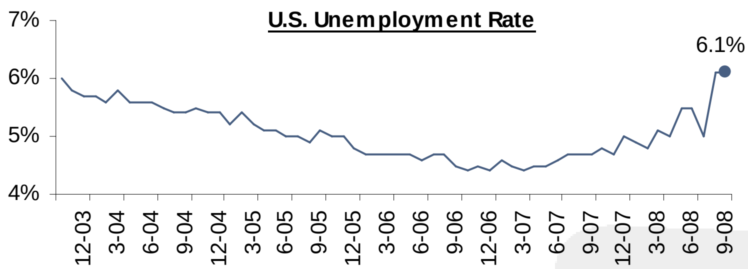
Your Quarterly Update on the Financial Markets
September 30, 2008

3rd Quarter

MARKET Recap

The Economy: *"Neither a borrower nor a lender be…"*

Beginning with the seizure of Fannie and Freddie in July, the economy leapt to the headlines and made for excellent melodrama. We believe reality, while sobering, is more mundane; the over-arching story remains a reduction of excess leverage throughout the financial system. Deleveraging should be accompanied by two measurable effects – contraction in spending, and deflation of asset values. Until we see those effects manifested through the entire system, we cannot have confidence that leverage has been reduced and stability achieved.

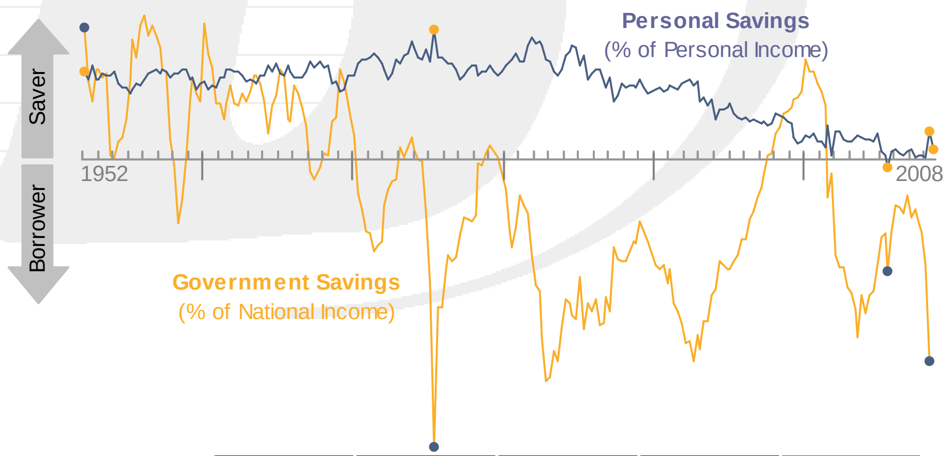


At the consumer level both effects are now in evidence, but to different degrees. Deflation in housing, the consumer's primary asset, continued in the third quarter but (based on preliminary data) at a decelerating pace. Reductions in consumer spending remained focused on autos and other durable goods in Q2, resulting in surprisingly robust 2.8% GDP growth, but spending fell in Q3 at a faster pace. In this cycle spending contraction lags asset deflation because home values have been the collateral for leveraged spending. Analysts have expected consumer spending to fall, but the timing has proven difficult to predict; this quarter's drama may help consumers attach "permanence" to asset deflation, providing the catalyst needed to change their spending behavior.

Asset deflation and spending contraction in financial businesses hardly needs mentioning. We would only note that, to date, depositors have been protected despite the turmoil; efforts of the FDIC and Federal Reserve have been admirable in this respect. Non-financial businesses are slashing budgets in anticipation of, or in reaction to, slowing demand. Stock prices are appropriately lower, not just for financials. Reduction in corporate leverage will continue, spurred along by higher financing costs, and non-financial corporate defaults will rise; but broadly speaking, businesses have taken more appropriate preparatory steps than consumers to manage through this cycle. An unfortunate side effect is unemployment, currently at 6.1% and rising based on non-farm payrolls – some 159,000 jobs were eliminated in September.

Finally, there is the government – no discussion of excess leverage would be complete without mentioning them. Government at all levels cannot escape the effects of deleveraging. As consumers and businesses work through the process, the next major problem area will likely be municipal financing. The third quarter closed with news that Jefferson County, Alabama will miss an interest payment on their sewer bonds. The uncanny timing of this particular default is coincidental, but it is virtually certain that municipal defaults will increase given the expansion of budgets over the past decade, and likely deceleration of tax revenues. Ultimately real federal spending will have to decline as well – either through budget discipline

Aggregate Personal and Government Savings/Spending Rates



	1952-Q1 (start)		1975-Q2 (high)		2006-Q3 (low)		2008-Q2 (stimulus)		2008-08 (current)	
Personal Income	$ 267.50		$ 1,314.20		$ 10,289.10		$ 12,188.90		$ 12,267.10	
(Less: Taxes)	(30.90)	11.6%	(121.10)	9.2%	(1,222.30)	11.9%	(1,354.10)	11.1%	(1,549.20)	12.6%
(Less: Personal Outlays)	(216.20)	80.8%	(1,044.50)	79.5%	(9,129.80)	88.7%	(10,538.20)	86.5%	(10,614.30)	86.5%
Equals: Personal Savings	$ 20.40	7.6%	$ 148.60	11.3%	- $ 63.00	-0.6%	$ 296.60	2.4%	$ 103.60	0.8%
	1952-Q1 (start)		1975-Q2 (low)		2006-Q3		2008-Q2 (stimulus)		(not yet available)	
Gov't Receipts	$ 84.70		$ 406.90		$ 3,989.30		$ 4,059.40			
(Less: Gov't Expenditures)	(74.90)		(508.50)		(4,175.50)		(4,766.30)	39.1%		
Equals: Gov't Savings	$ 9.80	3.7%	- $ 101.60	-7.7%	- $ 186.20	-1.8%	- $ 706.90	-5.8%		

Billions of U.S. dollars. Source: Department of Commerce, Bureau of Economic Analysis, NIPA series, published 9/30/2008. Quarterly data seasonally adjusted at annual rates.

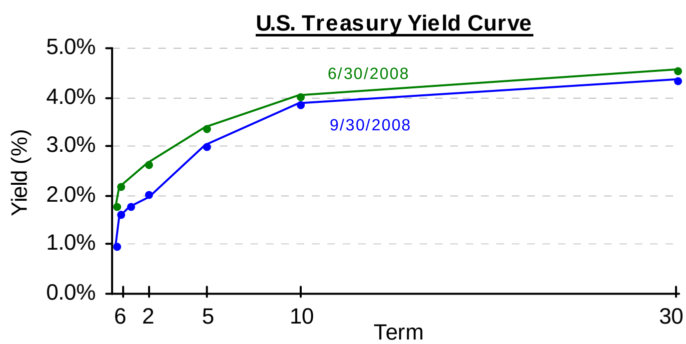
or debasement of the dollar. Until prudent levels of leverage are achieved throughout the system, volatility will continue; only the focus will change.

That underscores two important points about leverage. First, our goal should not be to eliminate it. Of course not. In fact, our standard of living is considerably higher than it would otherwise have been without the additional economic growth resulting from leverage. Policy goals should focus on reducing leverage at a reasonable pace, without "over-shooting" the mark and shuttering everything. A key lesson of the '30s is that we must keep the mechanics of finance in operation.

Second, relocating leverage from the balance sheets of banks and consumers to the government will not address the fundamental problem. Disguising leverage with book-value accounting will not address the problem either. The way to achieve stability is to allow system-wide leverage to actually fall, assets to deflate, and spending to contract. Intervention should be focused on keeping the system operating and protecting depositors, not preventing deleveraging in its entirety. In fact, we don't believe the government can stop that process. Therefore the near-term outlook is recessionary, regardless of any "bailout" package. However this is not the first recession we will have experienced, nor will it be the last. Sorry we can't be more dramatic than that.

The U.S. Bond Market

Another quarter of stock market weakness and economic uncertainty along with the acceleration of the financial sector meltdown led to bond performance that was generally ahead of stock performance. Unfortunately, this still meant negative returns in all but the government bond sectors.



Source: Bloomberg LP

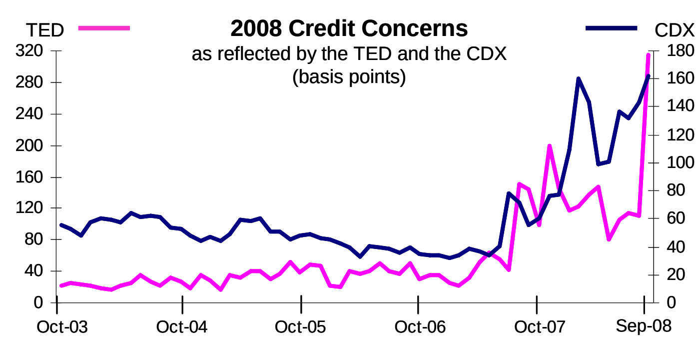
Compared to the second quarter close, the third quarter ended with the yield on the 3-month T-bill down 82 basis points to 0.92%. The yield on the 10-year treasury closed the quarter down 15 basis points to 3.83%, and the yield on the 30-year treasury ended down 22 basis points at 4.31%. With yields ending the quarter lower, prices on government bonds were up, reflecting the market's general flight to quality. In addition, yield curve steepening on the short end was a clear indication of investor skittishness.

The issue of the quarter was credit. As investors grew even more wary of riskier assets, the problems faced by financial-sector giants Fannie Mae, Freddie Mac, Lehman Brothers and AIG solidified a market-wide fear of default. Spreads on credit default swaps jumped to record levels. The Markit CDX North America Investment Grade Index, a gauge of risk tied to 125 companies in six sub-sectors (including consumer, energy, financial, industrial, technology, and telecom) and their ability to repay debt, jumped to 162 basis points by the end of the quarter, up from 137 basis points at the end of 2Q 2008 and more than double the end-of-4Q2007 figure of 78 basis points.

Bond Indices - 3Q08 Total Return	
Lehman Aggregate	-0.49%
Lehman Interm. Gov't	1.79%
Lehman Long Gov't	2.58%
Lehman Interm. Credit	-5.60%
Lehman Long Credit	-8.78%
Lehman High Yield	-8.89%

Another sign of the market's increasing fear of default was skyrocketing AA corporate spreads. After a second-quarter decline from the very high levels seen in Q1 (207 basis points), 10-year AA spreads shot to 260 basis points. Three-month AA spreads jumped from 146 basis points at the end of Q2 to 250 basis points by the close of Q3. Of course, increasing credit spreads make borrowing increasingly difficult. Not surprisingly firms requiring financing found it expensive or impossible to achieve, while news reports focused on the trickle down of tightening credit to consumers. In fact, higher spreads have caused corporate borrowing costs to rise 30% from the beginning of the year, according to Standard & Poors.

A third indicator of increasing credit concerns, the TED spread, jumped to a level last seen on October 20, 1987 (300 basis points) when the stock market collapsed. The TED spread is the difference in rates between 3 month futures contracts for U.S. Treasuries and 3 month contracts for Eurodollars (as measured by the London Interbank Offered Rate, or "LIBOR") and is an indicator of outlooks on credit risk. Prior to the sub-prime crisis, levels were around 40 basis points. But by mid-September, with plunging treasury rates and LIBOR spiking, the TED spread had climbed to 302 basis points and ended the quarter at 315 basis points.



The Federal Open Market Committee met three times during the quarter. After each session the federal funds rate remained at 2.00%. The July 24 meeting was called for the Fed to consider several proposals to extend or enhance Federal Reserve System liquidity facilities. In the meantime, the Treasury auctioned $40 billion of 35-day cash management bills towards quarter-end to help the Fed manage its own balance sheet after it had been pumping cash to banks and primary dealers to ease the credit crunch. The Fed did in fact step up its lending to financial firms. As of September 24, banks and securities firms had borrowed $348.2 billion from the central bank, up from $217.8 billion a week earlier.

The U.S. Stock Market

The third quarter was marked by severe weakness and volatility in the U.S. stock market. As the meltdown in the financial sector accelerated, it bled into the rest of corporate America in the form of a tightening credit market which drove down earnings for many firms. According to Thomson Reuters, as of September 26 the blended earnings growth rate for the S&P 500 for Q3 2008, combining actual numbers for companies that reported and estimates for companies yet to report, declined to -1.7%. The decline was attributed in part to downward estimate revisions in Energy and Financials. As recently as April 1, the estimated growth rate for Q3 was 17.3%.

Stock Indices - 3Q08 Total Return

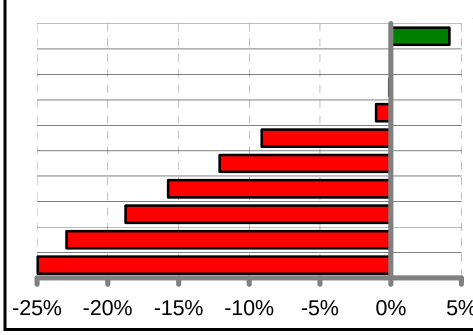
Largecap Stocks		**Midcap Stocks**	
S&P 500	-8.37%	S&P Midcap 400	-10.87%
Russell 1000	-9.35%	Russell Midcap	-12.91%
Growth	-12.33%	Growth	-17.75%
Value	-6.11%	Value	-7.52%
Broad Markets		**Smallcap Stocks**	
NASDAQ Comp.	-8.59%	S&P Smallcap 600	-0.86%
DJ Wilshire 5000	-8.67%	Russell 2000	-1.11%
		Growth	-6.99%
		Value	4.96%

The broad markets finished the quarter down, with the Dow Jones Wilshire 5000 returning -8.67%, the Russell 3000 returning -8.73%, and the MSCI Barra Broad Market Index returning -8.55%. Year-to-date the indices each lost almost 20% with returns at -18.64%, -18.81%, and -18.49%, respectively. Only the Consumer Staples sector posted returns in the black, for obvious reasons.

Probably the most surprising statistic, particularly in a quarter where industry troubles made major headlines on a daily basis, was the flat return in the large-cap Financial sector. A closer look reveals wide variations in performance of the underlying sub-sectors as well as in individual names. Within the S&P 500, the Bank group was one of the top-performing – 4th to be exact, with the S&P 500 Banks Index returning 5.43% for the quarter and the S&P 500 Commercial Banks Index returning 22.27%. J.P. Morgan Chase and Wells Fargo were two of the top performers in the S&P 500. The Financial sector did contain some of the worst-performing groups too. The S&P 500 Insurance Index returned -17.20% for the quarter, driven largely by AIG, and the S&P 500 Thrifts & Mortgage Finance Index returned an abysmal -75.05%. In the mid- and small-cap Financials, strong-performing REITs, particularly health care, self-storage, and apartment, helped buoy the sectors. Smallcap Financials overall did even better than largecaps, with financial firms in the S&P Smallcap 600 returning 17.58%, driving a positive quarterly return for the Russell 2000 Value.

Of further note was the bottom-of-the-heap performance of the Energy sector. A decline in gas consumption by a worried American public along with disruption from hurricanes in the Gulf of Mexico helped bring down many of the firms across capitalization sectors, including Exxon Mobil, Chevron, and Conoco Philips. With many active managers overweight Energy and underweight Financials, we should prepare for a quarter of disappointing absolute and relative returns.

S&P 500 Economic Group Components - Total Return



Sector	3Q08
Consumer Staples	4.14%
Healthcare	-0.01%
Financials	-0.10%
Consumer Disc.	-1.04%
Industrials	-9.12%
Information Tech.	-12.11%
Telecom	-15.74%
Utilities	-18.74%
Materials	-22.93%
Energy	-24.95%

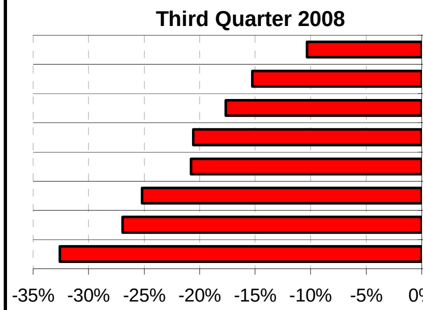
Source: Standard & Poor's

Overseas Markets

Over the last few decades as investors have sought ways to diversify portfolios and increase performance, overseas investments grew rapidly. However, these markets have proven to be more highly linked with the U.S. during periods of sharp negative performance than investors expected. Developed markets were hit hard during the quarter as were emerging markets. So called "BRIC" markets (Brazil, Russia, India, and China) fell due to significant drops in commodity prices, especially for oil. Iceland stands as an interesting microcosm of the greater problem facing both developed and emerging markets around the world as the bill comes due after years of heavy borrowing. As the quarter came to a close, the Icelandic Krona came under extreme selling pressure falling over 15% and 12% versus the U.S. dollar and Euro, respectively. Credit default swap spreads for Icelandic banks widened by more than 300 basis points with the fear that the country's current account deficit may widen to 20% of GDP this year. We can (and will) see the negative impact of deleveraging in markets around the world.

As little as a week before the end of the quarter Europe continued to play down the need for a U.S. type bailout for their domestic banks. However, repercussions of the credit liquidity squeeze, high energy prices and the housing correction have expanded well beyond the U.S. The end of the quarter saw EU officials promising support for lenders after U.S. lawmakers failed to pass a proposed $700 billion bank rescue. Trepidation is beginning to creep into European markets after Fortis and Dexia in Belgium and Germany's Hypo Real Estate required intervention. Leaders across Europe have either announced, or are planning to announce, plans for crisis measures or rescue packages to re-establish trust in the markets. Ireland announced it would guarantee the bank debts of its top 6 banks for up to two years, insuring an amount greater than the entire country's GDP to help ensure that domestic banks can continue to access international credit markets. Credit conditions in the Eurozone are slightly more favorable than in the U.S. However, the battered financial sector in Europe remains angst-ridden, and the ECB continues to inject liquidity into the market and stands ready to directly purchase debt securities from banks to try to prevent a deepening crisis.

Net Total Return of Selected MSCI Regional Indices



Region	3Q08
North America	-10.33%
World Index	-15.25%
Japan	-17.65%
EAFE	-20.56%
Europe	-20.77%
Pacific ex Japan	-25.20%
Emerging Markets	-26.95%
Latin America	-32.59%

Japan became a net importer for the first time in over a quarter century in 3Q. The economic contraction is tied to slowing auto and truck sales in an already weak U.S. auto market along with slowing exports to Europe. Japanese exports of cars and other transportation machinery to the U.S. slowed by 30% in August. Sales of factory equipment to China and other Asian countries also slowed sharply. Japan has mostly managed to side-step the effects from the mortgage crisis that has gripped the US and Europe, however rising food and energy prices at home have depressed weak consumer spending and have left the economy particularly vulnerable to an export slowdown. GDP shrank by 3% in annual terms in the second quarter, with the current quarter's consensus predicting a contraction.

Current Account Selected Sectors ($MM USD)

	2006	2007	2008	
			Q1-2008	Q2-2008
Country				
France	(15,434)	(30,551)	(10,213)	(17,372)
Germany	177,595	251,982	67,734	71,013
Iceland	(4,179)	(3,163)	(893)	(1,786)
Ireland	(7,865)	(14,084)	(4,203)	(3,432)
Japan	168,408	211,372	53,141	46,202
Mexico	(2,231)	(5,840)	(2,089)	(3,244)
United Kingdom	(82,870)	(105,190)	(10,862)	(21,590)
United States	(788,117)	(731,215)	(175,640)	(183,147)
Euro area	(1,599)	36,369	(19,216)	(19,112)
Brazil	13,621	1,460	(8,876)	..
China	253,268	371,833	..	..
India	(9,754)	(11,471)	(7,162)	..
Russian Federation	94,367	78,310	..	..

Source: OECD

After the economic surge running up to the Beijing Olympics, the Chinese economy appears, by all indicators, to be slowing significantly. Some were expecting a post-Olympic rebound since industrial production had weakened due to factory shut-downs in and around Beijing; however, falling commodity and real property prices are causing a severe negative impact. Some worrisome signs include rapid cuts in steel prices, deceleration in energy consumption and weakening coal prices. China's industrial production slowed to under 13% in August, year-over-year, the weakest pace in 6 years. Export volume fell sharply to 16.9% in July from 28.5% a year ago mirroring a slowdown in world demand for goods, even from the low-cost producer. A combination of falling wage growth and CPI inflation surging to 7.9% has resulted in sharp drop in real wage growth – severely eroding household consumption. Perhaps just as concerning is a strong deterioration in the property sector and its link to weakness in domestic demand. Reduced property development and significant sales declines point to a further deceleration of GDP growth.

Financial distress in the U.S. and weakness in Europe are making things difficult in Latin American markets. According to Standard & Poor's, real GDP growth in the region is expected to slow to 3.9% next year as economic conditions in the U.S. and Europe weigh on the global economy. The key question remaining is whether global demand holds up for commodities, especially from China and India. Central bank credit tightening will also weigh heavily on growth prospects. Inflation in the region is running at around 10%, nearly double the rate from 2007. Brazil's central bank has hiked rates by 2.5% since April. Brazil's direct exposure to the US is relatively small in trade terms at around 2.5% of GDP and banks have little exposure to mortgage bonds and complex instruments in developed markets. However, the real reversed its gains as global conditions have deteriorated and Brazil's trade balance has worsened. The real has depreciated by almost 25% against the US dollar in less than two months hurt by higher inflation estimates.

Focus On: *Keeping the "Stable" in Stable Value*

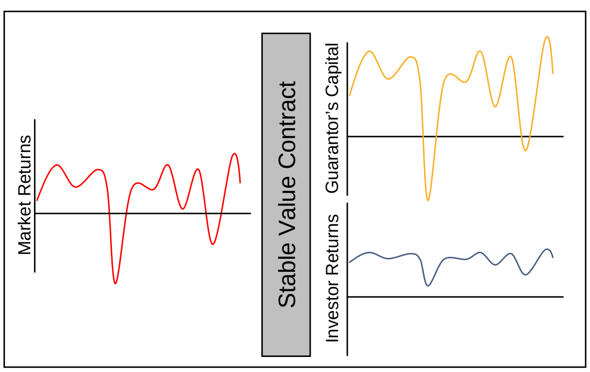
Tightening credit conditions throughout 2008 have placed significant pressure on the lowest-risk options available to participants in 401(k) and other defined contribution plans. On Tuesday, September 16th the dramatic failure of Lehman Brothers led to principal losses for the Reserve Primary Fund, reportedly the oldest money market mutual fund in the United States. Fiduciaries skittered about checking the holdings of their Plans' funds for Lehman exposure, but another potentially greater problem was brewing simultaneously – the imminent collapse of insurance giant AIG. As the eventful week progressed, the magnitude of AIG exposure throughout some of the largest stable value pools came sharply into focus. Ultimately, federal intervention forestalled a collapse, buying time for pool managers to work out of the situation.

It is hard to overstate the importance of principal protection in a stable value fund. Even a small loss of principal would have risked undermining public confidence in retirement plans, particularly coming at a time when many participants were actively fleeing market risk by moving money into these products. Sadly, many plan fiduciaries are more familiar with the inner workings of stock funds than the normally "sleepy" products that provide the stable base for participants that choose to avoid market risk. With the additional time the Fed's actions bought, fiduciaries should re-evaluate their policy benchmarks and goals for stable value and, if necessary, reacquaint themselves with the mechanics of these important but complex investment products.

Stable Value Mechanics

Stable value funds are complex financial instruments because they seek to achieve what modern portfolio theory suggests is improbable – to pass the return premium of riskier investments to the investor while stripping away or masking the risk itself. The return premium in question is a combination of credit risk (the risk that a bond issuer will default) and term risk (the risk of interest rate movement prior to maturity). Investors that prefer not to take these risks at all have only treasury money market instruments at their disposal, with correspondingly lower expected returns.

A stable value fund starts with a portfolio of bonds that are very conservative (high quality, short term) compared to a conventional market bond portfolio – but somewhat risky compared to a money market portfolio. The credit and term risk of the bonds produce a higher yield than safer instruments would, but should also cause values to fluctuate over time as interest rates and spreads change, and as issuers occasionally default. To mask the risk, an insurance company or bank enters the picture and provides a "book value guarantee" on the assets – as long as certain conditions are met, participants withdraw funds at book value (their original principal plus interest) regardless of the market value of the portfolio. If the market value is lower than book, the guarantor takes a loss, and vice-versa. Over an interest rate and credit cycle, the guarantor expects to break even on withdrawals and earn a fee that compensates them for the risk they assumed.



That is not to say that participants are unaffected by market interest rate changes or defaults. The guarantor generally takes the portfolio's experience into account when setting future interest crediting rates, by amortizing in the difference between market and book value over the duration of the contract. Essentially, the guarantor's balance sheet acts as a "shock absorber" for the portfolio, shaving off gains and losses to form a smoother return stream, one that under ordinary conditions is always positive. The guarantor and investors share the risk premium of the bond portfolio over time.

There are two possible stress points in this mechanism – the quality of the underlying bonds, and the financial strength of the guarantor. If either is significantly impaired, the process can break down.

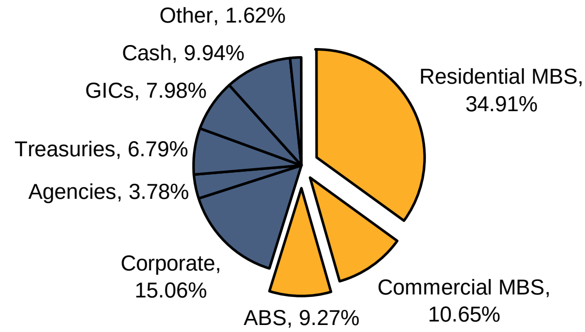
Problem 1 – Risky Bonds

Because crediting rates are driven by the yield of the underlying portfolio, both the investors and guarantors have an incentive to maximize the yield – in other words, increase the risk premium. But what happens when losses on the underlying bonds exceed expectations? At some point, the market value of the bond portfolio will be so far below the book value that it is impossible to amortize in the difference without reducing the book value – and passing a loss through to investors. Under these circumstances, book value withdrawals from the fund would worsen the problem.

During protracted periods of strong stable markets, stable value contracts with riskier underlying portfolios will generate higher interest crediting rates for participants. It is very tempting for fiduciaries to rely primarily on these past returns to select products – which in turn puts pressure on investment managers to take more risk and seek higher yields.

Over the past decade, mortgage-backed securities have enjoyed a considerable yield advantage over other bond types with "similar" risk, measured by credit ratings. Of course we now know that the ratings vastly understated the default risks, particularly over the last 5 years as the mortgage underwriting process broke down. Stable value funds are heavy investors in commercial and residential MBS, attracted by the higher yields. As of June 30, data from Hueler Analytics showed 54.8% of the underlying bonds in the pooled fund universe invested in securitized products. Although the vast majority of the exposure is very senior (as opposed to subprime), spreads on even the best securitized paper have widened considerably throughout 2008, putting downward pressure on market-to-book ratios.

Securitized Paper in Stable Value Pools
Hueler Universe, as of 6/30/2008



Source: Hueler Analytics (www.hueler.com)

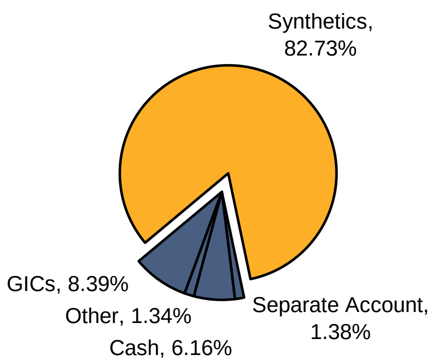
There is a wide degree of variation in credit risk for major stable value funds. In the near-term, we believe managers of funds with the highest exposure will struggle to maintain competitive crediting rates for their products due to low market-to-book ratios. In isolated cases, fee waivers or other interventions have already been necessary; more intervention may be necessary, depending on how market conditions evolve. While managers are not required to waive fees or otherwise intervene due to market losses, hopefully goodwill and reputation risk will be sufficient incentives.

Problem 2 – Risky Wrappers

Unless the underlying bond portfolio suffers catastrophic losses, the mechanics of the stable value contract protect participants from market losses by offsetting those losses against past and future gains, and by smoothing out the return stream. But what happens when the guarantor defaults?

Two trends in stable value investing have improved security for investors. First, assets are increasingly held separately from the guarantor's balance sheet, in a trust account dedicated specifically to support the investors. Synthetic "wrapper" contracts now dominate fund investments, allowing the bonds to easily detach from the bank or insurance company in the event of impairment. Second, pooled funds combine the investments of many different plans, creating sufficient scale to diversify exposure to any one wrap provider.

Contract Types in Stable Value Pools
Hueler Universe, as of 6/30/2008



Source: Hueler Analytics (www.hueler.com)

However, there are few firms willing and able to issue book value wrappers, limiting the ability of fund managers to achieve fully effective diversification. Therefore, while it is unusual to see exposures of more than a few percent to any one bond issuer in the underlying portfolio, double-digit exposure to a single wrap provider is common, and exposure of 20% or more is not unusual.

AIG's troubled financial products division was a major issuer of stable value wrappers and, unfortunately, unrelated and more risky paper as well. The Company's demise came at an inopportune time, when underlying bond portfolios were already weakened as discussed above. If AIG had defaulted, bond portfolios would have indeed detached, preventing any severe loss of value for investors – however, the net asset value of funds that were exposed to AIG paper would have to be marked to market, potentially "breaking the buck" and passing through a loss.

Fund managers can normally respond to an impending wrapper default by hiring a new guarantor to take over the risk, precluding the necessity of marking assets to market. In the case of AIG, the blinding speed of events on the week of September 14th made this very difficult in practice. Several very large funds were forced to negotiate with a small number of guarantors, each of whom were facing capital constraints and were very reluctant to assume risk associated with any fixed income portfolio without careful study. It is unclear, absent the government's intervention to support AIG, whether all of the exposed pools would have found willing wrap providers in time – it is clear, however, that it would have cost investors dearly.

It is very important to note that the magnitude of potential mark-to-market losses due to an AIG default were relatively small. First, only assets wrapped by AIG would be marked down; second, the impact would only be the difference between market and book value, since the underlying portfolio itself is not impaired. Losses exceeding 1% of total fund assets would be unusual, and no fund we are familiar with would likely have lost more than 2%. In an environment where the alternative is to take risk in a stock market generating double-digit quarterly losses, one is tempted to dismiss the issue entirely – but that would be a mistake. Investors in stable value funds are by definition not inclined to be risk-takers.

Lessons Learned So Far

For fiduciaries, one key lesson is that the principle of diversification actually works. The credit crunch demonstrated clearly that any financial institution can fail, no matter how old and storied, given the right conditions. Since you cannot prevent a failure and, often, you cannot react quickly enough once a collapse begins, you need to make sure your investment managers are diversifying your participants' investments. For stable value, that means managing (and disclosing) exposure to bond issuers and wrap providers.

Another lesson is that it is very dangerous to evaluate a stable value fund based only on past returns. There is an inescapable tradeoff between return and risk, but you must keep in mind that participants who choose this particular type of fund are especially averse to risk. Therefore every step up in risk for these funds should be viewed skeptically. Statistics that should be monitored regularly include market-to-book ratio, bond credit quality, wrapper ratings, concentration ratios, and duration – crediting rates and total returns should be relatively low on the list of important statistics.

All players in this important sector of the capital markets must be impressed with the speed of the AIG collapse. Fund managers must have backup plans for their backup plans – and fiduciaries should explore the depth and credibility of those plans during manager interviews. It should also not be lost on investment professionals that there are powerful correlations involved in a credit crunch – the same conditions that cause credit bonds to underperform also put pressure on guarantors, increasing their probability of default at the worst time, when market-to-book ratios are depressed.

Monitoring Stable Value Funds

- **Market/Book Ratio**
  Quantifies downside exposure to wrap providers; drives future crediting rate drag or boost.
- **Concentration Ratios**
  Measures % of portfolio exposure to any one guarantor at the wrap level, and any one issuer or group of issuers at the bond portfolio level.
- **Issuer Diversification**
  Identifies exposure to any one particular industry or economic sector.
- **Credit Quality**
  Indicates solvency, separately for issuers in the bond portfolio and for wrap providers.
- **Duration and Maturity**
  Determines responsiveness to future changes in market interest rates; sets the timetable to amortize away and surplus or shortfall in the market/book ratio.
- **Return History**
  Look for returns that are consistent with the risks assumed, not absolute maximum returns.
- **Manager Size and Reputation**
  Consider resources the pool manager could bring to bear in a crisis.

Bellwether Consulting LLC
PO Box 31, Millburn, NJ 07041
www.bellwetherconsulting.net