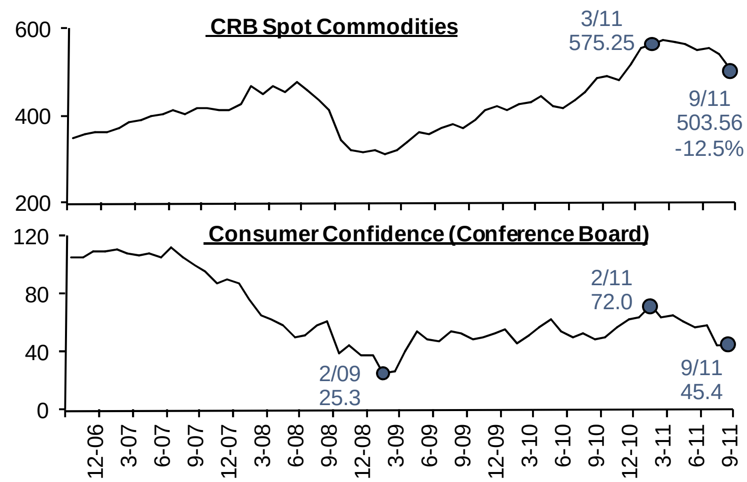
Bellwether CONSULTING

Your Quarterly Update on the Financial Markets
September 30, 2011

3rd Quarter

MARKET Recap

The Economy: *"Twisted Money for Troubled Times"*

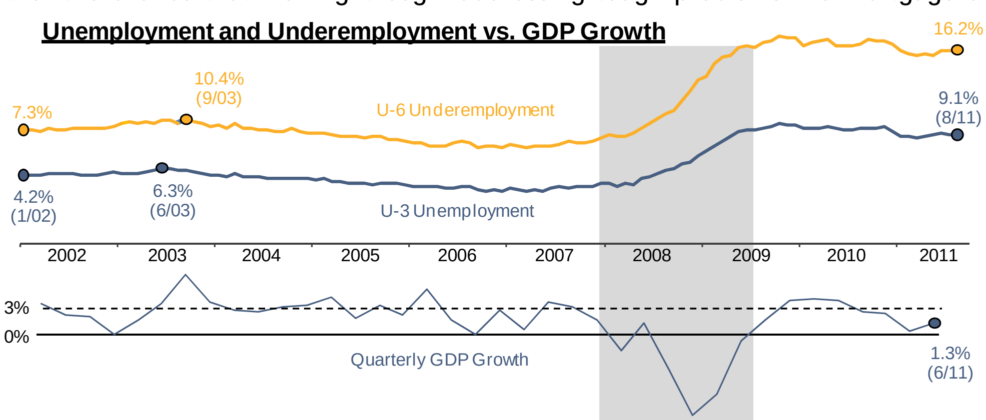


The US economy grew at a 1.3% annualized pace for the second quarter, a modest improvement over Q1 as global disruptions from Japan's earthquake and tsunami subsided. Increased federal government spending accounted for most of the acceleration as personal consumption expenditures, private inventory investment, and exports decelerated. Available Q3 data shows real personal consumption was flat for August after a brief uptick in July while personal income continued a troubling trend lower, actually contracting by 0.1% in August.

Earlier in the year consumers griped about gas prices, but falling prices have been accompanied by increased discontent. The real driver of gloom is persistent underemployment, not prices. Last year we discussed the issue of *structural unemployment*, caused by a systemic mismatch between employers and workers in terms of skill or geographic requirements. Now fully two years post-recession, the jury is still out on the degree of structural unemployment – is slow growth driving unemployment or is structural unemployment curtailing growth? The question is not rhetorical because each scenario calls for very different policy responses.

In early July our expectations were that the Fed would take another shot at the demand side through additional quantitative easing and, while it was likely to prove as ineffective against unemployment as did QE2, the resulting environment would be good for stocks in the short run. Clearly we were right in anticipating "Operation Twist", and dead wrong on the market impact. The sell-off is fascinating because the events of August contained very little real news, at least on the surface. Both the chronic and severe fiscal imbalances in the United States and the sorry state of sovereign debt in Europe are old news. Despite overly-dramatic coverage by the 24-hour media, partisanship in Washington is hardly new. And unlike 2008 when we had no clue how policymakers would respond to a growing solvency crisis, this time we know exactly how their playbook reads. Central banks will not allow the system to fail, in the US or Europe, no matter how much damage is done to paper currency or how many TARPs (or Euro-TARPs) must be hastily deployed. Voters will hold their noses and go along, despite their anger at being fleeced again, seeing no better option.

So why was one-sixth of global public equity value erased last quarter? We will hazard a guess that the US debt ceiling debacle was the catalyst – but not for the reasons cited. It is not political dysfunction that spooked the markets, but rather the chance that we might begin addressing tough problems like mortgage overhang, chronically low interest rates, and a runaway federal budget. The debate posed two paths, austerity measures and taxation, and the stock market liked neither; nor could it conceive an alternative. Both paths likely lead to an imbalance-clearing recession. If our reasoning is sound then the markets are being unusually far-sighted, since real progress along either path is not likely before the election 13 months hence, nor soon afterwards.



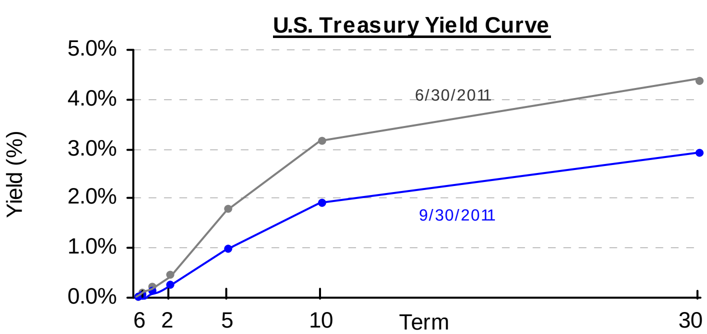
The US Bond Market

With the financial markets rocked by volatility and investors distracted by the US debt-ceiling debate and the European peripheral-market debt contagion, the third quarter saw renewed demand for the perceived safety of the bond market. Prices of US Treasuries surged with the 30-year returning an incredible 31%. Low- to medium-risk market segments, such as corporate bonds and mortgage-backed securities, delivered more modest returns. And the safer the sector, the better; for example, the highly defensive utility bond sector returned 7% during the quarter. Not surprisingly, the decrease in investor risk appetite had a negative impact on the less stable areas of the bond market like high-yield and emerging-markets bonds.

Q3 Index Total Returns	
BarCap Aggregate	3.82%
BarCap Interm. Gov't	3.19%
BarCap Long Gov't	23.92%
BarCap Interm. Credit	0.94%
BarCap Long Credit	9.13%
BarCap High Yield	-6.06%

The quarter ended with US Treasury yields down across the curve (except at the very short end) and the yield on the benchmark 10-year Treasury at 1.92%, down 124 basis points from the close of the prior quarter. The yield curve flattened over the summer months with the spread between the 2-year and 10-year Treasury narrowing by 100 basis points to 167 basis points. A flattening yield curve is often noted as an indicator of a pending economic recession, suggesting a negative long-term outlook. (However, we note that historically there have been non-recessionary periods where the yield curve has even been inverted.)

Amid the uncertainty, credit spreads widened over the quarter. Spreads on AA credit increased by roughly 20 – 60 basis points across the curve while high yield spreads increased by 115 – 135 basis points, moves of a magnitude not seen since the beginning of the credit crisis in 2008. While most analysts view credit risk as modestly increasing, the Q3 increase in credit spreads has been attributed largely to the heightened systemic risk emanating from Europe and not to deteriorating individual issuer fundamentals. Widening spreads were actually a bit of good news for pension plan sponsors as they helped mitigate the drop in discount rates and the associated increase in liabilities.



Source: Bloomberg LP

The third quarter saw headlines marking several historic events. Standard & Poor's cut the U.S. government's long-term credit rating to AA+ from AAA, a move they had signaled months earlier. Ordinarily a credit rating downgrade drives up yields since investors demand greater payment for greater risk. But in this case, the lone downgrade from a single agency was not enough to override investor perception of the relative safety of Treasury debt compared to the rest of the global market.

The Fed made headlines of its own during the quarter, first amid speculation that a third installment of quantitative easing was imminent. Then in mid-September, the Fed announced an alternative plan to begin purchasing long-term Treasuries while selling $400 billion in short-term holdings. Labeled "Operation Twist," the strategy has not been used since the 1960's and is an attempt to decrease long-term borrowing costs, thereby increasing corporate borrowing and bolstering consumer credit. The plan had its dissenters; some Fed members are worried about inflation risks and voted "no" on the policy. Stock markets responded by plunging in the wake of the announcement, and many analysts focused on the details of the plan's execution like the inclusion of more 30-year bonds than originally anticipated, viewing it as a sign that the Fed's economic outlook had become more pessimistic. It is likely that the program will make it difficult for the Fed to raise interest rates. But since the Fed has already stated it would keep short-term interest rates at their historic lows into 2013, at least it is consistent. Interestingly, while not the target of the program, the 3-month Treasury yield moved up 1 basis point over the quarter bringing a very tiny bit of relief to yield-starved money market investors.

The US Stock Market

The US stock market experienced its worst quarter since the depths of the financial crisis in early 2009. The quarter was fraught with worrisome events, beginning with dismal economic reports in July suggesting a slowed US recovery and continuing in August with the debate on the debt ceiling extension and a Standard & Poor's downgrade of the U.S. credit rating, which resulted in a rush out of US equities. Simultaneously, Europe's debt troubles worsened and, more recently, economic data out of China has faltered with new numbers indicating that the country's manufacturing sector shrank in September. The quarter was not without moments of optimism, with sporadic positive news from Europe and the recent fall in jobless claims in the US by 37,000 to 391,000, the lowest level since April 2, according to the Labor Department. The onslaught of bad news coupled with periodic glimmers of hope resulted in a very tumultuous period stocks. The Dow moved by more than 200 points 18 times during the quarter, swinging by more than 400 points on four consecutive days in August. Amid this volatility, all the major indexes finished the quarter down well into double digits.

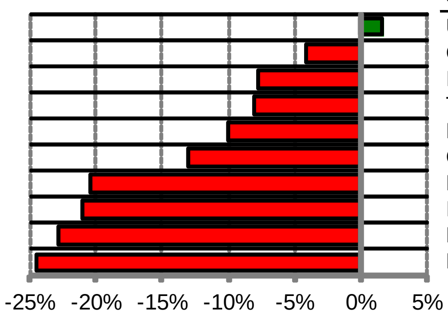
With investors fleeing to safe havens such as US Treasury debt and gold, all equity sectors ended in the red, regardless of capitalization, with the sole exception of utilities in the S&P 500. While posting a negative return, defensive-play consumer staples joined utilities in outperforming the rest of the stock market primarily due to the stability in demand inherent in these non-discretionary expenditures regardless of the economic environment.

Q3 Index Total Returns

Largecap Stocks		**Midcap Stocks**	
S&P 500	-13.87%	S&P Midcap 400	-19.88%
Russell 1000	-14.68%	Russell Midcap	-18.90%
Growth	-13.14%	Growth	-19.33%
Value	-16.20%	Value	-18.46%
Broad Markets		**Smallcap Stocks**	
Russell 3000	-15.28%	S&P Smallcap 600	-19.83%
DJ Wilshire 5000	-15.15%	Russell 2000	-21.87%
		Growth	-22.25%
		Value	-21.47%

In such a volatile quarter it is not surprising that the more economically sensitive sectors (i.e. materials, financials, industrials, and energy) were the worst performers in all capitalizations during the period. US front-month crude posted its weakest returns since 2008, driving down the energy sector. Concerns about global growth, particularly weak manufacturing indicators from China and ongoing uncertainties about Europe's sovereign debt problems, put pressure on oil prices. Global concerns brought down prices for other commodities as well, with copper down almost 26% for the quarter. Aluminum, coal, and steel posted negative double-digit returns. This overall fall in commodities dragged on the materials and industrials sectors with mining stocks and auto manufacturing stocks among the worst performers. But the big story for the quarter, particularly in the large cap space, was financials or more specifically banks. Bank of America was the largest contributor to the financial sector's decline as shares fell over 43% during the period. The sovereign debt crisis affected markets all quarter, and big banks have been especially impacted by the uncertainty in Europe due to their exposure to European bond markets.

S&P 500 Economic Group Components - Total Return



Sector	3Q2011
Utilities	1.55%
Consumer Staples	-4.19%
Info Tech	-7.70%
Telecom	-8.01%
Health Care	-10.02%
Consumer Disc.	-12.98%
Energy	-20.46%
Industrials	-21.02%
Financials	-22.80%
Materials	-24.52%

Source: Standard & Poor's

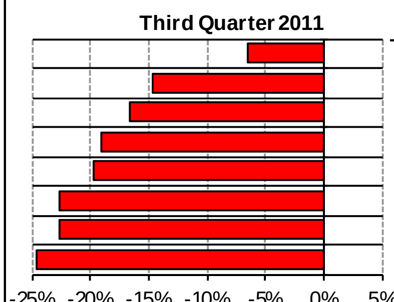
In this unpredictable market, large cap stocks outperformed small and mid cap offerings. In such a turbulent quarter the perceived stability of a larger firm with its steady revenues and predictable earnings was more appealing than the more volatile (higher beta) small and mid cap companies. Within large caps, growth stocks outperformed value, but value stocks saw better returns in the mid and small cap spaces.

Overseas Markets

World markets slumped during the third quarter as market volatility spiked due to the on-going sovereign debt crisis in Europe. The peripheral countries remained under pressure as credit downgrades and widening CDS spreads combined with other global geo-political issues, threatening to create a panic. With the exception of Japan, double-digit losses were the norm in both developed and emerging markets worldwide.

In the Eurozone, Greece remained the focal point as structural economic issues continued to plague the country. The Greek Parliament needed to agree on another round of austerity measures to tap additional bailout funds. In an effort to calm markets and bridge a €2 billion budget shortfall, Greece's finance minister outlined a plan to impose a special property tax. It appeared that the new measures would be enough to qualify Greece for its portion (€8 billion) of the initial bailout funds. At the time of this writing, Greece continued to balance on the precipice of default and is considering yet another round of austerity. The risk of contagion beyond Greece pushed sovereign credit-default swap prices to record highs across the Eurozone. European bank debt risk also rose to the highest level ever with French banks feeling the brunt as they are the most exposed Eurozone country to Greek borrowers and stand to lose heavily from a Greek default. Broader Eurozone bank shares also suffered and have fallen 55% since their peak earlier this year.

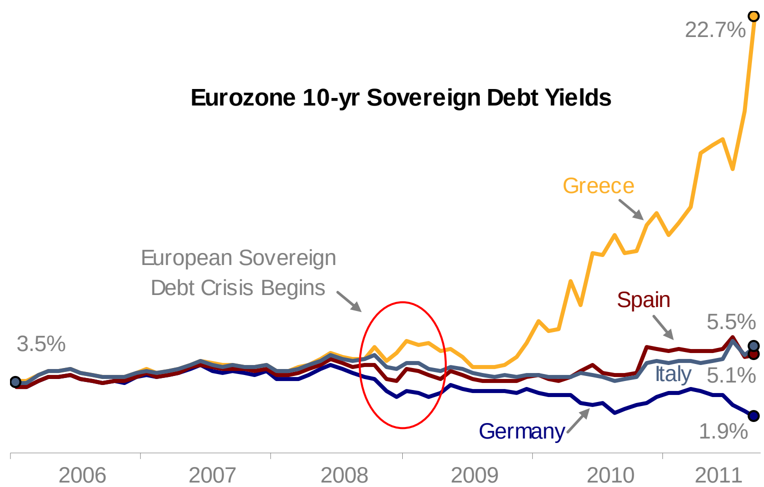
Net Total Return of Selected MSCI Regional Indices



Region	3Q11
Japan	-6.44%
North America	-14.64%
World Index	-16.61%
EAFE	-19.01%
Pacific ex Japan	-19.74%
Emerging Markets	-22.56%
Europe	-22.61%
Latin America	-24.54%

Around mid-quarter, ECB President Jean-Claude Trichet indicated that the Bank had resumed purchases of government bonds (stopped since March) amid fears the sovereign debt crisis could engulf Italy and Spain. Rising yields in both countries stirred worries that either or both would be unable to access credit markets. After his comments, yields on Italian, Spanish, and peripheral government bonds fell sharply. The Eurozone's rescue mechanism, the European Financial Stability Facility (EFSF), is widely seen as inadequate to handle a bailout of Italy, the region's third-largest economy, or Spain, the next largest. The IMF's economic modeling showed an "earthquake scenario" in which shockwaves spread across the Eurozone, cutting growth in the region by 2.5% and globally 1% over the next year. IMF directors called for a bigger, more flexible EFSF. The ECB's added liquidity measures and less hawkish tone on its monetary policy outlook hurt the euro, which sank versus the dollar. With a weakening euro, investors seeking a safe haven looked to the Swiss franc, forcing Switzerland to cut its key lending rate to zero and to take other steps to halt the franc's rise to record levels versus the beleaguered euro. The Swiss central bank used quantitative easing, narrowing its target range for three-month LIBOR to 0% - 0.25% from 0% - 0.75% and boosting the supply of liquidity of the Swiss franc to weaken the currency.

As Eurozone leaders continue meeting to try and staunch the bleeding in the peripheral countries and weaker core countries, there was talk of issuing Eurobonds. The idea is to create a single fiscal unification rather than having the current disjointed structure of single countries issuing their own debt. Fiscally challenged governments, like Italy's and Greece's, are obviously in favor of euro bonds. Issuing debt guaranteed by their Eurozone partners would provide easier access to global credit markets, putting less pressure on them to take extreme austerity measures. Investors, mainly banks, are also interested in the concept since it could help recoup their losses. However, it is unclear that the issuance of such bonds would solve the ongoing crisis, nor that fiscally-strong countries like Germany, Finland and the Netherlands would take on the debt of other member countries.



Eurozone PMI showed that private-sector activity across the 17-nation zone ground to a halt in July, with the composite purchasing managers index for the region falling more than expected to a 23-month low of 50.8. Economists had forecast a fall to 52.7. (A reading of more than 50 indicates expanding activity, while a figure of less than 50 signals contraction). In Germany, second quarter GDP growth slowed dramatically to 0.1% from 1.3% the prior quarter; 2011 growth expectations fell to around 3%. In France, the government announced a number of budget saving measures, cutting expenditures and increasing revenue to make up for slower economic growth to help meet its budget deficit forecast for this year of 5.7% of gross domestic product and next year's target of 4.6% of GDP. France's 2% growth forecast for 2011 is also expected to be cut.

In Japan, the government proposed a number of measures to soften the damage to its export-driven economy from the soaring yen. The government pledged to "take decisive steps when necessary" to deal with "excessive moves in the currency market." In late August, the dollar fell to as low as 75.94 yen, according to FactSet Research, surpassing the previous post World War II record of 76.25 set after the earthquake in March. Post-earthquake business sentiment continues to improve with the closely watched Tankan survey of large manufacturers moving up to +2 from -9 during the quarter. A positive number in the Tankan's main index indicates more firms are positive about conditions than are negative. Results for medium- and small-sized manufacturers remained in negative territory for the period, at -3 and -11, respectively.

China, the stalwart endowed with the task of pulling the globe out of recession, was not immune from jittery investor sentiment. In addition to a sensitive macro environment, China continues to face challenges of its own domestically. The country's inflation rate registered 6.2% year over year in August, well above the Chinese government's inflation target ceiling of 4%. The People's Bank of China (PBOC), the country's central bank, has continued its tight monetary policy, increasing rates another 25 basis points over the quarter to 6.56%. Furthermore, the country's reserve ratio requirement, or the amount of cash reserves banks must hold, was also indirectly increased as the central bank broadened the scope of reserve requirements to include customers' margin deposits. The ratio sits at an ultra-high level of 21.5%, compared to the United State's ratio of 10%. Highlighting the Chinese government's struggle with inflation, its food prices rose 13.4% year to year in August and have created an environment of civil unrest. In 2010 alone, there were 180,000 protests, mainly attributed to the rapid cost of living increases. Prices for pork, China's favorite meat, shot up 52.3% to record levels. Another way China has combated inflation is to allow its currency, the yuan, to appreciate in value relative to other currencies. Towards the end of the third quarter, the PBOC allowed the yuan to appreciate to a record against the US dollar, indicating the country's continued intention for a stronger yuan in an effort to fight inflation and remove its dependency on the dollar. The move also strengthens domestic consumption and fosters the case for the yuan to become a more global currency. For the quarter, the MSCI China Index was down -25.2%.

Latin America was affected by developed country credit concerns in the same way as most other emerging markets. The flight from risky assets created by the US debt downgrade and Eurozone debt crisis significantly impacted the Latin American region. Argentina and Brazil were hit hardest, down -31.7% and -26.9% respectively, while Peru hung strong, down a modest -4.7%. Global headlines drove much of the volatility, as Argentina released surprisingly positive 2nd quarter growth of 9.1%. Yet, this number is backwards looking and offset by stubbornly high inflation and moderating growth forecasts. Argentina's government has been frequently criticized for publishing dampened inflation numbers that do not represent reality. While Argentina's government reported July 2011 year over year inflation of 9.7%, most private sector economist estimate inflation is closer to 20%. Looking ahead, Argentina has lowered economic growth forecasts, expecting the economy to expand about 5% in 2012, down from estimated growth of 8.2% this year. Elsewhere, the Central Bank of Brazil decided to reduce interest rates by 50 basis points at its August meeting to 12.00%, emphasizing its concerns of moderating domestic growth. It cites a disinflationary bias in policy decisions as it sees continued global economic deleveraging in the coming months.

During the quarter, corporate credits in Europe and the U.S. were re-priced as European bank and sovereign credit risk surged on speculation of a Greek default, U.S. economic growth slowed, and recession risk increased. In China, fears of a hard landing have risen as news of worsening financial conditions and concerns around growing non-performing loans on the books of Chinese banks. Chinese investment grade quasi-sovereign debt underperformed over the quarter. However, growth prospects in Asia generally appear better than in most other sectors and it is believed that with a stronger economic backdrop, Asian credit will outperform most other global credit sectors in the near term.

Focus On: *Rounding out the Reals: TIPS*

Recently we've focused our attention on asset classes with real return potential – real estate and commodities. (See our 1Q2011 and 2Q2011 Market Recaps for the full discussions.) In summary, real estate and commodity funds present substantial desirable hedges against inflation, which is of particular concern to defined contribution participants whose future spending needs are valued post-inflation. However, both of these categories come with issues which DC plan participants are not accustomed to, including short-term volatility and illiquidity.

In this month's focus piece, we consider another top contender in the real assets space – Treasury Inflation Protected Securities (TIPS). Investor interest in TIPS has been strong. One need look no further than a recent auction where a 5-year TIPS issue was 2.5 times oversubscribed, with a real yield of negative 0.825%. Translated: investors are willing to give up 82.5 basis points per year in order to receive future inflation protection. With demand at all time highs since the asset class was created in 1997 we ask: should plan sponsors offer TIPS in DC plans, and is there value in paying up for an actively-managed portfolio?

The Asset Class

TIPS protect investors from inflation by offering both a nominal yield and a principal adjustment based on inflation or deflation, as measured by the Consumer Price Index for All Urban Consumers (CPI-U). The coupon rate is determined ahead of time by the Treasury Department, and yield is arrived at through investor demand at the auction. TIPS are auctioned on a monthly basis by the US treasury with 5, 10, and 30 year maturities. While 5 and 30 year TIPS are currently auctioned three times a year, the more popular 10 year issue has six yearly offerings.

In contrast to a nominal treasury bond with a fixed par value, the maturity value for a TIPS bond adjusts up or down based on CPI-U's reading of inflation or deflation. For instance, a newly issued TIPS has an initial par amount of 100. Over the next year, if inflation is 3%, the principal amount would adjust upward to 103. In addition, semiannual interest payments are adjusted for inflation since coupon rate is applied to the higher adjusted principal base.

Although the Federal Reserve seems committed to monetarily ease at any sign of deflation, it's worth noting TIPS have an extra protection called a "deflationary put." This simply means the principle adjustments have a floor of 100. During a period of prolonged deflation, the inherent put structure adds value and some shelter from the tempest of deflation.

TIPS are also used to calculate what financial publications frequently refer to as "breakeven inflation." Since nominal and real yields are provided by nominal treasury securities and TIPS respectively, the computation for inflation is difference of the two. As of September 6, 2011, nominal 10 year treasuries yielded 1.98% and 10 year TIPS yielded 0.02%. Subtracting the two, we arrive at a 10 year breakeven inflation rate of 1.96%. Interestingly, the Federal Reserve has published recent articles calling for the need of a new way to determine breakeven inflation, stating the subtraction of nominal and real treasury yields does not take into account the premium individuals are willing to pay for inflation protection.

As noted earlier, demand for TIPS has been nothing short of outstanding in the current environment of loose monetary policy. Investors are wise to consider inflation, as it effectively constitutes a continuous tax on the value of their investments. Just as a direct tax of 30% lowers an individual's buying power by 30%, cumulative inflation of 30% lowers an individual's future buying power by 30%.

CPI – A True Inflation Hedge?

Now we turn to the basis for TIPS inflation adjustments, the CPI-U. The Bureau of Labor Statistics (BLS) defines the Consumer Price Index as a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

CPI Market Basket

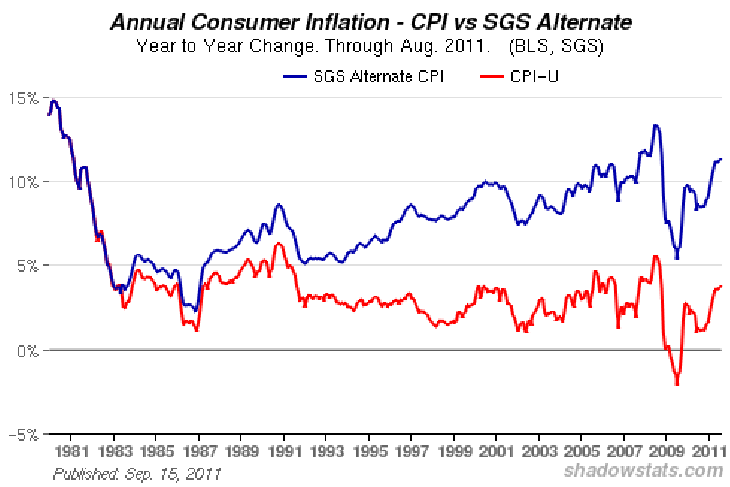
Expenditure Category	Weight
Food and beverages	14.8%
Housing	41.5%
Transportation	17.3%
Apparel	3.6%
Medical care	6.6%
Recreation	6.3%
Education and communication	6.4%
Other goods and services	3.5%

Source: U.S. Bureau of Labor Statistics

Let's take a closer look at the market basket of consumer goods and the methodology of calculating changing prices over time. Notice the heavy weighting towards housing, which is predominantly represented (23.3%) by *Owner Equivalent Rent* at one's primary residence (OER). OER is calculated by surveying individual homeowners and asking what rent levels they could get for their homes. In a weak housing environment with residential prices falling, the OER and more broadly Housing has a negative effect on the CPI reading.

CPI-U is often criticized as a measure of inflation because of the methodology used in its calculation. Over the past 30 years, the government has made many changes to the way the CPI is calculated. According to John Williams of Shadow Government Statistics, if we still used the pre-1990 calculation method, inflation readings would be significantly higher. More interesting information, statistics, and charts can be found on the website www.shadowstats.com.

Why the changes in CPI calculations? While not accounted for previously, the government argues that the application of product substitution and hedonics better represent inflation's true affect on an individual. First, substitution is when a person switches from good A to another similar good B due to a price increase in good A. For example, if steak prices double and a family decides to instead purchase ground beef, the government argues the substitution should be represented in a new basket of goods that has less steak and more ground beef. Secondly, the government uses hedonics to estimate the value of a product. For instance, the price for flat screen TVs is substantially higher than that of traditional TVs. Is this considered inflation? The government says "no" because the quality of the product has also increased. Therefore, since you are getting a bigger bang for your buck, the increased price is not considered inflation.



Although CPI-U may not be a perfect measure of inflation, it is the calculation used for TIPS principal adjustments and does represent at least some level of inflation. Debate will undeniably continue as to the 'best' measure of inflation. For now, we take note of and accept the issues of CPI's calculation, moving on to the question of TIPS fund management styles.

Active vs. Passive Management – The Levers

Like most other mutual fund categories, TIPS are broken down into passively and actively managed funds. Most passive funds seek to replicate the Barcap US TIPS Index minus a tracking error. Conversely, actively managed funds seek to outperform the index using five main levers: duration, yield curve positioning, break even inflation, on-the-run versus off-the-run security selection, and short term trading around auctions. Additionally, some active managers may take leverage or invest part of the portfolio in securities other than US TIPS.

Duration and yield curve positioning are common to all actively managed bond funds. Using strategic positioning, managers can express bullish or bearish as well as yield curve steepening or flattening market views. Through QE2, the Fed has suppressed the shorter end of the curve in an attempt to spur another credit expansion through low borrowing rates. In addition, active TIPS managers use break even inflation expectations as another curve to express their views by taking long or short positions at different maturity points based on their market expectations.

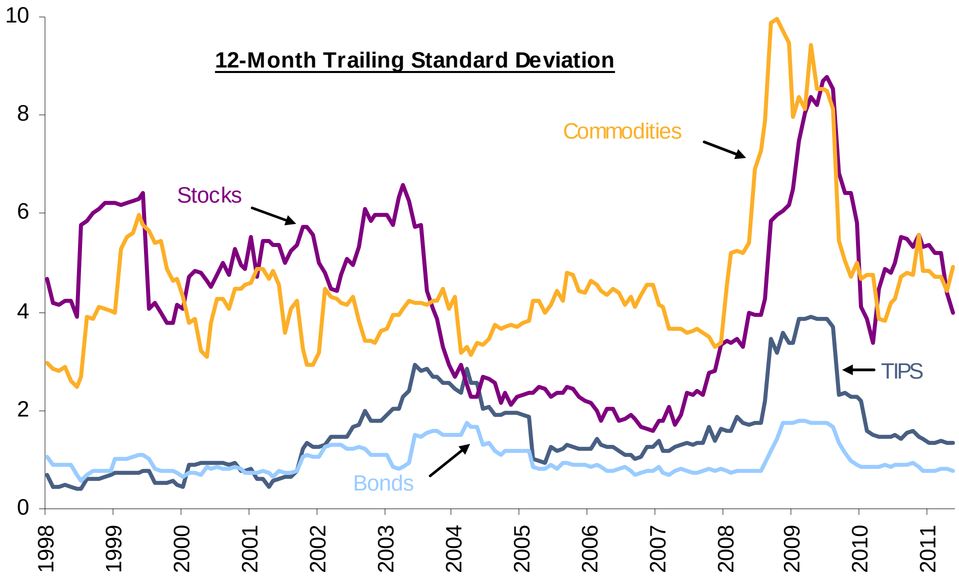
On-the-run TIPS are the most-recently auctioned issues for each maturity (5, 10, and 30 year) whereas off-the-run TIPS are issues that have been out for a longer period of time and may have a larger, inflation-adjusted principal base. With greater inflation-adjusted principal, off-the-run TIPS are further away from the deflationary put of 100. Fund managers can position their portfolios based on their expectations of inflation or deflation. In a deflationary environment, investors would sell off-the-run TIPS in favor of on-the-run TIPS that offer a closer deflationary put.

Finally, some managers will engage in short term trading opportunities around TIPS auctions. Like a high stake poker game, active managers will read and anticipate the moves of competitor funds. Specifically, TIPS index funds will follow the methodology of the Barcap TIPS Index and roll to new on-the-run securities at predetermined dates. Active short term managers strategically position their TIPS portfolio to take advantage of these forced moves by large index funds.

For this asset class, we are skeptics of active management. With limited securities to choose from, in our opinion portfolio managers have little opportunity to overcome fee drag with alpha other than through strategy-diluting, non-TIPS positions. When considering actively-managed alternatives, we err toward options that are managed close to the benchmark with very competitive fees.

Role of TIPS in Retirement Plan Investment Portfolios

DB and DC plans face unique situations regarding security selection. DB plans manage to a defined liability while DC plan participants deal with a varying future liability due to inflationary forces. Since a US defined benefit plan's liability is rarely linked to inflation through cost of living adjustments, we see no strategic role for TIPS or other inflation linked securities. Instead, focus on meeting the liability in U.S. dollar terms through Liability Driven Investing (LDI) where fixed future pension payments are matched with fixed income assets.



Conversely, DC plan participants tackle a future liability that can significantly increase due to inflation. Real assets are potentially useful as an inflation-hedging tool, but are they suitable for individual investors?

The chart reveals TIPS volatility compared with other broad asset classes. Although TIPS have generally been more volatile than nominal bonds as measured by the BarCap Aggregate Index, they offer considerably smaller swings than real equities. The combination of fixed income-like characteristics in the form of coupon payments, and an equity-like characteristic in the form of principal inflation adjustments make TIPS a unique security within "the reals".

Plan fiduciaries, we think, are served well by considering a TIPS fund for their DC plan. Participants' needs include the protection of purchasing power into retirement. A TIPS fund addresses that fundamental need directly and offers lower volatility than other real-return options. It stands alone as an inflation hedge, or forms the base for a real-return asset allocation strategy including riskier alternatives. Offering both inflation protection and low volatility, TIPS constitute a class of their own.