netherlands Industrials): Basket and stock level price momentum signals are the motivation behind overweight positions in Europe's largest consumer electronics producer, Philips. The company has announced plans to continue cost cutting in 2010 to increase operating margins. Philips plans to reduce fixed costs by 700 million Euros this year. Growth in the health care division, which is the largest global producer of patient monitoring systems, is expected to have a positive impact on Philips' earnings.

Nokia OYJ (Finland Information Technology): Nokia, the world's largest mobile phone maker, plans to continue new product development in 2010 to keep pace with competitors. The company has announced plans to unveil new mobile devices in the second half of the year, coinciding with the completion of its upgraded version of the popular Symbian mobile operating system. Nokia plans to enhance its offering of paid applications and media to generate revenue in this growing segment. Overweight positions in Nokia are motivated by favorable basket level earnings and value terms.

**January 2010 Active Country Weights (%)
(MSCI World)**



**January 2010 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 January.

December 2009 Investment Outlook

Emerging Markets Equity Strategy

Emerging Markets Overview: 4th Quarter 2009

The MSCI Emerging Markets index rose 8.58% in USD terms for the quarter, capping off gains of 79% of 2009. Brazil and China were the largest contributors to the index's gains as the countries benefitted from rising domestic demand that has been even stronger than the recovery in developed countries.

Chilean stocks were the best performers on the country level during the fourth quarter. Share prices rose on news that billionaire Sebastian Pinera won the first round of Chile's presidential elections. Pinera, who has pledged to create jobs by cutting taxes and bureaucracy, is expected to move Chile towards more free-market policies and benefit Chilean companies. The Czech Republic was one of the worst Emerging Markets countries. The country's stock index was hurt as utilities company Cez, saw share prices fall amid anti-trust investigations by Czech authorities and the European Commission. Cez also reported lower profit numbers for the third quarter on lower demand for electricity.

Every sector in the Emerging markets saw positive returns during the fourth quarter of 2009. The Consumer Staples sector was the best performing sector, gaining over 15%. Chinese Consumer Staples stocks helped push the sector higher as government programs to boost domestic demand took effect and the Chinese economy continued to show resilience to the global slowdown. The Telecommunications sector was the worst performing sector, gaining only 1.6%.

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:

Turkish Industrials - Turk Hava Yollari provides passenger and cargo air services for Turkish businesses and consumers. The stock was up over 47% on news firm orders were placed for several different plane models. The company reported solid growth in traffic and profits and stated they will be focusing on expanding aggressively. Our overweight position was

based on stock level momentum and basket level value signals.

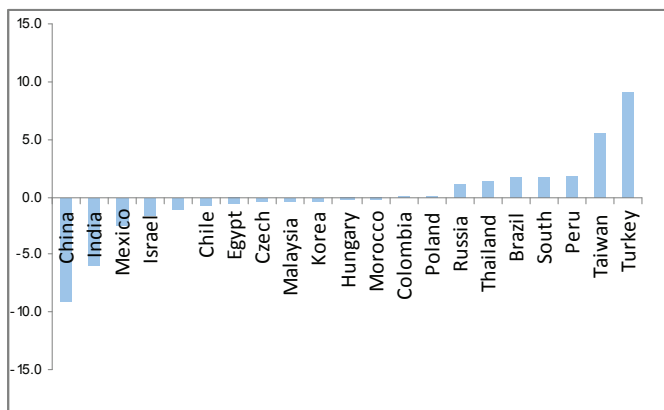
Korea Information Technology - Samsung Electronics, Asia's largest maker of memory chips, flat screens, and cell phones, was down 1.96% in Q4. South Korean stocks fell, led by exporters on concerns an appreciating won will dampen earnings. Samsung announced a wage increase, raising the company's costs. Our overweight position was based on basket level momentum, basket level value and stock level value signals.

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

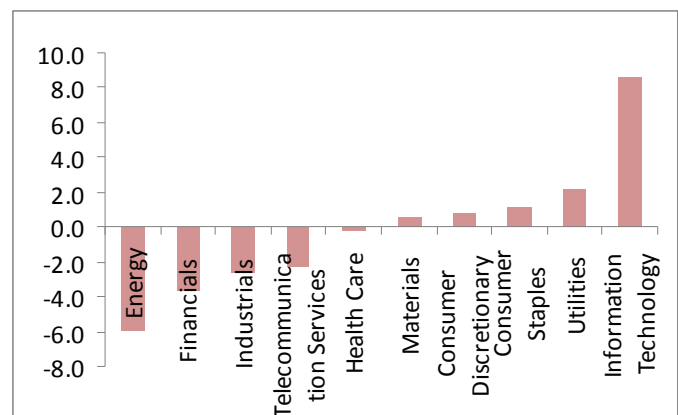
Turk Hava Yollari (Turkey Industrials): Turk Hava Yollari, known as Turkish Airlines, provides passenger and cargo air services for Turkish businesses and consumers. The company announced plans to grow passenger traffic by 15% in 2010, after carrying more than twenty-five million people in 2009. To facilitate expansion, Turkish Airlines has agreed to buy twenty Airbus planes in the next two years; with the option to purchase ten more in subsequent years. Turkish Airlines shares are attractive based on stock level momentum and basket level value signals.

Mobile Telesystems (Russia Telecommunications): Russia's largest mobile operator, Mobile Telesystems, has recently surpassed the one hundred million subscriber mark. Morgan Stanley has forecasted extreme demand growth in the sector over the next five years. Mobile Telesystems recently acquired Eurotel's optical fiber network to add capacity and build infrastructure to facilitate demand. Mobile Telesystems shares are attractive based on country level macroeconomic indicators and basket level momentum signals.

January 2010 Active Country Weights (%)
(MSCI EM Index)



January 2010 Active Sector Weights (%)
(MSCI EM Index)



Data provided above is for Arrowstreet's longest standing representative portfolio for the Emerging Markets Equity strategy as of the end of January .

Employee Profiles



Erica Monroe
Associate, Business Development
Erica is responsible for supporting Arrowstreet's sales and marketing efforts. Prior to joining Arrowstreet, Erica was a registered representative at a private wealth-management firm in Newton, MA. Erica graduated from Providence College with a B.A. in Mathematics in 2004. She is currently studying to take the CFA Level I exam. In her spare time, she loves to dance.

Neil Garceau
Associate, Business Development
Neil works with our marketing team and is responsible for new business development within the United States. Prior to joining Arrowstreet, he worked as an Institutional Relationship Manager at The Boston Company Asset Management. Neil graduated from Bentley University with a M.S in Finance in 1999 and has a B.S. in Accounting from the University of Rhode Island.

