Q3

Quarterly Investment 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

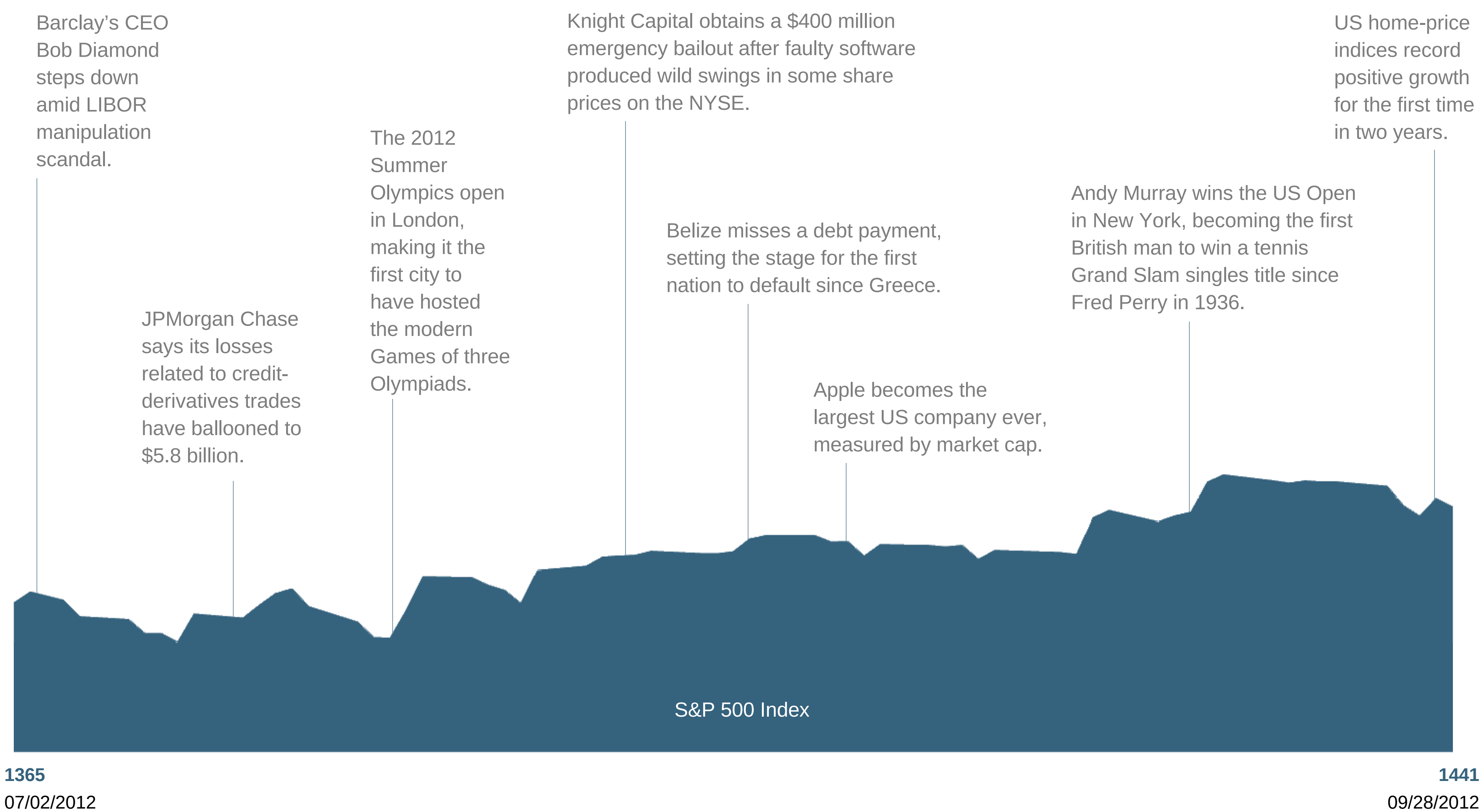
Third Quarter 2012 Index Returns

STOCKS				BONDS	
US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market
+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. Russell data copyright © Russell Investment Group 1995–2012, all rights reserved. MSCI data copyright MSCI 2012, all rights reserved. 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.

Timeline of Events: Quarter in Review

Third Quarter 2012

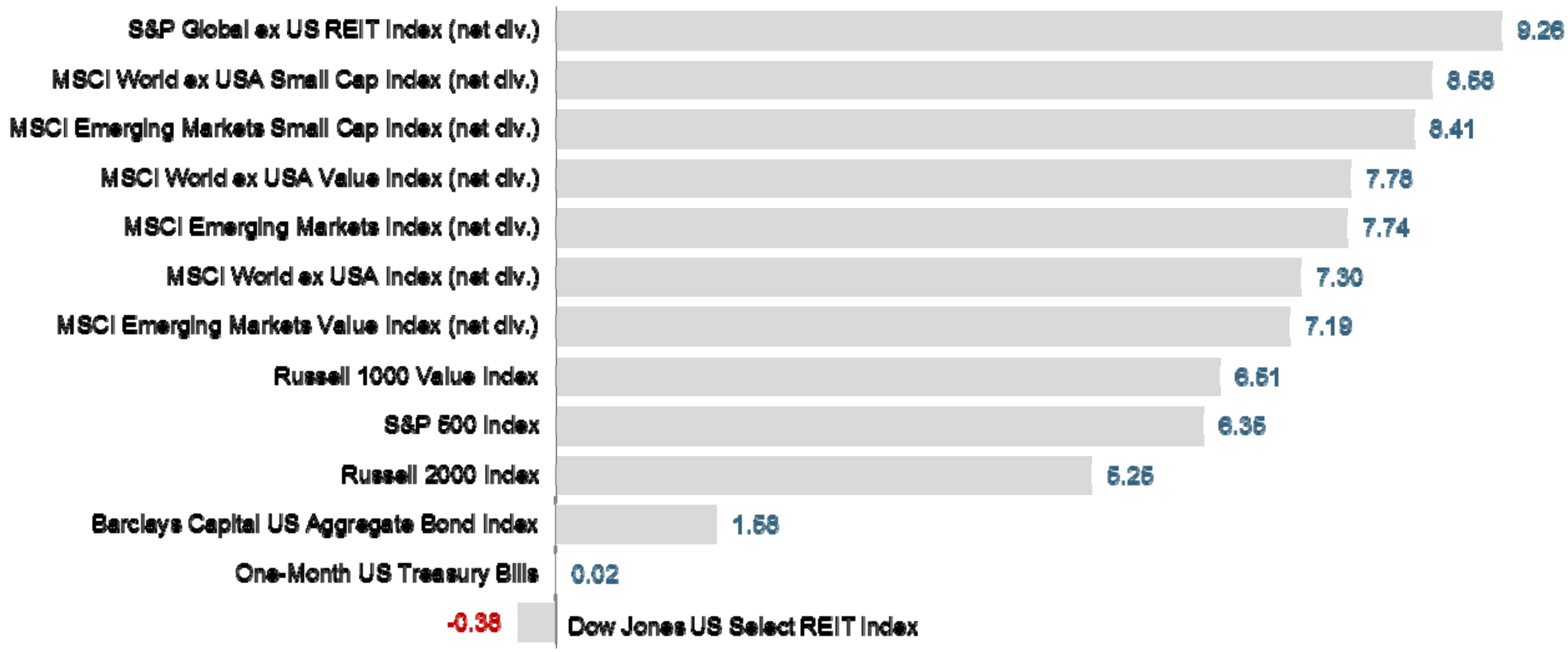


The graph illustrates the S&P 500 index price changes over the quarter. The return of the price-only index is generally lower than the total return of the index that also includes the dividend returns. Source: The S&P data are provided by Standard & Poor's Index Services Group. The events highlighted 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.

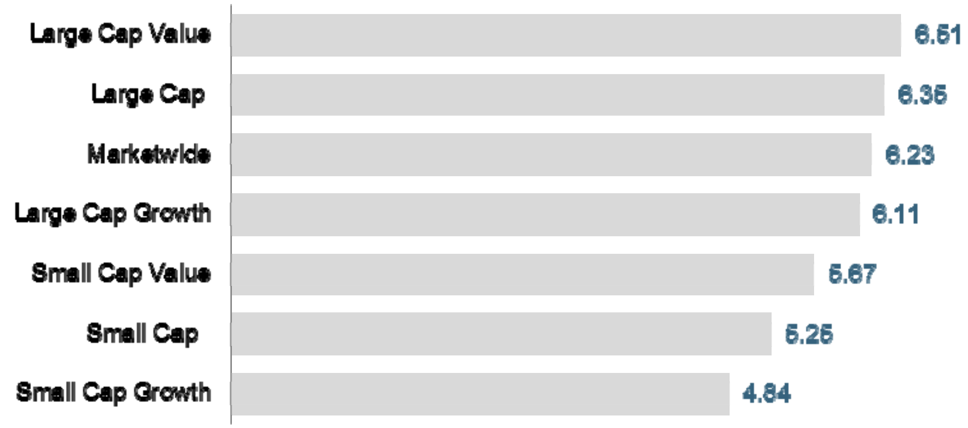
US Stocks

Third Quarter 2012 Index Returns

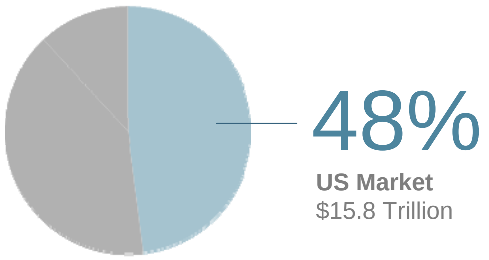
All major US asset classes logged positive performance in the 3rd quarter, with the broad market returning 6.23%. Asset class returns ranged from 4.84% for small growth stocks to 6.51% for large value stocks.

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

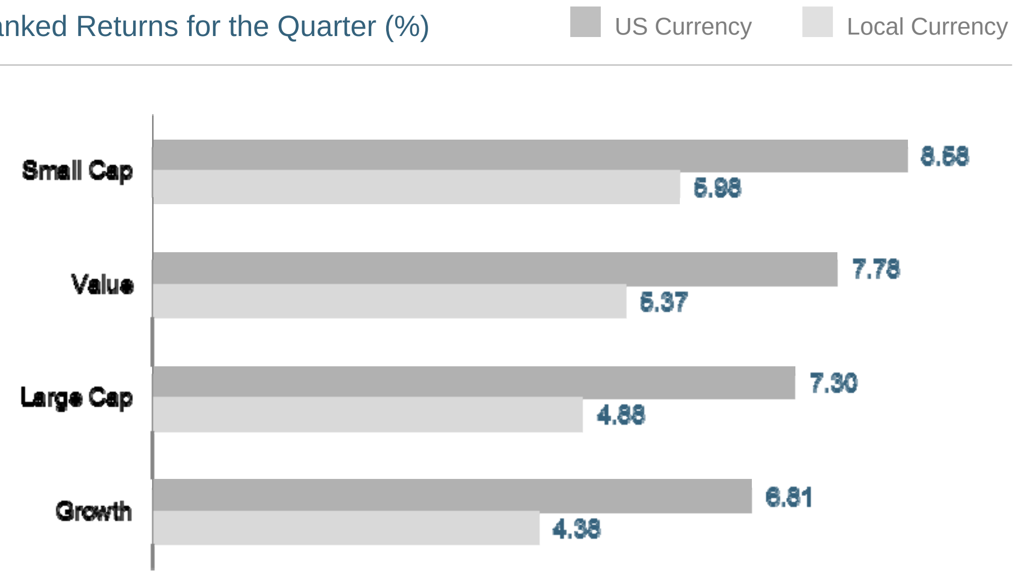
Third Quarter 2012 Index Returns

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%.

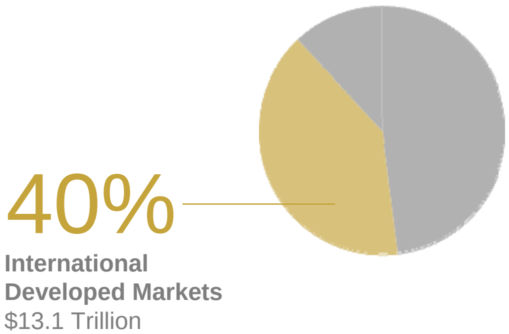
Following the trend from the second quarter, the US dollar depreciated against all major foreign currencies, boosting the returns of dollar denominated foreign investments.

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

Ranked Returns for the Quarter (%)



World Market Capitalization—International Developed



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

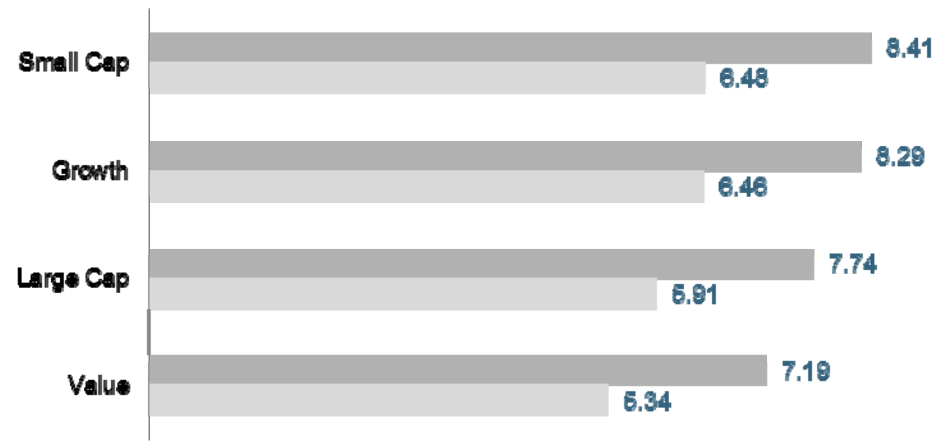
The broad market returned 7.74%, with all other major asset classes posting positive returns. Small cap led the way at 8.41% while value stocks finished last, slightly trailing at 7.19%. All emerging markets countries posted positive returns with the exception of Morocco at -3.75%.

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.

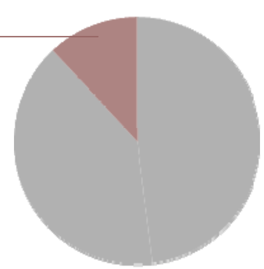
Ranked Returns for the Quarter (%)

US Currency | Local Currency



World Market Capitalization—Emerging Markets

12%
Emerging Markets
$4.1 Trillion



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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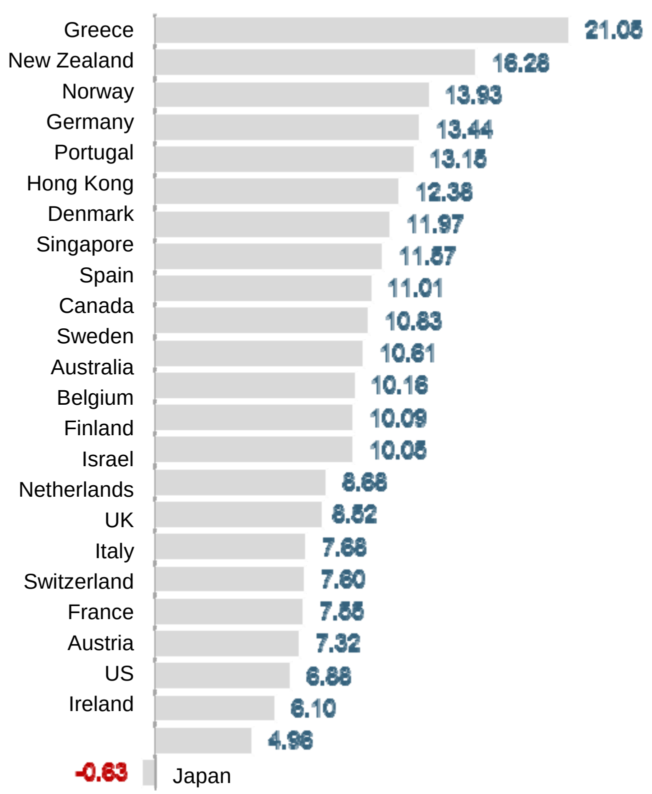
Select Country Performance

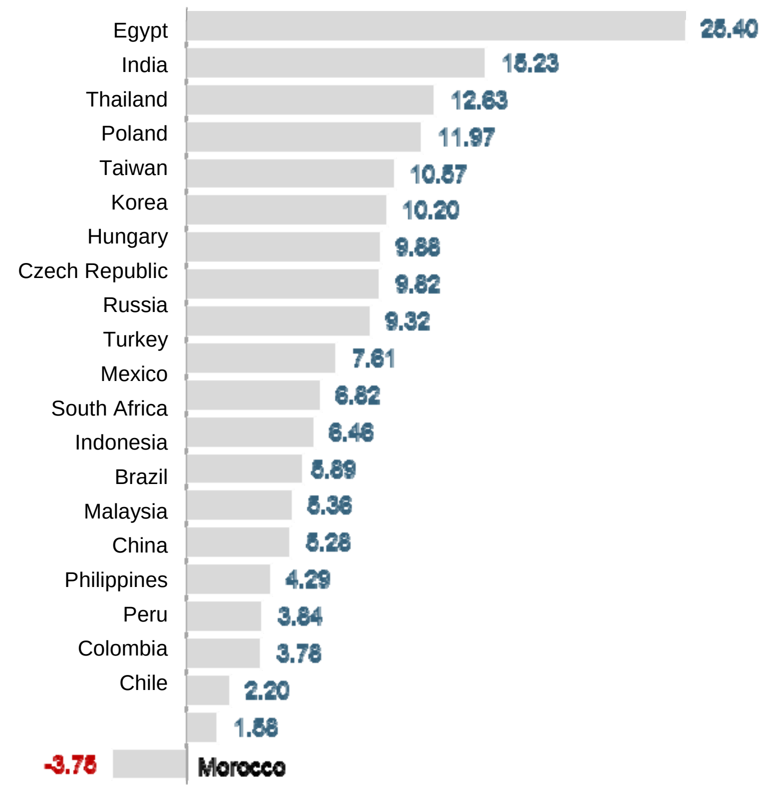
Third Quarter 2012 Index Returns

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)



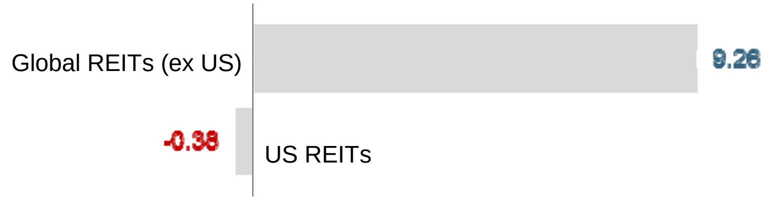
Real Estate Investment Trusts (REITs)

Third Quarter 2012 Index Returns

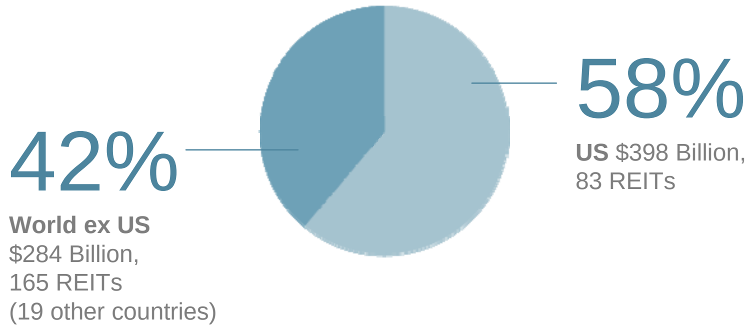
International REITs outperformed US REITs in the quarter, posting a positive return of 9.26% versus a 0.38% loss.

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%.

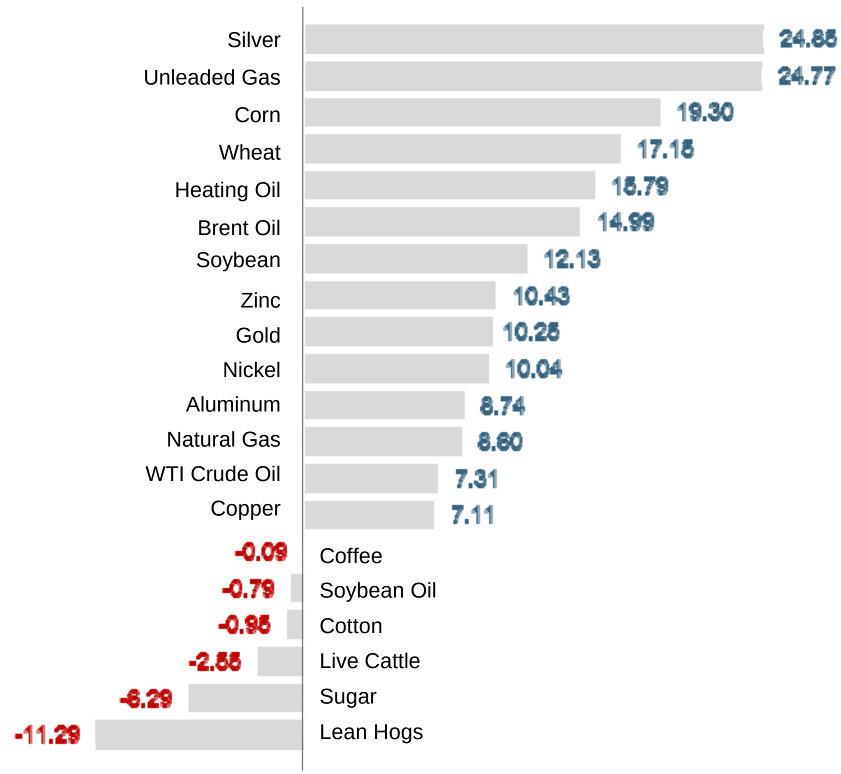
Leading the rise were silver and unleaded gas, with returns of 24.85% and 24.77%, respectively. Lean hogs trailed all other commodities, posting a return of -11.29% for the quarter.

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*

Individual Commodity (% Returns)



Index is 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 ©. Past performance is not a guarantee of future results.

Fixed Income

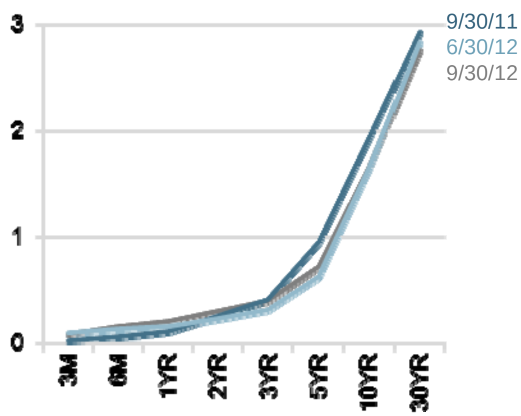
Third Quarter 2012 Index Returns

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

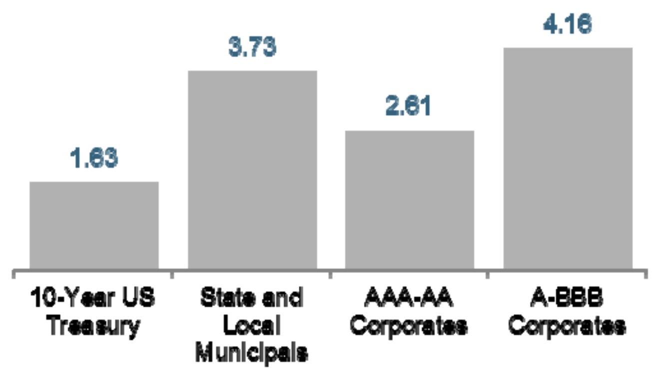
The relative safety of sovereign debt—and fixed income, in general—remains the preferred allocation for investors seeking a high quality refuge. Absolute yields on sovereign debt have remained at or near historical lows and even at negative levels.

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*

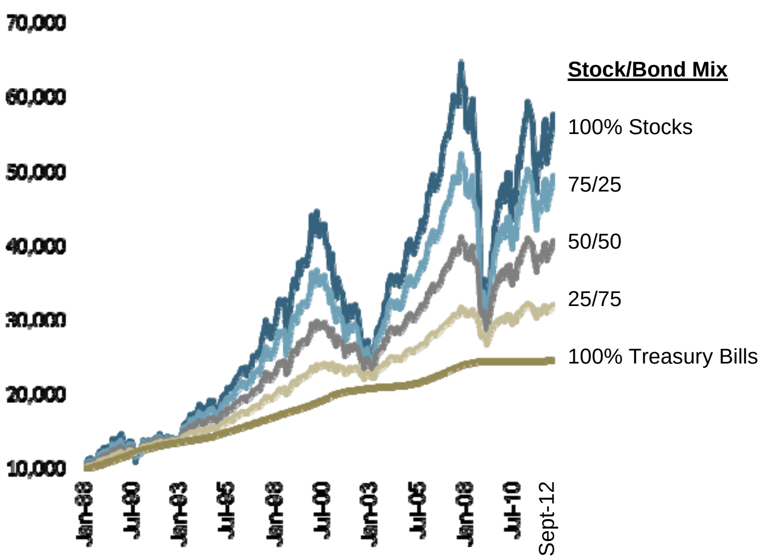
Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the Bond Buyer Index, general obligation, 20 years to maturity, mixed quality. 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). Citigroup bond indices copyright 2012 by Citigroup. The Merrill Lynch Indices are used with permission; copyright 2012 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. Past performance is not a guarantee of future results.

Global Diversification

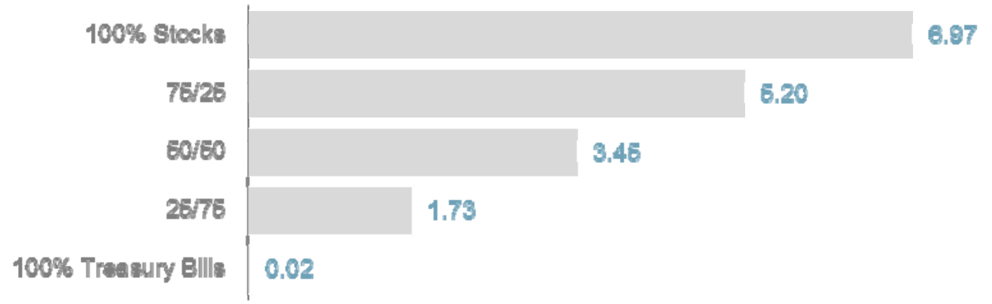
Third Quarter 2012 Index Returns

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. 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."