

Russell Research

Investment Manager Outlook

DATE

September 2009

AUTHOR

Mark Eibel, Director, Investment Division, Client Investment Strategies, North America

COUNTRY

United States

SYNOPSIS

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

WHAT IS RUSSELL'S INVESTMENT MANAGER OUTLOOK?

Russell, a global leader in manager research, surveys investment managers quarterly on their opinions about U.S. equity markets, sectors/styles to watch, and trends that could impact investment strategy. The results are published in the Investment Manager Outlook. 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 200 investment managers participated in this survey and their voices are represented in the results.

WHY IS IT IMPORTANT?

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

Summary of key findings and Russell's perspective

SUMMARY OF FINDINGS

- › **Market is no longer undervalued.** More than half the surveyed investment managers, 54%, believe the U.S. equity market is now fairly valued. The remaining managers are split nearly evenly between believing the market to be undervalued or overvalued, 24% and 22% respectively.
- › **Managers rethink bonds.** *Corporate bonds* dropped to 44% bullish from 66% in the June survey. *High yield bonds* dropped from 66% bullish to 52% bullish. These two asset classes experienced some of the largest declines in this survey, yet still remain at relatively high levels of bullishness over the history of the IMO.
- › **A comeback for health care.** *Technology* scored the highest bullish rating at 78% followed by *health care* which jumped to 56% from a 44% bullish rating in last quarter's survey.
- › **Managers go global.** The managers gave *emerging market equities* the highest bullish rating (67%) followed by *non-U.S. (developed market) equities* (63%).
- › **Managers say no to oil and energy.** *Integrated oils* and *other energy* bullishness fell a combined 29 percentage points since last quarter's survey.

RUSSELL'S PERSPECTIVE

- › **Managers "wait and see."** Having checked their bullishness from last quarter, managers are waiting for clarity on the direction of the economy in 2010.
- › **No more low hanging fruit in bond space.** The recent payoff in fixed income, particularly in corporate bonds, has caused managers to be less bullish on corporates, but they still see opportunity in fixed income at the broad level.

Key trends / September 2009 Investment Manager Survey*



*Compared to survey results from 06/09 Investment Manager Outlook Poll

- › **Politics plays a role in health care.** The managers appear to like the message coming out of Washington D.C. that any final legislation will be cheaper to implement and less comprehensive than the original reform proposal.
- › **International offers better values.** Managers made a valuation call, deciding that international equities, as opposed to U.S. equities, represents the better investment this quarter. They continue to like emerging markets as a long-term investment.
- › **Energy is an economically sensitive sector.** When businesses and consumers believe with conviction that the economy is back, the demand for oil, gas, and other energy will grow and the need for materials will rise.

Valuation of the U.S. equity market

SUMMARY OF FINDINGS

Managers less bullish

- › The percentage of managers surveyed who believe the U.S equity market to be undervalued dropped to 24% from last quarter’s survey level of 38%.
- › Fifty-four percent of managers surveyed believe the U.S. equity market to be fairly valued, compared to 44% in the June survey.

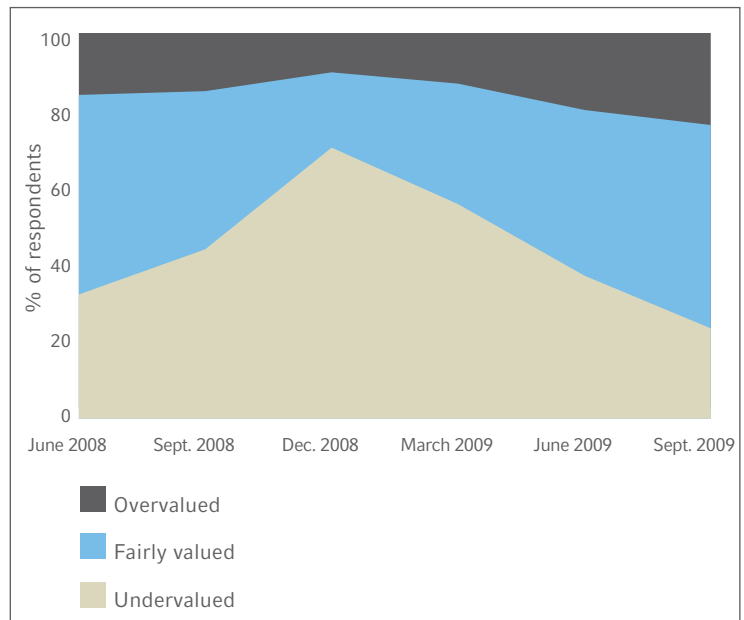
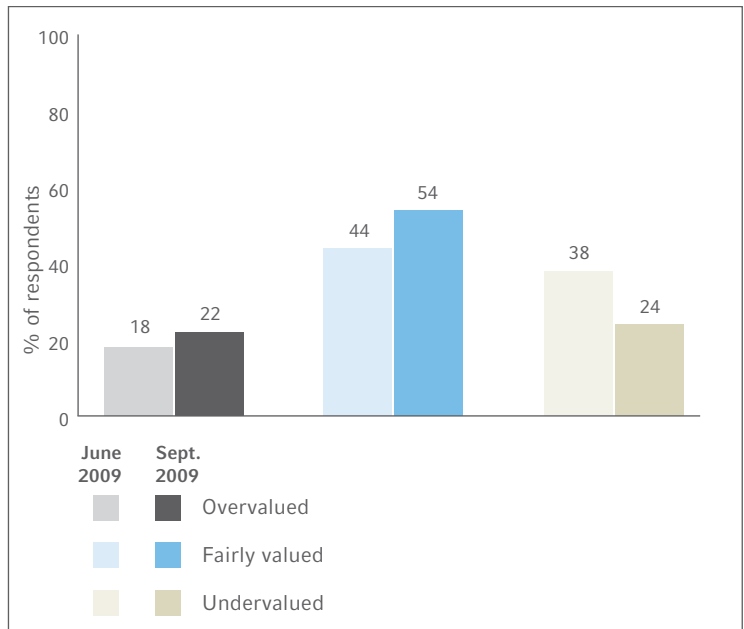
RUSSELL’S PERSPECTIVE

Unemployment is the wild card.

- › Russell believes these drops of the undervalued statistic are due to the significant market rally since March 2009. Managers have changed their assessment of the U.S. equity market because they feel uncertain about the unemployment picture, which is a critical component to any improvement in the economy. However, Russell currently doesn’t expect employment to resume consistent, triple-digit gains until 2011, indicating a slow recovery.

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

Bonds take deep dives.

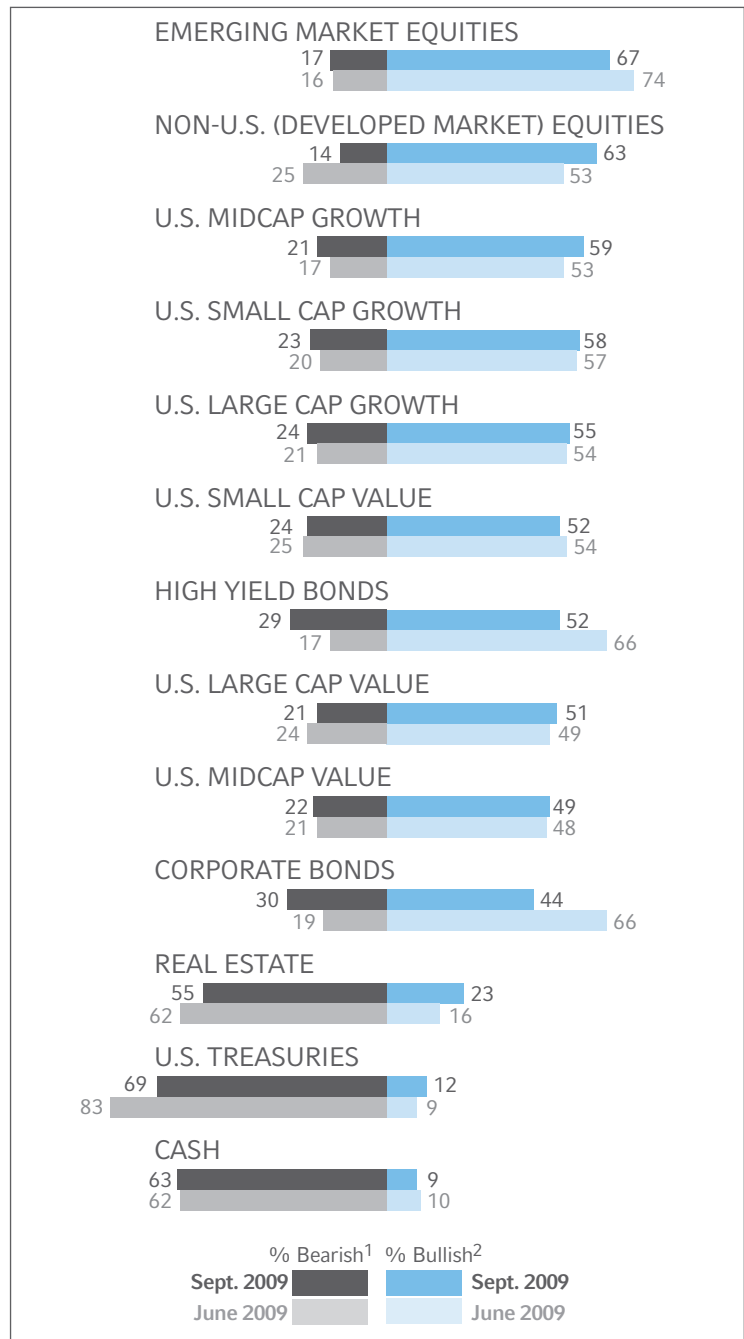
- › Bullishness on *corporate bonds* dropped 22 percentage points from last quarter's survey. Similarly, the positive sentiment for *high yield bonds* fell from 66 percent to 52 percent.
- › Managers were the most bullish on *emerging market equities*, and *non-U.S. (developed markets) equities* and the most bearish on *real estate* (55%), *cash* (63%), and *U.S. Treasuries* (69%), although managers dislike Treasuries a little less than they did in the June survey when the asset class received an 83% bearish rating.
- › Overall, managers preferred growth over value stocks in this quarter's IMO survey.

RUSSELL'S PERSPECTIVE

Still opportunities in fixed income.

Russell is not surprised that bullishness on bonds dropped considerably in this quarter's survey. At the end of 2008 and at the beginning of this year, the managers viewed fixed income as a tremendous opportunity that was offering yields at historic levels. However, despite the decline in manager bullishness in this quarter's survey, Russell believes that there are still ripe opportunities for fixed income this year.

Manager expectations by asset class (As of September 2009)



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

Several sectors decline in manager bullishness.

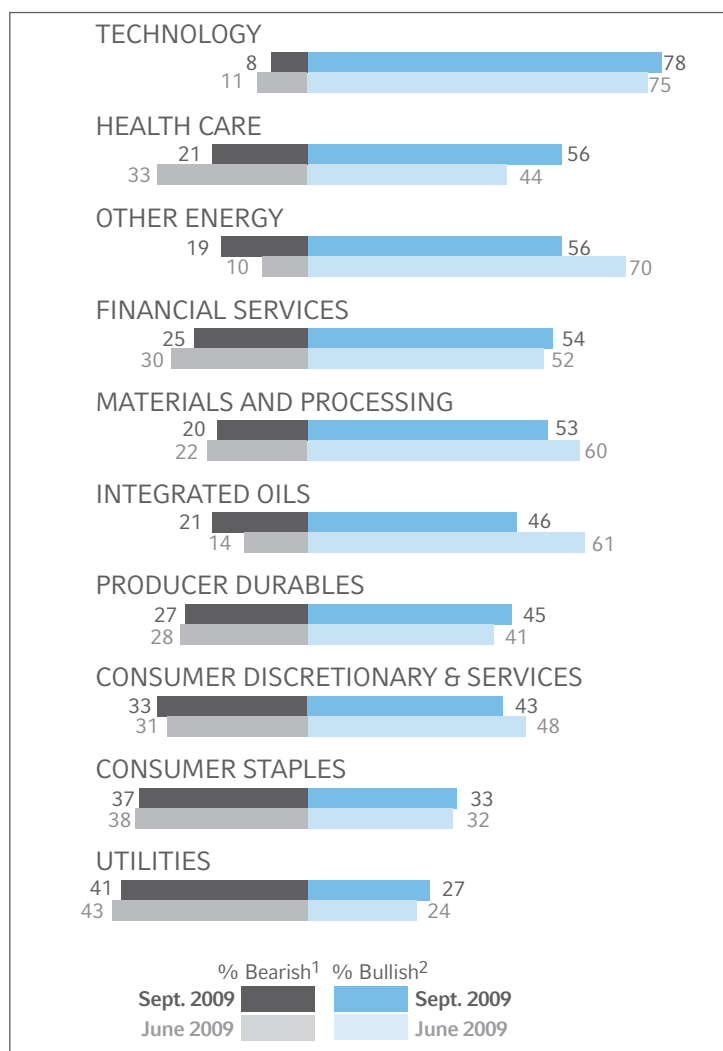
- › The three sectors that fell the most in this quarter’s survey were *materials and processing*—which declined in bullishness from 60 percent to 53 percent—and two sub sectors of energy; *integrated oils*, which declined from 61 percent to 46 percent bullishness; and *other energy*, which fell from 70 percent to 56 percent bullishness.
- › Managers gave *health care* the second highest bullish rating. It scored 12 percentage points higher in bullishness in this quarter’s survey compared to the June survey, although other defensive sectors did not receive high bullish ratings such as *consumer staples* (33%) and *utilities* (27%).
- › *Technology* received a bullish rating of 78%, an all-time IMO high for this sector.

RUSSELL’S PERSPECTIVE

Bullishness on health care is not a “run” to defensive stocks.

- › Managers appear to like the health care message coming out of Washington D.C., causing a return to health care stocks but notably not to other defensive sectors.
- › Managers like technology because the investment plays in both good economic times and bad, and it’s an area where the U.S. has a big competitive advantage.
- › Energy is an economically sensitive sector, and the managers are waiting before throwing their support too strongly behind it.

Manager expectations by sector (As of September 2009)



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: By the end of 2010, what do you expect the year-over-year rate of consumer price inflation to be?

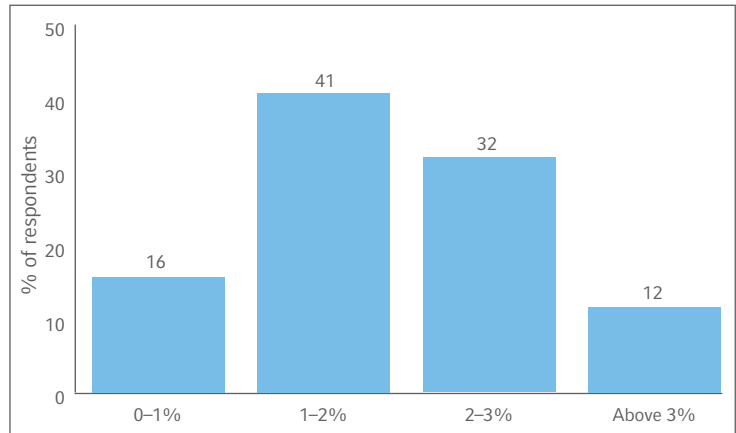
SUMMARY OF FINDINGS

- › More than 70 percent of the surveyed managers believe the year-over-year rate of consumer price inflation will be between 1 and 3 percent at the end of 2010.
- › Of the remaining managers, there were more who believe the CPI will be below 1 percent at the end of 2010 than who believe it will be above 3 percent (16% versus 12%, respectively).

RUSSELL'S PERSPECTIVE

Short-term inflation is not a concern.

- › The managers' consensus appears to be that we are in the midst of a post-recession recovery that will not measure up to historical standards, even though we all know this has been no ordinary recession. For this reason, the managers do not appear to be fearful about short-term inflation.
- › If the managers expected the economy to rapidly improve, positioning businesses to raise prices in a meaningful way, the managers would be far more worried about inflation.
- › Russell agrees with the managers' perspective that inflation is not a worry, even though we are seeing typical inflationary signals, such as the increasing price of commodities and gold and the weakening of the dollar.
- › Based on its reading of several economic indicators, Russell believes the recession is now over.
- › The big questions remaining are: "Where is the economy headed in 2010?"; and "How long will full economic recovery take?"



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

Asset class and sector performance

Index performance for the period ending August 31, 2009.

Index	Asset class	Latest three months	Ytd	Annualized total returns (%)			
				One year	Three year	Five year	Ten year
Russell 1000® Index	Large Cap	11.8	16.4	-18.4	-5.6	0.9	-0.3
Russell 1000® Growth Index	Large Cap Growth	10.5	21.9	-16.8	-3.0	1.2	-3.2
Russell 1000® Value Index	Large Cap Value	13.0	10.6	-20.3	-8.4	0.4	1.8
Russell Midcap® Index	Mid Cap	14.5	25.5	-19.9	-5.3	3.4	5.1
Russell Midcap® Growth Index	Mid Cap Growth	11.7	29.7	-20.2	-4.2	3.4	1.5
Russell Midcap® Value Index	Mid Cap Value	17.3	20.8	-20.0	-7.0	3.0	6.3
Russell 2000® Index	Small Cap	14.4	15.8	-21.3	-6.1	2.2	4.3
Russell 2000® Growth Index	Small Cap Growth	12.3	21.2	-22.0	-4.4	2.7	0.6
Russell 2000® Value Index	Small Cap Value	16.5	10.8	-20.7	-7.9	1.6	7.3
Russell 3000® Index	Broad Cap	12.0	16.3	-18.6	-5.7	1.0	0.1
Russell Developed ex-U.S.	Non-US Equities	14.1	28.4	-14.6	-3.7	7.0	3.6
Russell Emerging Markets	Emerging Markets	9.7	52.9	-11.0	4.5	16.0	8.4
Barclays Capital U.S. Treasury Bond	U.S. Treasuries	1.1	-3.0	6.1	6.9	5.1	6.2
Barclays Capital U.S. Aggregate Bond	Corporate Bonds	3.2	4.6	7.9	6.3	5.0	6.3
Barclays Capital U.S. Corp. High-Yield Bond	High-Yield Bonds	11.2	41.0	6.5	3.9	5.3	5.6
FTSE NAREIT U.S. Real Estate	Real Estate	20.6	10.0	-32.8	-13.7	0.1	8.4
Citigroup 3-Month T-Bill	Cash	0.0	0.1	0.5	2.8	3.0	3.0

Index	Sector	Latest three months	Ytd	One year	Three year	Five year	Ten year
	Consumer Staples	8.7	7.9	-7.7	1.7	6.1	5.3
	Energy	-3.4	24.7	-42.0	-7.3	9.6	6.0
	Financial Services	18.8	16.3	-24.7	-17.9	-7.2	0.2
	Health Care	11.9	10.3	-10.5	-1.9	2.2	1.9
	Material Processing	12.8	30.9	-23.9	-0.3	5.7	5.2
	Producer Durables	12.8	14.5	-26.0	-5.8	2.2	2.9
	Technology	16.7	41.5	-8.7	1.4	4.8	-4.6
	Utilities	7.6	1.6	-17.4	-4.3	3.9	-2.3

Russell Investments is the owner of the trademarks, service marks, and copyrights related to its indexes.

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 August 27 and September 4, 2009. 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, 217 survey responses were received representing 157 investment management firms. On average, the companies that responded individually manage an estimated \$102 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\$152 billion in assets as of June 30, 2009. 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 September 21, 2009 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.

Russell Investment Manager Outlook is a product of Russell Investments, produced independently of Russell's investment and manager research services.

The information contained herein has been obtained from sources that we believe to be reliable, but its accuracy and completeness cannot be guaranteed. The information, analysis, and opinions expressed herein result from surveys of persons outside Russell Investments and may not represent the opinion of Russell Investments, its affiliates, or subsidiaries. This report is provided for general information only and is not intended to provide specific advice or recommendations for any individual or entity.

This is not an offer, solicitation, or recommendation to purchase any security or the services of any organization.

Please note, managers surveyed do not necessarily manage Russell products.

Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the equity and fixed income markets, or of any specific investment.

Russell Investment Group is a Washington, USA corporation, which operates through subsidiaries worldwide including Russell Investments, and is a subsidiary of The Northwestern Mutual Life Insurance Company.

Russell Financial Services, Inc., member FINRA, part of Russell Investments.

Copyright © Russell Investments 2009.

All rights reserved.

First used September 2009.

RFS 09-2380