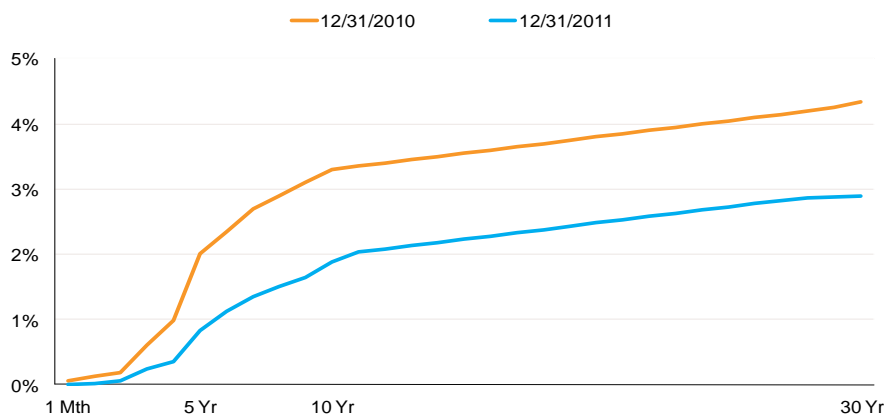


FOURTH QUARTER 2011

## 2011 YEAR IN REVIEW

World events continued to take center stage in 2011 and drove the “risk-on” and “risk-off” environment we have become accustomed to the last few years. Positive news drove the equity markets to rally, but when the outlook turned bleak, investors sought safety and risk assets sold-off. With the exception of the U.S., which realized flat stock market returns, most equity markets experienced double-digit losses. Treasury yields fell all along the curve (see chart below), especially during the late summer flight-to-quality period, and intermediate and long-term Treasuries enjoyed double-digit gains.

### U.S. Treasury Yield Curve



Source: Bloomberg

The European debt crisis continued throughout 2011 and had the largest influence on the markets. (See the FEG Insight publication, *What Should We Do About the European Debt Crisis?*) When the European leaders appeared to reach agreement on bailouts or positive solutions to the debt crisis, risk assets performed well. Other events, such as the “Arab Spring”, with its demonstrations and eventual overthrow of several governments, brought hope for democracy to the region, as well as fear of increased instability to the Middle East. In March, an earthquake under the Pacific Ocean caused a tsunami that struck Japan, devastating that country and crippling its already weak economy. In August, Congress waited until the last minute to reach an agreement on raising the debt ceiling, avoiding a potential default, yet Standard & Poor’s still downgraded U.S. long-term debt.

Economic headwinds also impacted the global markets. Sluggish economic growth (U.S. GDP grew 1.7% in 2011), high unemployment, a weak housing



**Christopher M. Meyer, CFA**  
 Managing Principal  
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market, fears of recession in Europe, and lower economic growth in emerging markets negatively impacted stock returns.<sup>1</sup> Unlike the quantitative easing in much of the developed world, emerging markets faced inflationary pressures and early in the year central banks tightened monetary policy by raising interest rates and reserve requirements, thus slowing GDP growth.

Will the “risk-on” and “risk-off” cycle continue in 2012 or will a level of normalcy return to the markets? Before reviewing our outlook and opportunities for 2012, however, we review our recommendations from one year ago (in italics) and what actually occurred.

### Review of Outlook for 2011

#### *Global Equity*

- *There is a mixed outlook for **developed equities**. U.S. corporate earnings are expected to grow 16% in 2011 and many companies are flush with cash. Valuations, however, are near or above their long-term averages. Therefore, should corporate earnings grow as expected, **U.S. stocks** could produce another solid year of gains. Risks include P/E multiple contraction, due to rising interest rates for bonds, weaker than expected growth, or an unanticipated global shock (e.g., skyrocketing oil prices, military conflict, etc.).*

The mixed outlook was reality for **U.S. equities** in 2011, as the S&P 500 Index experienced quite a bit of volatility. There were 35 days where the index closed more than 2% from the previous day's value, compared to 22 in 2010. Interestingly, this occurred twice in 2006 and not once in 2005. In late April the index was up 8% on a year-to-date basis. Late summer, investors feared the economy could slide back into recession amid the European sovereign debt crisis and Standard & Poor's downgrade of U.S. long-term debt, and the index was down 13% by early October. A fourth quarter rally propelled the index back into positive territory, ending the year with a 2% gain.

Although corporate earnings were healthy, P/E contraction, due to concerns about economic growth, inhibited returns. Small and mid cap stocks posted modest losses for the year and growth generally fared better than value.

- *Valuations for **international developed equities** appear reasonable. The 15.5x P/E multiple for the MSCI EAFE Index is below both the long-term average (21.6x) and the Russell 1000 Index multiple (17.4x). Thus, returns will most likely be dependent on economic conditions, as valuations are neither especially rich nor cheap. Risks include the European sovereign debt crisis, deflationary concerns in Japan, as well as those risks mentioned above for the U.S. market.*

Returns definitely were dependent on economic conditions and the risks identified at the beginning of the year proved to be major factors. **International developed markets**, as measured by the MSCI EAFE Index, declined 12% (both in local currencies and the U.S. dollar). For the year, the dollar strengthened versus the euro, but weakened versus the Japanese yen.

Japan, and nearly all of the major European markets, with the exception of the U.K., which fell 2%, realized double-digit losses in 2011. The ongoing European sovereign debt crisis clearly weighed on investors' appetite to seek risk. The appreciation of the yen impacted exports and provided a headwind for companies in Japan.

- ***Emerging markets** trade at reasonable valuations (14.6x) compared to the developed markets. Additionally, economic growth continues to create favorable opportunities. Risks include a slowdown or reversal of the strong capital flows experienced the last few years, as well as increasing inflationary pressures.*

<sup>1</sup> Bureau of Economic Analysis

A slowing global economy, central bank tightening to contain inflation, and debt crises in the developed world negatively impacted **emerging markets**, as the MSCI Emerging Markets Index declined 18% (12% in local currencies) in 2011. No regions were spared, as all major countries experienced double-digit losses.

- **Private equity** is attractive due to a decrease in the amount of capital flowing into this area, less competition than previous years, and an improving merger and acquisition market. The risks, though, are a weakening economy, unavailability of credit, and a poor exit market.

**Private equity** appeared attractive, but capital committed in 2011 is still being invested; therefore evaluating returns is premature at this point. Data through June 30, however, show that one year returns for both venture capital and buyout returns were above 20%.<sup>2</sup>

- **Hedged equity** mandates, or unconstrained active management, should perform well with a return to fundamentals. Investors wishing to participate in the equity markets over the long-term, but skeptical that the rally will continue over the near term, may want to increase their exposure to hedged equity, as these mandates seek to provide equity-like returns, but with less volatility and lower drawdowns.

With continued high inter-stock correlations and macro events driving returns, **hedged equity** managers contend 2011 was not a return to fundamentals. The HFRI Equity Hedge Index fell 8% for the year. Compared to the performance of the overall U.S. market (Russell 1000 Index: +1%), this was a major disappointment. Many hedged equity managers, however, employ a global approach to investing and do not restrict their universe to the U.S. stock market. When compared to the -13.7% return for the MSCI All Country World Index, the hedged equity returns appear more reasonable, but still disappointing. Although hedged equity generally protected on the downside (e.g., realizing only half the 17% loss for the MSCI All Country World Index in the third quarter), they were unable to participate during the market rallies (e.g., returning only 2% in the fourth quarter).

### *Global Fixed Income and Credit*

- Yields on **U.S. Treasuries** remain low (the 10-year Treasury yield was at 3.3% at the beginning of the year) and at risk of price declines should interest rates rise. Rates could rise due to a strengthening economy or rising inflation. Treasuries could perform well in a flight-to-quality environment, but this probably would be due to some sort of crisis.

Neither a strengthening economy nor rising inflation was a threat to interest rates in 2011. U.S. GDP growth was a modest 1.7% and core inflation (less food and energy) was contained at 2.2%. Coupled with a flight-to-quality environment due to several macro events, including the European sovereign debt crisis and the downgrade of U.S. long-term debt, **U.S. Treasury** yields fell across the yield curve, with the 10-year Treasury yield ending 2011 at 1.88%. The Barclays Capital Treasury Index gained nearly 10% for the year, while 10-year Treasuries returned 17% and 30-year Treasuries returned 35%. Due to low yields, short-term Treasuries realized only modest returns, with 2-year Treasuries advancing 1.5%.<sup>3</sup>

- The implied inflation rate (the difference between the 10-year Treasury yield and the 10-year TIPS yield), stood at 2.3% at the beginning of 2011. Expected inflation also can be forecasted by analyzing expected 5-year inflation 5 years from now. This is calculated by subtracting the TIPS 5-year forward contract from the nominal Treasury 5-year forward contract. This measure shows expected inflation at 2.8%. Thus, the market is expecting 2-3% inflation over the next several years. Therefore, **TIPS** should outperform nominal Treasuries in even a modest inflationary environment.

<sup>2</sup> Thomson One  
<sup>3</sup> Venture Economics

Modest inflation concerns and falling yields boosted **TIPS** returns in 2011. The Barclays Capital TIPS Index returned 13.6% for the year.

- ***High yield** spreads have tightened dramatically over the last two years and are now near long-term averages. Although high yield bonds no longer offer the compelling opportunities of the last two years, they still provide attractive yields compared to Treasuries, and spreads could tighten below long-term averages with an improving economy and low expected default rates. Risks include widening credit spreads and higher defaults due to a weakening economy.*

**High yield bond** spreads widened for the year, mainly during the flight-to-quality environment in August and September. Nevertheless, the high yields and low defaults allowed for solid returns, with the Barclays Capital High Yield Index gaining 5% for the year. This compared favorably to stock returns, but below the 7.8% return for the broad investment grade bond market, as measured by the Barclays Capital Aggregate Bond Index.

- ***Bank loans**, generally rated non-investment grade but senior in the capital structure, yield approximately 80% of high yield, but with shorter durations (rates typically reset every three months), lower default rates, and higher recovery rates. Thus, bank loans offer attractive credit exposure but better risk-adjusted returns in a rising interest rate environment. Risks are similar to high yield bonds, as spreads could widen and defaults could rise.*

With yields falling and credit spreads widening, **bank loans** were among the weakest performing areas of the fixed income markets. In 2011, the CSFB Leveraged Loan Index returned 1.4%.

- ***Commercial mortgage backed securities (CMBS)** continue to offer compelling return potential as spreads remain well above historical levels. These wide spreads reflect continued fear in the commercial real estate markets, but should this market not retreat and continue to recover, returns could be impressive again this year. Risks include a deteriorating commercial real estate market, rising interest rates, and high defaults.*

The **commercial mortgage backed securities** market continued to recover and the Barclays Capital Investment Grade CMBS Index posted a solid 6.5% return in 2011. Those willing to invest in these securities three years ago, despite the horrible commercial real estate market environment at that time, were amply rewarded, with the index up 17% since the end of 2008.

### Real Assets

- *Real assets include **real estate, timber, energy, commodities, and other natural resources**. These assets should be considered as inflation-protection strategies. Furthermore, they provide capital appreciation potential and diversification to the portfolio. Real assets should benefit from any manifestation of higher inflation, but also from global economic growth. Risks include a stagnant or deflationary economic environment and overpaying for assets.*

Many of the energy investments are in private capital structures and returns for the full year are not yet available. Timber returns were flat, as measured by the NCREIF Timberland Index. Publicly-traded **commodities**, however, produced disappointing returns, with the Dow Jones UBS Commodities Index falling 13%.

- *With commercial **real estate** trading at depressed prices, we continue to recommend focusing on distressed and value-added opportunities.*

Publicly-traded REITs, up 8%, as measured by the FTSE NAREIT All Equity Index, provided solid returns. Private core real estate, as measured by the NCREIF Property Index, gained 14% in 2011, with preliminary data also showing double-digit gains for valued-added and opportunistic strategies.

In our 2008 year end commentary we noted a plethora of attractive opportunities for 2009, and recommended overweighting credit, underweighting Treasuries, and re-balancing stocks back to or above target. For 2010, we noted a few attractive opportunities, such as emerging markets, high yield bonds, CMBS, and distressed real estate. Unlike the previous two years, however, where we had much higher convictions in our recommendations, we stated the opportunities for 2011 were not nearly as apparent and 2011 would be tougher to predict. Nevertheless, we were generally on point with our analysis of 2011, with the notable exception of U.S. Treasuries rallying. We now turn to the outlook for 2012, which is similar to that from last year with few high conviction attractive opportunities.

### Outlook for 2012

We continue to face the same threats to economic growth as we have the last few years. The largest threat is the impact of policy decisions to combat the growing sovereign debt issues in the developed markets, especially in Europe. With huge debt burdens, policy makers basically have five choices:

1. *Grow their economies enough to pay off debt* – highly improbable based on current economic conditions
2. *Employ austerity measures to pay off debt* – unpopular with citizens (see riots in Greece) and may negatively impact short-term growth
3. *Devalue their currency and reflate their way out of this problem* – not practical for any individual euro zone member to implement independently
4. *Seek a bailout* – delays debt payments but does not resolve structural issues
5. *Default* – least attractive option and last resort for most policy makers

None of the final four realistic options are attractive and all come with negative consequences. How the European debt crisis unfolds likely will have an impact on the global markets.

On a positive note, the U.S. economy is showing signs of incremental improvements. GDP grew 2.8% in the fourth quarter, initial jobless claims have been trending lower, and inflation appears under control.<sup>4</sup>

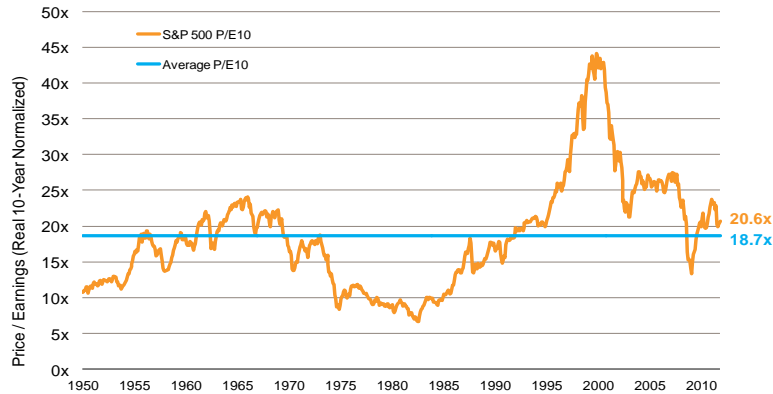
Although we may be able to identify the issues beforehand, we do not know with any certainty the outcomes over the course of the year. Nevertheless, we must recognize the issues and how they could impact investment portfolios. With that in mind, we now review the major asset categories, focusing on the opportunities and risks in 2012.

### Global Equity

- **U.S. equity** valuations trade slightly above the long-term normalized average, whereas profit margins and earnings remain above the long-term trends. Potential economic headwinds include sluggish economic growth, high unemployment, and a weak housing market. Additional risks include the European sovereign debt crisis, slowing economic growth in emerging markets, and geopolitical risks. Hedged equity can reduce volatility in global equity allocations.

<sup>4</sup> Bureau of Economic Analysis

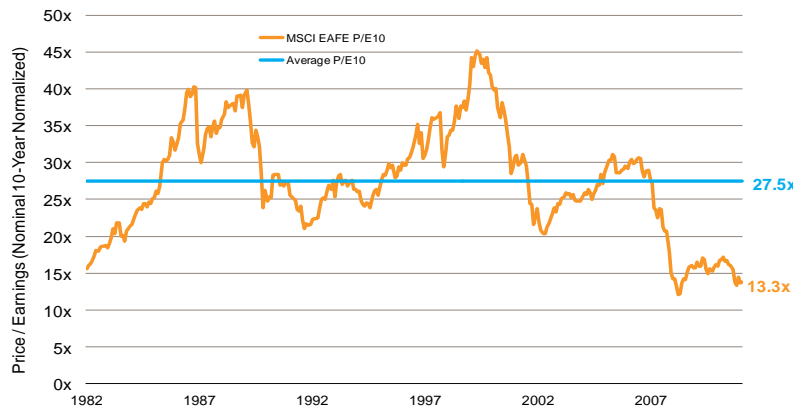
### Historical Valuations: U.S. Price/10-Year Normalized Earnings S&P 500, 1950 - Present



Source: Robert Shiller and Standard & Poor's

- Just as in 2011, there is a mixed outlook for **developed international equities**. The European sovereign debt crisis, the potential for a deep recession in Europe, and economic weakness in Japan remain ongoing headwinds in the international equity markets. Valuations, on the other hand, are attractive. Price-to-earnings ratios (based on 10-year normalized earnings) are at decade lows, indicating that even modest economic improvements can spur stock market returns.

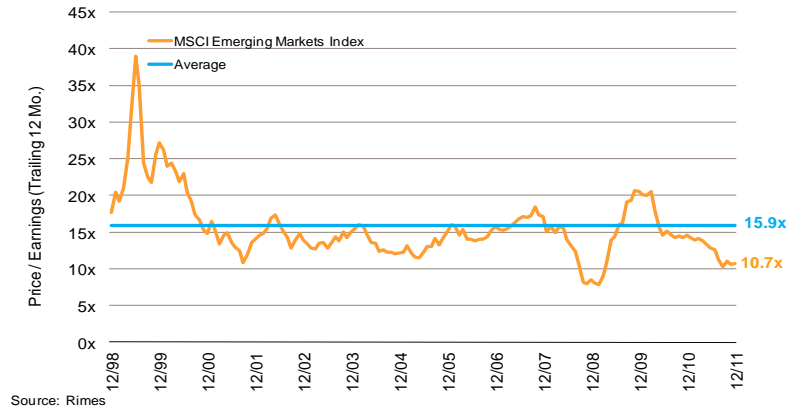
### Historical Valuations: International Price/10-Year Normalized Earnings MSCI EAFE, 1982 - Present



Source: MSCI

- Compelling valuations and a favorable long-term economic forecast create a persuasive investing opportunity for **emerging markets**, but risk of economic growth below potential and inflationary pressures persist in the short-run.

### Historical Valuations: Emerging Markets P/E

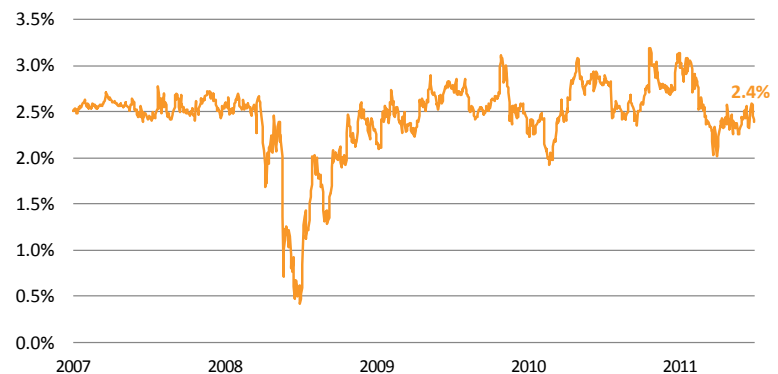


- Continued contraction (capital and number of active private equity funds) in the **private equity** industry compared to pre-2008 levels, can provide investment opportunities for long-term appreciation.

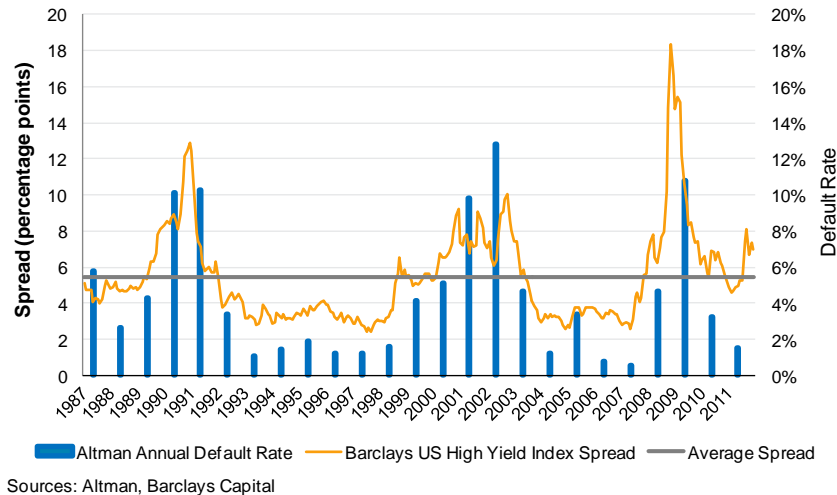
### Global Fixed Income and Credit

- U.S. Treasuries** are unattractive from an expected return perspective, as yields remain low (the 10-year Treasury yield was at 1.88% at the beginning of the year) and at risk of price declines should interest rates rise. A strengthening economy or rising inflation likely would cause prices to decline. Treasuries may only perform well in a flight-to-quality environment, likely caused by some sort of crisis, such as a disorderly break-up of the European Union or military conflict in the Middle East.
- Treasury Inflation Protected Securities (TIPS)** face the same risks as nominal Treasuries, namely low yields and potential price declines in a rising interest rate environment. TIPS provide some protection against inflation, however, and should outperform nominal Treasuries if inflation accelerates. The implied inflation rate, based on the difference between the 10-year Treasury yield and the 10-year TIPS yield, stood at 2.0% at the beginning of 2012. The 5-year by 5-year forward inflation rate shows expected inflation at 2.4%. Thus, the market is expecting 2-2.5% inflation over the next several years. Therefore, **TIPS** should outperform nominal Treasuries in even a modest inflationary environment.
- High yield** spreads widened above historical averages and provide compelling yields. Risks include widening credit spreads and higher defaults due to a weakening economy.

### 5-Year by 5-Year Forward Inflation Rate

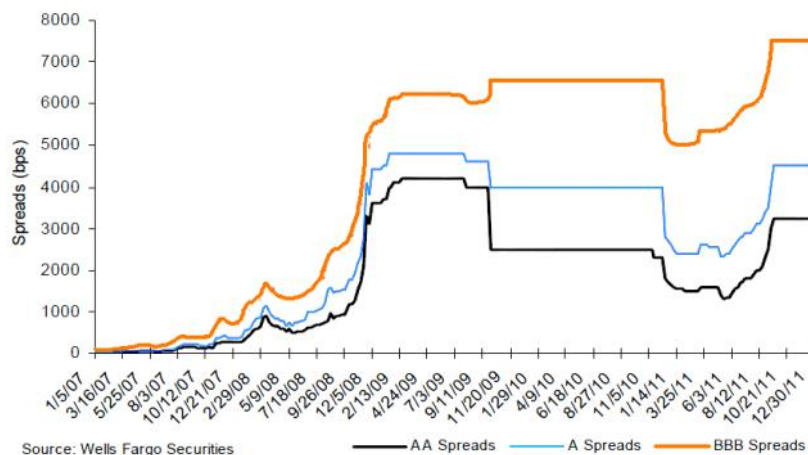


### U.S. High Yield Bond Spreads over Treasury Yields



- Average prices for **bank loans** are in the mid-90s and spreads, at 450 basis points above LIBOR, are above their historical average. Although yields are not as attractive as high yield bonds, with shorter durations (rates typically reset every three months) bank loans can provide protection in a rising interest rate environment. Widening spreads and higher defaults are potential risks.
- Distressed **residential mortgage backed securities (RMBS)** trade at attractive loss-adjusted credit spreads amid a dwindling supply and improving investor demand. With a housing market showing signs of stabilizing, RMBS can offer attractive returns for fixed income investors. Potential risks include a deteriorating housing market, increased defaults and foreclosures, and rising interest rates.
- Seasoned **commercial mortgage backed securities (CMBS)** offer attractive spreads over Treasuries, and thus the opportunity to capture yield with gradual improvements in commercial real estate. Risks include a weakening commercial real estate market, rising interest rates, and high defaults.

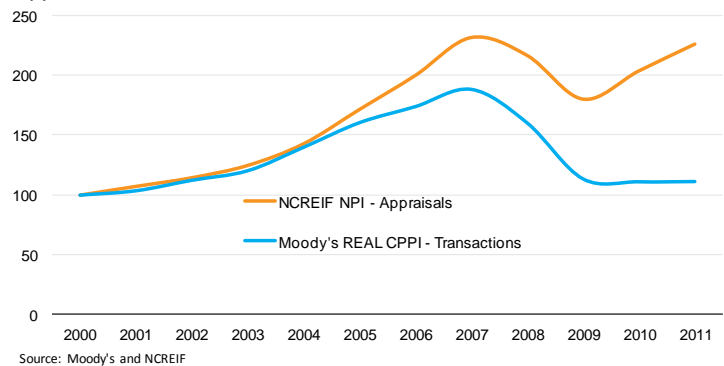
### CMBS Yield Spreads versus Treasuries



**Real Assets** - include real estate, timber, energy, commodities, and other natural resources

- **Natural resources** can protect against unexpected inflation and serve as event risk protection strategies, as well as portfolio diversifiers. Investments in natural resources can also benefit from global economic growth.
- **Commodities** can serve as a hedge against event risk (e.g., disruption to the Strait of Hormuz), provide protection against unexpected inflation, and offer diversification to a portfolio.
- **Master Limited Partnerships (MLPs)** provide exposure to midstream energy assets, specifically companies that own and operate oil and gas pipelines, gathering and processing systems, storage facilities, and refineries. A key opportunity for growth in MLPs is in shale gas, where there is a lack of infrastructure and services needed to process natural gas with a high liquid content (“wet gas”). MLP distribution yields of 6% and distribution growth rates estimated at 6-8% for 2012 imply attractive return potential. Risks include a decline in distribution or growth rates.
- Despite private **real estate** appraisals returning towards peak levels, transaction activity illustrates that commercial real estate has yet to fully recover and provides an opportunity to gain from expected improvement in the sector. Distressed and value-added real estate may provide more attractive opportunities than core real estate.

**Private Real Estate Values**  
Appraisals vs. Transactions



Although we focused much of our analysis on the public markets, investors can implement these strategies in a variety of ways, depending on their risk tolerance and liquidity needs. For example, investors seeking certain exposures can hire traditional long-only managers, with full liquidity. Likewise, investors can invest in hedge funds, which are semi-liquid, allowing the manager more flexibility than a long-only manager. Another approach would be through private partnerships, which have limited liquidity, but allow managers to focus on the long-term.

## Conclusion

As we review our outlook for 2012, the risks are evident, but the outcomes unknowable in advance. Answers to the following questions would surely help us understand how to position portfolios in 2012:

- Will the U.S. economy continue to improve or will growth stagnate?
- Will the euro zone break-up or continue to muddle along?
- Will Europe suffer a mild or deep recession?
- Will the emerging markets contain inflation, and if so, will this inhibit economic growth?

Unfortunately, we do not know how those events will unfold. Furthermore, there could be an unforeseen geopolitical event that disrupts the markets. Thus, we recommend investors review their risk tolerances and determine whether there are risks they wish to avoid or hedge. Where the rewards outweigh the risks, investors may want to prudently accept the risks and overweight those asset strategies. With so much uncertainty and a lack of clear direction, a portfolio well-diversified by risk, and not simply by assets, can provide downside protection.

## ECONOMIC UPDATE

### FOMC to Begin Releasing Fed Funds Rate Forecasts

The minutes to the FOMC meeting released on January 3, 2012, showed that the Federal Open Market Committee will begin releasing the committee's federal funds rate forecast, a move that the Federal Reserve hopes will bring added transparency to the committee's monetary policy goals. The forecast will include information about participants' projections for the target federal funds rate and will be projected for the coming calendar year, as well as over the long-term. A zero-bound federal funds rate, in place since December 2008, has had multiple effects on the economy, including (but certainly not limited to) a suppression of interest rates across the Treasury yield curve, interest rates in savings accounts at levels marginally above the federal funds rate, and an increase in the prices of risky assets.

### Headline Unemployment Rate Continues to Head Lower

The December employment report, released by the Bureau of Labor Statistics on January 6, 2012, showed an increase in private nonfarm payrolls, as well as a reduction in the headline unemployment rate. The rate, which stood at 8.7% in November, declined to 8.5% during the month of December. The underemployment rate (U6) also declined from 15.6% in November to 15.2% in December. Nonfarm payrolls increased 200,000 during the month, on economists' expectations of an increase of 155,000. A portion of the decline in the unemployment rate was due to a continued decline in the civilian labor force from 153.937 million in November to 153.887 million in December as well as an increase in the civilian non-institutional population from 240.441 million in November to 240.584 million in December. As such, the labor force participation rate was unchanged on the month at 64.0%, one of the lowest rates in almost 30 years.<sup>1</sup>

### Third Quarter GDP Revised Lower

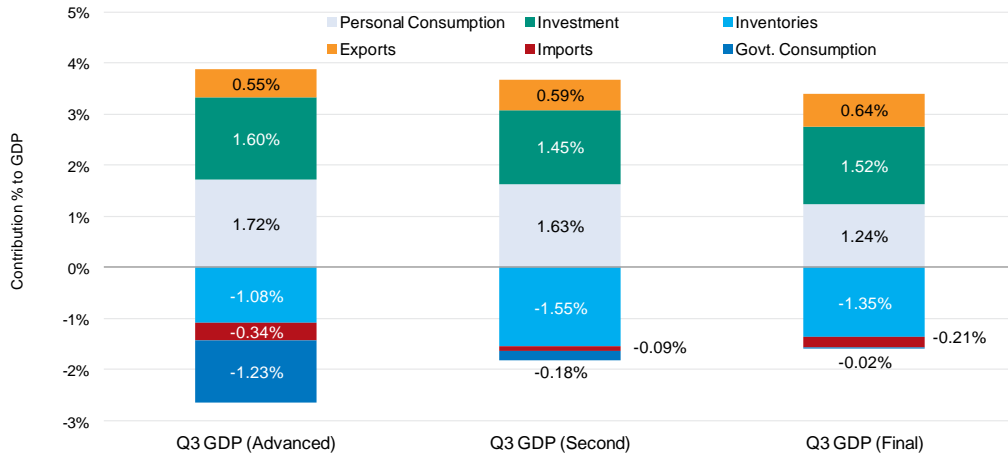
According to the third and final estimate released by the Bureau of Economic Analysis on December 22, 2011, GDP increased at an annual rate of 1.8% during the third quarter of 2011. This reading was 0.2 percentage points lower than the second estimate of 2.0%. One of the largest contributors to the downward revision was a decline in the personal consumption expenditure, which came in at 1.24% versus the prior estimate of 1.63%. Inventories surprised on the upside, however, detracting just 1.35% instead of the 1.55% rate forecasted previously.



**Michael J. O'Connor**  
Research Analyst

**“The unemployment rate, which stood at 8.7% in November, declined to 8.5% during the month of December.”**

### GDP Components



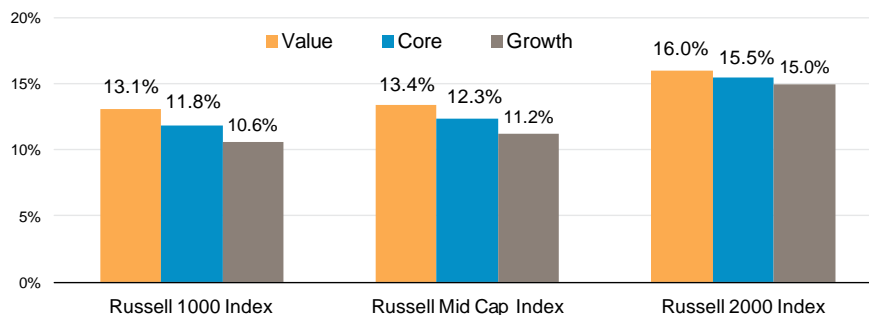
Source: Bureau of Economic Analysis, Fund Evaluation Group

1 Bureau of Labor Statistics. "The Employment Situation – December 2011." Information available from <http://www.bls.gov>. 6 January 2012.

### DOMESTIC EQUITY

U.S. equity markets experienced modest increases in December, and returns were strong across all market capitalizations, posting double-digit gains, for the fourth quarter. Economically sensitive sectors were the strongest performers during the quarter, as energy, industrials, and materials stocks led the way. Defensive areas of the market, such as utilities and telecommunications stocks lagged behind; however, all sectors posted positive returns for the quarter.<sup>1</sup> Value stocks outperformed growth stocks for the fourth quarter across small, mid, and large market capitalizations.

#### Fourth Quarter 2011 Russell Indices Performance



Source: Russell

Large cap indices realized positive returns for the year, as investors were attracted to blue chip stocks and dividend payers. The amount of institutional assets in U.S. dividend-focused strategies increased 51% over the first nine months of 2011, up from \$36.1 billion at the end of 2010 to \$54.6 billion as of September 30, according to the eVestment Alliance database.<sup>2</sup> Active managers were challenged by a tough environment, as macro-economic events were key drivers of stock prices. Based on Morningstar data, only 17% of large-cap stock funds outperformed the S&P 500 Index in 2011, which is the fewest number since 1997, when only 12% exceeded the index.<sup>3</sup>

While small-cap indices had a strong fourth quarter, returns were negative for the year. The inter-correlation of small cap stocks hit an all-time high for the Russell 2000 Index, creating a headwind for active managers.<sup>4</sup> Fundamentals were not the primary drivers of performance and defensive areas of the market, such as utilities and consumer staples were the best performing sectors for the year. Although the environment was difficult, those managers with a focus on high quality stocks were rewarded during both the quarter and year, as high quality, measured by return-on-equity (ROE), outperformed low quality. For the year, 62% of small cap core managers outperform their benchmark, compared to 45% and 57% of small cap growth and small cap value managers, respectively.<sup>5</sup>



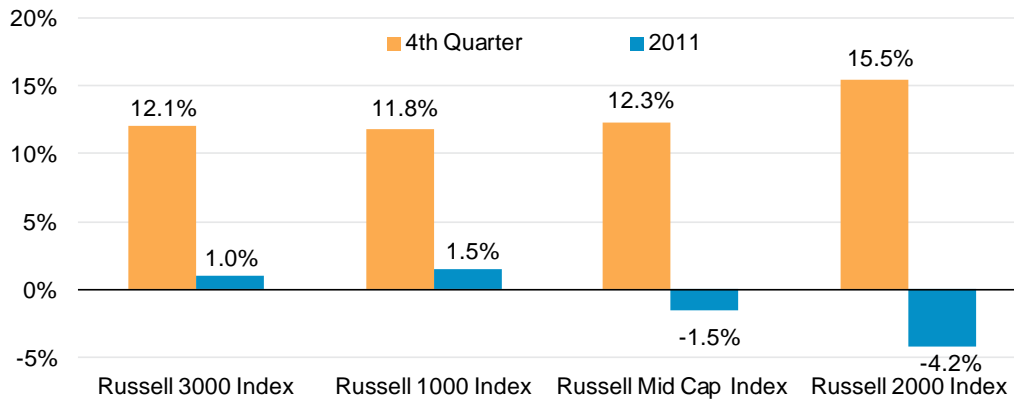
**Brian A. Hooper**  
Senior Research Analyst



**Christina M. Sunderman**  
Senior Research Analyst

**“Active managers were challenged by a tough environment, as macro-economic events were key drivers of stock prices.”**

### Russell Indices Performance



Source: Russell

Mid-cap managers did not fare as well as small-cap managers. While mid-cap managers performed well during the fourth quarter, they struggled to keep up with their respective indices for the entire year. For the year, only 32% of mid cap growth managers beat their index, compared to 24% for both mid cap core and value managers.<sup>6</sup>

1 "World Markets Review – December 2011." Capital Guardian.

2 FundFire. "Managers, Inst'l Investors Turn to Dividends." 21 December 2011. Information available at <http://www.fundfire.com>.

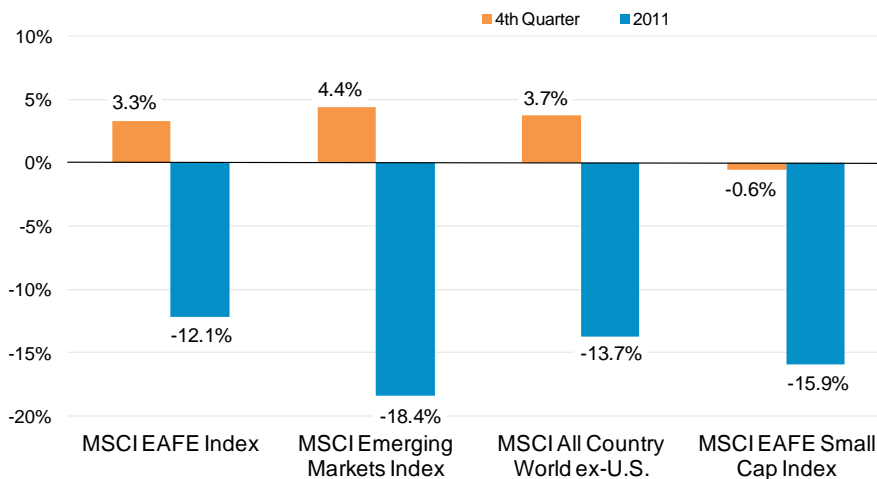
3 Ignites. "Just 17% of Big-Cap Funds Beat S&P 500." 12 January 2012. Information available from <http://www.ignites.com>.

4-6 DeSanctis, Steven, Christina Giannini, and Matthew Trapp. "BoFA Merrill Lynch Small-Cap Research – 2012 outlook and 2011 Performance recap." 4 January 2012.

### INTERNATIONAL EQUITY

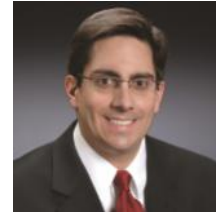
As European leaders worked to address the ongoing sovereign debt crisis and the prospects for global economic growth improved, international equities gained 4.1% when measured in local currencies. Due to the strengthening U.S. dollar, however, performance of the MSCI EAFE Index was up slightly less, gaining 3.3% when measured in U.S. dollars terms. For 2011, developed market equities fell approximately 12% in both U.S. dollars and local currencies. International small cap stocks posted modest declines in the fourth quarter, down 0.6% in U.S. dollars (-0.2% in local currencies). While emerging market equities gained 4.4% for the quarter (4.8% in local currency). Emerging market equities, however, were down more than 18% (-12.7% local) for the year, making emerging markets one of the weakest segments of the equity markets. The MSCI All Country World ex-U.S. Index, which includes both developed and emerging markets, returned 3.7% in U.S. dollars for the quarter. Performance of the MSCI Indices is shown in the following chart.<sup>1</sup>

**MSCI Indices Performance**  
Returns in U.S. dollars



Source: MSCI

The U.S. dollar appreciated substantially against the euro (+3.8%) and the Swiss Franc (+3.8%), but declined against the Australian dollar (-5.2%) and slightly against the Japanese yen (-0.2%). The dollar also gained substantially against the Indian rupee (+8.5%), but depreciated against the Chinese yuan (-1.3%) and the South Korean won (-1.9%). For the year, the dollar appreciated against the euro (+3.1%), the Canadian dollar (+2.2%), and most emerging market currencies, but declined against the Japanese yen (-5.2%).<sup>2</sup>



**Gregory D. Houser, CFA**  
Vice President



**Brian A. Hooper**  
Senior Research Analyst

“Fitch raised Australia’s long-term foreign currency rating to AAA.”

### Developed Markets

(All returns in local currency unless otherwise indicated)

#### *Europe*

In the euro zone, stocks gained 6.3%, as European leaders struggled to develop a resolution to their fiscal problems. Northern European countries were among the best performing countries. Denmark (+11.8%), Norway (+12.0%), and the Netherlands (+10.1%) each posted double-digit returns. Consumer stocks were strong in Denmark and Norway, while technology stocks in the Netherlands returned more than 24%. Energy stocks (+17.8%) were the strongest sector within Europe, benefiting from higher oil prices during the quarter, led by Italian and French energy companies. Expectations for a European recession did not hamper returns in other cyclical areas of the market, with the materials and industrials sectors gaining 10.6% and 9.3%, respectively. Merger and acquisition activity in the health care sector (+10.1%) added to returns in Europe. Financials, however, continued to weigh on returns in Europe. The sector declined 0.3%, as banks' exposures to highly indebted countries, such as Greece, Portugal, and Spain, negatively impacted earnings due to forced write-downs of bond holdings in those countries. Greek stocks fell more than 25% in the fourth quarter, with the country nearing default on its sovereign debt. Portuguese stocks declined 6.5% and Spanish stocks lagged the broad market, posting a gain of 1.1%.<sup>3</sup>

#### *Asia Pacific*

In Japan, equities declined 4.0%, amid weakness in financials, materials, and health care stocks. Japan's Ministry of Finance purchased more than \$100 billion U.S. dollars in an attempt to affect Japanese currency. This negatively impacted many of the companies who export their goods, such as Toyota Motor Company. Economic growth was curtailed in part by the persistent trend of a declining population and workforce, as well as the high government debt levels. In Australia, stocks posted a 1.9% return amid slowing economic growth. Fitch, however, raised Australia's long-term foreign currency rating to AAA. The Australian materials sector (-2.7%) and consumer staples sector (-3.0%) were the key drivers of the relative underperformance of the country. Singapore declined 1.5%, as concerns heightened regarding the country's weakening real estate market and economic growth. Hong Kong was the lone Asian developed market to outperform the MSCI EAFE Index, gaining 6.0%. The World Economic Forum announced in December that Hong Kong was at the top of its index of financial market development.<sup>4</sup>

### Emerging Markets

(All returns in local currency unless otherwise indicated)

Emerging market equities gained 4.8%, with the commodity-rich nations benefiting from higher commodity prices in the fourth quarter. Latin America was the strongest region within emerging markets, driven primarily by performance in Brazil. Energy stocks were strong in Brazil, as oil prices positively impacted many of the commodity-related companies. Mexico returned 10.4% following better-than-expected economic growth. Consumer-related stocks were among the strongest areas of the Mexican market, directly benefiting from the country's strong economic growth.<sup>5</sup>

Chinese stocks gained 7.9% despite slightly slower growth. Chinese financials were especially strong in the quarter, up 16.9%. Korean equities returned 3.6% due in part to strong returns among utilities companies. Indian stocks fell 7.0% amid concerns about political gridlock and declining corporate earnings. Russian equities posted a 5.9% return, benefiting from higher energy prices.<sup>6</sup>

1 All performance data from <http://www.msibarra.com>. MSCI Barra.

2 Bloomberg L.P..

3-6 "World Markets Review." Capital Guardian Trust Company. Fourth Quarter 2011.

### FIXED INCOME

The Barclays Aggregate Bond Index (BCAG) advanced 1.1% during the fourth quarter. Within the largest segments of the index, investment grade corporate bonds outperformed, with a return of 1.7%. Agency mortgage-backed securities underperformed the index, gaining 0.9%. Treasuries also underperformed during the quarter, returning 0.8%. Investment grade commercial mortgage-backed securities (CMBS), a smaller component of the BCAG, outperformed during the fourth quarter, with a gain of 3.1%. Internationally, dollar-denominated emerging market debt outperformed U.S. Treasuries with a gain of 5.3%, as the dollar witnessed broad-based strength against its most active trading counterparts. Local currency emerging market debt underperformed U.S. Treasuries, with a loss of 1.0%.

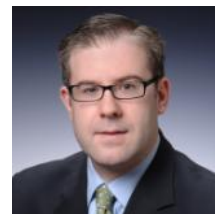
#### Treasuries Underperform During Fourth Quarter Risk Rally

Sovereign debt concerns, particularly in the euro zone, coupled with a rally in risk assets, resulted in Treasury prices that were pulled in multiple directions during the fourth quarter. This volatility caused a yield range of 64 basis points on the 10-Year note and 73 basis points for the 30-Year bond during the quarter. Despite the volatility, the 10-Year note was little changed from the beginning of the quarter, decreasing 4 basis points to end the quarter at 1.88%. The yield on the 30-Year bond also fell slightly, ending the fourth quarter at 2.90%, a 2 basis point decrease. The modest rally in Treasuries resulted in an advancement of 0.8% for the Barclays Capital Government Bond Index. The widely followed barometer for the steepness of the Treasury curve, measured by the difference between the yield on the 10-Year U.S. Treasury note and the 2-Year U.S. Treasury note (“2s/10s”), decreased during the quarter from 1.7 percentage points to 1.6 percentage points.

An increase in market expectations for inflation led to a rally in Treasury Inflation Protected Securities (TIPS). TIPS outperformed nominal Treasuries, as well as the broader fixed income market, with a return of 2.7% during the quarter, bringing their 2011 return to 13.6%. The implied inflation rate, as referenced by the difference between the yield on the 10-Year U.S. Treasury note and the 10-Year TIPS, moved significantly during the quarter amid heightened volatility, ultimately ended at 2.0%, 0.2 percentage points higher than at the end of the third quarter.

#### Increased Uncertainty in the Securitized Assets Market

Agency mortgage-backed securities (MBS) underperformed the BCAG during the quarter, with a gain of 0.9%, as speculation surfaced about renewed aid for homeowners that could potentially increase refinancing activity and prepayment speeds. Conjecture of a third round of quantitative easing by the



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“...the fourth quarter brought relief to investors willing to accept higher volatility for the potential of higher returns.”

Federal Reserve, which could include further MBS purchases, also added to uncertainty in this area. Investment grade commercial mortgage-backed securities (CMBS) strengthened during the fourth quarter, returning 3.1% as prices rose amid a general “risk-on” environment.

### Credit Rallies in “Risk-on” Quarter

Investment grade credit outperformed the BCAG during the fourth quarter as option-adjusted spreads tightened. The Barclays Capital Credit Index returned 1.7%, compared to the BCAG’s performance of 1.1%. A and AA rated corporates outperformed AAA bonds during the quarter, as investors sought higher yielding securities. From a sector perspective, industrials were the strongest performer, gaining 2.3%, while utilities gained 2.2%. Corporate bonds of financial institutions underperformed, returning 1.2%.

### Below Investment Grade Credit Regains its Footing

After a disappointing third quarter in fixed income risk sectors, the fourth quarter brought relief to investors willing to accept higher volatility for the potential of higher returns with high yield bonds gaining 6.5%. Lower quality (CCC-rated) high yield bonds outperformed higher quality (BB-rated and B-rated) bonds, as investors favored lower quality/higher risk. High yield bonds traded at a dollar price of approximately \$98 with a yield-to-maturity near 8.5% at the end of the quarter, after trading in the mid-\$90s earlier in quarter. Bank loans performed well, with a return of 2.7%, underperforming high yield bonds, but outperforming the broader fixed income market.

#### Major Fixed Income Indices

	<b>4Q11</b>	<b>YTD</b>
Barclays Capital Aggregate Bond	1.1%	7.8%
Barclays Capital U.S. TIPS	2.7%	13.6%
Barclays Capital Government	0.8%	9.0%
Barclays Capital Municipal Bond	2.1%	10.7%
Barclays Capital Asset-Backed	0.2%	5.1%
Barclays Capital Mortgage-Backed	0.9%	6.3%
Barclays Capital Credit	1.7%	8.4%
CSFB Leveraged Loan Index	2.7%	1.4%
Barclays Capital High Yield	6.5%	5.0%
Merrill Lynch BB-B Index	5.9%	5.4%
Barclays Capital Investment Grade CMBS	3.1%	6.5%
JP Morgan Emerging Market Bond Plus Index	5.3%	9.2%
JP Morgan Emerging Market Local Plus Index	-1.0%	-5.2%
JP Morgan Global Bond Non-US (US\$)	0.8%	4.5%
JP Morgan Global Bond Non-US (Unhedged)	-0.2%	5.9%
90-Day US LIBOR	0.1%	0.3%

Source: Bloomberg, L.P.

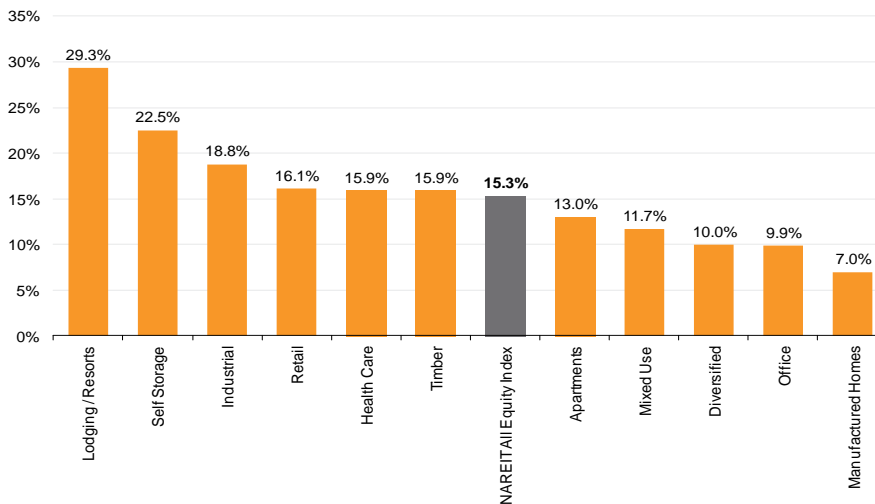
### REAL ASSETS

#### Domestic

Real estate investment trusts (REITs), as measured by the FTSE NAREIT All Equity Index, outperformed the broad equity market in the fourth quarter of 2011 with a return of 15.3% versus a gain of 11.8% for the S&P 500 Index.<sup>1</sup> This marked the strongest quarterly gain in REITs since the third quarter of 2009. REITs declined in November, but posted solid gains in both October and December. For the full-year, REITs returned 8.3% compared to a gain of 2.1% for the S&P 500 Index. As of year-end, REITs' dividend yield stood at 3.8%, versus a yield of 1.9% for the 10-year Treasury.

U.S. REITs outperformed U.S. equities in the fourth quarter, largely due to strong operating performance and fundamentals. Investors continued to favor higher-yielding securities in the low Treasury rate environment.<sup>2</sup> Concerns of a recession in the U.S. began to abate during the quarter, as well as fears of the European debt crisis derailing a recovery in commercial real estate. The delinquency rate on U.S. loans tied to CMBS ticked up in the fourth quarter to 9.6%, and 2012 will mark an important year for CMBS, as the 2007 originated loans begin to mature next year.<sup>3</sup> Total 2011 CMBS issuance for 2011 was approximately \$32.7 billion.

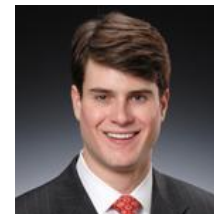
**FTSE NAREIT All Equity Index**  
Sector Returns - Fourth Quarter 2011



All property sectors in the FTSE NAREIT All Equity Index posted positive returns for the quarter. The top performing sector was hotels/lodging, gaining 29.3% after a weak third quarter. The sector was positively impacted by robust increases to both occupancy and RevPAR (revenue-per-available-room). Within the hotels/lodging sector, Host Hotels returned 31.3% during the quarter despite lower convention revenue.<sup>4</sup> Self-storage (+22.5%) also outperformed, as the sector continued to benefit from the foreclosure crisis in the U.S. Occupancy rates were at 90% and rental rates grew by 5-10% in some markets this year. Extra Space Storage gained 26.1% and profitted



**Christian Busken**  
Senior Vice President /  
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**Jay R. Johnston**  
Research Analyst

**“U.S. REITs outperformed U.S. equities in the fourth quarter, largely due to strong operating fundamentals.”**

from newer facilities located in the most densely populated markets.<sup>5</sup> Conversely, the worst performing sector was manufactured homes, which gained only 7.0% during the quarter. The sector is heavily reliant on financing, which tightened in the fourth quarter. The office sector (+9.9%) underperformed in the fourth quarter largely due to weakness in the suburban office property markets, as companies and major corporations aren't expanding into new buildings or are opting for cities like New York or San Francisco when leasing new floor space. This contributed to vacancy rates, especially in the suburban markets.

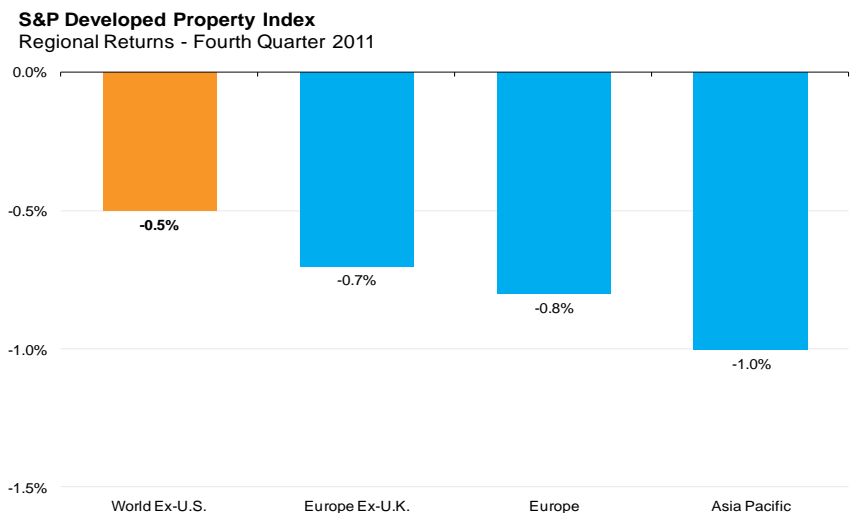
### International

(All returns quoted in local currency terms unless otherwise indicated)

International real estate securities significantly underperformed U.S. REITs during the fourth quarter, as the S&P Developed Ex-U.S. Property Index posted a return of 0.1% (in U.S. dollars), versus the FTSE NAREIT All Equity Index's 15.3% return.<sup>6</sup> For the full-year, the S&P Developed Ex-U.S. Property Index declined 14.7% (in U.S. dollars), significantly underperforming the FTSE NAREIT All Equity Index, which gained 8.3% over the same period. Currency fluctuations were mixed for U.S. investors in the fourth quarter of 2011, with the dollar declining versus the Japanese yen (-0.2%) and strengthening against the euro (+3.8%).

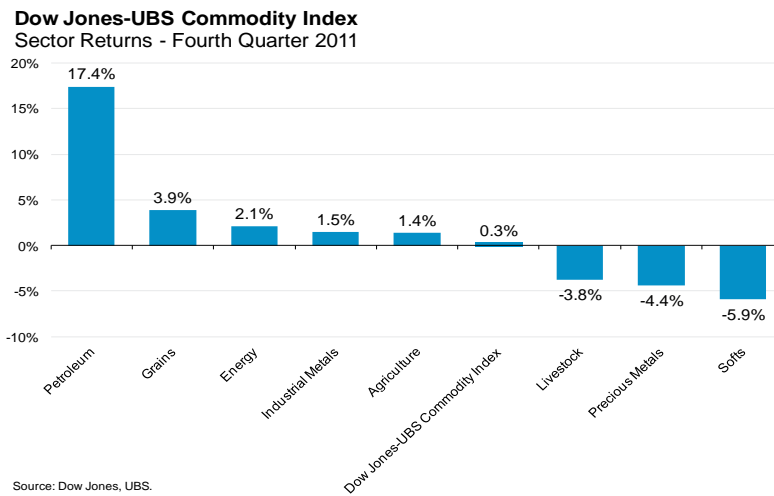
The Asia-Pacific region underperformed the global real estate securities market in the fourth quarter. Performance was positive across most of the major property markets in the region, but was negatively impacted by the 8.4% decline in Japan's property market during the quarter. Japan was negatively impacted by a contraction in industrial production in the fourth quarter, in addition to falling retail sales and weak consumer spending.<sup>7</sup> Mainland China (+17.3%) was the strongest property market within the region. The country remained insulated from the European debt crisis on strong domestic demand during the quarter.

Furthermore, Chinese industrial production continued to grow, and bank loans and fixed investments moderated only slightly, as the People's Bank of China cut the required reserve ratio in reaction to the threat of a global recession.<sup>8</sup> The Hong Kong property market rose 6.9% as owner-occupiers were reluctant to sell, holding down supply and providing support for prices. Additionally, there was a decline in transactions during the quarter, as mortgage rates rose. Australian property (+3.6%) rose during the quarter on strong employment and the continued strength of the Aussie dollar, largely predicated on commodity exports. European property (-0.8%) underperformed the global real estate securities market due to continued turmoil surrounding their debt crisis and the economic and fiscal stance of many of the countries in the region. The U.K. real estate market declined 0.8% during the fourth quarter, amid continuation of its national austerity measures. The market also was negatively impacted by the ongoing European sovereign debt crisis. Furthermore, manufacturing continued to contract and fell to its lowest level since June 2009.<sup>9</sup> Continental Europe (-0.6%) underperformed and was pushed lower again this quarter by the ongoing debt crisis. France was the only positive performing property market and grew 1.2% during the quarter, partly due to the strength seen in the French financial institutions and banks. German property declined 1.6%. Sentiment levels in Europe, especially those related to confidence and exports, receded further during the quarter.



### Commodities

Commodities, as measured by the Dow Jones-UBS Commodity Index, gained 0.3% during the fourth quarter, but declined 13.3% during 2011.<sup>10</sup> The best performing sector in the fourth quarter was petroleum, fueled largely by the significant rise in the spot prices of crude oil (+24%), unleaded gasoline (+7.2%), and heating oil (+4.5%). Crude oil spot prices were driven higher earlier in the quarter on an improving economic outlook in the U.S. and to rising energy demand overseas. Later in the quarter, heightened tensions surrounding Iran raised supply disruptions in response further increasing the spot price of crude oil. The grains sector also outperformed the broad index, as corn prices rose 7.5% on forecasts of tight global supply, especially on the loss of production in South America due to dry weather in the region.<sup>11</sup> The worst performing sector in the fourth quarter was softs, which declined 5.9% for the period. Softs were negatively impacted by declines in the spot prices of sugar (-7.9%), coffee (-2.3%), and cotton (-8.1%). The precious metals sector also underperformed and declined 4.4% in the quarter. Gold fell by 3.6%, largely precipitated on a surge in the value of the U.S. dollar during the end of 2011.



### Master Limited Partnerships (MLPs)

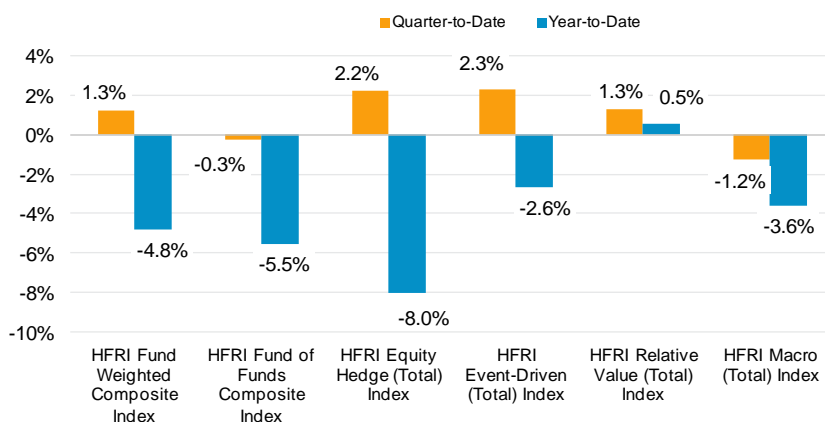
Master limited partnerships, as measured by the Alerian MLP Index, gained 16.3% during the fourth quarter, and for the full-year returned 13.9%.<sup>12</sup> As of the end of December, MLPs' dividend yield stood at 6.1%, versus a yield of 1.9% for the 10-year Treasury. MLPs were positively impacted by the growth in demand for energy infrastructure in the various shale plays in the U.S., as well as positive investor sentiment related to MLPs' stable and secure cash flow distributions. Those companies with exposure to the Utica and Marcellus Shales performed the best. Earlier in the quarter, Kinder Morgan announced plans to acquire El Paso Corporation for roughly \$21 billion in cash and stock; in a deal valued at \$38 billion, making it the second largest merger in 2011.<sup>13</sup> In November, Lime Rock Resources completed an initial public offering as an upstream MLP. The deal priced at approximately \$19 per unit, well within the expected range.

- 1 All performance data from [www.nareit.com](http://www.nareit.com) and [www.sp-indexdata.com](http://www.sp-indexdata.com). Accessed on 16 January 2012.
- 2 Pruitt, A.D. "Real-Estate Stock Recover." *The Wall Street Journal*. 4 January 2012.
- 3 "Commercial Delinquencies Down, for Now." *The Wall Street Journal*. 2 December 2011.
- 4 Pruitt, A.D. "Real-Estate Stock Recover." *The Wall Street Journal*. 4 January 2012.
- 5 Pruitt, A.D. "Storage REITs Enjoy a Boom." *The Wall Street Journal*. 11 January 2012.
- 6 All performance data from [www.nareit.com](http://www.nareit.com) and [www.sp-indexdata.com](http://www.sp-indexdata.com). Accessed on 16 January 2012.
- 7-8 CBRE Global Investors. *Asia Pacific EconoWatch* – January 2012.
- 9 CBRE Global Investors. *European EconoWatch* – January 2012.
- 10 All performance data from [www.djindexes.com](http://www.djindexes.com). Accessed on 16 January 2012.
- 11 Plevin, Liam. "Rallies, Retreats and Round Figures." *The Wall Street Journal*. 3 January 2012.
- 12 All performance data from [www.alerian.com](http://www.alerian.com). Accessed on 16 January 2012.
- 13 Reuters.

### HEDGE FUNDS

Hedge funds closed a tumultuous year with relatively muted returns in the fourth quarter. The broad hedge fund proxies of the HFRI Fund Weighted Composite Index and the HFRI Fund of Funds Composite Index returned 1.3% and -0.3%, respectively. During the year, global markets were fraught with a succession of exogenous events and macro-economic overhangs that created a complex environment for hedge funds to navigate. These headwinds included the earthquake tsunami in Japan, the Arab Spring, downgrade of the U.S. credit rating, and default risk of peripheral Europe. The terms “risk-off” and “risk-on” made their way into investing lexicon as financial assets traded in lock-step, trading more on incremental news coming out of Europe’s summits, as opposed to company specific fundamentals. Hedge funds did their best to dodge the land mines of increased correlations and spikes in volatility, but they were unable to garner positive returns for 2011. The HFRI Fund Weighted Composite Index and HFRI Fund of Funds Composite Index declined 4.8% and 5.5%, respectively.

#### HFRI Indices Performance Returns in U.S. dollars



Source: HedgeFund Research

#### Directional

While the 2.1% return for the S&P 500 Index from 2011 might appear rather subdued, it veiled a volatile year of technical / macroeconomic forces that produced drawdowns and recoveries of +20%. Coming into the fourth quarter, the S&P 500 Index declined in the five previous months with August and September returning -5.4% and -7.0%, respectively. As a result of the downturn and continued macro concerns, managers had reined in market exposures to historically low levels. Equity markets, however, quickly shifted course in October with the S&P 500 Index rallying 10.9%. Hedged equity managers benefitted from the recovery, but they captured little of this upside due to hedges and conservative portfolio construction. The HFRI Equity Hedge (Total) Index gained 2.2% for the quarter.



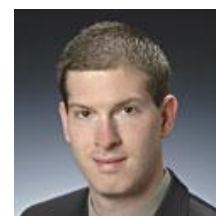
**J. Alan Lenahan, CFA, CAIA**  
Managing Principal /  
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**Gregory M. Dowling, CFA, CAIA**  
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Director of Hedged Strategies



**David L. Mason**  
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**Jeffrey D. Furst, CFA**  
Senior Research Analyst

Optimism among hedged equity managers cautiously increased, an aspect reflected in marginally higher exposures. During 2011, stocks moved in unison with little dispersion between good and bad companies. At year-end, managers began to cite that fundamentals were gaining in importance, stock intra-correlations decreasing, and that ample opportunities began to develop, both the long and short. On the long side, managers began to find opportunities in high quality, undervalued companies with healthy balance sheets and high free cash flow, while trends in shorts include businesses in longer-term, secular decline, as well as stocks with near term catalysts, such as European financials market, that could create downward price pressure. One of the other trends to come out of 2011 was that while portfolios can certainly be driven by fundamental, bottom-up oriented researched companies, managers must not ignore macro forces. Many performance standouts during 2011 were nimble managers who maintained their fundamental theses but dynamically traded around positions and adjusted exposures.

Equity market neutral managers posted positive returns with the HFRI EH: Equity Market Neutral Index returning 2.8% for the quarter. The environment for equity market neutral strategies improved during the quarter with a decline in volatility, the VIX Index decreased from 43.0% to 23.4%, and an increase in dispersion among stocks. Particularly accretive strategies for equity market neutral managers during the quarter were short-term momentum and mean reversion trading.

### Diversifying Strategies

Investors' shifting risk appetite, spikes in volatility, and range-bound pricing activity were headwinds for global macro strategies during the quarter. Discretionary managers fared better than their systematic counterparts as the HFRI Global Macro (Total) Index and HFRI Macro: Systematic Diversified Index fell 1.2% and 3.5%, respectively. Systematic trading programs were whipsawed by the velocity and severity of trend reversals of several asset classes during the quarter, including October's relief rally in the equity markets and Japan's intervention to curtail strength in the yen. In general, managers benefitted from short positions in natural gas, which continued to decline due to warm weather and excess supply, and long positions in the U.S. dollar and U.S. rates, which proved to be as safe haven investments. Performance detraction was generally realized in trades in oil and precious metals.

The HFRI Event Driven (Total) Index gained 2.3% for the fourth quarter with positive attribution from managers focusing on merger arbitrage and distressed investing. The HFRI ED: Merger Arbitrage Index gained 1.6% as deal spreads narrowed. There was a dearth of deal flow activity, as global volume declined approximately 15% from the three months prior and 30% from the fourth quarter 2010 (according to Bloomberg). For the year, global deal volume was essentially flat when compared to 2010, totaling \$2.3 trillion. While the U.S. Justice Department blocked AT&T's proposed \$39 billion acquisition of T-Mobile, there were several notable deals completed during the quarter, including Kinder Morgan's acquisition of El Paso for \$21.1 billion and Gilead Sciences, Inc. acquisition of Pharmasset, Inc., for approximately \$11 billion. Tailwinds for pent up M&A activity remain intact for 2012, including healthy corporate balance sheets, high levels of cash, and attractive valuations.

The HFRI ED: Distressed/ Restructuring Index gained 1.9% due to a rally in high yield and strong flows into the asset class. High yield, as measured by the Barclay's Capital High Yield Index gained 6.5% for the fourth quarter. While managers were encouraged by fourth quarter's rally, their enthusiasm was tempered by diminishing liquidity as a result of dealers reining in inventories and reduction in activity from proprietary trading desks. While corporate default activity was relatively low in 2011, distressed focused managers should have a robust pipeline of opportunities in 2012, including the bankruptcies of Eastman Kodak, American Airlines, and Dynegy.

The HFRI Relative Value (Total) Index gained 1.3% for the fourth quarter and was one of the few strategies with positive performance on the year, up 0.5%. Several strategy-focused indices posted positive returns during the quarter, while the HFRI RV: Multi-Strategy Index declined 0.3%.

**Indices:**

The S&P Global Property Indices define and measure the investable universe of publicly traded property companies. With more than 450 constituents from more than 35 countries, the index is ideal for a range of investment activities, including benchmarking active funds and setting the foundation for passive funds. See [www.standardandpoors.com](http://www.standardandpoors.com) for more information.

The Dow Jones-UBS Commodity Indexes<sup>SM</sup> are composed of exchange-traded commodity futures contracts rather than physical commodities. By tracking commodity futures rather than commodity “spot” prices (meaning the prices quoted for immediate payment and delivery of physical commodities), the indexes are investable benchmarks, meaning they can generally be replicated using futures contracts. The weightings for each commodity included in DJ-AIGCI are calculated in accordance with rules that ensure that the relative proportion of each of the underlying individual commodities reflects its global economic significance and market liquidity.

The CSFB Leveraged Loan Index is designed to mirror the investable universe of the \$US-denominated leveraged loan market. Loans are added to the index upon issuance if they qualify according to certain criteria. See [www.credit-suisse.com](http://www.credit-suisse.com) for more information.

The Merrill Lynch BB-B Index measures the performance of securities that pay interest in cash and have a credit rating of BB or B. Merrill Lynch uses a composite of Fitch Ratings, Moody’s and Standard and Poor’s credit ratings in selecting bonds for this index. These ratings measure the risk that the bond issuer will fail to pay interest or to repay principal in full. See [www.ml.com](http://www.ml.com) for more information.

J.P. Morgan’s Global Index Research group produces proprietary index products that track emerging markets, government debt, and corporate debt asset classes. Some of these indices include the JPMorgan Emerging Market Bond Plus Index, JPMorgan Emerging Market Local Plus Index, JPMorgan Global Bond Non-US Index and JPMorgan Global Bond Non-US Index. See [www.jpmorgan.com](http://www.jpmorgan.com) for more information.

The London Interbank Offered Rate (LIBOR) is a daily reference rate based on the interest rates at which banks borrow unsecured funds from other banks in the London wholesale money market.

Russell Investments rank U.S. common stocks from largest to smallest market capitalization at each annual reconstitution period (May 31). The primary Russell Indices are defined as follows: 1) the top 3,000 stocks become the Russell 3000 Index, 2) the largest 1,000 stocks become the Russell 1000 Index, 3) the smallest 800 stocks in the Russell 1000 Index become the Russell Midcap index, 4) the next 2,000 stocks become the Russell 2000 Index, 5) the smallest 1,000 in the Russell 2000 Index plus the next smallest 1,000 comprise the Russell Microcap Index. See [www.russell.com](http://www.russell.com) for more information.

S&P 500 Index consists of 500 stocks chosen for market size, liquidity and industry group representation, among other factors by the S&P Index Committee, which is a team of analysts and economists at Standard and Poor’s. The S&P 500 is a market-value weighted index, which means each stock’s weight in the index is proportionate to its market value and is designed to be a leading indicator of U.S. equities, and meant to reflect the risk/return characteristics of the large-cap universe. See [www.standardandpoors.com](http://www.standardandpoors.com) for more information.

Morgan Stanley Capital International – MSCI - A series of indices constructed by Morgan Stanley to help institutional investors benchmark their returns. There are a wide range of indices created by Morgan Stanley covering a multitude of developed and emerging economies and economic sectors. See [www.morganstanley.com](http://www.morganstanley.com) for more information.

Barclays Capital Fixed Income Indices – an index family comprised of the Barclays Capital Aggregate Index, Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, Municipal Index, High-Yield Index, and others designed to represent the broad fixed income markets and sectors within constraints of maturity and minimum outstanding par value. See <https://ecommerce.barcap.com/indices/index.dxml> for more information.

The FTSE NAREIT Composite Index (NAREIT Index) includes only those companies that meet minimum size, liquidity and free float criteria as set forth by FTSE and is meant as a broad representation of publicly traded REIT securities in the U.S. Relevant real estate activities are defined as the ownership, dispose, and development of income-producing real estate. See [www.ftse.com/Indices](http://www.ftse.com/Indices) for more information.

The HFRI Monthly Indices (HFRI) are equally weighted performance indexes, compiled by Hedge Fund Research Inc. (HFRI), and are used by numerous hedge fund managers as a benchmark for their own hedge funds. The HFRI are broken down into 37 different categories by strategy, including the HFRI Fund Weighted Composite, which accounts for over 2000 funds listed on the internal HFR Database. The HFRI Fund of Funds Composite Index is an equal weighted, net of fee, index composed of approximately 800 fund- of- funds which report to HFR. See [www.hedgefundresearch.com](http://www.hedgefundresearch.com) for more information on index construction.

Information on any indices not currently provided can be obtained either through your consultant or by written request to [information@feg.com](mailto:information@feg.com).

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This report is prepared for informational purposes only. It does not address specific investment objectives, or the financial situation and the particular needs of any person who may receive this report.

Information on any indices mentioned can be obtained either through your consultant or by written request to [information@feg.com](mailto:information@feg.com).

## RESEARCH TEAM

FOURTH QUARTER 2011

<i>Name</i>	<i>Title</i>	<i>Focus</i>
James W. Angelica	Senior Research Analyst - Private Capital/Buyouts	Private Capital - Buyouts
Nolan M. Bean, CFA, CAIA	Managing Principal	Investment Philosophy and Portfolio Construction
Keith M. Berlin	Senior Vice President - Director of Global Fixed Income and Credit	Global Fixed Income and Credit
Christian S. Busken	Senior Vice President - Director of Real Assets	Real Assets
Kevin J. Conroy, CFA, CAIA	Senior Research Analyst - Hedged Strategies	Hedge Funds
Sarah Cooper	Office Administrator / Analyst Support	Office Administrator / Analyst Support
Gregory M. Dowling, CFA, CAIA	Managing Principal / Director of Hedged Strategies	Hedge Funds
Susan Mahan Fasig, CFA	Managing Principal / Director of Private Capital	Private Capital
Jeffrey D. Furst, CFA	Senior Research Analyst - Hedged Strategies	Hedge Funds
Brian A. Hooper	Senior Research Analyst	Global Equities
Gregory D. Houser, CFA	Vice President	Global Equities and Fixed Income
Jay R. Johnston	Research Analyst	Real Assets
J. Alan Lenahan, CFA, CAIA	Managing Principal / Director of Hedged Strategies	Hedge Funds
David L. Mason	Senior Research Analyst – Hedged Strategies	Hedge Funds
Christopher M. Meyer, CFA	Managing Principal / Chief Investment Officer	Investment Philosophy and Portfolio Construction
Michael J. O'Connor	Research Analyst	Global Fixed Income and Credit
Michael J. Oyster, CFA	Managing Principal / Portfolio Strategist	Special Projects and Options Strategies
William B. Phelps	Operations Analyst	Hedge Funds
J. David Stein *	Chief Investment Strategist	Investment Philosophy and Portfolio Construction
Christina M. Sunderman	Senior Research Analyst	Domestic Value Equities
Nathan C. Werner, CFA	Vice President Private Capital/Venture Capital	Private Capital – Venture Capital
Ryan S. Wheeler, CAIA	Director of Operations	Hedge Funds

\*Effective March 31, 2012, J. David Stein is retiring and will remain in an advisory role through the end of 2012.