

MARKET Recap

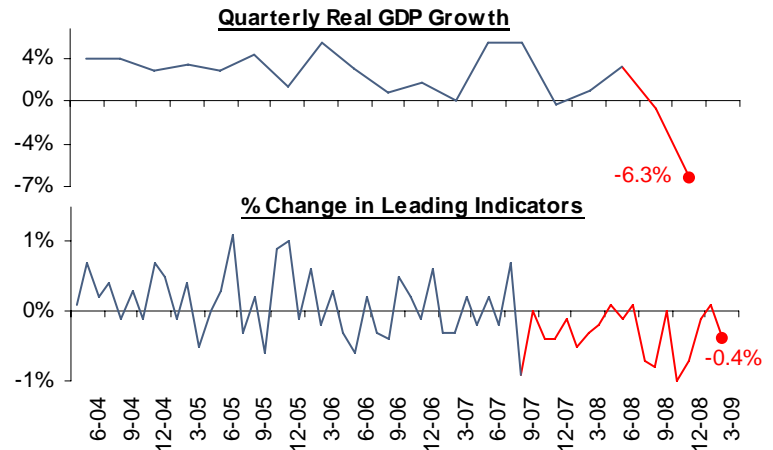
The Economy: "Frost on Green Shoots"

The US economy shrank at a -6.3% annualized pace in the fourth quarter, largely in line with expectations. Real personal consumption expenditures continued to decline, at a -4.3% pace versus -3.8% in Q3; motor vehicle output alone subtracted 2.01% from the fourth quarter GDP change. Consumer spending increased in January then reversed in February, again with deferrable purchases (e.g., motor vehicles) driving the decline.

Market pundits and economists continue to offer predictions on the timing of recovery. Subjectively, we note that the usual predictions of improvement starting two quarters from the predication date seem to be lengthening to three quarters ahead. Our counsel is to ignore the predictions and watch the data; for example, the Conference Board's Index of Leading Economic Indicators continues to signal contraction.

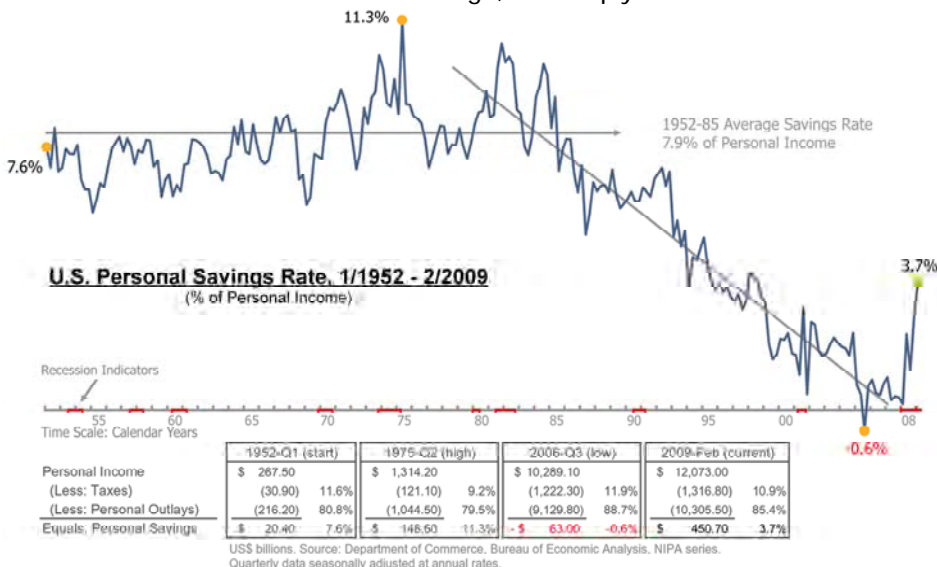
Examining the 10 components of this compound indicator, we group them roughly into three groups as of the February data release. Indicators focused on the financial economy (interest rate spread and money supply) were up in response to truly unprecedented government stimulus, moderated by a declining stock market (which reversed in March). Indicators focused on production flow moderated, with manufacturer's new orders moving higher on reduced inventories. Indicators focused on the consumer remain negative, including consumer confidence and initial claims for unemployment. With falling income prospects and a heavy debt overhang, the US consumer threatens to be the frost on Chairman Bernanke's "green shoots" of recovery.

We see, somewhat with the benefit of hindsight, that frenzied consumer spending drove the economy through an "era" dating from the mid-80's. For the past 20 years consumers spent an increasing percentage of their increasing incomes, eventually spending all of their aggregate income. Since the start of the current recession personal savings has surged as consumer spending contracted faster than income contracted; yet viewed in a longer historical context, the savings rate has yet to reach half the average level of post-Depression savings prior to 1985. There is nothing particularly "correct" about that 7.9% level to our knowledge, we simply note that historical data provides little hope that the contraction in



consumption expenditures is likely to abate soon.

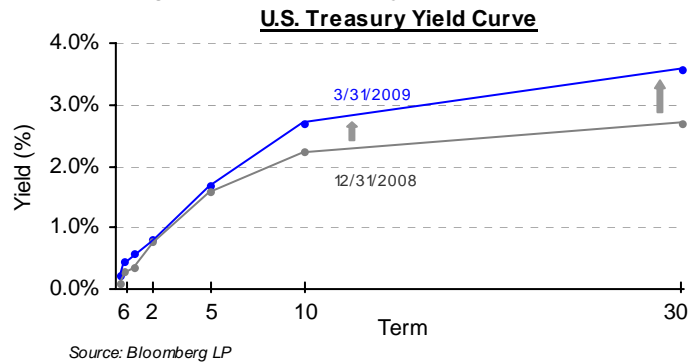
Even if consumer spending settles at near-current levels, sustainable growth needs to flow from rising real income leading to unfinanced increases in consumption, as opposed to financially "engineered" growth of the 90's and 00's. For that to happen, we need robust and stable employment in increasingly competitive private industries. That is clearly not the state affairs we read from current data; for now the government must substitute its debt capacity for the consumers' until growth is restored or its debt capacity is also depleted.



The U.S. Bond Market

Treasury prices soared in late March on the news that the Fed would buy \$300 billion in Treasuries over a six-month period and add \$750 billion to its other credit-easing programs through a new facility to buy more mortgage-backed securities and agency debt. Corresponding yields plummeted by the largest amount since the 1987 market crash as the bellwether 10-year Treasury note fell to 2.54%. Despite the late-quarter activity, yields ultimately ended the period higher across the curve as investors, looking for better-yielding opportunities, began to venture away from the safe haven of Treasuries. The first quarter of 2009 ended with the yield on the 3-month bill up 13 basis points to 0.20%. The yield on the 10-year treasury closed the quarter up 45 basis points to 2.66%, and the yield on the 30-year treasury ended up 86 basis points at 3.53%.

While bonds generally continued to outperform stocks, the best performance was seen in sectors that have been out of favor since the credit crisis began with mortgage and corporate securities topping Treasury notes and bonds. U.S. corporate investment-grade bond issuance reached \$298 billion in the first quarter of 2009, according to Dealogic, a sign that investors had become comfortable once again with taking a little more risk to find more return. High-yield bonds also improved in the first quarter. While an unusually wide spread to Treasuries persists, default rates on high-yield bonds have



remained relatively low, convincing some more risk-tolerant investors there is value to be gained in that sector. And although default rates on junk bonds are widely expected to rise significantly in the next year, most analysts do not expect them to remain for any length of time at the high rate that is currently priced into the spread.

By quarter end, the TED spread, the price difference between 3 month futures contracts for U.S. Treasuries and 3 month contracts for Eurodollars (as measured by LIBOR), fell to just under 100. Normal levels are around 25 basis points. But last October, with plunging treasure rates and LIBOR spiking, the TED spread peaked around 460 basis points. Without doubt credit markets have improved from 2008 crisis levels. However, it remains to be seen if fundamentals have really improved and if the credit market can function without government intervention.

Bond Indices - Q1 Total Return	
BarCap Aggregate	0.12%
BarCap Intern. Gov't	-0.08%
BarCap Long Gov't	-5.30%
BarCap Intern. Credit	-0.05%
BarCap Long Credit	-6.94%
BarCap High Yield	5.98%

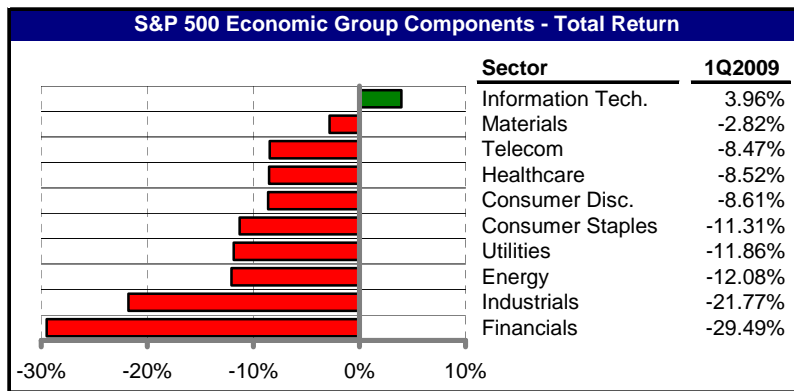
The U.S. Stock Market

The first quarter of 2009 closed with all major indices posting negative returns (although not as negative as 4Q 2008). The Dow closed the quarter at 7,609 (down 13.3% or 1,167 points), and the NASDAQ closed the quarter at 1,529 (down 48 points). But within the period, March was a bright spot with a turnaround beginning in the first half of the month ultimately trimming losses for the quarter overall. The Dow, which had been down 25% for the quarter by March 9th, was up 7.7% in March alone. The S&P 500 was up 8.5% for the month while the NASDAQ gained 11.4% in March, its best month since November 2002 when it started to recover from the dot-com bust and the September 11th attacks.

Stock Indices - Q1 Total Return			
Largecap Stocks		Midcap Stocks	
S&P 500	-11.01%	S&P Midcap 400	-8.66%
Russell 1000	-10.45%	Russell Midcap	-8.98%
Growth	-4.12%	Growth	-3.36%
Value	-16.77%	Value	-14.68%
Broad Markets		Smallcap Stocks	
NASDAQ Comp.	-2.79%	S&P Smallcap 600	-16.84%
DJ Wilshire 5000	-10.56%	Russell 2000	-14.95%
		Growth	-9.74%
		Value	-19.64%

Just as results were mixed across the quarter, performance was quite mixed across sectors as well. The value sector, heavily weighted in Financial names, significantly underperformed the growth sector with its concentration of Tech holdings (the only S&P 500 sector to post positive performance). Tech sector companies like Microsoft and Dell benefitted from reports of increased demand for PCs in China and the U.S., while other tech holdings began to see the benefits of cost-cutting measures (like layoffs at 2002 levels) in the form of results that were not as bad as expected.

Within the Financial sector, the S&P 500 Banks Index returned -44.9% and the S&P 500 Real Estate Index posted a return of -36.41%, the two worst returns within the component groups of the S&P 500. While real estate makes up about 8% of the Financial Sector of the S&P 500, banks make up over 40%, explaining its bottom-of-the-heap performance. Bank underperformance also drove the dismal returns in the smallcap value space where many regional banks reside. The S&P 600 Banks Index returned -36.8% for the quarter. Many financial institutions, especially banks, have been challenged by their mortgage security holdings as the market for these largely collapsed over 2008. Just after the close of the first quarter, the Financial Accounting Standards Board voted unanimously to give auditors more flexibility in valuing illiquid



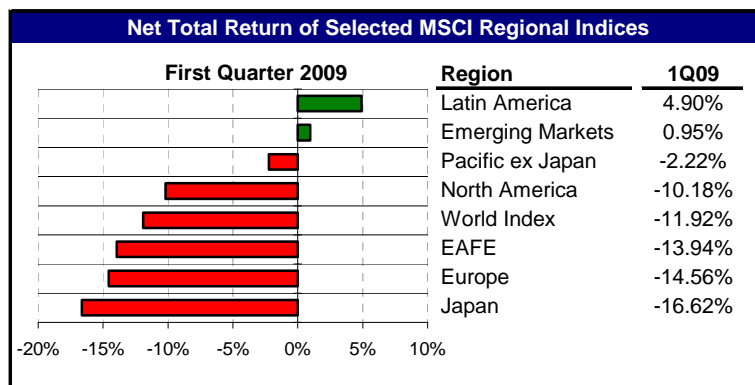
counter-intuitively given the wide focus on decreased consumer spending, this was led by an 18.22% return in the S&P 400 Retailing Index which contains some companies familiar to bargain shoppers among the ritzier names.

Throughout the quarter, analysts continued their struggle to determine how the recession will impact corporate earnings. At the beginning of March, Thomson Reuters reported that analysts projected 1Q earnings for companies in the S&P 500 to fall 31% from those in 1Q 2008. This figure is down from a January projection for a 1Q 2009 fall of 12.5% and a February projection for a 1Q 2009 decline of 25.9%.

Overseas Markets

Global markets continued to experience severe volatility during the first quarter. According to its latest outlook, the World Bank expects the global economy to shrink by 1.7% in 2009, significantly recasting its November 2008 estimate of around 1% growth. Developed economies are expected to contract nearly 3%, while developing economies are expected to grow about 2% or about one-third as fast as they grew in 2008, setting the stage for continued unsettled market performance throughout the world.

Europe remained in the doldrums, falling near the bottom of the performance range among developed markets. In March, the Eurozone manufacturing purchasing managers index (PMI) rose to a better than expected 34.0 from 33.5 in February. However, this level remains significantly below the 50-point mark, a generally accepted level signaling growth, and therefore the consensus expectation remains for a contraction in gross domestic product. According to the EU's statistical agency, the Eurozone's seasonally adjusted unemployment rate rose to 8.5% in February, from 7.2% a year earlier. There are also mounting fears among policy makers and analysts that the region may be on the verge of a deflationary spiral as annual inflation for the 16 Eurozone countries fell to a record low of 0.6% in March from 1.2% in February. Data from Germany, the largest economy in the region, has been soft. Retail sales fell by 0.2% for February after a 0.9% fall



in January. The MSCI Germany index was down 19.54%. In France, March business confidence held at 68 while the forward looking business outlook indicator jumped to -70 from -76 suggesting that companies are slowly getting less pessimistic about the future outlook. February consumer spending dropped 2.0% versus the prior month and also 2.0% from a year earlier. The MSCI France index was down 15.98%.

Preliminarily Japan appeared relatively unscathed last quarter, but its economy has been hurt in recent months by declining overseas demand and a stronger yen. Exports slumped as consumers abroad bought

fewer Japanese cars and electronics. Capital outlays were hurt as companies cut investment. Consumer spending also stalled as households reined in spending amid layoffs. Companies like Sony have cut jobs, increasing Japan's unemployment rate to 4.4% late in 2008. Near the end of the first quarter the Bank of Japan kept interest rates unchanged at 0.1%, but said it would broaden its purchases of government bonds to bolster liquidity and ensure market stability. The central bank also forecast that the economy would remain under stress and that substantial liquidity would be required to ensure stability in financial markets. At its policy meeting at the end of the quarter the BOJ announced that it will increase its outright purchases of Japanese government bonds by 4.8 trillion yen to 21.6 trillion yen (\$219 billion) per year, effective immediately. Perhaps most worrisome is that Japan's banks are also showing weakness. At issue are the vast holdings on Japanese banks' balance sheets, which have been under pressure during the recent market sell-off, forcing many banks to raise capital in recent weeks.

In China the Purchasing Managers Index showed that while purchasing activity continued to weaken in February, the pace of contraction eased from earlier readings and remained just below the neutral threshold of 50. Headline PMI rose to 49, up from 45.3 in January and above the record low of 38.8 in November. Reports also indicated that new lending continued at a strong pace in February, with banks extending about 1 trillion yuan in fresh loans following an estimated 1.62 trillion yuan in new lending reported in January. Consensus expectations for additional stimulus from China's central bank were dashed during the quarter as Premier Wen Jiabao said he remained committed to bolstering the economy and increasing spending on social programs, but did not expect to provide additional support above the government's \$585 billion stimulus package announced in November. As the quarter closed, China began to flex its political and economic muscle, calling for a new international reserve currency to replace the U.S. dollar. It appears that the central bank is more actively promoting the yuan as a reserve currency, essentially providing export manufacturers a way to hedge against large currency moves. As the quarter closed China's central bank signed currency-swap agreements with central banks in Hong Kong, South Korea, Malaysia, Indonesia and Belarus. The MSCI China Index was up 1.33% for the quarter.

Major Latin American emerging markets were mixed for the quarter. In Brazil, the central bank revised its 2009 growth forecast downward by two percentage points to 1.2% and cut its inflation outlook for 2009 and 2010 to 4%, well below government targets. After holding interest rates unchanged through the end of 2008, the central bank has cut the reference Selic rate by 2.5 percentage points this year in an effort to head off a recession. Analysts believe that there is room for at least an additional two percentage points of cuts in the Selic rate. The Brazilian real weakened 1.5% to 2.33 per dollar in reaction to the likelihood of even lower domestic interest rates. The MSCI Brazil index was up 12.45% for the quarter. In Argentina, economic growth slowed to 2.3% in January from a year earlier, slightly below consensus forecasts. Industrial production declined 6.1% in January from the previous month and auto sales fell 39% from a year earlier. Continued unrest in the agricultural sector has also hurt as rumors that the government may take over the country's grains trade sparked vocal outrage from farmers. The MSCI Argentina index was down 15.07%.

Focus On: Not Your Father's Annuity

Every day more retirees and near-retirees are contemplating how to make their savings last through potentially longer retirements. Participants have spent their working lives accumulating nest-eggs within their 401(k) plans and, as they are nearing or entering retirement they have begun to ask: what now? Is there any way to preserve the nest-egg and produce income? Do I need to give up control to get income? Plan sponsors have begun asking similar questions, and as they become more paternalistic, they have been grappling with ways to make their benefit plans more competitive without increasing expenses. The retirement industry has revived the annuity as the answer to both plan sponsors' and participants' needs. But the new breed of annuity is not your father's annuity. The industry has added new twists including institutional pricing, high water marks, control of assets and unfettered access.

For a number of reasons plan participants have generally shied away from annuities even when they were available. First, most people underestimate the amount of money needed in retirement and are surprised at how much, in current assets, they must pay to secure even a modest income. Second, most people believe that they can manage their cashflow needs on their own. Lastly, most don't want to give up control of their account balance, a general requirement when purchasing annuities. Even though group annuity contracts designed for larger plans can be competitively priced, high fees for individual annuity products have also given them a bad name.

The New Breed

Plan sponsors are assessing new products that offer an income protection benefit that provides the downside protection of a guaranteed benefit. In addressing concerns about longevity risk, pricing, structure, and control vendors have introduced a number of features that address both plan sponsor and participant needs. The changes are geared towards providing a DB-style benefit within the context of a DC plan.

Insurance companies have introduced Guaranteed Minimum Withdrawal Benefit (GMWB) products to address the market need. With a GMWB the insurer guarantees participants a minimum monthly withdrawal amount from their plan accounts, regardless of market performance or their longevity; if their accounts are depleted, the insurer continues to make the guaranteed minimum payment for the rest of the participant's life. From the perspective of a participant these products operate as an investment option within a 401(k) plan such as a balanced or target-date fund. It provides the downside protection of an annual minimum withdrawal with

Features	GMWB
Structure	Variable Annuity Wrap Contract
Fees	75-150bps
Upside Potential	Yes, through high water marks
Surrender Charges	None
Control of Assets	Yes – assets remain in plan
Withdrawals	Yes, but withdrawals decrease account value and payout stream

the potential for upside market participation. The main advantages to a participant are that assets continue to accumulate while control over the assets is maintained. Asset control sets the GMWB apart from its variable annuity counterpart since a participant can take their account balance and walk away from the withdrawal benefit at any time.

From the fiduciary's perspective, the allure of the GMWB is its structural flexibility and transparency. Unlike a traditional annuity where control of assets is ceded, the GMWB provides a structure that provides both the participant and fiduciaries access to the assets. For participants, the retention of control of the assets alleviates the trap-door risk of the decision to annuitize; however, for the plan sponsor the risk of having provided a benefit that cannot easily be taken back remains. Once offered, it is difficult for fiduciaries to terminate the product since participants would lose accumulated guarantees which they have paid considerable fees to gain; therefore it pays to do your homework before committing.

Issues to Consider

The structure of a GMWB product adds additional layers of complexity within the context of a plan. The fiduciary needs to determine the usability of the product and whether or not it will be understood by the participant base. Strong communication around the product concept is necessary so that a participant can assess the benefits of buying the protection these products offer. Too many bells and whistles may make it difficult to understand the product with the end result being an unhappy participant base that has either purchased a benefit they won't use or don't need or avoided a benefit which they do need.

Fiduciaries also need to assess the viability of the guarantee. Annuity guarantees were major contributors to the poor results, and eventual downgrading of claims paying ability, in the insurance sector during the fourth quarter of 2008 as significant losses on the assets backing these commitments flowed through insurance company financial statements. These are long-term promises from the insurance companies; a critical assessment of the long-term health of the insurer is necessary given the current state of the financial industry.

Recordkeeping and transferability is an area of great concern to sponsors. GMWBs are so new, and coming to market so quickly, that real world recordkeeping issues may not have been considered. Does a plan sponsor marry a recordkeeper with the selection of a GMWB product? There is a great deal of participant-level recordkeeping involved with the product – fund records on the asset side, tracking of high water marks, withdrawals, accrued benefit levels, etc. Does the recordkeeper have the technical level of expertise to calculate the account value and associated minimum benefit payment? What does a participant statement look like? Does the infrastructure exist to communicate with all of the interested parties in the reporting chain – plan sponsor, recordkeeper, investment manager, GMWB contract writer (if different) and participant? Until the products are more seasoned it is unlikely that any recordkeeping standard will develop, making it difficult for a sponsor to be able to transfer between recordkeepers.

<p>Some questions to ask:</p> <ul style="list-style-type: none">•How safe is the issuer?•What are the fees?•Is there recordkeeper transferability?•Are the underlying funds proprietary?•Balanced fund or target-date strategy?•Long-term viability of the guarantee?•What does a participant statement look like?•What type of participant communication and education is available?

A fiduciary also needs to peer under the hood regarding the underlying investments and fees. Implementation has generally taken the form of balanced fund or target-date structures. The plan sponsor needs to assess the investments and determine if they meet investment guidelines. Are the funds proprietary or are there external managers? How has performance been versus benchmarks and peers? For target-date funds, are they indexed or actively managed? Is there a comfort level with the stock and bond allocations along the glideslope? From a fee perspective, it is difficult to benchmark these new products and there is a wide dispersion of fees among a small number of products. Fees will mainly be driven by the underlying fund structure and the type of guarantee. Investments that are indexed should drive a lower fee level versus actively managed underlying funds.

Conceptually, GMWBs represent a significant step forward in the evolution of retirement programs. Vendors have come up with a product that fits within a defined contribution plan line up and provides a benefit that meets the needs of both sponsors and participants with respect to pricing, control and income preservation. As the landscape continues to evolve, and these new products become more seasoned, we expect changes in the product structure to improve a number of the issues currently facing plan sponsors.