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CAPITAL MANAGEMENT

Q3

Quarterly Market Review

Third Quarter 2012

Quarterly Market Review

Third Quarter 2012

This report features world capital market performance and a timeline of events for the last quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the performance of globally diversified portfolios and features a topic of the quarter.

Overview:

Market Summary

Third Quarter 2012 Index Returns

	STOCKS				BONDS	
	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market
Return	+6.23%	+7.30%	+7.74%	+3.31%	+1.58%	+2.00%

Market segment (index representation) as follows: US Stock Market (Russell 3000 Index); International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Barclays Capital US Aggregate Bond Index), and Global Bond Market (Barclays Capital Global Aggregate Bond Index [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Barclays Capital data provided by Barclays Bank PLC. US long-term bonds, bills, and inflation data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

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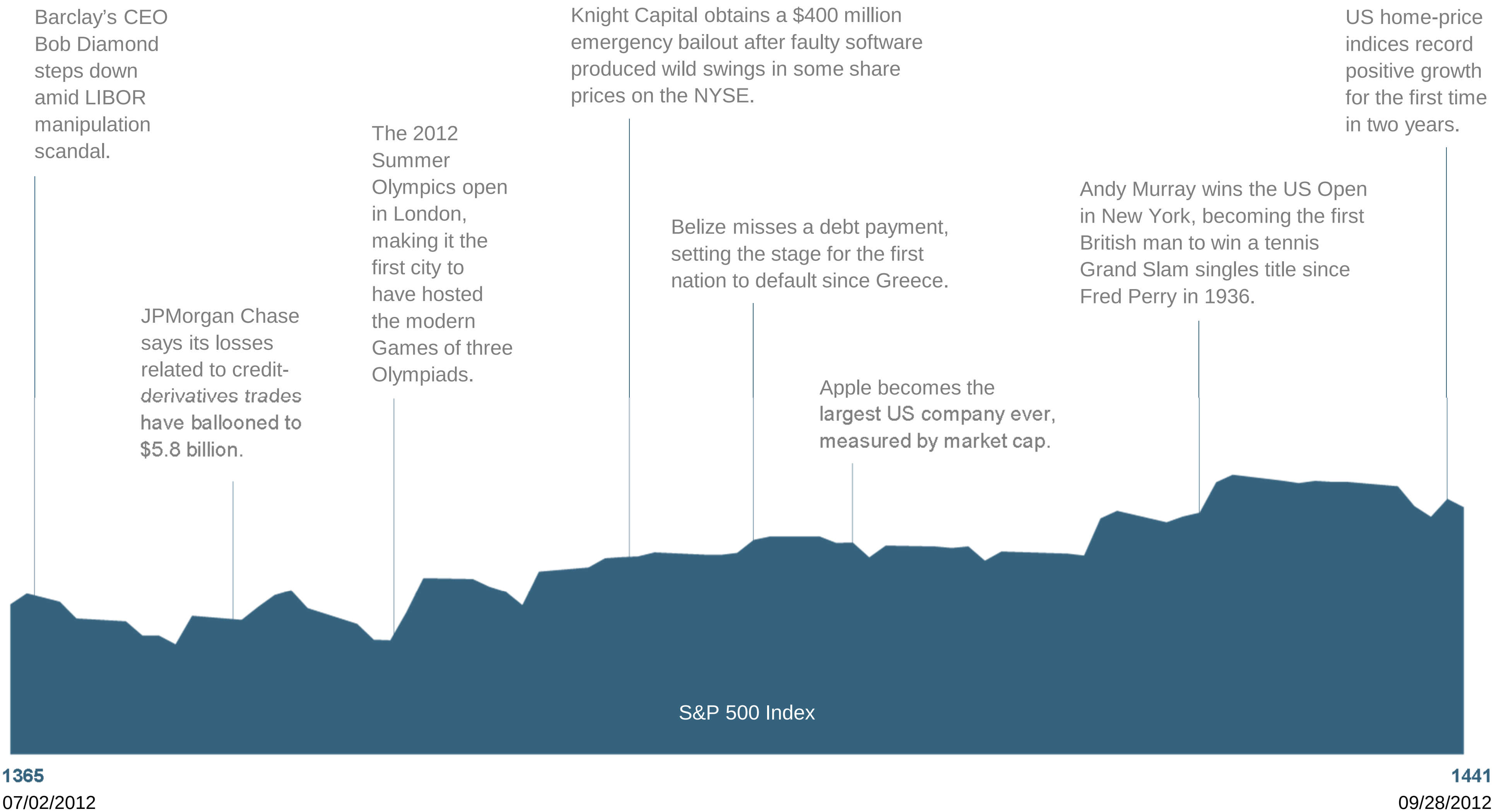
Timeline of Events: Quarter in Review

Third Quarter 2012

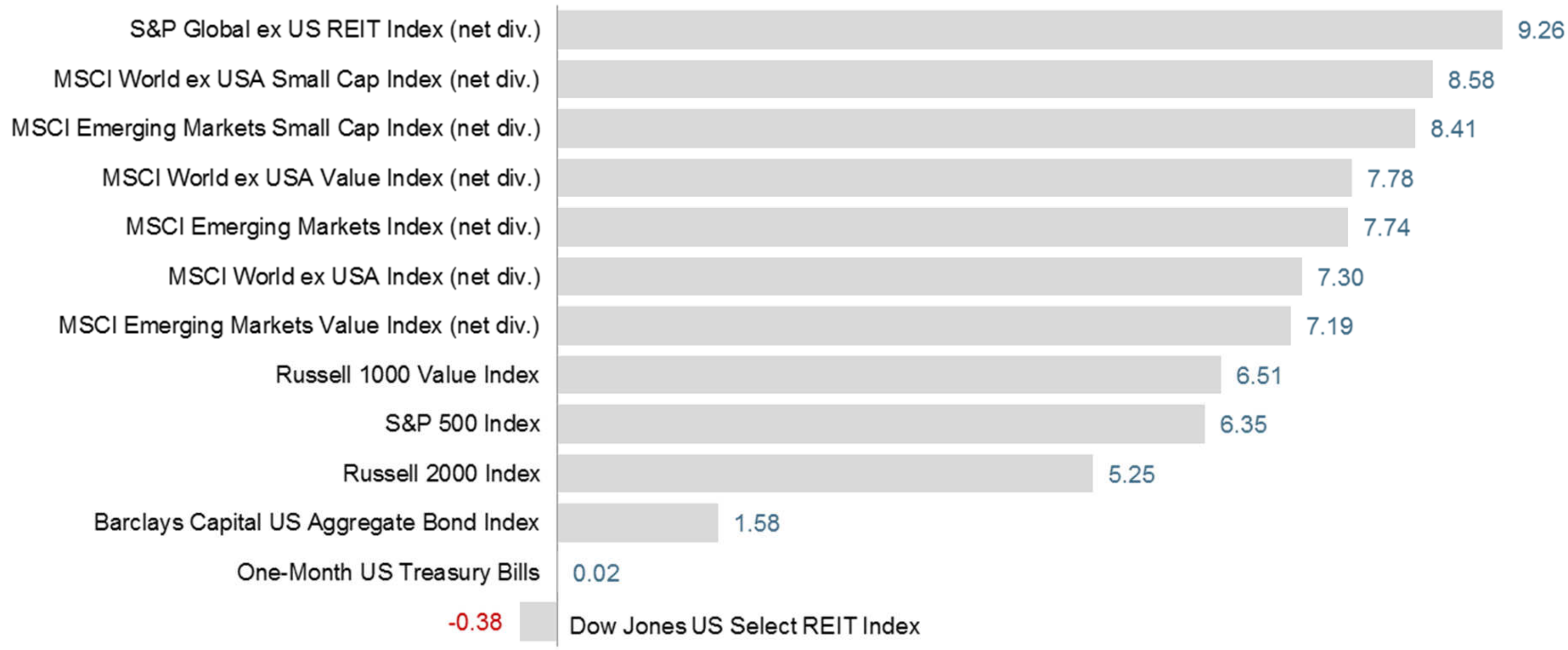


The graph illustrates the S&P 500 index price changes over the quarter. The return of the price-only index is generally lower than the total return of the index that also includes the dividend returns.
Source: The S&P data are provided by Standard & Poor's Index Services Group. The events highlighted are not intended to explain market movements.

World Asset Classes

Third Quarter 2012 Index Returns

Global equity markets posted strong returns in the third quarter, turning the tide on the year-to-date figures and bringing them back firmly into the positive. Continued quantitative easing in the US, Japan, and EU seemed to improve overall investor sentiment toward equities while also keeping fixed income yields at historical lows.



Market segment (index representation) as follows: US Large Cap (S&P 500 Index), US Small Cap (Russell 2000 Index), US Value (Russell 1000 Value Index), US Real Estate (Dow Jones US Select REIT Index), Global Real Estate (S&P Global ex US REIT Index), International Developed Large, Small, and Value (MSCI World ex USA, ex USA Small, and ex USA Value Indexes [net div.]), Emerging Markets Large, Small, and Value (MSCI Emerging Markets, Emerging Markets Small, and Emerging Markets Value Indexes), US Bond Market (Barclays Capital US Aggregate Bond Index), and Treasury (One-Month US Treasury Bills). The S&P data are provided by Standard & Poor's Index Services Group. Russell data copyright © Russell Investment Group 1995–2012, all rights reserved. MSCI data copyright MSCI 2012, all rights reserved. Dow Jones data (formerly Dow Jones Wilshire) provided by Dow Jones Indexes. Barclays Capital data provided by Barclays Bank PLC. US long-term bonds, bills, and inflation data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

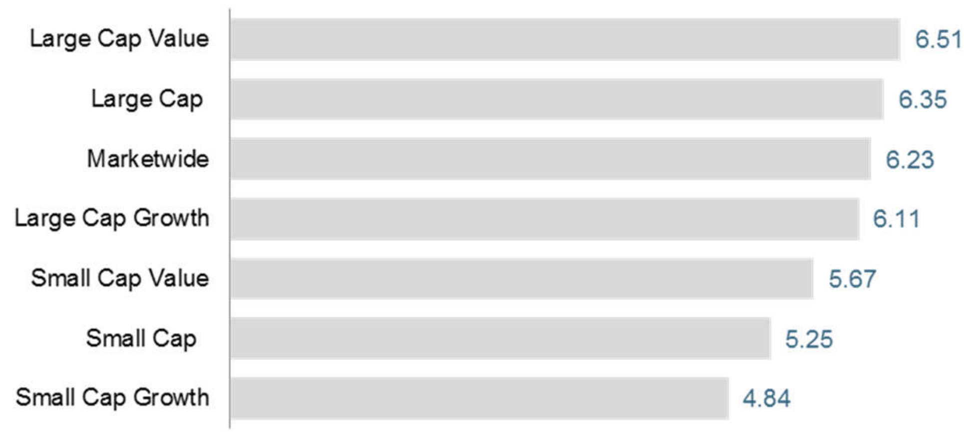
US Stocks

Third Quarter 2012 Index Returns

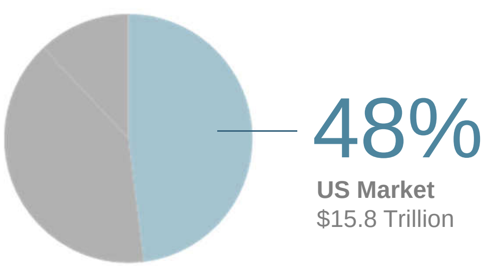
All major US asset classes logged positive performance in the 3rd quarter, with the broad market returning 6.23%. Asset class returns ranged from 4.84% for small growth stocks to 6.51% for large value stocks.

Across the size and style spectrum, large outperformed small while value bested growth.

Ranked Returns for the Quarter (%)



World Market Capitalization—US



Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Marketwide	30.20	13.26	1.30	8.49
Large Cap	30.20	13.20	1.05	8.01
Large Cap Value	30.92	11.84	-0.90	8.17
Large Cap Growth	29.19	14.73	3.24	8.41
Small Cap	31.91	12.99	2.21	10.17
Small Cap Value	32.63	11.72	1.35	9.68
Small Cap Growth	31.18	14.19	2.96	10.55

Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (S&P 500 Index), Large Cap Value (Russell 1000 Value Index), Large Cap Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Cap Value (Russell 2000 Value Index), and Small Cap Growth (Russell 2000 Growth Index). World Market Cap: Russell 3000 Index is used as the proxy for the US market. The S&P data are provided by Standard & Poor's Index Services Group. Past performance is not a guarantee of future results.

International Developed Stocks

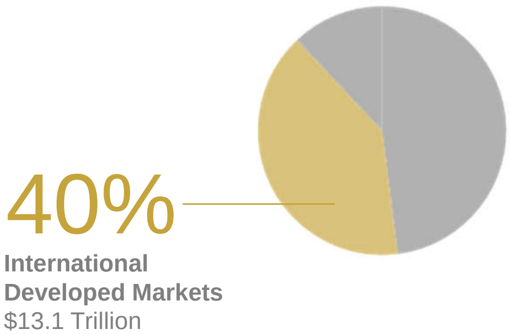
Third Quarter 2012 Index Returns

International developed equities followed a story similar to that of the US, with all major asset classes posting positive returns for the quarter. At the country level, Greece led the way with a return of 21.05%.

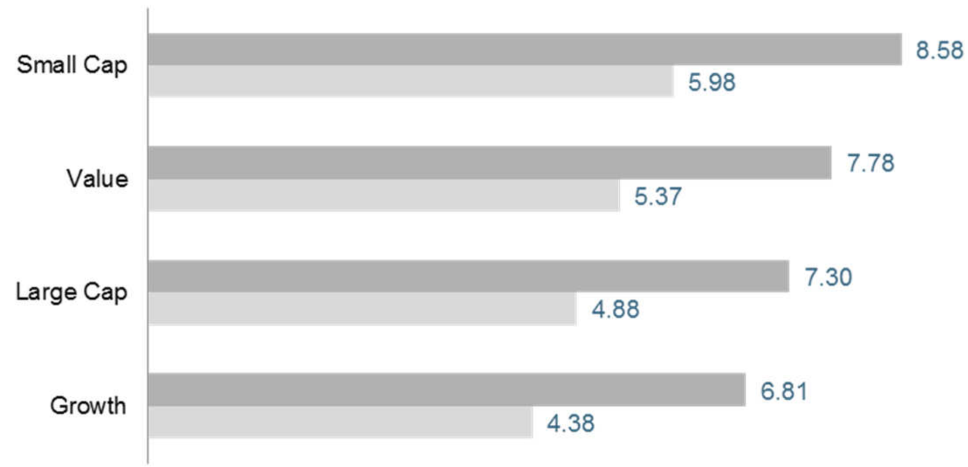
Following the trend from the second quarter, the US dollar depreciated against all major foreign currencies, boosting the returns of dollar denominated foreign investments.

Across the size and style spectrum, small beat large and value bested growth.

World Market Capitalization—International Developed



Ranked Returns for the Quarter (%)



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	13.76	2.50	-4.84	8.66
Small Cap	12.82	5.68	-2.62	11.55
Value	12.98	0.72	-5.66	9.03
Growth	14.48	4.25	-4.09	8.21

* *Annualized*

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Emerging Markets Stocks

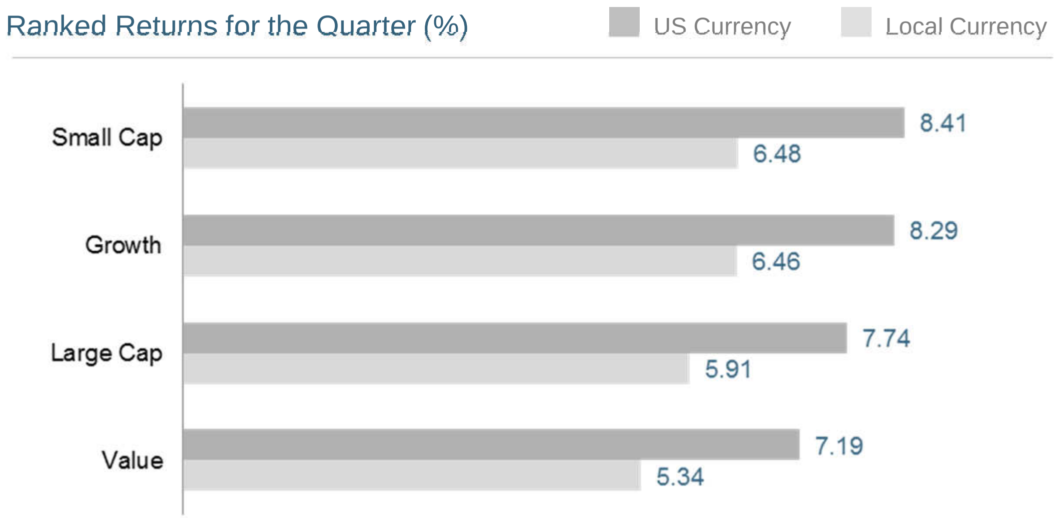
Third Quarter 2012 Index Returns

The broad market returned 7.74%, with all other major asset classes posting positive returns. Small cap led the way at 8.41% while value stocks finished last, slightly trailing at 7.19%. All emerging markets countries posted positive returns with the exception of Morocco at -3.75%.

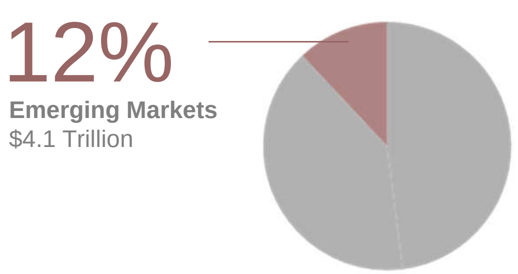
The performance of the US dollar was mixed against the other major currencies, appreciating against the Brazilian real, South African rand, and Indonesian rupiah but depreciating against the rest of the majors.

The results of the size and style dimensions were mixed, with small beating large and growth besting value.

Ranked Returns for the Quarter (%)



World Market Capitalization—Emerging Markets



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	16.93	5.63	-1.28	17.00
Small Cap	15.52	6.54	-1.04	17.75
Value	15.41	5.21	0.00	18.77
Growth	18.47	6.05	-2.60	15.20

** Annualized*

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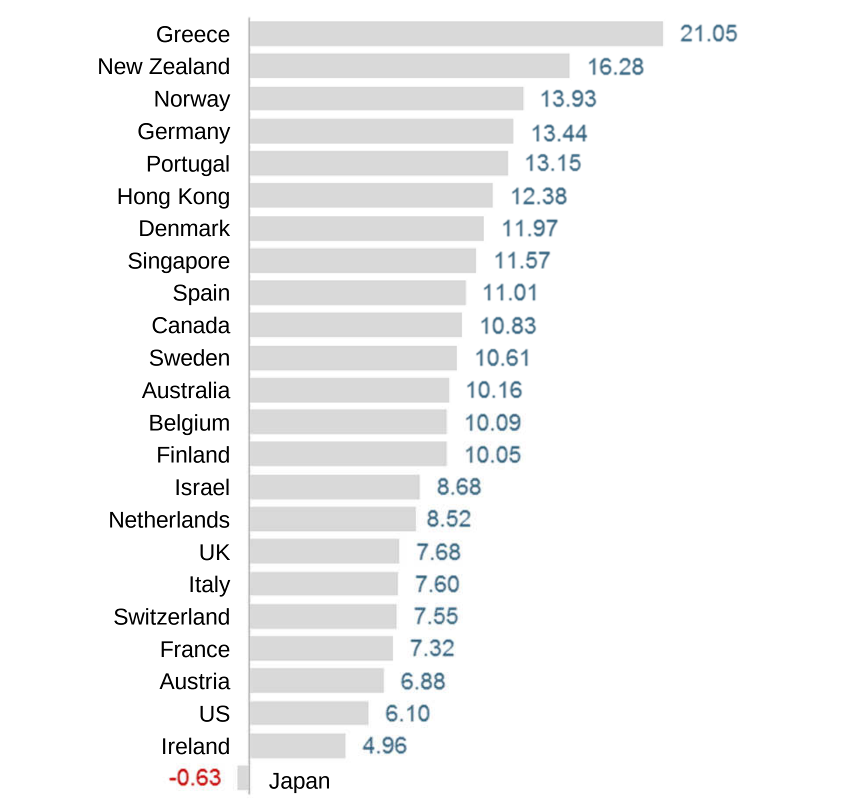
Select Country Performance

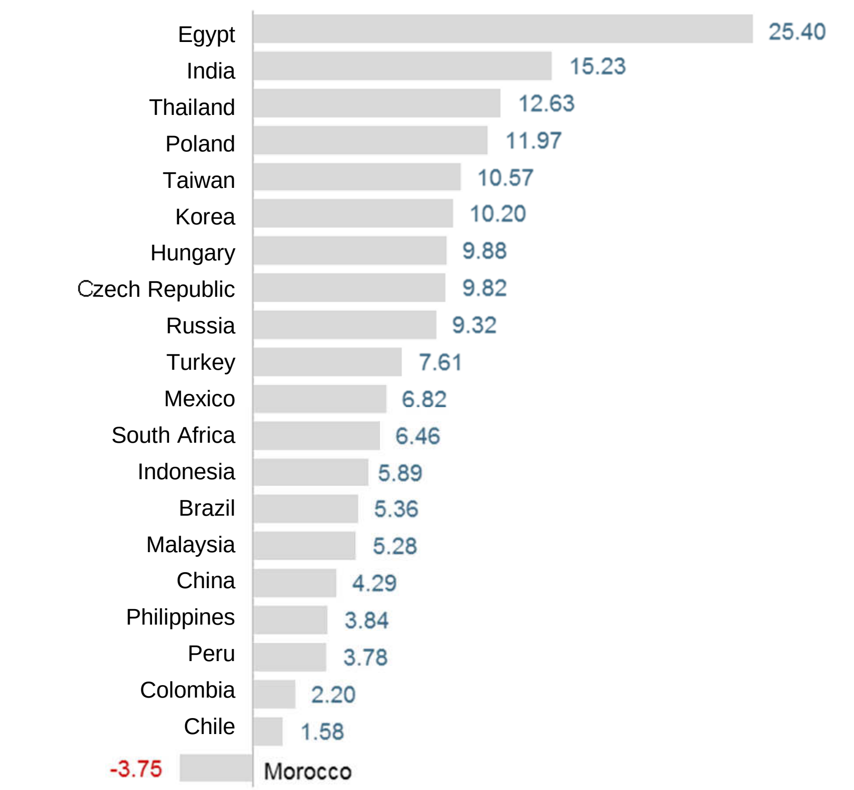
Third Quarter 2012 Index Returns

With confidence in equities appearing to rebound after previous concerns over the European debt crisis, all developed markets countries posted positive returns with the exception of Japan. Despite being the epicenter of the European debt crisis, Greece led the way with a quarterly return of 21.05%. Emerging markets told a similar story: all but one country posted positive returns.

Developed Markets (% Returns)



Emerging Markets (% Returns)



Country performance based on respective indices in the MSCI All Country World IMI Index (for developed markets) and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends.

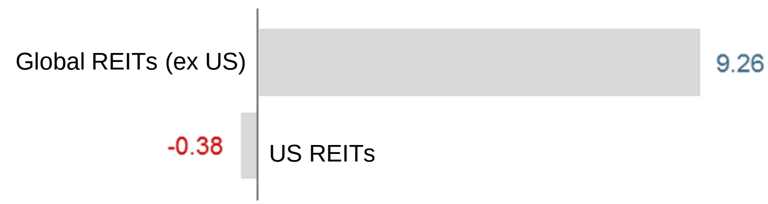
Real Estate Investment Trusts (REITs)

Third Quarter 2012 Index Returns

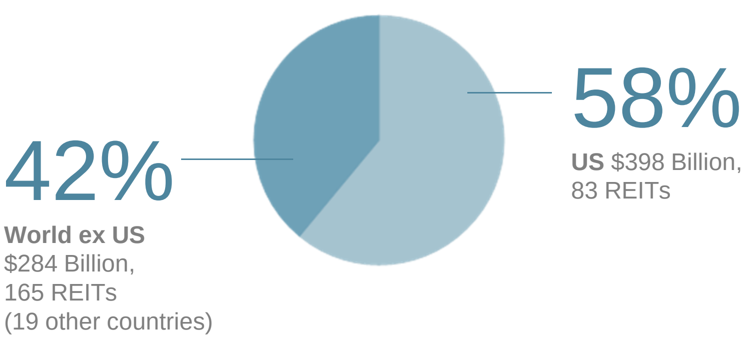
International REITs outperformed US REITs in the quarter, posting a positive return of 9.26% versus a 0.38% loss.

The negative return for US REITs marked only the 2nd negative quarter since 2010, while international REITs posted their 4th straight positive quarter.

Ranked Returns for the Quarter (%)



Total Value of REIT Stocks



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
US REITs	32.06	20.52	1.60	11.28
Global REITs (ex US)	25.64	9.96	-4.65	10.82

** Annualized*

Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's © 2012. Past performance is not a guarantee of future results.

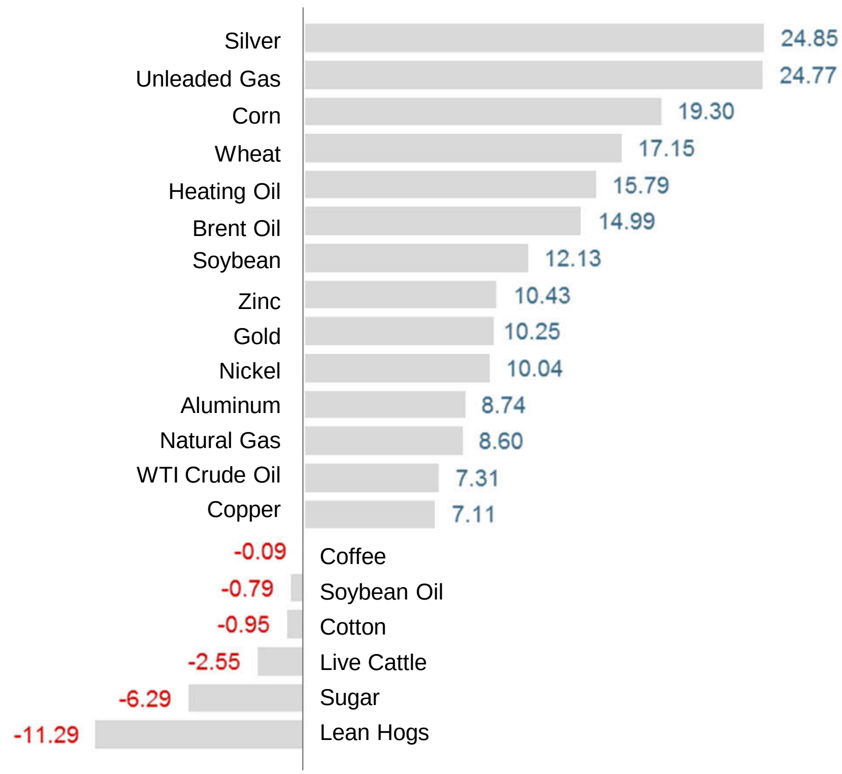
Commodities

Third Quarter 2012 Index Returns

Reversing the trend of the previous quarter, Commodities posted a positive return of 9.69%.

Leading the rise were silver and unleaded gas, with returns of 24.85% and 24.77%, respectively. Lean hogs trailed all other commodities, posting a return of -11.29% for the quarter.

Individual Commodity (% Returns)



Period Returns (%)

Asset Class	Q3	1 Year	3 Years*	5 Years*	10 Years*
Commodities	9.69	5.99	5.26	-3.03	5.20

** Annualized*

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Fixed Income

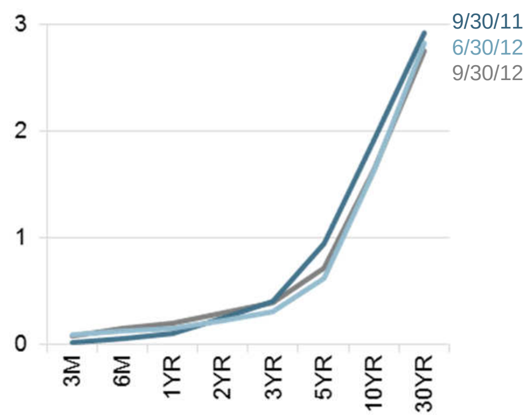
Third Quarter 2012 Index Returns

Global investor demand for high-quality paper continued in the third quarter, producing sustained low yields and high prices.

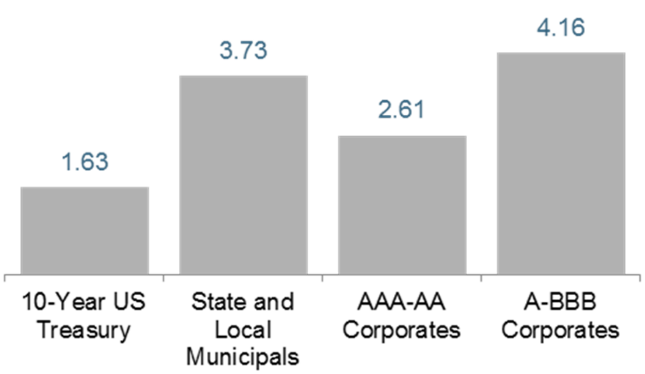
The relative safety of sovereign debt—and fixed income, in general—remains the preferred allocation for investors seeking a high quality refuge. Absolute yields on sovereign debt have remained at or near historical lows and even at negative levels.

Over the quarter, credit risk was rewarded, driven by investor desire for incremental yield. US corporate spreads relative to Treasuries narrowed over the quarter by 43 basis points. Spread compression was largely driven by the lower rung of the investment grade universe.

US Treasury Yield Curve



Bond Yields across Different Issuers



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
One-Month US Treasury Bills (SBBI)	0.04	0.07	0.58	1.69
Bank of America Merrill Lynch Three-Month T-Bills	0.07	0.11	0.72	1.82
Bank of America Merrill Lynch One-Year US Treasury Note	0.27	0.57	1.72	2.25
Citigroup World Government Bond 1-5 Years (hedged)	2.12	2.08	3.35	3.38
US Long-Term Government Bonds (SBBI)	7.89	11.83	10.93	7.73
Barclays Capital Corporate High Yield	19.37	12.90	9.34	10.98
Barclays Capital Municipal Bonds	8.32	5.99	6.06	5.03
Barclays Capital US TIPS Index	9.10	9.29	7.93	6.64

** Annualized*

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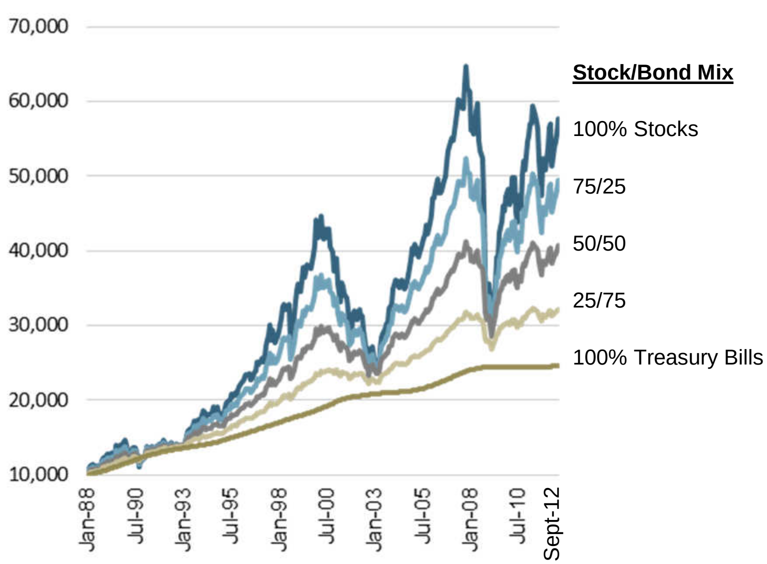
Global Diversification

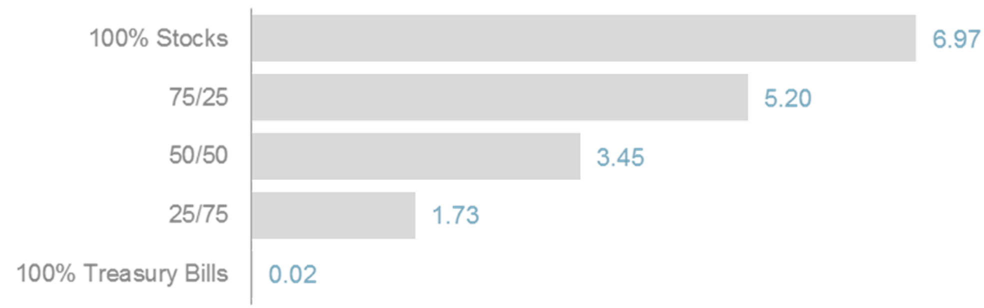
Third Quarter 2012 Index Returns

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but also have higher expected returns over time.

Growth of Wealth: The Relationship between Risk and Return



Ranked Returns for the Quarter (%)



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
100% Stocks	21.67	7.78	-1.54	9.16
75/25	16.18	6.10	-0.55	7.55
50/50	10.74	4.24	0.12	5.76
25/75	5.35	2.23	0.50	3.80
100% Treasury Bills	0.04	0.07	0.58	1.69

** Annualized*

Hypothetical allocations are for illustrative purposes only. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management an actual portfolio.

Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified portfolios rebalanced monthly. Data copyright MSCI 2012, all rights reserved. © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

Knightmare on Wall Street

Third Quarter 2012

QUESTION:

Which of the following statements applies to this summer's stock market behavior?

A) Computer errors at a major trading firm generated millions of faulty trades, causing dramatic and puzzling price swings in dozens of stocks.

B) A *New York Times* columnist fumed that "Wall Street has created its own Frankenstein. The machines are now in charge."

C) The S&P 500 Index rose 13.51% for the year through the end of August.

ANSWER: All of the above.

The July 31 trading session was marked by unusual activity in 148 stocks listed on the New York Stock Exchange, many of which swung sharply in the first hour of trading due to an apparent error in a newly installed software program developed by seventeen-year-old Knight Capital Group Inc., one of the country's largest market-making and trading firms.

For some, the incident was an unwelcome reminder of the so-called "flash crash" on May 6, 2010, which saw the Dow Jones Industrial Average plunge over 700 points in fifteen minutes. *Wall Street Journal* columnist Jason Zweig sounded out a number of individual investors for their thoughts on the market gyrations and got an earful. A New York lawyer observed that the investors he talks to are convinced "the game is stacked against them" and that earning a pittance in safe fixed income investments was preferable to "losing it all on a roulette-wheel stock market."

Incidents such as the "flash crash" are often cited as a contributing factor to investor skepticism of equity investing. One can sympathize with investors who fear that the investment industry machinery somehow places them at a disadvantage, but we think such concerns should be placed in a proper context. We live in a complicated world, and it's unrealistic to expect power plants, airliners, or stock exchanges to work perfectly 100% of the time. The lights go out, flights are canceled on short notice, and computers freeze up just when we need to print that important document. These malfunctions serve to remind us that technology is a mixed blessing, but few of us would prefer a permanent return to the era of spinning wheels and candlelight.

Some of us are old enough to remember the commission schedule at NYSE-member firms in the days before negotiated commission rates and high-speed trading algorithms. A 100-share order of IBM or Procter & Gamble used to cost $80.73. These days, a customer with a meaningful checking account balance can execute one hundred trades a year for free. More traders and more trading paves the way to greater liquidity and lower transaction costs.

We do wonder how many investors were even aware of the trading gyrations as they were taking place. We suspect those expressing the greatest alarm were accustomed to watching market developments minute by minute.

In this regard, we cannot improve on Jason Zweig's observation, so we'll quote him directly: "It's harder than ever for long-term investors to ignore the trading madness of Mr. Market. But ignoring it remains the very essence of what it means to be an investor."

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Q2

Quarterly Market Review

Second Quarter 2012

Quarterly Market Review

Second Quarter 2012

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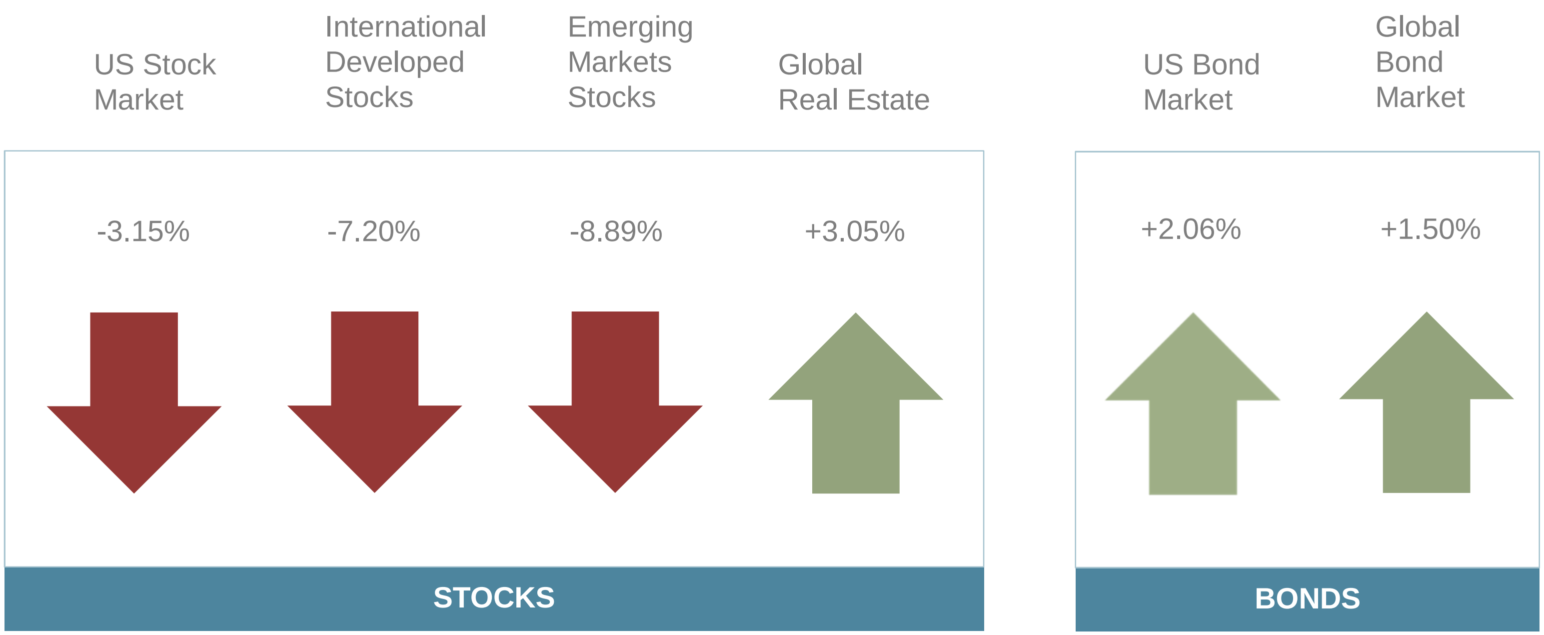
This report features world capital market performance and a timeline of events for the last quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the performance of globally diversified portfolios and features a topic of the quarter.

Overview:

Market Summary

Second Quarter 2012 Index Returns



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Timeline of Events: A Quarter in Review

Second Quarter 2012

US stocks finish at multi-year highs. The S&P 500 Index has its highest close since May 2008.

Mitt Romney officially named Republican Party's presumptive nominee.

Facebook's long-awaited IPO valued the firm at over $100 billion, yet in the weeks following the listing, it lost almost a quarter of its market value.

JPMorgan Chase reported losses in excess of $2 billion from trades made by a division that was supposed to manage risk. The CEO subsequently testified in front of Congress.

Dalian Wanda agreed to buy the theater chain AMC Entertainment, in the largest US acquisition by a private Chinese firm.

Investors in German two-year bonds accepted negative nominal yields, reflecting the uncertainty in the banking system.

The European crisis continued, with Spanish banks receiving capital from other countries and Greece voting for a leadership determined to preserve the euro and adhering to austerity.

The Supreme Court ruled that many of the provisions of the healthcare law are constitutional, including the requirement that most Americans obtain insurance or pay a penalty "tax."

1,419
04/02/2012

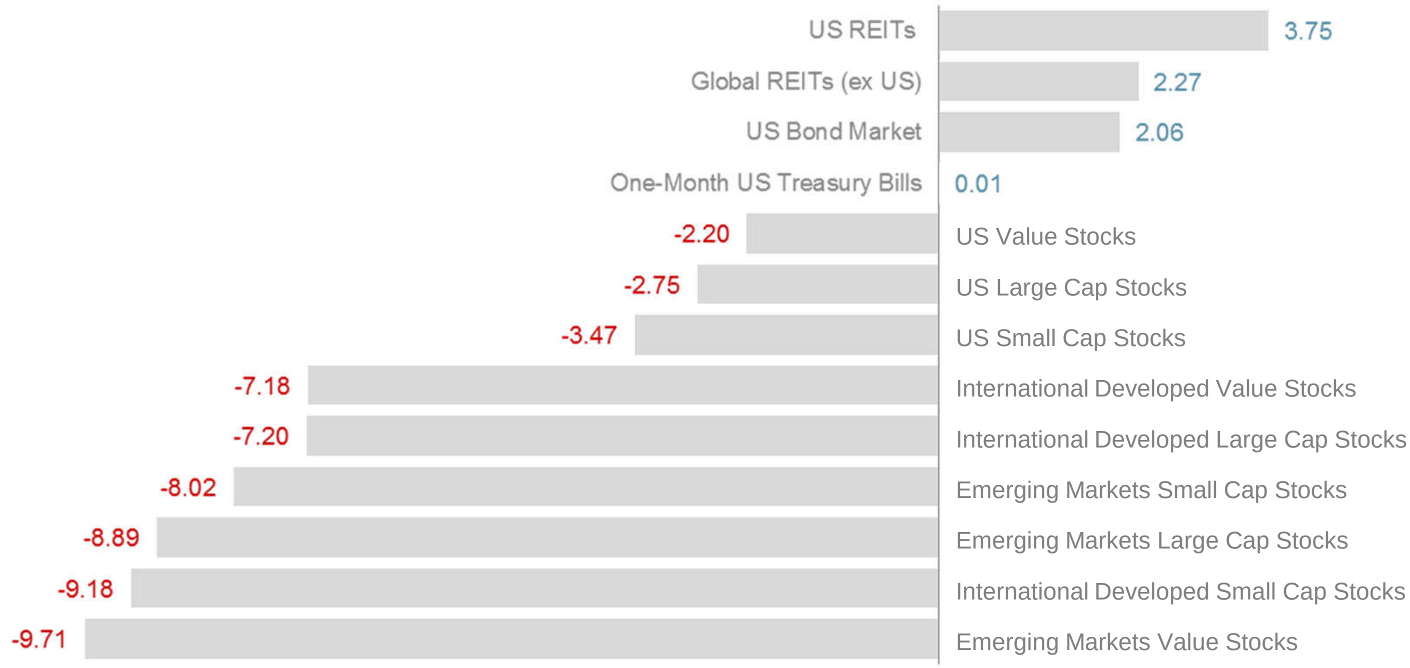
1,362
06/29/2012

The graph illustrates the S&P 500 Index price changes over the quarter. The return of the price-only index is generally lower than the total return of the index that also includes the dividend returns.
Source: The S&P data are provided by Standard & Poor's Index Services Group. The events highlighted are not intended to explain market movements.

World Asset Classes

Second Quarter 2012 Index Returns

Global equity markets retreated in the second quarter, giving up much of their gains for the year. Fiscal and economic strain in Europe continued to capture headlines, weighing especially heavy on non-US markets. Investors continued to turn to US government bonds for safety, pushing yields lower.



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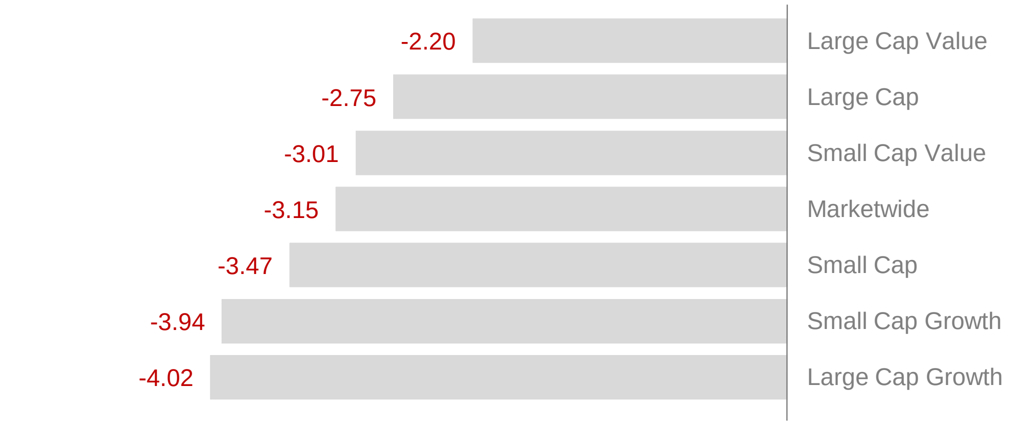
US Stocks

Second Quarter 2012 Index Returns

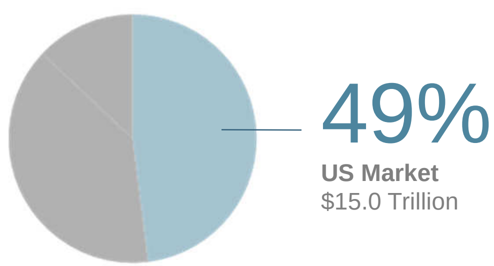
With all major asset classes logging negative quarterly performance, the US equity markets posted a -3.15% return for the quarter. Asset class returns ranged from -2.20% for large value stocks to -4.02% for large growth stocks.

Across the size and style spectrum, large outperformed small while value bested growth.

Ranked Returns for the Quarter (%)



World Market Capitalization—US



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Marketwide	3.84	16.73	0.39	5.81
Large Cap	5.45	16.40	0.22	5.33
Large Cap Value	3.01	15.80	-2.19	5.27
Large Cap Growth	5.76	17.50	2.87	6.03
Small Cap	-2.08	17.80	0.54	7.00
Small Cap Value	-1.44	17.43	-1.05	6.50
Small Cap Growth	-2.71	18.09	1.99	7.39

** Annualized*

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International Developed Stocks

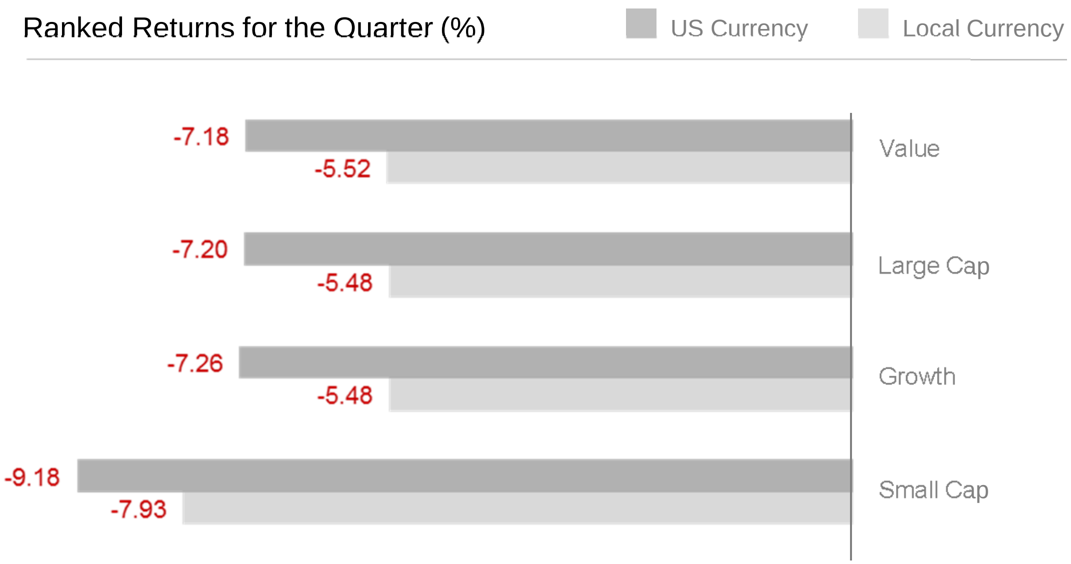
Second Quarter 2012 Index Returns

Developed international markets (as measured by the MSCI World ex USA Index) were -7.20% in the quarter, marking the index's third worst quarter since March 2009. The US dollar appreciated against all major foreign currencies, which reduced returns on dollar-denominated foreign investments.

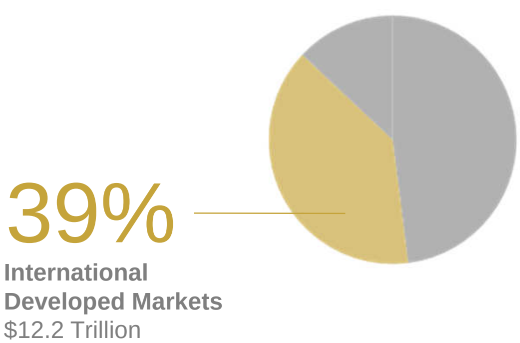
All developed countries posted negative returns in the quarter, with country dispersion ranging from -1.40% to -20.99% for Belgium and Finland, respectively.

Across the size and style spectrum, large beat small with value slightly outperforming growth.

Ranked Returns for the Quarter (%)



World Market Capitalization—International Developed



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	-14.13	6.20	-5.67	5.57
Small Cap	-15.75	10.14	-4.94	8.70
Value	-14.93	5.04	-6.97	5.80
Growth	-13.36	7.30	-4.44	5.25

* *Annualized*

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Large Cap (MSCI World ex USA Index), Small Cap (MSCI World ex USA Small Cap Index), Value (MSCI World ex USA Value Index), and Growth (MSCI World ex USA Growth). All index returns are net of withholding tax on dividends. World Market Cap: Non-US developed market proxies are the respective developed country portions of the MSCI All Country World IMI ex USA Index. Proxies for the UK, Canada, and Australia are the relevant subsets of the developed market proxy.

Emerging Markets Stocks

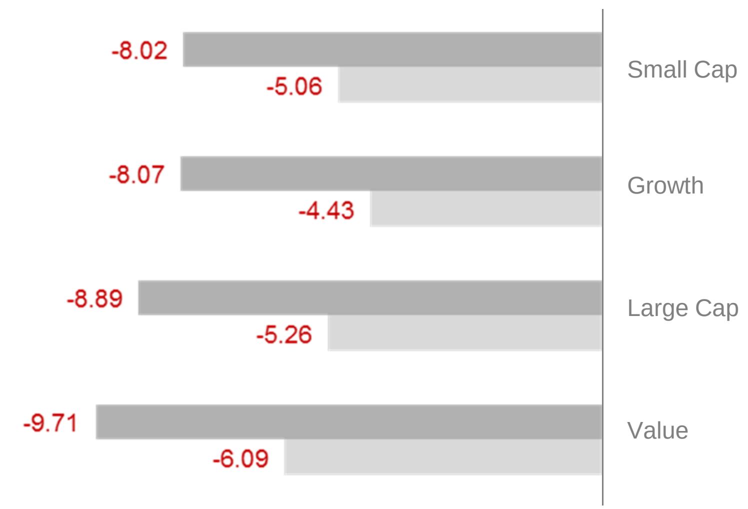
Second Quarter 2012 Index Returns

In US dollar terms, emerging markets logged a -8.89% return in their second-worst quarter since December 2008. The dollar appreciated against all the main emerging market currencies, negatively affecting dollar-denominated returns of emerging markets equities by 3.63%.

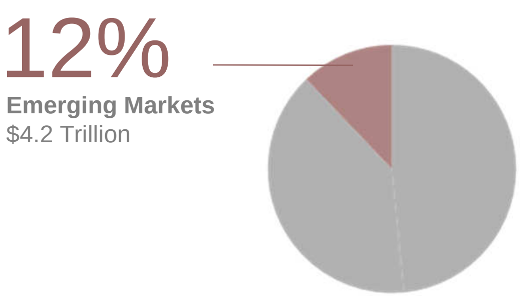
All country markets posted negative returns, with the exception of the Philippines and Turkey. The Philippines had the best return of the quarter at 4.71%, while Brazil fared the worst at -18.64%.

Performance of the size and style dimensions was mixed in the quarter, with small beating large and growth besting value.

Ranked Returns for the Quarter (%)



World Market Capitalization—Emerging Markets



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	-15.95	9.77	-0.09	14.08
Small Cap	-18.90	11.13	-0.72	15.06
Value	-15.79	9.64	1.39	15.73
Growth	-16.11	9.90	-1.59	12.40

** Annualized*

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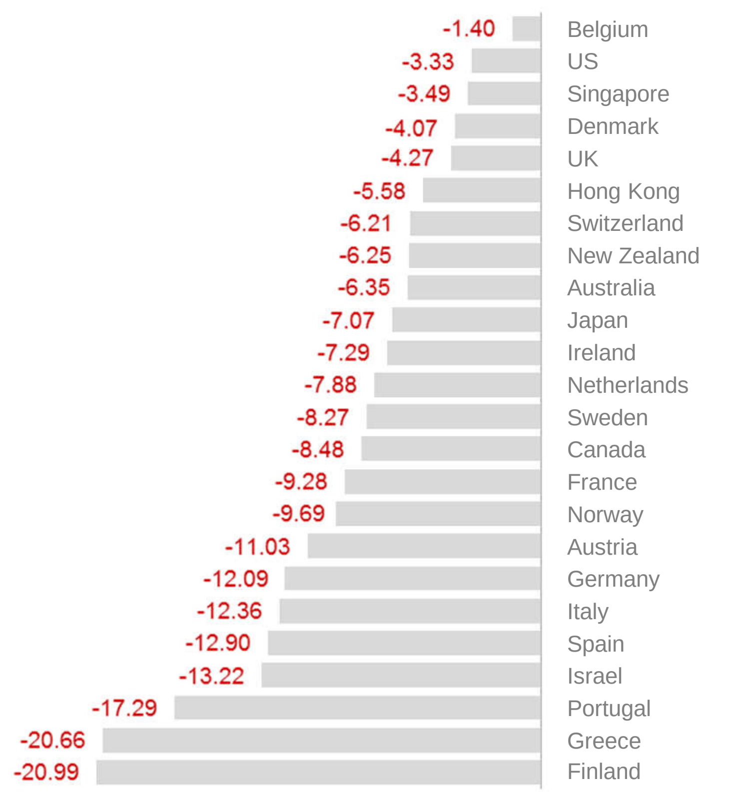
Select Country Performance

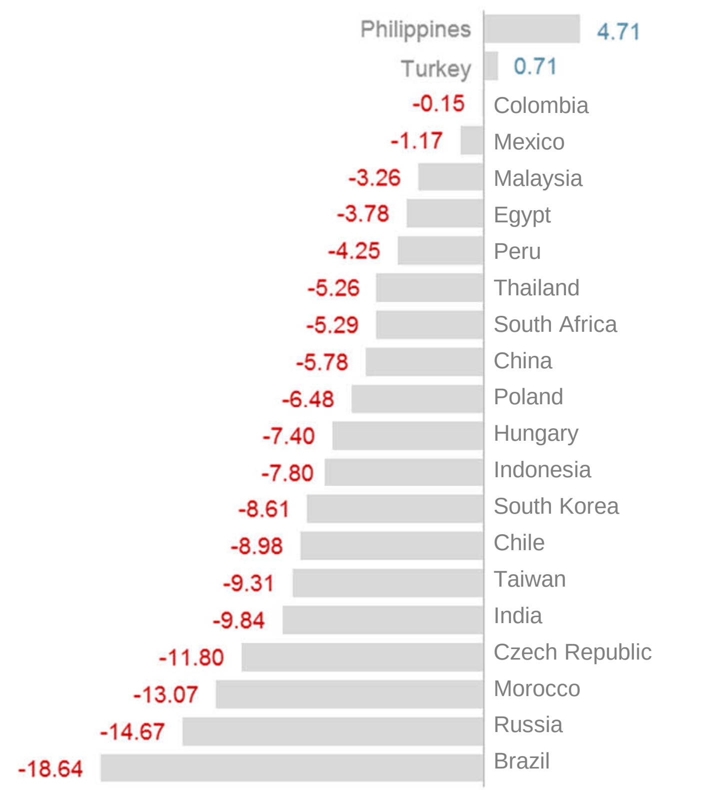
Second Quarter 2012 Index Returns

With equities under pressure as European debt concerns intensified, developed market countries were unable to avoid negative performance in the second quarter. Emerging markets faced a similar outcome with a few exceptions. On a year-to-date basis, many developed and emerging country returns were still flat to positive due to strong first quarter performance.

Developed Markets (% Returns)



Emerging Markets (% Returns)



Country performance based on respective indices in the MSCI All Country World IMI Index (for developed markets) and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends.

Real Estate Investment Trusts (REITs)

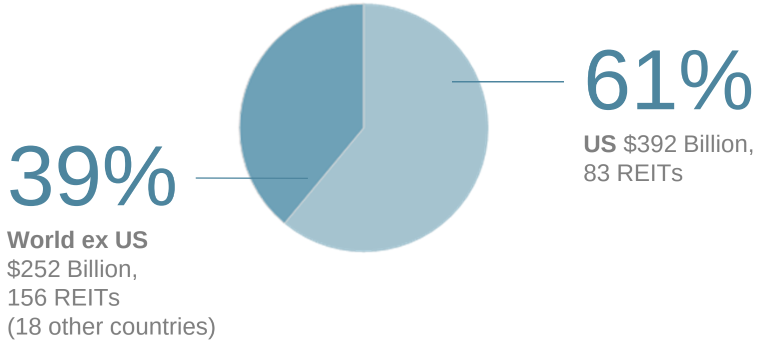
Second Quarter 2012 Index Returns

Real estate securities appreciated in the second quarter to outperform stocks and bonds. US REITs outpaced international REITs in the quarter, extending a five-year trend.

The dispersion between ten-year and five-year trailing returns was wide. REITs maintained strong annualized ten-year returns, while sharp declines in 2007 and 2008 continued to weigh heavily on five-year figures.

Ranked Returns for the Quarter (%)

Total Value of REIT Stocks



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
US REITs	13.29	33.52	1.97	10.27
Global REITs (ex US)	-4.72	16.68	-6.03	9.48

** Annualized*

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's © 2012.

Commodities

Second Quarter 2012 Index Returns

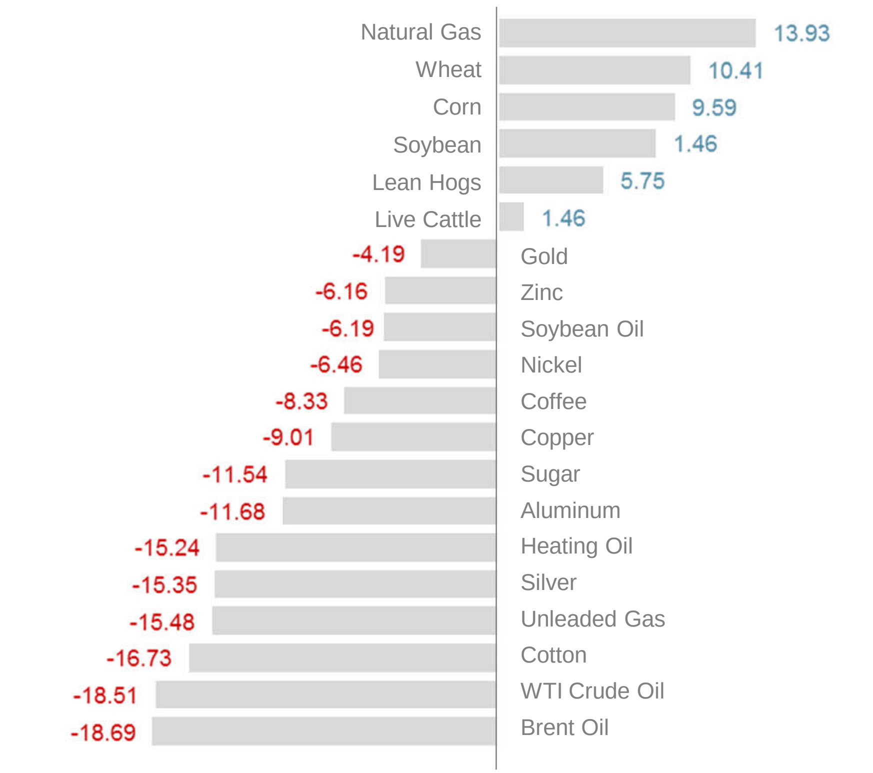
Commodities declined in the second quarter, extending a year-long drop in prices across a broad basket of individual raw goods. Leading the negative decline were petroleum-based commodities, with West Texas Intermediate (WTI) Crude and Brent Oil falling by 18.51% and 18.69%, respectively.

Period Returns (%)

Asset Class	Q2	1 Year	3 Years*	5 Years*	10 Years*
Commodities	-4.55	-14.32	3.49	-3.65	4.96

** Annualized*

Individual Commodity (% Returns)



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. All index returns are net of withholding tax on dividends. Dow Jones-UBS Commodity Index Total Return data provided by Dow Jones ©.

Fixed Income

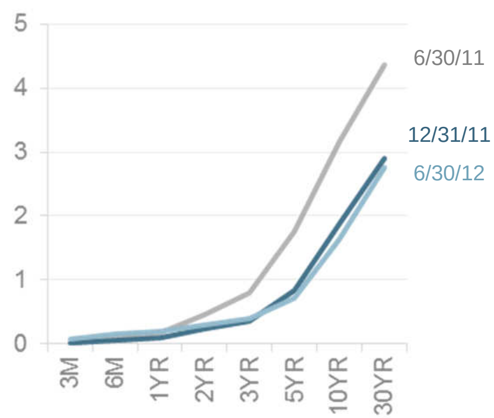
Second Quarter 2012 Index Returns

Strong investor demand for high-quality bonds continued in the second quarter, driving yields lower and prices higher. US Long-Term Government bonds extended their strong performance streak with a gain of 9.52% for the quarter. The ten-year US Treasury note rallied in early June to hit an all-time low yield of 1.47%.

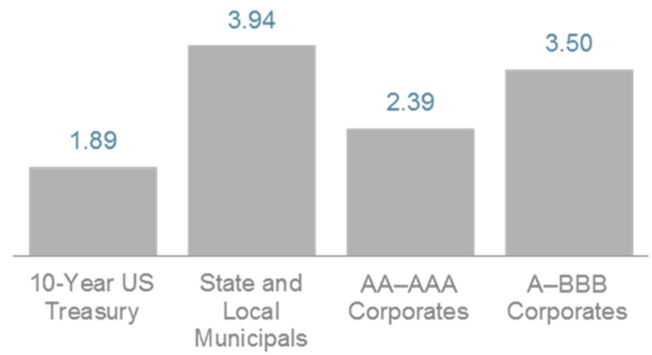
Investors' appetite for safety was so prevalent that many sovereign bond yields dipped into negative territory, indicating investors were willing to pay a steep price for the perceived safety.

US credit spreads increased through the quarter with most of the change (15 basis points) occurring during the third week of May as investors responded to news of a weakening economy and required extra yield to hold credit over government.

US Treasury Yield Curve



Bond Yields across Different Issuers



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
One-Month US Treasury Bills (SBBI)	0.03	0.07	0.81	1.73
Bank of America Merrill Lynch Three-Month T-Bills	0.05	0.12	0.98	1.87
Bank of America Merrill Lynch One-Year US Treasury Note	0.26	0.64	2.07	2.33
Citigroup World Government Bond 1-5 Years (hedged)	2.62	2.17	3.69	3.54
US Long-Term Government Bonds (SBBI)	29.48	13.24	11.92	8.94
Barclays Capital Corporate High Yield	7.27	16.29	8.45	10.16
Barclays Capital Municipal Bonds	9.90	7.62	5.95	5.28
Barclays Capital US TIPS Index	11.66	9.63	8.44	7.24

** Annualized*

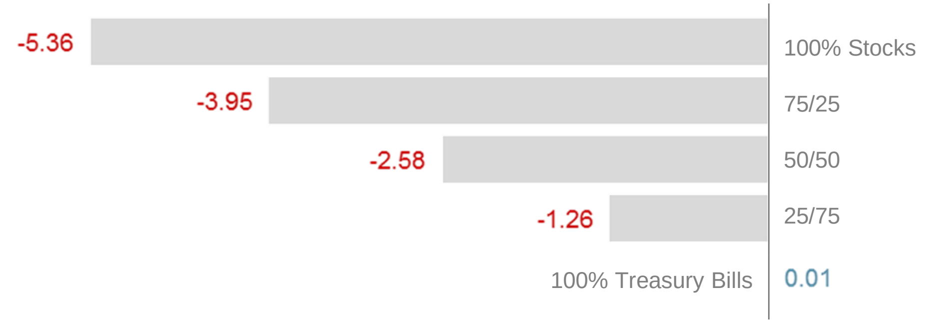
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. **Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Yield curve data from Federal Reserve. State and local bonds are from the Bond Buyer Index, general obligation, 20 years to maturity, mixed quality. AAA–AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA–AAA rated. A–BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB–A rated. Barclays Capital data, formerly Lehman Brothers, provided by Barclays Bank PLC. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

Global Diversification

Second Quarter 2012 Index Returns

These portfolios illustrate performance of different global stock-bond mixes and highlight the benefits of diversification. Those with larger allocations to stocks are considered riskier but also have higher expected returns over time.

Ranked Returns for the Quarter (%)



Growth of Wealth:
The Relationship between Risk and Return

Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
100% Stocks	-5.96	11.36	-2.17	6.27
75/25	-4.10	8.76	-0.98	5.44
50/50	-2.48	6.00	-0.08	4.39
25/75	-1.10	3.10	0.51	3.15
100% Treasury Bills	0.01	0.03	0.07	0.81

** Annualized*

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance.

Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified portfolios rebalanced monthly. © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

The Cost of Caviar: Lower Expected Returns

Second Quarter 2012

Australia's champion racehorse Black Caviar is unbeaten over twenty-two races. Think of her as a growth stock with four legs. With a brilliant bloodline and a huge fan base—she even has her own Facebook page—Black Caviar is turning into the most popular racehorse since the legendary Phar Lap.

The five-year-old mare prevailed in Britain's premier racing event at Royal Ascot late last month. But unless you own part of Black Caviar, you're unlikely to make much money from placing a bet on her fortunes. "The Wonder from Downunder," as she is known, pays close to even odds with bookmakers.

That's the problem with (perceived) no-risk bets. The high probability of a win means your expected return is very low.

It's reminiscent of the equity market, where you can choose to buy highly priced growth stocks. Many investors are prepared to put a high price on these companies' expected cash flows. In other words, they are prepared to accept a lower expected return for the perceived lower risk of owning a stock that is growing faster than the wider market. This is similar to how gamblers in aggregate are prepared to accept a much lower return than the wider field for the perceived lower risk of putting their money on Black Caviar.

So why not back the favorite all day? Well, that could be a legitimate decision for some investors, if they are prepared to accept lower expected returns for lower risk. On the other hand, there is strong academic evidence that there is a long-term premium for tilting your portfolio to lower-priced "value" stocks. You could think of these as the unknown or unfancied horses—the ones with the wider odds.

Unlike the racetrack, however, there is more than one winner on the stock market. It is just a question of how much risk you wish to take. Backing past winners means you forgo the chance of earning a bigger dividend on the outsiders.

And keep in mind that even if you put it all on the stock market equivalent of Black Caviar, there is still no guarantee you will be rewarded. Even champion racehorses eventually lose. And by concentrating your bet, you leave yourself more exposed to specific risks related to that one entity.

With long-term investment, you are better to spread your risk through diversification. Backing the entire field—or sections of the field—leaves you less prone to the risk associated with individual runners.

Ultimately, a great company or champion racehorse is one thing. A great investment is another. Black Caviar comes at a cost.