

Russell Research

Investment Manager Outlook

DATE

June 2010

AUTHOR

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COUNTRY

United States

SYNOPSIS

Russell's quarterly survey of managers and their views of the market.

WHAT IS RUSSELL'S INVESTMENT MANAGER OUTLOOK?

Russell's Investment Manager Outlook is intended to provide a meaningful snapshot of investment manager sentiment each quarter in order to help investors better understand the direction of the markets and key investment trends.

For the current installment of the survey, Russell collected the opinions of senior-level investment decision-makers at U.S. large- and small-cap equity investment managers, as well as U.S. fixed-income investment managers. More than 150 managers participated in this survey.

Summary of key findings and Russell’s perspective

SUMMARY OF KEY FINDINGS

- › Reflecting managers’ views of the market, 47 percent of respondents believe the market to be undervalued, a substantial rise from the 28 percent figure from the March 2010 survey. Only 9 percent of managers believe the market to be overvalued.
- › Concerns about economic issues in the Eurozone, including sovereign debt and faltering growth expectations, appear to weigh heavy on managers’ minds; 73 percent of managers identify European economic issues as a significant risk to U.S. equity performance over the next 12 months.
- › At 63 percent bullishness, *U.S. large cap growth* displaced *emerging market equities* in this survey as the asset class managers like the most. While positive sentiment towards *emerging market equities* has dipped 8 percentage points since a year ago, 61 percent of respondents remain bullish on the asset class despite global volatility.

RUSSELL’S PERSPECTIVE ON KEY FINDINGS

- › Managers see opportunity in the markets, but seem unclear about the short-term market outlook. Managers appear to be holding a “risk on, risk off” switch and swing between loving risk and hating it, changing preferences quickly. This quarter, this lack of clarity appears to be causing them to take some risk off the table. An improvement in employment, earnings, or the situation in Europe could encourage managers to turn to risk again in short order.

Key trends / June 2010 Investment Manager Survey*

Non-U.S. (developed market) equities

↓
LESS BULLISH

“The American economy and capital markets—with its scale, flexible workforce, transparency and culture of admitting mistakes and moving forward—are likely to lead out of the collapse while Europe and developing Asia continue to struggle.”

James C. Abbott
Chief Investment Officer
Eagle Asset Management

Cash & U.S. Treasuries

↑
MORE BULLISH

“The market is ignoring strong fundamentals and attractive valuations, gripped by fear of the next headline.”

Tom Weary
Portfolio Manager
Pacific Income Advisers

Consumer discretionary

↑
MORE BULLISH

“Recent developments in the U.S. are helping to support sentiment and the macro environment, including indications that unemployment has peaked and consumer confidence is neutral-to-rising.”

Renee Hoffman
Acadian Asset Management

*Compared to survey results from 3/10 Investment Manager Outlook Poll

Valuation of the U.S. equity market

SUMMARY OF FINDINGS

Nearly half of managers believe the market to be undervalued.

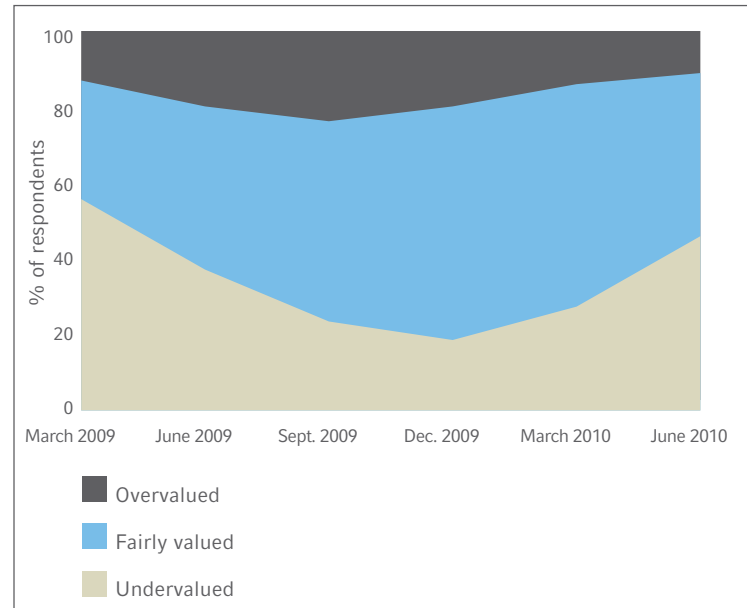
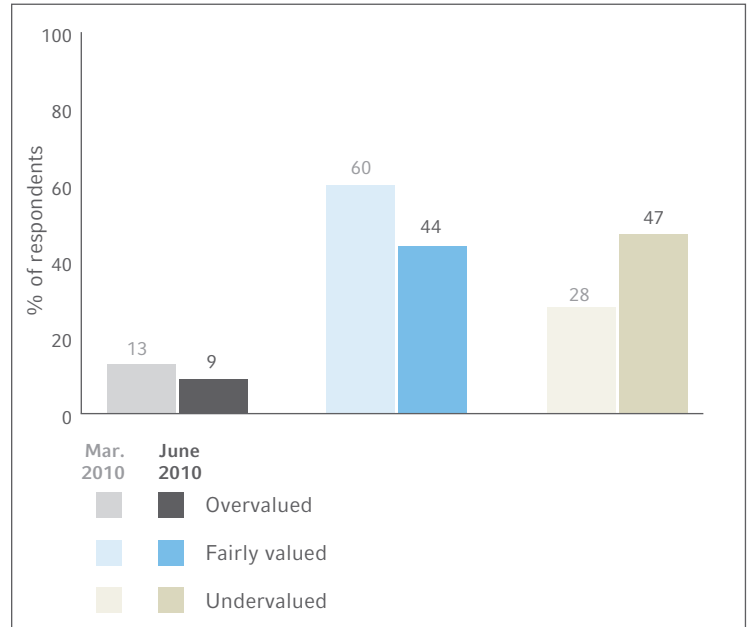
- › Forty-seven (47) percent of the managers surveyed believe the market to be undervalued, an increase of 19 percentage points from the March 2010 iteration of the survey.
- › The number of managers believing the markets to be overvalued continued to decline, from 13 percent in the last survey to 9 percent this quarter.

RUSSELL'S PERSPECTIVE

- › Managers believe the market is undervalued and see opportunity in the current valuation levels, but are still on heightened alert for the downside of risk.

Russell's Investment Manager Outlook

Which of these general valuation conditions best describes the current U.S. equity market?



Note: Numbers may not add to 100 percent due to rounding.

Expectations by asset class

SUMMARY OF FINDINGS

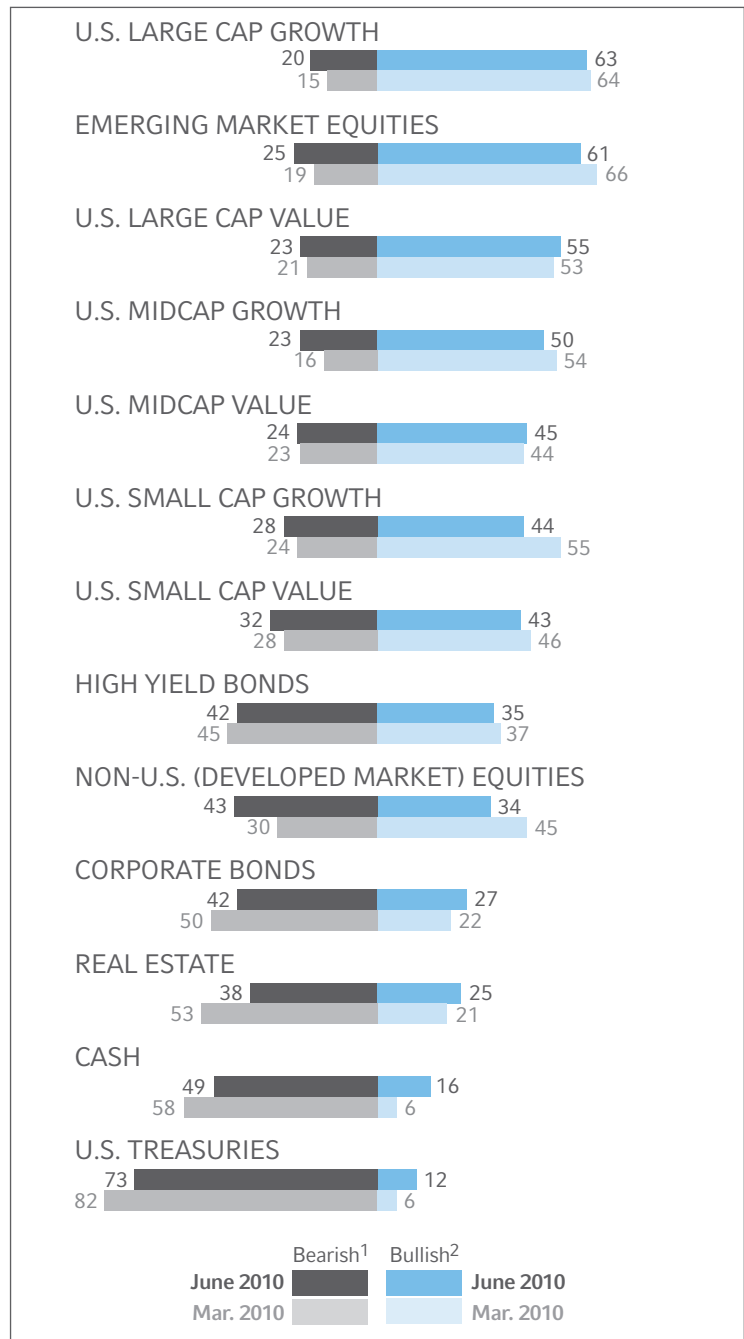
Europe concerns stifle bullishness for non-U.S. (developed market) equities.

- › Manager bullishness for *non-U.S. (developed market) equities* fell 11 percentage points from the last survey to 34 percent, reflecting managers' concerns around the impact of economic issues in Europe.
- › *U.S. large cap growth* took over the most-favored asset class position with 63 percent bullishness. While *emerging market equities* fell to the second most-favored position, 61 percent of respondents remain bullish on the asset class despite global volatility.
- › Bullishness for *cash* rose 10 percentage points from the March 2010 all-time survey low to 16 percent, and *U.S. Treasuries* also saw a 6 point increase from the last survey to 12 percent.

RUSSELL'S PERSPECTIVE

- › Managers are showing more confidence in the U.S. market this quarter, yet they still see reasons to be worried about risk, which is causing managers to be more bullish about defensive, risk-minded areas of the market.

Manager expectations by asset class



Note:

¹ Bearish = percent of managers responding with 1–3 on a scale of 1–7.

² Bullish = percent of managers responding with 5–7 on a scale of 1–7.

Scores for neutral (4) are not included.

Expectations by sector

SUMMARY OF FINDINGS

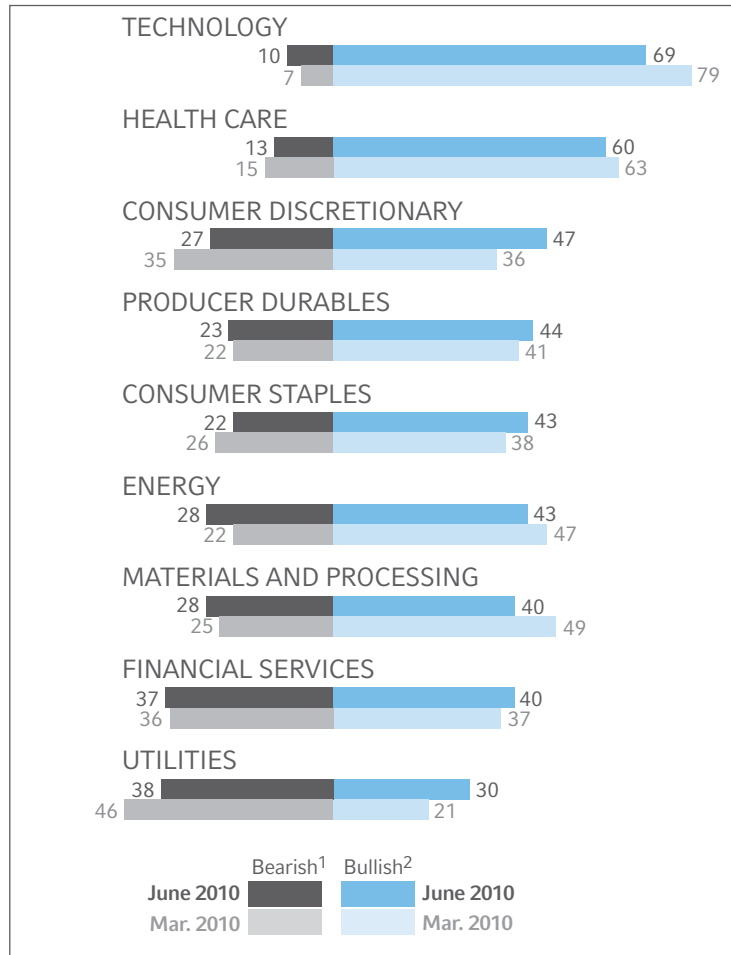
Sector preferences reinforce technology's stronghold.

- › *Technology* continued its long run as the most-favored sector, although manager bullishness for the sector declined 10 percentage points from March 2010 to 69 percent.
- › *Consumer staples* (43 percent), *financial services* (40 percent) and *utilities* (30 percent) comprise three of the four sectors that the managers like the least in this iteration of the survey. However, managers did indicate an increase in positive sentiment to each of these sectors.
- › The *materials and processing* sector also saw a sizable drop in bullishness to 40 percent, a decrease of 9 percentage points from the last survey.

RUSSELL'S PERSPECTIVE

- › Managers' sector preferences echo their fears amidst global volatility. Despite being among the four least-favored sectors, the traditionally "defensive" *consumer staples* and *utilities* sectors did see a 5 percentage point and 9 percentage point respective increase from the March 2010 survey, underscoring managers' sensitivity to risk.

Manager expectations by sector



Note:

¹ Bearish = percent of managers responding with 1–3 on a scale of 1–7.

² Bullish = percent of managers responding with 5–7 on a scale of 1–7.

Scores for neutral (4) are not included.

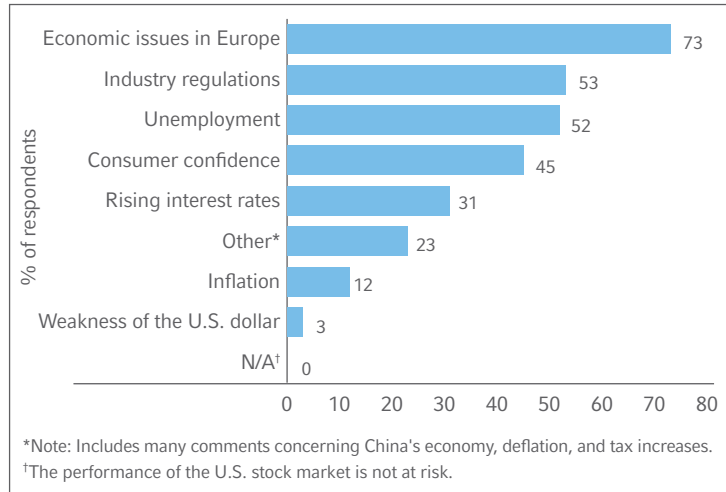
Manager Q&A: quarterly topic

Question:

Which economic or market issue poses a significant risk to performance of U.S. stocks over the next 12 months?

SUMMARY OF FINDINGS

- › Seventy-three (73) percent of managers named economic issues in Europe as an issue posing a significant risk to performance of U.S. stocks over the next 12 months.
- › More than half of respondents also pointed to industry regulations (53 percent) and unemployment (52 percent) as primary concerns for U.S. equity performance.
- › Among managers' lowest-priority concerns were inflation (12 percent) and the weakness of the U.S. dollar (3 percent).



Note: Numbers may not add to 100 percent due to rounding.

RUSSELL'S PERSPECTIVE

- › Concerns about Europe are top-of-mind for managers now, yet Russell views continued high unemployment as a key market risk because high unemployment tends to stifle consumer confidence and spending.

Asset class and sector performance

Index performance for the period ending May 31, 2010.

Index	Asset class	Latest month	Ytd	Annualized total returns (%)			
				One year	Three year	Five year	Ten year
Russell 1000® Index	Large Cap	-7.9	-0.9	22.3	-8.4	0.7	-0.4
Russell 1000® Growth Index	Large Cap Growth	-7.6	-2.3	21.6	-5.6	1.4	-3.9
Russell 1000® Value Index	Large Cap Value	-8.2	0.5	23.0	-11.3	-0.3	2.5
Russell Midcap® Index	Mid Cap	-7.4	4.5	33.9	-6.9	3.1	5.2
Russell Midcap® Growth Index	Mid Cap Growth	-6.9	3.3	30.1	-6.0	3.1	-0.3
Russell Midcap® Value Index	Mid Cap Value	-7.8	5.6	37.6	-8.4	2.7	7.8
Russell 2000® Index	Small Cap	-7.6	6.3	33.6	-6.6	2.8	4.7
Russell 2000® Growth Index	Small Cap Growth	-6.6	4.7	30.5	-5.6	3.2	0.2
Russell 2000® Value Index	Small Cap Value	-8.4	7.8	36.6	-7.8	2.2	8.8
Russell 3000® Index	Broad Cap	-7.9	-0.3	23.2	-8.2	0.8	0.0
Russell Developed ex-U.S.	Non-US Equities	-11.0	-10.1	11.8	-11.2	2.8	2.5
Russell Emerging Markets	Emerging Markets	-9.7	-5.3	24.4	-1.6	13.1	9.6
Barclays Capital U.S. Treasury Bond	U.S. Treasuries	1.7	3.9	4.5	7.1	5.1	6.2
Barclays Capital U.S. Aggregate Bond	Corporate Bonds	0.8	3.7	8.4	6.9	5.3	6.5
Barclays Capital U.S. Corp. High-Yield Bond	High-Yield Bonds	-3.6	3.2	28.8	5.5	7.3	7.4
FTSE NAREIT U.S. Real Estate	Real Estate	-5.6	8.8	46.0	-15.7	-4.2	3.7
Citigroup 3-Month T-Bill	Cash	0.0	0.0	0.1	1.5	2.7	2.6

Index	Sector	Latest month	Ytd	One year	Three year	Five year	Ten year
Russell 3000® Index	Consumer Discretionary	-7.1	8.3	40.0	-5.0	1.3	0.6
	Consumer Staples	-4.6	0.0	18.6	1.5	6.2	7.8
	Energy	-11.6	-6.6	4.3	-7.7	5.3	6.4
	Financial Services	-9.0	3.3	23.9	-20.6	-7.3	-0.1
	Health Care	-6.8	-5.1	16.8	-4.3	1.3	1.5
	Material Processing	-8.9	-2.1	24.2	-9.4	3.6	6.1
	Producer Durables	-9.0	5.8	33.6	-8.7	0.1	0.7
	Technology	-7.4	-3.5	30.6	-1.1	4.6	-6.1
	Utilities	-5.3	-6.4	10.1	-10.7	1.7	-1.7

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Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment.

Russell equity sector returns are calculated by categorizing the securities that make up the Russell 3000® Index into discrete industry groupings and then computing the net return for each grouping.

Methodology and background about Russell

Methodology

Russell Investments conducted the Investment Manager Outlook survey between May 25th and June 3rd, 2010. The survey was sent to a group of U.S. large and small cap equity and U.S. fixed income investment managers, researched by Russell. Having a financial relationship with Russell was not part of the criteria for being included in the survey. In total, 157 survey responses were received representing 117 investment management firms. On average, the companies that responded individually manage an estimated \$127 billion* in assets. The large majority of individual respondents to Investment Manager Outlook have senior-level investment decision responsibilities and are often portfolio managers or chief investment officers (CIOs). Other participants include investment strategists, research analysts, and others. The manager research that Russell conducts for investment purposes is independent of Investment Manager Outlook, and responses to the survey are voluntary.

About Russell Investments

Russell Investments provides asset management and investment services to institutional and individual investors. We offer mutual funds, indexes, alternative investments and implementation services such as transition management and trade execution. Russell has offices in most major financial centers and serve clients in more than 40 countries.

Russell is one of the world's most influential and trusted providers of investment services. A pioneer in multi-manager investing and the creator of the Russell Indexes, Russell manages approximately US\$179 billion in assets as of March 31, 2010. We work with more than 2,900 clients, ranging from small and mid-sized organizations to many of the world's largest and most sophisticated investors, responsible for hundreds of billions of dollars. Our innovative investment approach is made available to individuals through a network of strategic distribution alliances and independent investment advisors. Our clients include banks and insurance companies, investment advisors, defined benefit and defined contribution plans, endowments, foundations and sovereign wealth funds.

We seek to understand capital markets and identify investment managers we believe have exceptional capabilities. To achieve these goals, our analysts hold more than 5,000 research meetings each year with investment managers around the world. The cumulative knowledge we gain from this in-depth research serves as the foundation for all of our products and services.

Founded in 1936, Russell is headquartered in Tacoma, Washington. Russell is a subsidiary of Northwestern Mutual, and the company's executive management has a minority equity participation in the firm. More information about Russell's investment products and services is available at www.russell.com.

* Estimated assets under management is based on a majority of survey respondents. Data reported as of June 18, 2010 from Standard & Poor's.

Asset class definitions

Large Cap

Large capitalization (large cap) investments involve stocks of companies generally having a market capitalization between \$10 and \$200 billion. The value of securities will rise and fall in response to the activities of the company that issued them, general market conditions and/or economic conditions.

Small Cap

Small capitalization (small cap) investments involve stocks of companies with smaller levels of market capitalization (generally less than \$2 billion) than larger company stocks (large cap). Small cap investments are subject to considerable price fluctuations and are more volatile than large company stocks. Investors should consider the additional risks involved in small cap investments.

Mid Cap

Middle capitalization (middle cap) investments involve stocks of companies generally having a market capitalization between \$2 billion and \$10 billion and considered more volatile than large cap companies. Mid cap investments are often considered to offer more growth potential than larger caps (but less than small caps) and less risk than small caps (but more than large caps).

Growth

Growth investments focus on stocks of companies whose earnings/profitability are accelerating in the short term or have grown consistently over the long term. Such investments may provide minimal dividends which could otherwise cushion stock prices in a market decline. Stock value may rise and fall significantly based, in part, on investors' perceptions of the company, rather than on fundamental analysis of the stocks. Investors should carefully consider the additional risks involved in growth investments.

Value

Value investments focus on stocks of income-producing companies whose price is low relative to one or more valuation factors, such as earnings or book value. Such investments are subject to risks that their intrinsic values may never be realized by the market, or, such stock may turn out not to have been undervalued. Investors should carefully consider the additional risks involved in value investments.

Bonds

Bond investors should carefully consider risks such as interest rate, credit, repurchase and reverse repurchase transaction risks. Greater risk, such as increased volatility, limited liquidity, prepayment, non-payment and increased default risk, is inherent in portfolios that invest in high yield ("junk") bonds or mortgage-backed securities, especially mortgage-backed securities with exposure to subprime mortgages.

Real Estate

Specific sector investing such as real estate can be subject to different and greater risks than more diversified investments. Declines in the value of real estate, economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments. Investments in non-U.S. markets can involve risks of currency fluctuation, political and economic instability, different accounting standards and foreign taxation.

Emerging Markets

Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and to political systems which can be expected to have less stability than those of more developed countries. Securities may be less liquid and more volatile than U.S. and longer established non-U.S. markets.

Non-U.S. (Developed Market) Markets

Non-U.S. markets entail different risks than those typically associated with U.S. markets, including currency fluctuations, political and economic instability, accounting changes and foreign taxation. Securities may be less liquid and more volatile.

U.S. Treasuries

Treasuries are debt obligations of the U.S. Treasury. Principal and interest payments are guaranteed by the U.S. Government.

Cash

Short-term investments typically involve instruments such as 90-day government Treasury Bills, high quality short-term notes and commercial paper issued by major financial institutions and blue chip companies. While highly liquid, cash generally has not kept pace with inflation.

Sector definitions

Technology

Contains companies that serve the information technology, telecommunications technology and electronics industries. Companies developing and marketing internet software and/or providing internet services including online databases and interactive services, web address registration services, database construction and Web design services are found here. Also includes companies involved in entertainment software, including video games, and companies that produce machinery for making high-end electronics. E-commerce companies are not included in the technology sector.

Health Care

Consists of companies that manufacture health care equipment and supplies or provide health care-related services such as lab services, in-home medical care and health care facilities. Also included are companies involved in research, development and production of pharmaceuticals and biotechnology.

Consumer Discretionary

Contains companies that manufacture products and provide discretionary services directly to the consumer. Household durable goods, apparel, home electronic devices, leisure equipment and automotive are included. The services segment includes hotels, restaurants and other leisure facilities, media production services, consumer retailing and services, wholesalers, and importers/exporters. E-commerce companies are also included in the consumer discretionary sector.

Consumer Staples

Consists of companies that provide products directly to the consumer that are typically considered nondiscretionary items on the basis of consumer purchasing habits. It includes manufacturers and distributors of food, beverages and tobacco as well as producers of non-durable household goods. It also includes food- and drug-retailing companies as well as agriculture, fishing, ranching and milling companies. Consumer Staples is said to be a less dynamic Sector and to remain static, while the rest tend to be more cyclical in nature.

Energy

Contains of energy-related businesses, such as oil companies involved in the exploration, production, servicing, drilling and refining processes, and companies primarily involved in the production and mining of coal and other fuels used in the generation of consumable energy. Gas extraction, distribution and pipeline companies classify into this Sector. The alternative energy Sub-Sector includes companies engaged in any aspect of the solar power, wind power, hydro power and biofuel industries.

Materials and Processing

Consists of companies that extract or process raw materials, and companies that manufacture chemicals, construction materials, glass, paper, plastic, forest products and related packaging products. Metals and minerals miners, metal alloy producers, and metal fabricators are included.

Producer Durables

Contains companies whose businesses are dominated by any of the following activities: Manufacturing and distribution of capital goods, including aerospace, industrial machinery and electrical equipment. Also included are companies that supply transportation services, such as shipping, trucking, railroads and railroad equipment. Other areas include office equipment and services to businesses. Commercial services are also included in this group as an input to the manufacturing and distribution of capital goods.

Financial Services

Consists of companies involved in banking, mortgage finance, consumer finance, specialized finance, investment banking and brokerage, asset management and custody, corporate lending, insurance, financial investments and real estate, including REITS.

Utilities

Contains companies in industries heavily affected by government regulation, such as electric, gas and water utilities. Also includes companies providing telephone services, as well as companies that operate as independent producers or distributors of power.

Index definitions

Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, representative of the U.S. large capitalization securities market.

Russell 1000® Growth Index measures the performance of those Russell 1000® Index securities with higher price-to-book ratios and higher forecasted growth values, representative of U.S. securities exhibiting growth characteristics.

Russell 1000® Value Index measures the performance of those Russell 1000® Index securities with lower price-to-book ratios and lower forecasted growth values, representative of U.S. securities exhibiting value characteristics.

Russell Midcap® Index measures the performance of the mid-cap segment of the U.S. equity universe and is a subset of the Russell 1000® Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership.

Russell Midcap® Growth Index measures the performance of the mid-cap growth segment of the U.S. equity universe. It includes those Russell Midcap Index companies with higher price-to-book ratios and higher forecasted growth values.

Russell Midcap® Value Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, representative of the U.S. small capitalization securities market.

Russell 2000® Growth Index measures the performance of those Russell 2000® Index securities with higher price-to-book ratios and higher forecasted growth values, representative of U.S. securities exhibiting growth characteristics.

Russell 2000® Value Index measures the performance of those Russell 2000® Index securities with lower price-to-book ratios and lower forecasted growth values, representative of U.S. securities exhibiting value characteristics.

Russell 2500™ Index measures the performance of the 2,500 smallest companies in the Russell 3000® Index, representative of the U.S. small to medium-small capitalization securities market.

Russell 3000® Index measures the performance of the 3,000 largest U.S. securities based on total market capitalization.

Russell Developed ex-U.S. Index measures the performance of the largest investable securities in developed countries globally, based on market capitalization, excluding securities classified in the United States. The index covers 46% of the investable global market.

Russell Emerging Markets Index measures the performance of emerging market securities in the Russell Global Index, based on market capitalization. The index includes approximately 2,800 securities and covers 20% of the investable global market.

Barclays Capital U.S. Treasury Bond Index covers public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Barclays Capital U.S. Aggregate Bond Index
An index, with income reinvested, generally representative of intermediate-term government bonds, investment grade corporate debt securities, and mortgage-backed securities.

Barclays Capital U.S. Corporate High-Yield Bond Index covers the universe of fixed rate, non-investment grade debt. Pay-in-kind (PIK) bonds, Eurobonds, and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, and 144-As are also included. The index includes both corporate and non-corporate sectors.

FTSE NAREIT Equity REITs Index is an index, with dividends reinvested, representative of tax-qualified REITs listed on the New York Stock Exchange, American Stock Exchange and the NASDAQ National Market System.

Citigroup 3-Month Treasury Bills is an index, with income reinvested, generally representative of the average yield of three-month Treasury-Bills.

General disclosures

Performance quoted represents past performance and should not be viewed as a representation of future results.

¹ We define bearish as...on balance, an organization's or individual's predominant view based on a belief that general market conditions for the period in question will be negative, and relative valuations of securities in general will trend downward. This view should not be considered investment advice nor does it apply to any specific security.

² We define bullish as...on balance, an organization's or individual's predominant view based on a belief that overall market conditions for the period in question will be positive, and relative valuations of securities in general will trend upward. This view should not be considered investment advice nor does it apply to any specific security.

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