

Market Review

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2011 Market Review

The year in review

The year 2011 presented investors with a host of challenges – including natural disasters in Asia, political upheaval in the Middle East and carryover from the 2010 Eurozone debt crisis. The year may be one that investors are glad to put behind them. This Market Review provides an analysis of 2011 global equity markets performance that covers regions, capitalization sizes and style components and includes comparisons to historical results. We also provide a performance analysis of the recently launched Russell Stability Indexes™, which were developed to represent what Russell has identified as the “third dimension of style”² – stability – as it is manifested in defensive and dynamic aspects of markets.

Broad market performance

2011 started out on a positive note for three of the four broad markets, represented in Figure 1 by the Russell 3000®, Russell Developed ex-U.S., Russell Emerging Markets and Russell Frontier™ indexes.³ During the first four months of the year, performance was mixed, and the divergence in market returns was pronounced. Performance began converging toward the end of April; beginning in May, markets declined in lockstep as weak economic data from the U.S. and additional bad news from the Eurozone periphery sent markets across the globe plummeting to 2011 lows.⁴ Although a strong upswing in October brought performance to 2011 highs for most markets, the year still closed strongly in the red, as displayed in Table 1. The sole exception was the U.S. market, which crept just barely into the black in December with a return for the year of 1.03%.

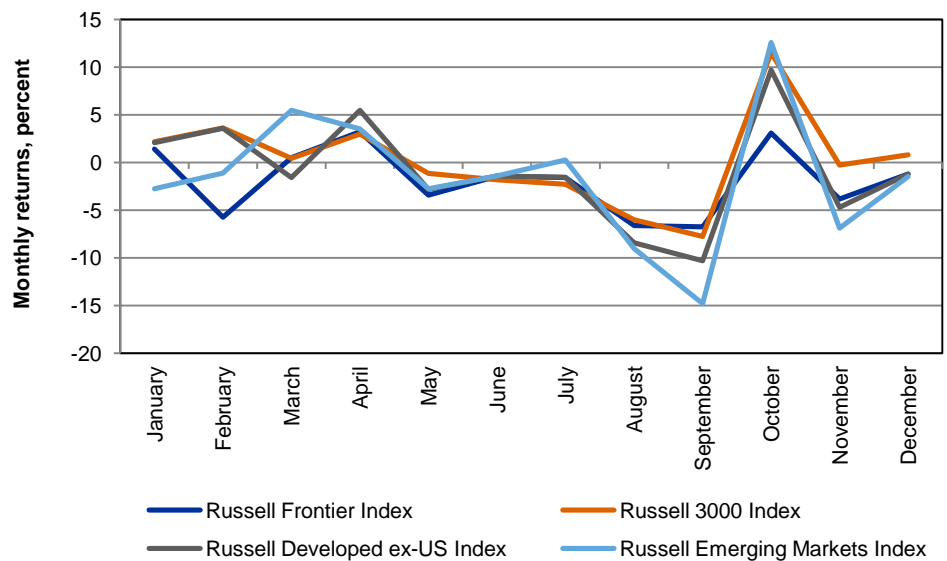
¹ The author would like to thank Mary Fjelstad, Kyla Roberts and Mark Paris for their contributions to this paper.

² For more information, see Hintz, Dave, “The Third Dimension of Style™: Introducing the Russell Stability Indexes,” Russell Research (December 2010).

³ Throughout this commentary, we utilize the Russell Indexes to represent markets, regions and styles. Consult the appendix for a complete list of all the markets covered and their Russell index proxies.

⁴ Market lows for 2011 occurred in the month of September.

Figure 1 / Monthly performance of major equity market indexes, January–December 2011



Source: Russell Indexes. Please reference the appendix for index inception dates.

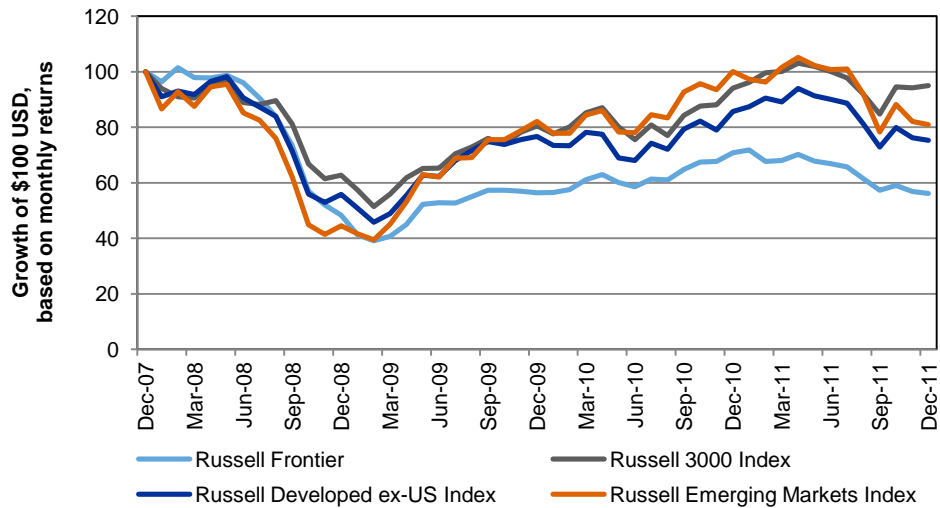
Table 1 / 2011 total return of broad market indexes

Index	2011 return (%)
Russell Developed ex-U.S. Index	-12.13
Russell 3000 Index	1.03
Russell Emerging Markets Index	-19.20
Russell Frontier	-20.74

Figure 2 takes a longer-term perspective and shows the growth of a \$100 unit for the broad markets since December 31, 2007. After the meltdown of 2008, these markets continued to experience positive, yet rocky, cumulative performance through April 2011. However, 2011 was plagued by market volatility – with mild upswings and steep downturns – as the Eurozone crisis continued to foster uncertainty around the globe.

While emerging markets reached higher performance levels than those of the other broad markets, they experienced periods of deep decline characterized by rapid deceleration. This behavior was particularly evident in the second half of 2011, with a month-to-month performance upswing of over 27 percentage points (pp) (between September and October 2011; see Figure 1) followed by aggressive sell-offs fueled by the macroeconomic events of the Eurozone debt crisis.

Figure 2 / Cumulative returns to major equity markets, December 31, 2001– December 31, 2011



Source: Russell Indexes. Please reference the appendix for index inception dates.

Last year’s 15 top-performing markets in the Russell Global Index and the Russell Frontier Index were primarily in the Europe and Asia Pacific regions, although all geographical regions were represented in this group by at least one country (see Table 2). The two top performers, Jamaica and Trinidad and Tobago, were in the Americas region. Tanzania, one of two African countries to make the top 15, ranked as the third-best performer. Ireland, one of five countries representing Europe in the top 15, came in fourth, and Qatar, the sole Middle East representative, was the fifth-best performer. Only four countries – Indonesia, the Philippines, Thailand and Malaysia, all representing the Asia Pacific region – made both the 2010 and the 2011 top 15 lists.

Note that four of the top five performers were frontier markets. Developed, emerging and frontier markets were represented in equal numbers (five each).

Table 2 / The 15 top-performing countries in the combined Russell Global and Russell Frontier indexes, ranked by 2011 returns

Country	Category	World region	2011 return (%)	2010 return (%)
Jamaica	Frontier	Americas	32.29	42.95
Trinidad and Tobago	Frontier	Americas	31.64	4.88
Tanzania	Frontier	Africa	22.41	11.71
Ireland	Developed	Europe	7.23	6.68
Qatar	Frontier	Middle East	7.18	29.87
New Zealand	Developed	Asia Pacific	4.52	13.82
Indonesia	Emerging	Asia Pacific	4.38	43.09
Philippines	Emerging	Asia Pacific	2.87	76.97
USA	Developed	Americas	1.03	16.93
Malaysia	Emerging	Asia Pacific	0.87	40.76
Gabon	Frontier	Africa	-2.00	18.30
Netherlands	Developed	Europe	-2.01	9.11
Thailand	Emerging	Asia Pacific	-4.72	59.34
United Kingdom	Developed	Europe	-4.80	9.58
Czech Republic	Emerging	Europe	-8.32	2.78

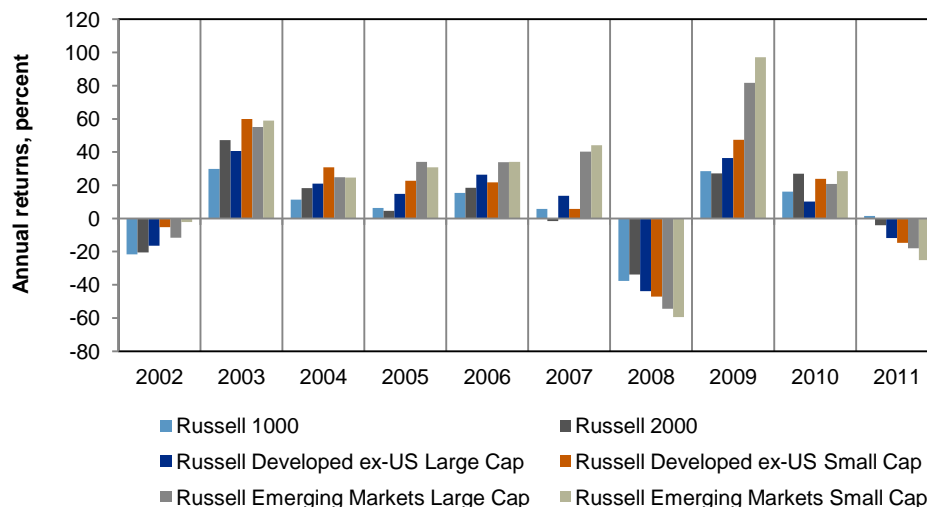
Source: Russell Indexes. Please reference the appendix for index inception dates.

The three dimensions of style: capitalization, valuation and stability

Performance of cap tiers

Global large cap stocks (as represented by the Russell Global Large Cap Index) fared better than small cap stocks (as represented by the Russell Global Small Cap Index), by 6.73pp, in 2011; the cap tiers' returns were -6.96% and -13.69%, respectively. Figure 3 displays the annual returns of the large cap and small cap segments of the broad markets. With risk aversion high, large cap companies performed better than small cap companies across all markets represented. The U.S. large cap segment, as measured by the Russell 1000 Index, outperformed the other market segments with the only positive gain, albeit a slight one, of 1.50%. The U.S. small cap segment, as measured by the Russell 2000 Index, was the second-highest performer of the group, outperforming all market segments except U.S. large cap. Contrary to recent trends, the emerging markets large cap and small cap market segments were the worst performers of 2011. This performance contrasts strongly to that of 2010, when small cap outperformed large cap and the small cap emerging markets segment outperformed all others.

Figure 3 / Calendar-year returns of cap tiers, 2002–2011

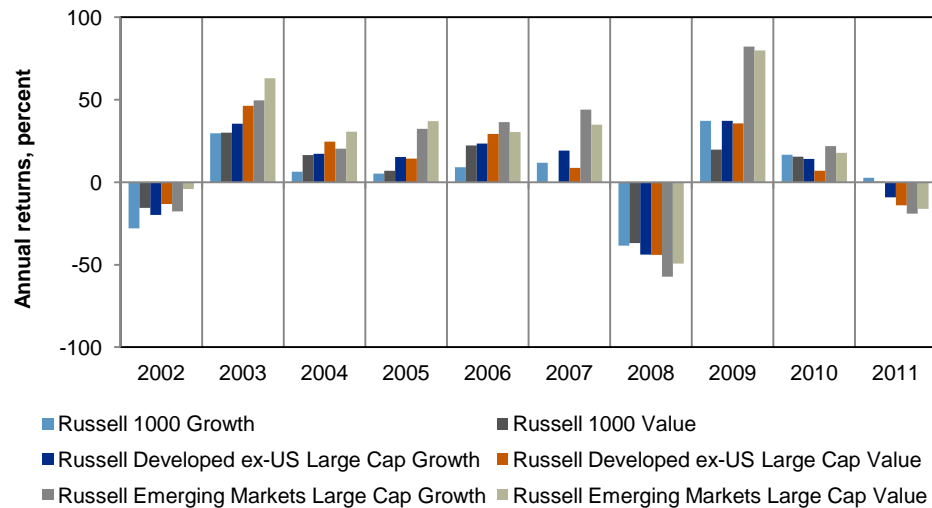


Source: Russell Indexes. Please reference the appendix for index inception dates.

Performance of valuation styles (growth and value)

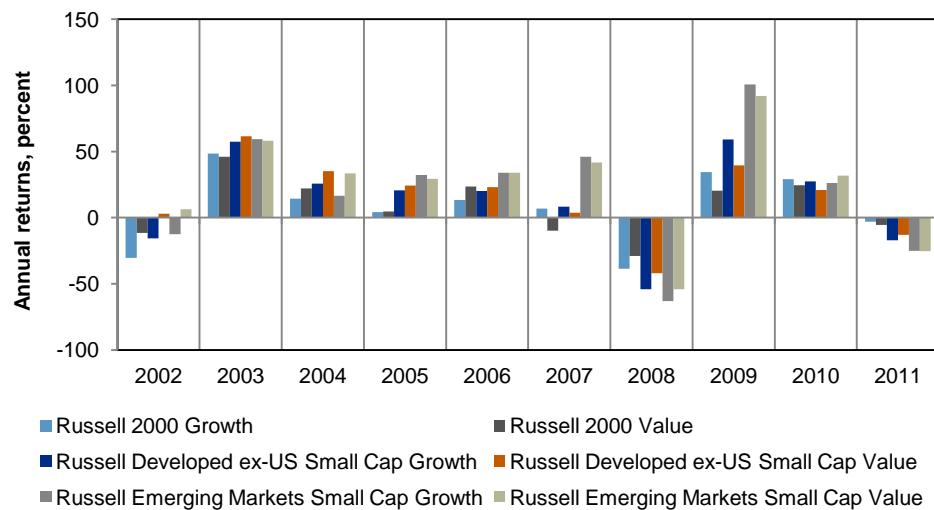
Global growth stocks (as represented by the Russell Global Growth Index) outperformed global value stocks (as represented by the Russell Global Value Index) by 1.46pp last year, with returns of -6.94% and -8.40%, respectively. Figures 4 and 5 display 10 years of annual returns within the growth and value segments of the large and small cap indexes for U.S., developed ex-U.S. and emerging markets. Growth companies tended to persevere in 2011, as they did in 2009 and 2010, in both the U.S. large cap and developed ex-U.S. large cap arenas. Growth companies lagged slightly behind value companies in the emerging markets large cap space. In small cap markets, growth stocks in the U.S. and emerging markets outperformed value stocks, with value slightly outperforming growth in the developed ex-U.S. small cap markets. The strongest performance, 2.64%, occurred in the U.S. large cap growth space, as measured by the Russell 1000 Growth Index. The poorest performance, -25.35%, occurred in emerging markets small cap value, as measured by the Russell Emerging Markets Small Cap Value Index. These results mirrored the outcomes of the capitalization size indexes, reported in the previous section, in which U.S. markets outperformed ex-U.S. developed markets as well as emerging markets. The most dramatic difference between growth and value occurred within the developed ex-U.S. large cap markets, with growth outperforming value by 4.92pp.

Figure 4 / Annual performance of large cap growth and large cap value styles, 2002–2011



Source: Russell Indexes. Please reference the appendix for index inception dates.

Figure 5 / Annual performance of small cap growth and small cap value styles, 2002–2011



Source: Russell Indexes. Please reference the appendix for index inception dates.

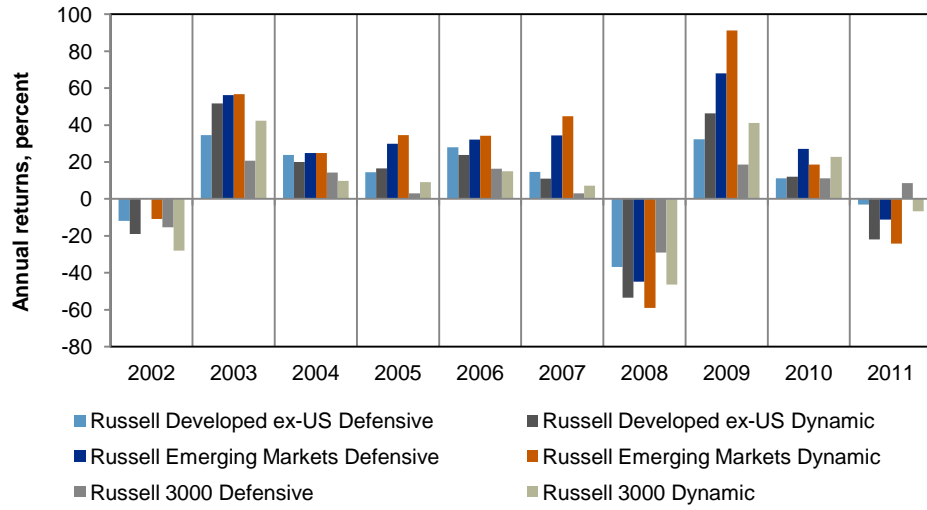
Stability – the third dimension of style

Russell has identified a “third dimension of style” – stability.⁵ Russell’s defensive and dynamic indexes, known as the Russell Stability Indexes, complement the existing Russell Style framework – size (large/small) and valuation (growth/value). Defensive indexes measure the performance of companies with relatively stable business conditions that have historically been less sensitive to economic cycles, credit cycles and market volatility, based on their stability indicators. Dynamic indexes measure the performance of companies that have historically experienced less stable business conditions and have been more sensitive to market cycles.

In 2011, defensive stocks in both developed and emerging markets outperformed those classified as dynamic, as may be expected during weak market environments. We see this phenomenon in the defensive and dynamic sub-indexes of the Russell 3000, Russell Developed ex-U.S. and Russell Emerging Markets indexes (Figure 6). The top-performing index in this category was the Russell 3000 Defensive Index, with a positive gain of 8.57%. The worst performance, a negative return of –24.24%, was realized by the Russell Emerging Markets Dynamic Index. This result contrasts with high emerging markets performance in 2009 and 2010. The developed ex-U.S. defensive and dynamic indexes experienced the largest returns gap, with a performance differential of 18.83pp. Drilling down further, this divergence was particularly prominent in the developed ex-U.S. large cap stability space, which experienced a spread of 19.35pp. In the developed ex-U.S. small cap stability indexes, the spread was 14.37pp.

⁵ See Hintz, Dave, “The Third Dimension of Style: Introducing the Russell Stability Indexes,” Russell Research (December 2010) and Thurston, Mark, “Expansion of the Russell Stability Indexes: The Global Series,” Russell Research (October 2011).

Figure 6 / Annual performance of defensive and dynamic styles, 2002–2011



Source: Russell Indexes. Please reference the appendix for index inception dates.

Regions: developed, emerging and frontier

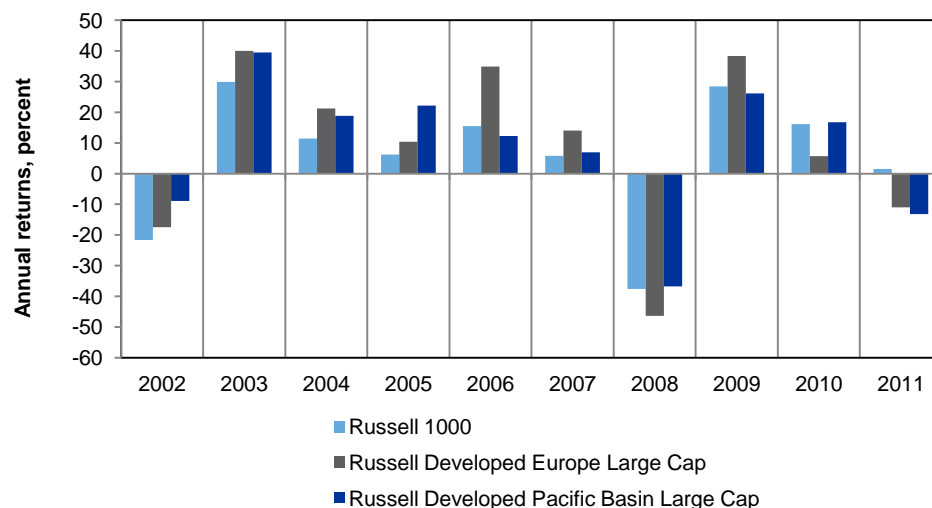
Developed markets

Developed large cap markets, highlighted in Figure 7, experienced negative performance at the close of 2011 – with, again, the exception of the U.S. large cap market segment, as measured by the Russell 1000 Index, which delivered a marginally positive return of 1.50%. The negative performance of the large cap segment of the Russell Developed Europe Large Cap Index may have been attributable to ongoing concern over the European debt crisis, the impact of which spread across many Eurozone countries and beyond. Concerns over rising sovereign borrowing costs in both Spain and Italy, as well as the questioning of France's once-stellar credit rating, may also have contributed to the downturn of this market segment, which closed the year with a negative return, -11.03%.

The Pacific Basin large cap markets, as measured by the Russell Developed Pacific Basin Large Cap Index, were not immune to the widespread effects of the doubt surrounding the European debt crisis and the weak global recovery. These markets also experienced their own economic issues after several natural disasters wreaked havoc in the region. Japan's negative performance, -14.08% (as represented by the Russell Japan Large Cap Index), combined with its hefty weight (nearly 60%) in the Russell Developed Pacific Basin Large Cap Index, contributed to the region's -13.21% performance. For the first time since 2001, the U.S. large cap market segment outperformed the large cap developed markets of Europe and the Pacific Basin for the year, presumably due at least in part to the challenges outlined above for Europe and the Pacific Basin.

The best-performing country-level index represented in these markets was the Russell Eire Large Cap Index,⁶ with a positive return of 11.20%; the Russell Greece Large Cap Index experienced the worst performance of the year (perhaps attributable to the political drama and risk of default that characterized Greece in 2011), with a return of -59.85%.

Figure 7 / Annual performance of developed large cap markets, 2002–2011

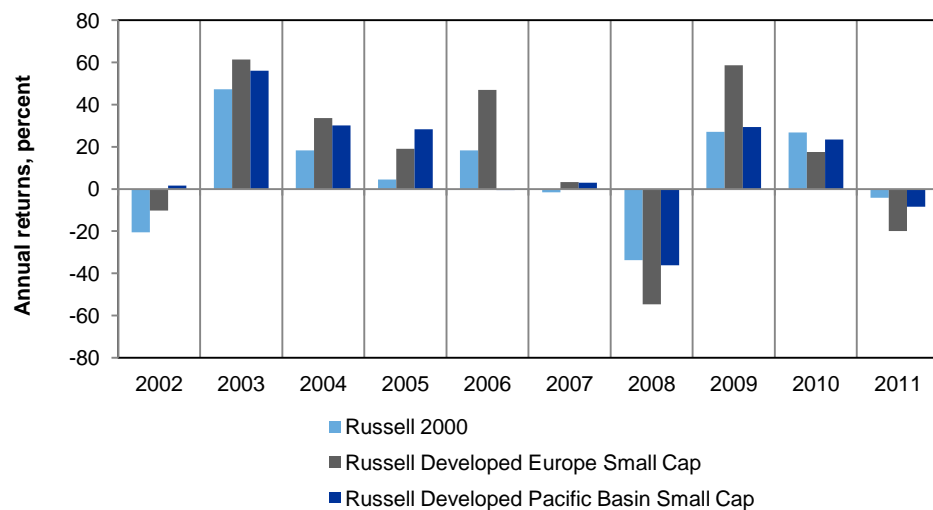


Source: Russell Indexes. Please reference the appendix for index inception dates.

⁶ This index represents the large cap stocks of Ireland.

Figure 8 illustrates the losses experienced in 2011 across small cap market segments, as measured by the Russell Developed Pacific Basin Small Cap Index, the Russell Developed Europe Small Cap Index and the Russell 2000 Index. All developed small cap markets shown in Figure 8 suffered from the same negative influences as their large cap counterparts, closing the year in the red. Similarly to what we observed in the large cap space, U.S. small cap stocks outperformed the small cap stocks of developed Europe and the developed Pacific Basin. The country-level index with the best 2011 performance in these regions was the Russell New Zealand Small Cap Index, with a return of 6.25%; the country-level index with the worst performance in 2011 was the Russell Greece Small Cap Index, which closed the year with a return of -49.65%.

Figure 8 / Annual performance of developed small cap markets, 2002–2011

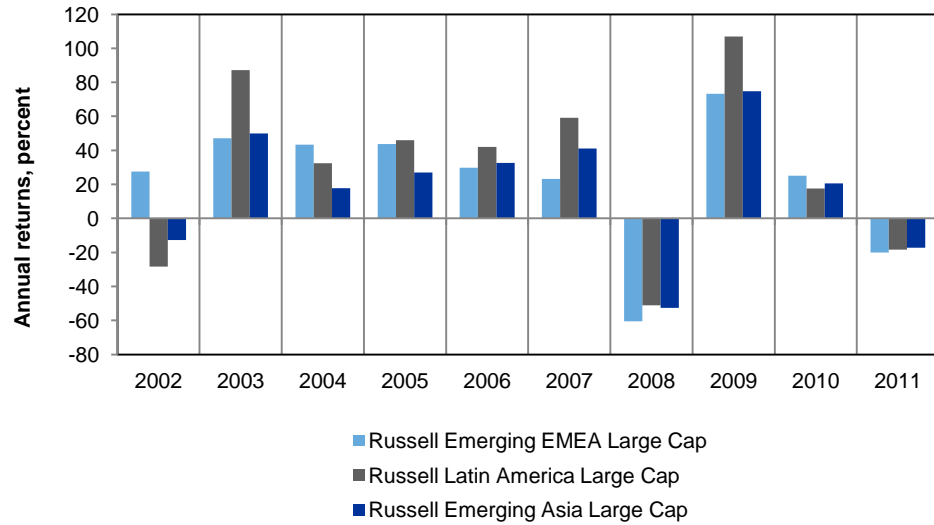


Source: Russell Indexes. Please reference the appendix for index inception dates.

Emerging markets

Figure 9 displays annual returns for the large cap segments of the Russell Emerging Asia Index, the Russell Latin America Index and the Russell Emerging EMEA Index. For the first time since 2008, all three market segments closed the year 2011 with negative returns. These markets were plagued by volatility and investor uncertainty, which were fueled by events such as the historic Arab Spring and the Eurozone’s sovereign debt crisis. This effect is particularly notable given that the Eurozone primarily comprises developed nations. In addition, natural forces such as the devastating floods in Thailand also produced headwinds for the Emerging Asia region. The three regions performed similarly, with results ranging from -17.19% to -20.08%, suggesting that the poor performance of emerging markets was systematic rather than attributable to any particular region. The best-performing country-level index represented in these markets was the Russell Indonesia Large Cap Index, with a positive return of 5.79%. The Russell India Large Cap Index experienced the worst performance of the year (-36.08%) amid general instability and the effects of the falling rupee and a slowing economy.

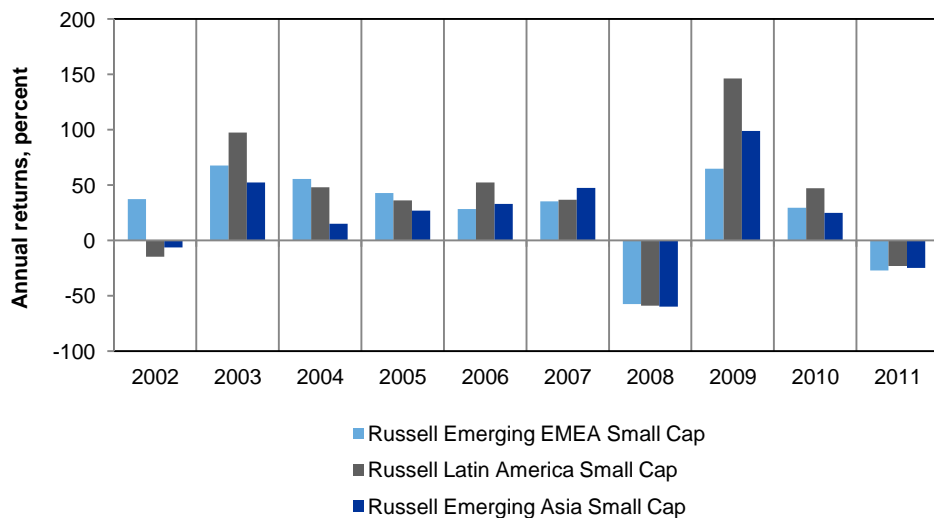
Figure 9 / Annual performance of emerging large cap markets, 2002–2011



Source: Russell Indexes. Please reference the appendix for index inception dates.

Struggling with the same political and natural forces as the emerging large cap market segment faced, emerging small cap markets produced returns similar to their large cap counterparts, with negative performance across the board (Figure 10). Just as we observed across emerging large cap regions, the returns of these three emerging small cap regions were fairly similar, ranging from -23.10% to -27.10%. The small cap segment of emerging markets underperformed the large cap segment. On the country level, the Russell Philippines Small Cap Index was the top performer, with a positive return of 7.38%. India again realized the poorest performance, with the Russell India Small Cap Index closing the year at -44.01%.

Figure 10 / Annual performance of emerging small cap markets, 2002–2011

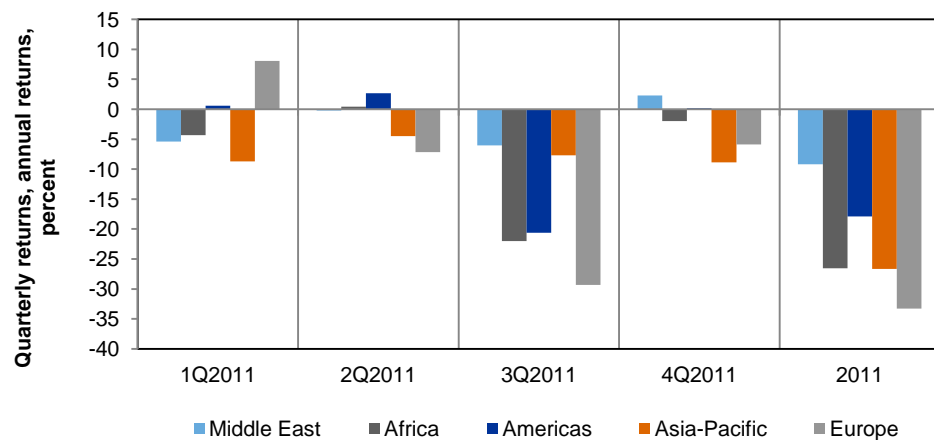


Source: Russell Indexes. Please reference the appendix for index inception dates.

Frontier markets

The Russell Frontier Index, which measures the markets of 36 frontier countries across the globe, closed the year with performance similar to that of the Russell Emerging Markets Index (the indexes were down -20.74% and -19.20%, respectively), and regional frontier markets displayed considerable volatility. This volatility was particularly evident in the wild swings from quarter to quarter in the frontier Europe regions (Figure 11). Frontier Europe continued to be negatively impacted by the Eurozone crisis, particularly in the third quarter of 2011. Despite the slight uptick that occurred across nearly all five frontier regions in the last quarter of the year (two of the five regions had positive fourth-quarter returns), all regions experienced overall negative returns for 2011. Surprisingly, given the political upheaval experienced in 2011, the frontier Middle East region showed the least volatility and produced the best performance of the frontier regions for the year.

Figure 11 / 2011 quarterly returns of regions within the Russell Frontier Index

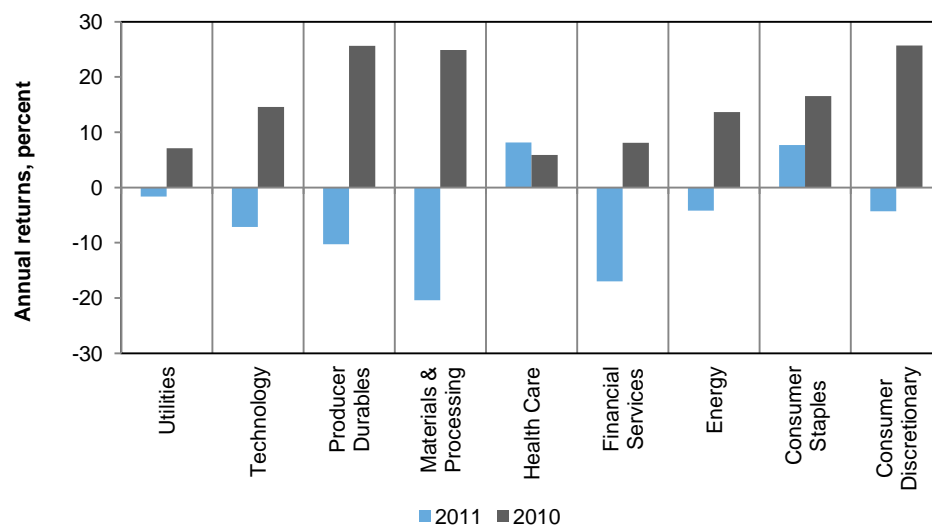


Source: Russell Indexes. Please reference the appendix for index inception dates.

Sectors

Figure 12 illustrates the performance of the Russell Global Index sectors. Health Care, which was the poorest performer in 2010, generated the highest returns of all of the global sectors in 2011 (8.15%), as decreasing worries about health care regulation in the U.S. had investors gravitating toward cheap stocks and solid earnings reports. Consumer Staples, a defensive sector that investors in market environments characterized by uncertainty have tended to favor, also did relatively well in 2011, with a return of 7.71%. Materials & Processing, a strong performer in 2010, took a nosedive in 2011 and closed the year as the worst-performing sector (-20.40%). Financial Services was another weak performer in 2011 (-16.98%).

Figure 12 / 2010–2011 performance of Russell Global Index sectors



Source: Russell Indexes. Please reference the appendix for index inception dates.

Conclusion

The last year was a rocky one for most markets and asset classes. The U.S. market outperformed international stocks on the whole, with recent strong performers such as emerging markets underperforming the U.S. market. In 2011, large cap stocks tended to outperform small cap, and growth tended to outperform value. Consistent with historical investor behavior during unstable markets, less risky (defensive) sectors such as Health Care and Consumer Staples outperformed riskier (cyclical) sectors such as Financial Services. Although results were mostly disappointing across the board, the best-performing market segment, as measured by the Russell 3000 Defensive Index, provided a positive return of nearly 9% – a substantial result when compared to the performance of other asset classes.

Is the dramatic market downturn over? In retrospect, we see that the overall performance of equity markets in 2011 was, while generally unfavorable, not as much so as during some years in recent history. We find that broad equity markets' performance in 2011 was more similar to that of 2002 than that of 2008.

Appendix

Asset class	Category	Cap tier	Style	Index	Inception date
Europe Large Cap	Developed	Large	Broad	Russell Developed Europe Large Cap Index	1/2007
Europe Small Cap	Developed	Small	Broad	Russell Developed Europe Small Cap Index	1/2007
Global ex-U.S. All Cap	Developed	Broad	Broad	Russell Developed ex-U.S. Index	1/2007
Global ex-U.S. Large Cap	Developed	Large	Broad	Russell Developed ex-U.S. Large Cap Index	1/2007
Global ex-U.S. Large Cap Growth	Developed	Large	Growth	Russell Developed ex-U.S. Large Cap Growth Index	4/2008
Global ex-U.S. Large Cap Value	Developed	Large	Value	Russell Developed ex-U.S. Large Cap Value Index	4/2008
Global ex-U.S. Small Cap	Developed	Small	Broad	Russell Developed ex-U.S. Small Cap Index	1/2007
Global ex-U.S. Small Cap Growth	Developed	Small	Growth	Russell Developed ex-U.S. Small Cap Growth Index	4/2008
Global ex-U.S. Small Cap Value	Developed	Small	Value	Russell Developed ex-U.S. Small Cap Value Index	4/2008
Pacific Basin Large Cap	Developed	Large	Broad	Russell Developed Pacific Basin Large Cap Index	1/2007
Pacific Basin Small Cap	Developed	Small	Broad	Russell Developed Pacific Basin Small Cap Index	1/2007
U.S. All Cap	Developed	Broad	Broad	Russell 3000 Index	1/1984
U.S. Large Cap	Developed	Large	Broad	Russell 1000 Index	1/1984
U.S. Large Cap Growth	Developed	Large	Growth	Russell 1000 Growth Index	1/1987
U.S. Large Cap Value	Developed	Large	Value	Russell 1000 Value Index	1/1987
U.S. Small Cap	Developed	Small	Broad	Russell 2000 Index	1/1984
U.S. Small Cap Growth	Developed	Small	Growth	Russell 2000 Growth Index	6/1993
U.S. Small Cap Value	Developed	Small	Value	Russell 2000 Value Index	6/1993
Emerging Markets	Emerging	Broad	Broad	Russell Emerging Markets Index	1/2007
Asia Large Cap	Emerging	Large	Broad	Russell Emerging Asia Large Cap Index	1/2007
Asia Small Cap	Emerging	Small	Broad	Russell Emerging Asia Small Cap Index	1/2007
EMEA Large Cap	Emerging	Large	Broad	Russell Emerging EMEA Large Cap Index	1/2007
EMEA Small Cap	Emerging	Small	Broad	Russell Emerging EMEA Small Cap Index	1/2007
Global Large Cap	Emerging	Large	Broad	Russell Emerging Markets Large Cap Index	1/2007
Global Large Cap Growth	Emerging	Large	Growth	Russell Emerging Markets Large Cap Growth Index	4/2008
Global Large Cap Value	Emerging	Large	Value	Russell Emerging Markets Large Cap Value Index	4/2008
Global Small Cap	Emerging	Small	Broad	Russell Emerging Markets Small Cap Index	1/2007
Global Small Cap Growth	Emerging	Small	Growth	Russell Emerging Markets Small Cap Growth Index	4/2008
Global Small Cap Value	Emerging	Small	Value	Russell Emerging Markets Small Cap Value Index	4/2008
Latin America Large Cap	Emerging	Large	Broad	Russell Latin America Large Cap Index	1/2007
Latin America Small Cap	Emerging	Small	Broad	Russell Latin America Small Cap Index	1/2007
Frontier Markets	Frontier	Broad	Broad	Russell Frontier Index	10/2010
Frontier Middle East	Frontier	Broad	Broad	Russell Frontier Middle East Index	9/2011
Frontier Africa	Frontier	Broad	Broad	Russell Frontier Africa Index	9/2011
Frontier Asia-Pacific	Frontier	Broad	Broad	Russell Frontier Asia-Pacific Index	9/2011
Frontier Europe	Frontier	Broad	Broad	Russell Frontier Europe Index	9/2011
Frontier Americas	Frontier	Broad	Broad	Russell Frontier Americas Index	9/2011



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