RAPPAPORT REICHES
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2011 In Review

The past year reminded investors that they should hope for the best, prepare for the worst, and be thankful when reality does not match their fears. Investors entered 2011 with hopes that the world economy would continue recovering from a long and painful deleveraging process. Equity markets had posted two straight years of positive performance, central banks remained committed to pro-growth monetary policy, and major developed nations were focused on reducing debt.

By mid-year, however, optimism faded as troubling events around the world dominated headlines. The devastating earthquake and tsunami in Japan, political unrest in the Middle East, rising oil prices, a US credit downgrade, the threat of another global recession, and an escalating debt crisis in Europe weighed heavily on markets. As stock market volatility returned to global financial crisis levels, investors faced a major test of their discipline and staying power.

Although US stocks experienced some of the highest volatility in years, the broad US market delivered flat performance for 2011. Both international developed markets and emerging markets logged negative returns. The bright spots were in the fixed income arena, where a flight to quality, triggered by the euro debt crisis and US credit downgrade, boosted returns of US government securities, inflation-protected securities, and municipal bonds.

The chart on the following page features some of the year's most highly publicized events in the context of the Russell 3000 Index, a broad indicator of US stock market performance. These events are not offered as an explanation of market performance, but as an illustration that a volatile news environment can challenge even the most disciplined long-term investors.

The World Stock Market Performance chart on page 3 offers a snapshot of global stock market performance, as measured by the MSCI All Country World Index. Actual headlines from publications around the world are featured.

Throughout the year, investors could find a host of reasons to avoid stocks and wait for more positive news before returning to the market. As these select headlines suggest, timing the markets is a difficult task since the market anticipates news and quickly factors in new information.

Themes in 2011

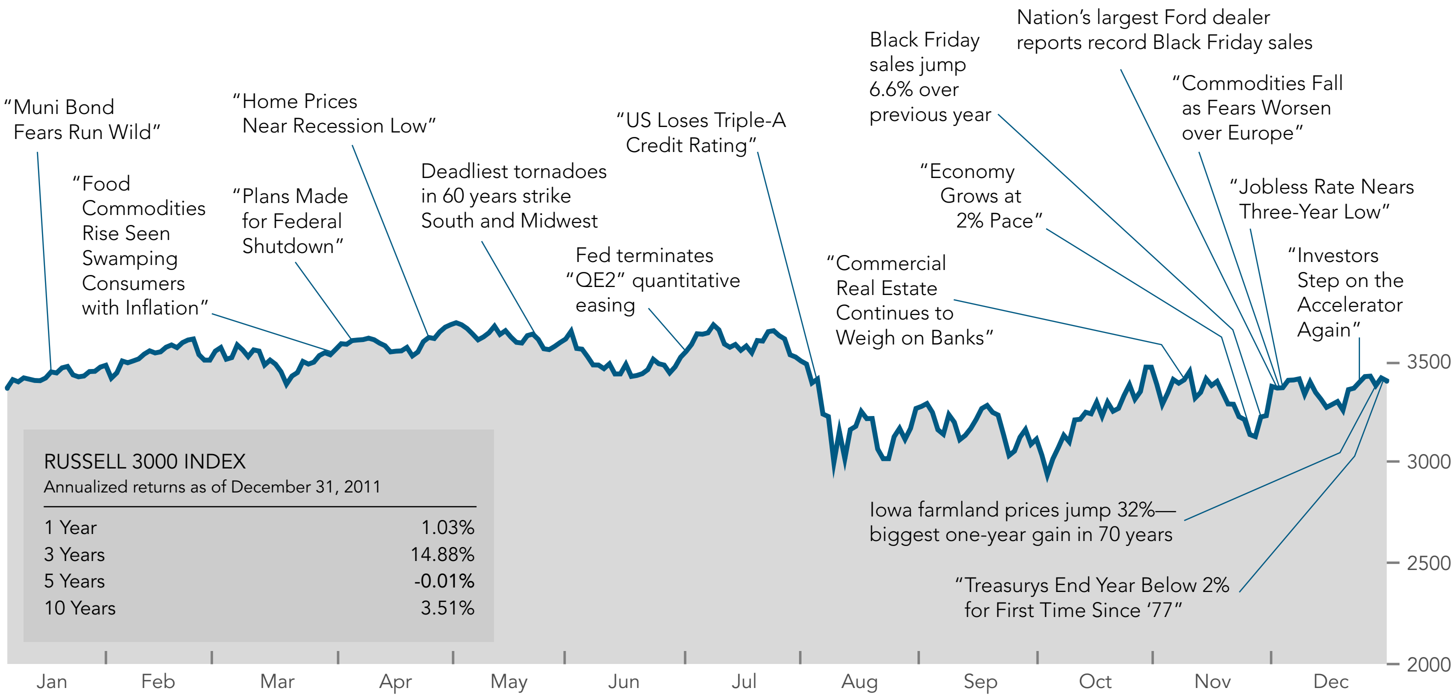
Major themes during the year included:

European Debt Problems

The sovereign debt crisis intensified as European authorities struggled to avert a Greek debt default and alleviate fiscal pressures in Italy and France. But these restructuring attempts fell short of market expectations,

US Stock Market Performance

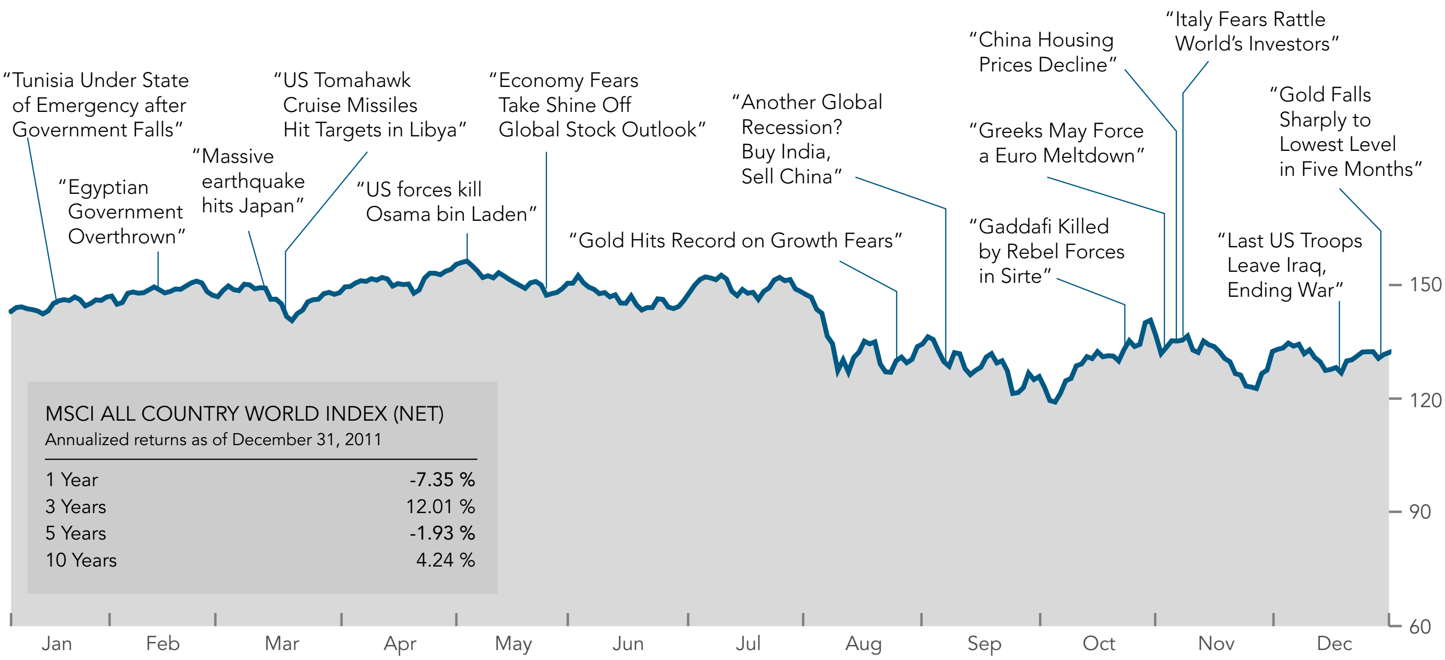
Russell 3000 Index with Major Events during 2011



Source: Russell Investment Group.
In US Dollars. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

World Stock Market Performance

MSCI All Country World Index with Major Headlines from 2011



MSCI ALL COUNTRY WORLD INDEX (NET)
Annualized returns as of December 31, 2011

1 Year	-7.35 %
3 Years	12.01 %
5 Years	-1.93 %
10 Years	4.24 %

Source: MSCI.
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which spooked investors and raised concerns of additional sovereign debt downgrades and a possible breakup of the Eurozone. The crisis also hurt European banks holding large positions in sovereign debt. To avoid losses, leading institutions reduced lending and sold assets, which depressed values. Higher borrowing costs in the most indebted countries, combined with reduced government spending and revenues, raised more concerns that the Eurozone was entering a recession in late 2011.

Economic Uncertainty

Since the global financial crisis in 2008, central banks and governments have taken bold measures to fuel business activity and stabilize financial markets—and investors have eagerly awaited signs that economic recovery has taken hold. The economic signals continued to be mixed in 2011. Favorable US news included strong corporate profits and dividends, substantial levels of cash on corporate balance sheets, low interest rates and inflation, a booming domestic energy sector, continuing strength in auto sales, record-high share prices for some multinationals, and improved fourth-quarter numbers in manufacturing, exports, consumer confidence, and employment. Pessimists could point to the longstanding jobless trend, slumping home prices, tepid growth in retail sales, worrisome levels of government debt, and political gridlock at both the national and state levels.

Although emerging economies showed resilience, investors were concerned that another recession in Europe would impact its trading partners in emerging economies—and particularly in China, where high inflation and a manufacturing slowdown threatened to send its previously fast-growing economy into recession.

Rising Volatility

Investors in US equities had to endure a heavy dose of uncertainty for their modest gains. The S&P 500 Index reflected this volatility by closing up or down over 2% on thirty-five days in 2011, compared to twenty-two days in 2010. By contrast, before the global financial crisis, the index did not have a single day with a 2% or more movement in 2005, and only two days in 2006.

Market observers also documented higher correlations among individual stocks and between asset classes. In 2011, there were sixty-nine days in which 90% of the S&P 500 stocks moved in the same direction, which is more than the combined total for 2008 and 2009.

Higher correlations are common during periods of uncertainty, as macroeconomic forces overshadow the impact of a company's business fundamentals on its stock price.

Falling Commodity Prices

In early 2011, commodities soared with expectations of improving economic growth around the world. Copper, cotton, and corn hit all-time highs in the first half of the year. Crude oil experienced double-digit returns in response to anticipated higher demand and threats of supply disruptions tied to political unrest in the Middle East. The Dow Jones-UBS Commodity Index peaked in April, then fell 20% as the global economic outlook faded. The index returned –13% for the year—its first negative return since 2008. The most notable exception was gold, which peaked at $1,889 per ounce in August before declining in the fourth quarter to return about 10% for the year.

Investor Risk Aversion

The fragile world economy made markets particularly vulnerable to shifting investor sentiment. During the year, investors reacted to uncertainty by moving to asset classes they deemed more stable, including large cap stocks and government bonds. Despite the Standard & Poor's downgrade of the US credit rating in early August, investors fled to US government securities as concerns mounted over the sovereign debt crisis in Europe and political stalemate over the US debt ceiling.

2011 – By the Numbers

Most global equity investors experienced negative returns in 2011. After a strong first-quarter start, developed equity markets grew more volatile in response to discouraging news on the economy and sovereign debt crisis. Despite a brief rebound in July and during the fourth quarter, most equity markets had negative performance for the year.

The US stock market was one of the few developed markets to experience positive returns. The S&P 500 returned 2.11% (dividends reinvested), and the Russell 3000 returned 1.03% for the year. Despite strong returns in the fourth quarter, developed and emerging markets logged negative returns, with thirty-seven of the forty-five countries that MSCI tracks posting losses. The MSCI World ex USA Index returned –12.2% and the MSCI Emerging Markets Index returned –18.4% for the year. Ireland and New Zealand were the only developed markets besides the US to end the year in positive territory. Indonesia was the only emerging market that ended the year with positive returns.

The US dollar finished about 3% above where it started against most developed-market currencies. It sharply appreciated against the main emerging market currencies. This relative strength negatively impacted dollar-denominated returns of emerging market equities. The euro remained stable during the year even as analysts began predicting the dissolution of the currency zone.

Major World Indices[2]

US Equity Returns

As of December 31, 2011	Return (%)		
Index	Fourth Quarter	One Year	Three Years*
Russell 3000	12.12	1.03	14.88
Russell 2500	14.52	-2.51	18.41
Russell 2000	15.47	-4.18	15.63
Russell 2000 Value	15.97	-5.50	12.36
Russell 2000 Growth	14.99	-2.91	19.00
Russell 1000	11.84	1.50	14.81
Russell 1000 Value	13.11	0.39	11.55
Russell 1000 Growth	10.61	2.64	18.02
S&P 500	11.82	2.11	14.11

Non-US Equity Returns

As of December 31, 2011	Return (%)		
Index	Fourth Quarter	One Year	Three Years*
MSCI EAFE Small Cap	-0.56	-15.94	14.62
MSCI World ex USA Small Cap	0.69	-15.81	16.50
MSCI EAFE	3.33	-12.14	7.65
MSCI World ex USA	3.51	-12.21	8.53
MSCI EAFE Value	2.74	-12.17	6.77
MSCI EAFE Growth	3.92	-12.11	8.47
MSCI Emerging Markets	4.42	-18.42	20.07
MSCI Emerging Markets Small	-0.66	-27.18	25.57

Fixed Income Returns

As of December 31, 2011	Return (%)		
	Fourth Quarter	One Year	Three Years*
BofA Merrill Lynch Three-Month US T-Bill	0.00	0.10	0.14
BofA Merrill Lynch One-Year US Treasury Note	0.09	0.57	0.73
Citigroup World Government Bond 1-3 Years (hedged)	0.34	1.43	1.61
Barclays Capital US Government Bond	0.84	9.02	4.01
BofA Merrill Lynch 1-5 Year US Treasury and Agency	0.40	3.19	2.52
Citigroup World Government Bond 1-5 Years (hedged)	0.42	2.31	2.20
Barclays Capital US TIPS	2.69	13.56	10.38

Real Estate Returns

As of December 31, 2011	Return (%)		
	Fourth Quarter	One Year	Three Years*
Dow Jones US Select REIT	15.36	9.37	21.63
S&P Global ex US REIT	1.14	-8.61	13.86

*Annualized

In the fixed income arena, US intermediate-term government securities and Treasury Inflation Protected Securities performed exceptionally well, returning over 9.4% and 14.5%, respectively. Real estate securities in the US had strong positive returns, while in international developed markets, real estate securities had sharply negative returns.

In 2011, diversification proved as important as ever. Although it may not have prevented losses, investors with broadly diversified portfolios were better equipped to endure the uncertainty and volatility.

Sources & Disclosures

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Our Value Added Indexing℠ approach utilizes passive and index-related portfolios as part of a comprehensive solution to meet our clients' long term goals. The result is a disciplined investment experience based on sound research and planning, rather than forecasts, emotions or trends.

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