

Russell Research

By: Curtis Yasutake, Research Analyst

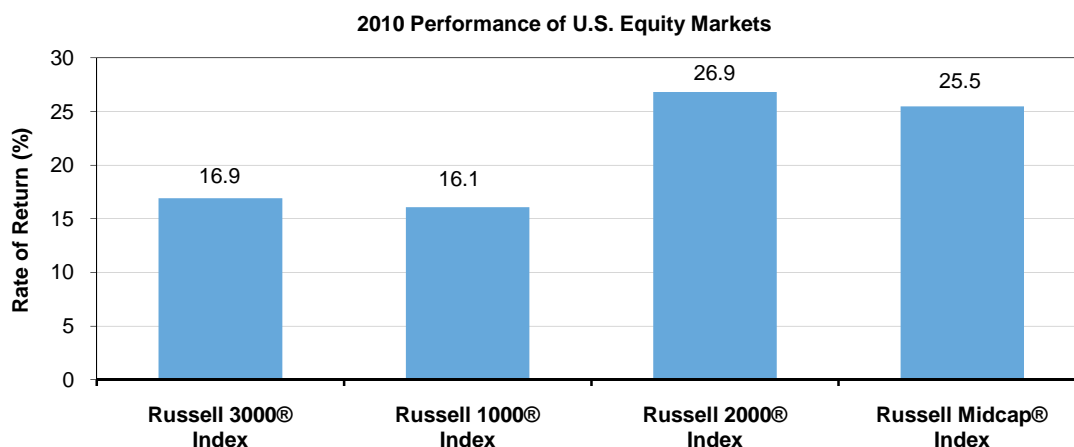
MARCH 2011

U.S. Equity Annual Active Management Performance Review

U.S. Equity Market Performance in 2010

The strong rally from 2009 continued in 2010 as all major capitalization tiers of the U.S. equity market ended the year with double-digit positive returns.¹ The market pulled back in the second quarter as concerns regarding the sustainability of the global economic recovery weighed on stocks, but the second half of the year was incredibly strong in response to stimulative government policy and decreased economic uncertainty. Except during the second quarter, investors generally embraced risk throughout the year, leading smaller cap and higher beta stocks to outperform. Small cap and mid cap stocks outperformed larger cap equities by approximately 10 percentage points in 2010.

Figure 1 / Data as of 12/31/2010



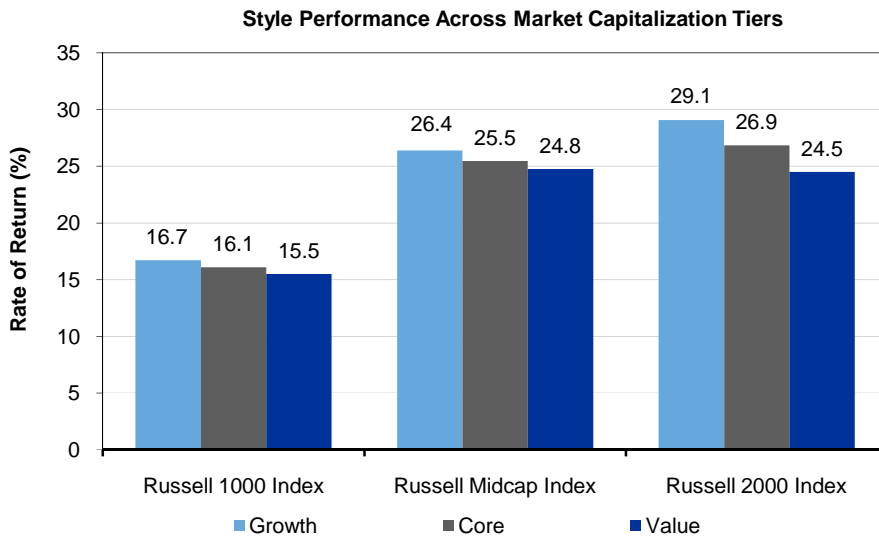
¹ This document uses Russell Indexes to represent U.S. equity market performance and characteristics. Indexes and universes are unmanaged and cannot be invested in directly. Past performance is not indicative of future results. Returns represent past performance, are not a guarantee of future performance and are not indicative of any specific investment. Universe means are total return and gross of advisory fees.

The author thanks Dave Hintz, Mary Fjelstad, Linda O'Donnell, Oanh Hoang and Irina Prisacari for their assistance in this research.

Style Performance

The disparity between style benchmarks was less pronounced in 2010. Growth indexes outperformed value indexes slightly. Value generally outperformed in the first half of the year, while growth outperformed in the second half of the year as investors gained confidence and stocks of rapidly growing companies led the market upward.

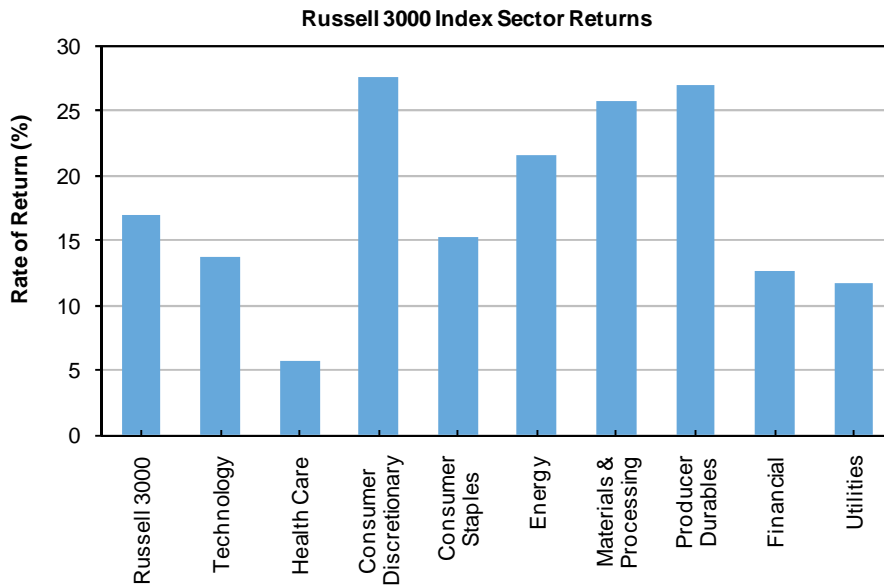
Figure 2 / Data as of 12/31/2010



Sector Performance

Performance was strong in 2010 as all nine sectors in the Russell 3000 Index produced positive returns. Cyclical sectors—such as consumer discretionary, producer durables, materials & processing and energy—performed the best as markets surged in the second half of the year. Health care was the worst-performing sector, as investors considered it unlikely to be a significant beneficiary of the global economic recovery.

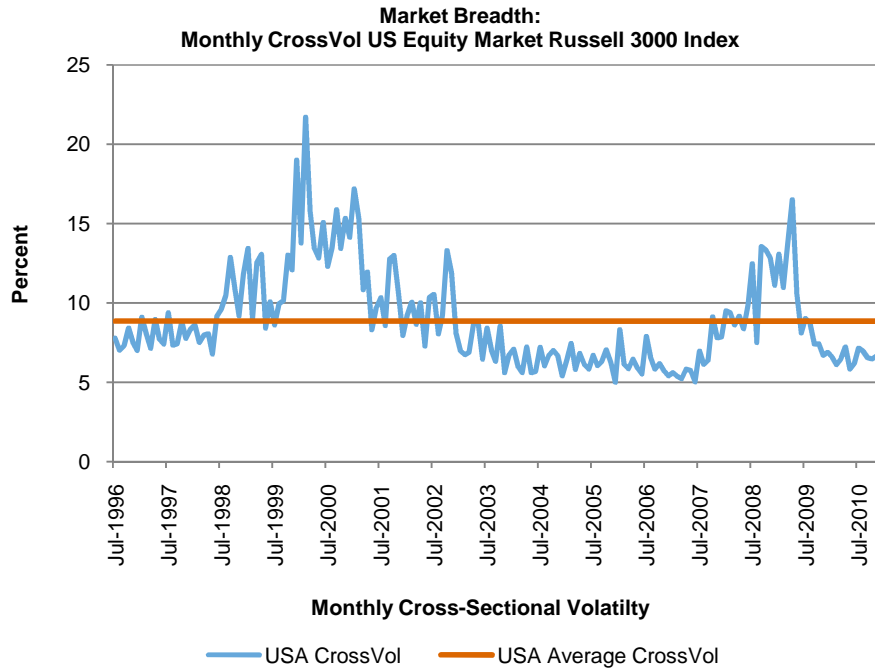
Figure 3 / Data as of 12/31/2010



Market Breadth

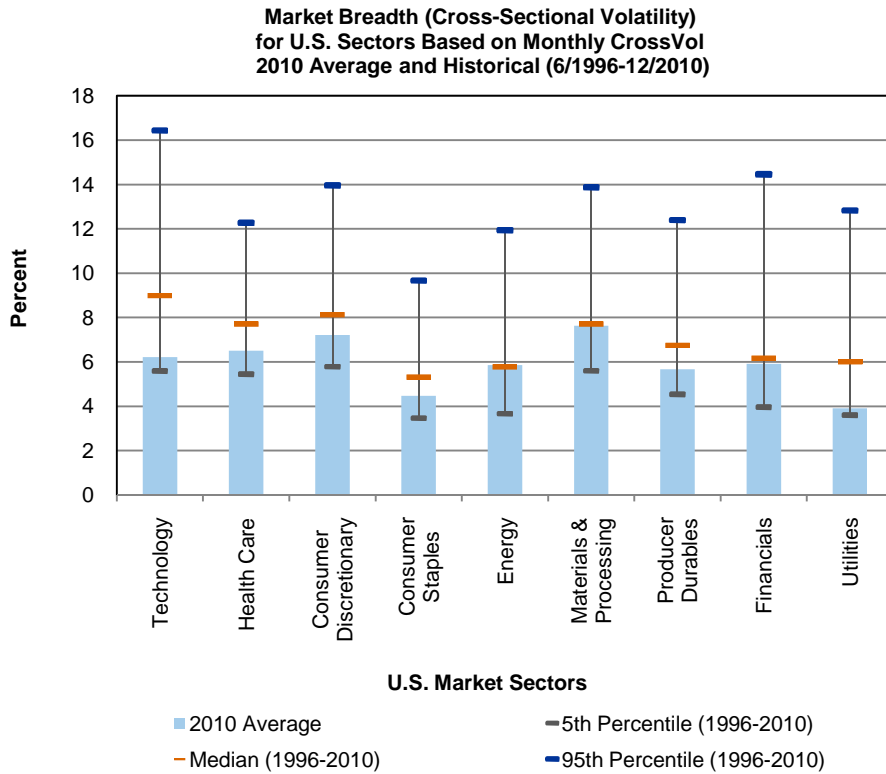
Cross-sectional volatility (CrossVol™) is a good measure of dispersion within a universe of securities and of alpha potential within markets.² CrossVol in the Russell 3000 Index for 2010 was slightly greater than the historic lows of 2007, but still below the average since June 1996, and well below the levels seen during the credit crisis and the early phase of the market recovery. Lower CrossVol generally indicates fewer opportunities for U.S. managers to provide differentiated returns from the index.

Figure 4 / Data as of 12/31/2010



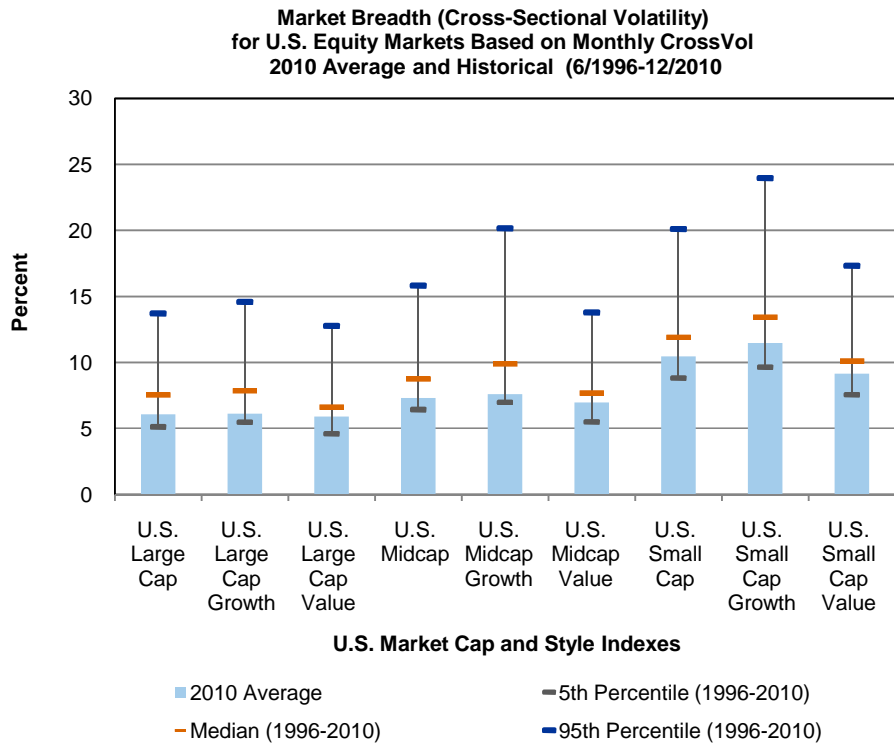
² Bouchey, P., M. Fjelstad and H. Vadlamudi. 2010. "Measuring Alpha Potential in the Market," *Russell Research*, September.

Figure 5 / Data as of 12/31/2010



An analysis of historical monthly CrossVol of U.S. market sectors since July 1996 indicates that relative to the historical median there was less dispersion within almost every sector. Energy, Materials & Processing, and Financials stood out as the only sectors approaching the median historical level of CrossVol in 2010.

Figure 6 / Data as of 12/31/2010

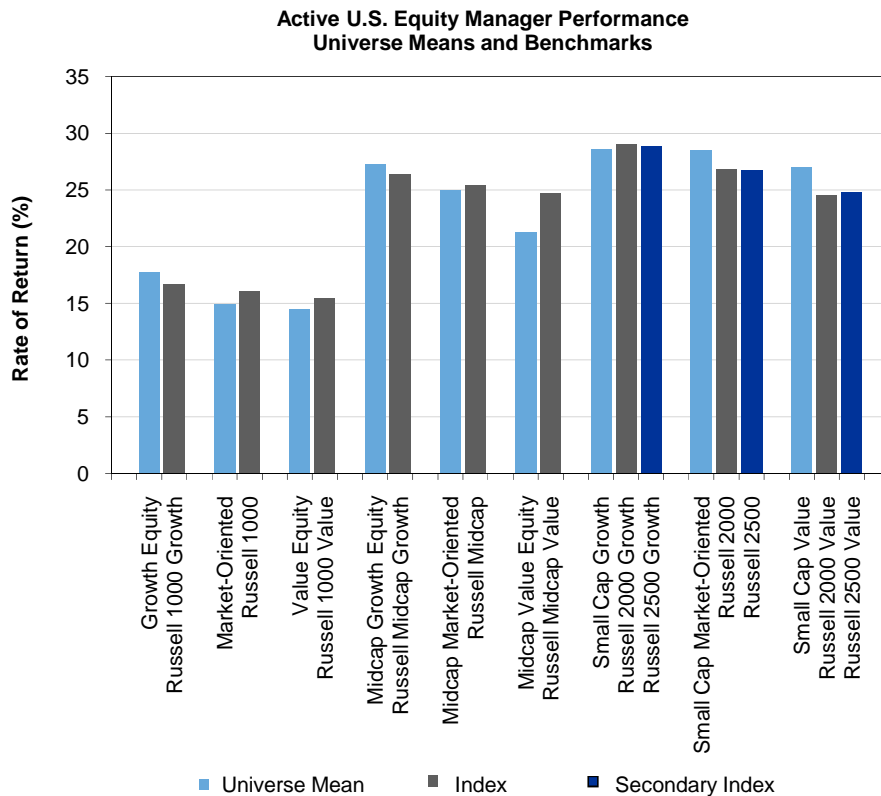


Similarly, the CrossVol during 2010 within all U.S. capitalization and style indexes was well below the historical averages since 1996. Across the capitalization spectrum, the value indexes exhibited relatively higher cross volatility versus their own history than the growth indexes did.

Active Management

Active management results were mixed during 2010. In large cap and mid cap, only growth managers, as measured by Russell's Large Cap and Midcap Growth Equity universe means,³ were able to surpass their style benchmarks. The average large cap and mid cap value and market-oriented managers lagged their respective indexes. In small cap, this trend was reversed, as market oriented and value managers were able to beat both the Russell 2000 and Russell 2500 Indexes, while growth managers generated benchmark-like returns.

Figure 7 / Data as of 12/31/2010



Large Cap Value Substyles: Managers in the Yield substyle of Russell's Value universe were the worst-performing of all value substyle managers, underperforming the Russell 1000 Value Index by 164 basis points. High-yielding stocks did not generally have a positive payoff during 2010. Investors' preference for higher-volatility, relatively lower-quality stocks also served as headwinds for yield managers. Managers in the Low P/E substyle universe fared better, but still underperformed the Russell 1000 Value Index by 80 basis points. On average, low P/E managers beat the index three out of four quarters, as the cheaper, lower-quality stocks led throughout most of the year. Annual performance was restrained by poor performance in the second quarter, when technology overweights and utilities underweights were punished during the second quarter market decline.

³ Throughout this document, Russell manager universes are used to represent manager performance and behavior. See Appendix for further information on Russell manager universes.

Large Cap Growth Substyles: Managers in the Consistent Growth substyle of Russell's Growth universe were unable to keep up with the broader growth market, as they tend not to participate in the fastest-growing, higher-beta companies, which led the markets higher. Strong performance in cyclical versus defensive sectors also hurt consistent growth managers. The Consistent Growth substyle mean trailed the Russell 1000 Growth Index by 289 basis points. Managers in the Earnings Momentum substyle fared better than those in the Consistent Growth substyle, outperforming the Russell 1000 Growth index by 190 basis points. Many earnings momentum managers focus on earnings surprises and positive estimate revisions, which are factors that did well in 2010.

Large Cap Market-Oriented Substyles: Managers in the Market-Oriented space struggled across the board in 2010. An overweight of the health care sector was an aggregate bet that was detrimental to the results of market-oriented managers. The Growth at a Reasonable Price substyle of Russell's Market Oriented universe performed the worst, trailing the Russell 1000 Index by 247 basis points on average. Consistent with the performance of the pure Large Cap Value and Growth universes, the Growth substyle outperformed the Value substyle within the Market Oriented universe, with growth managers underperforming the index by 73 basis points and value managers underperforming by 174 basis points on average. The Market-Normal substyle, which includes the majority of quantitative managers, performed the best, but it still underperformed the index by 69 basis points on average.

Figure 8 / Data as of 12/31/2010

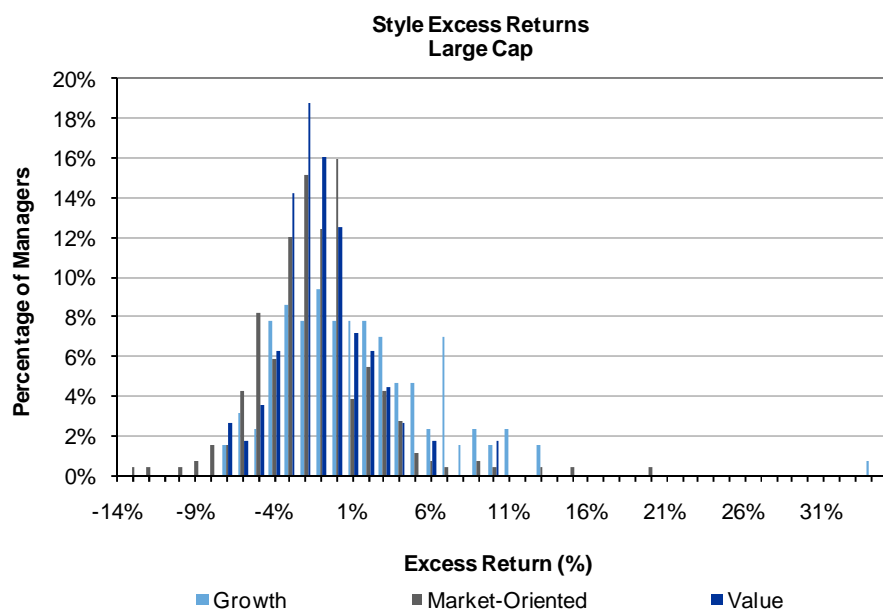


Table 1 / Data as of 12/31/2010

Universe	Mean Excess Return	Observations	Minimum Excess Return	Maximum Excess Return
Growth Equity	1.09%	128	-7.36%	33.61%
Market-Oriented	-1.14	257	-12.58	20.42
Value Equity	-.097	112	-7.21	10.46

Large Cap Growth

In 2010, approximately 56% of the managers in Russell's Large Cap Growth universe outperformed the Russell 1000 Growth Index. Differentiated sector weights generally did not add significant value for growth managers, but most factor tilts were additive. Factors with strong positive payoffs were: high beta, smaller capitalization stocks, and companies with rising earnings estimates and positive earnings surprises.

Contributors: Higher-beta, smaller capitalization, and earnings momentum exposure

Detractors: Financials, health care and technology overweight

Producer durables underweight

Large Cap Market-Oriented

Less than 30% of the managers in Russell's Large Cap Market-Oriented universe outperformed the Russell 1000 Index in 2010. The average manager's overweight to health care hurt the most, as it was by far the worst-performing sector in the Russell 1000.

Contributors: Consumer discretionary overweight
Financials and utilities underweight

Detractors: Health care and technology overweight

Large Cap Value

Only 32% of the managers in Russell's Large Cap Value universe outperformed the Russell 1000 Value Index during 2010. Managers were punished significantly for overweighting relatively higher-quality, larger market capitalization stocks.

Contributors: Consumer discretionary and producer durables overweight
Utilities underweight

Detractors: Technology overweight
Higher-quality and larger cap exposure

Figure 9 / Data as of 12/31/2010

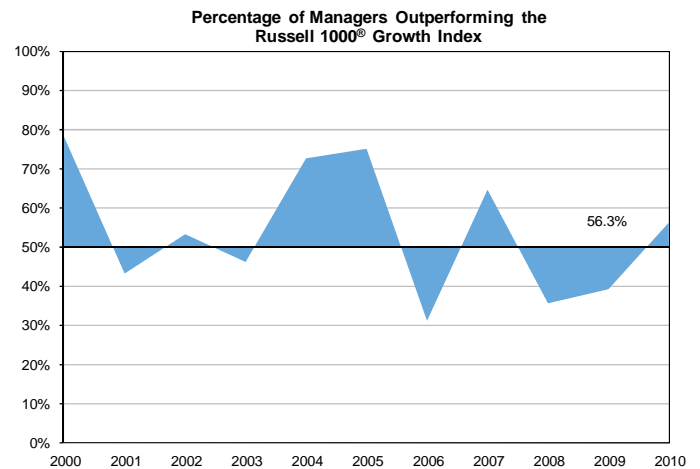


Figure 10 / Data as of 12/31/2010

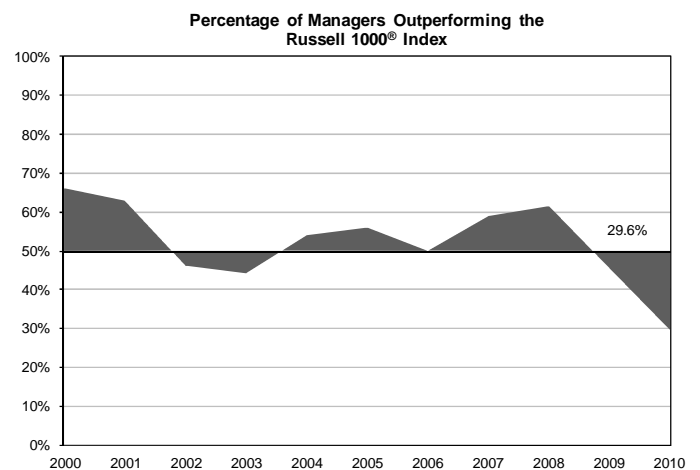
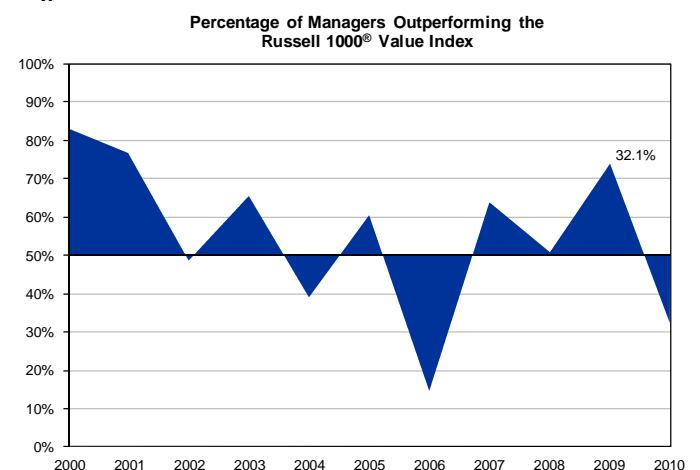


Figure 11 / Data as of 12/31/2010



Mid Cap

In general, the mid cap indexes performed well relative to larger cap indexes, but the payoff to active management was mixed. For the year ending December 31, 2010, the average manager in Russell's Midcap Growth universe outperformed the Russell Midcap Growth Index by 92 basis points. The universe mean of mid-cap market-oriented managers was 45 basis points behind the Russell Midcap Index. Mid cap value managers performed the worst, trailing the Russell Midcap Value Index by 342 basis points.

Figure 12 / Data as of 12/31/2010

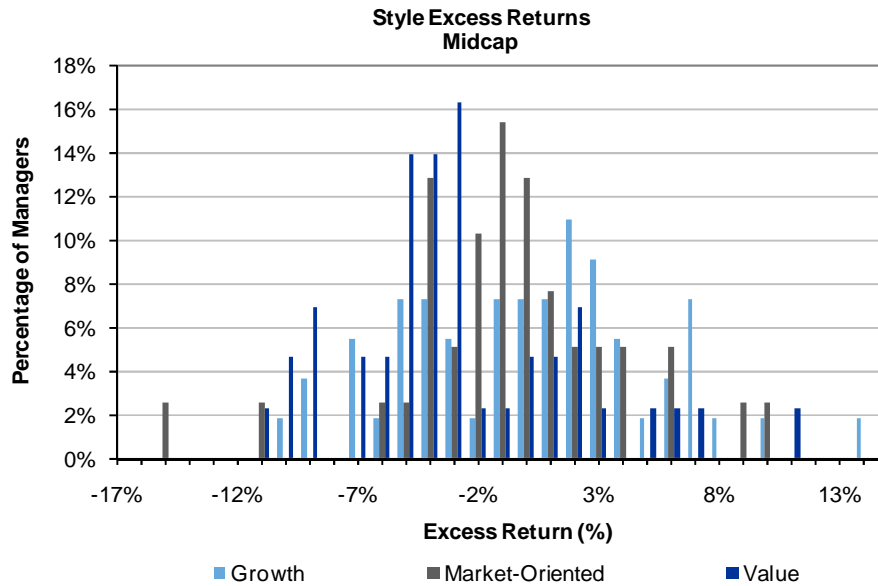


Table 2 / Data as of 12/31/2010

Universe	Mean Excess Return	Observations	Minimum Excess Return	Maximum Excess Return
Midcap Growth	0.92%	55	-9.56	13.57%
Midcap Market Oriented	-0.45	39	-15.35	10.12
Midcap Value	-3.42	43	-11.46	11.15

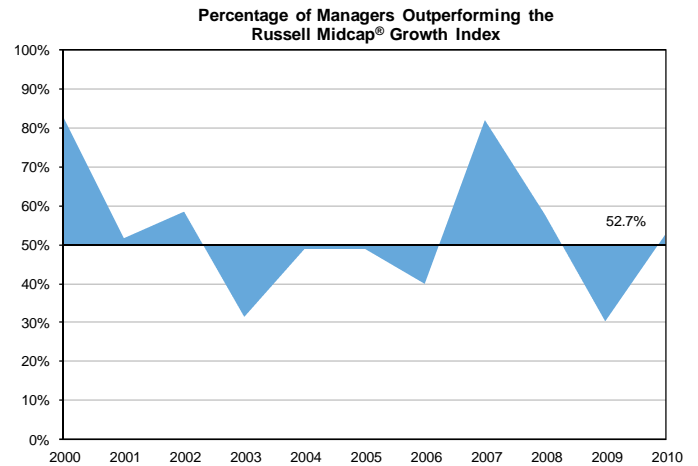
Mid Cap Growth

Approximately 53% of the managers in Russell's Midcap Growth universe outperformed the Russell Midcap Growth Index during 2010. No major factor or sector exposures stood out as big contributors to mid-cap growth managers' delivering the best benchmark-relative returns of all mid-cap manager styles.

Contributors: Lower exposure to dividend yield

Detractors: High historical 1-year earnings growth
 Producer durables underweight

Figure 13 / Data as of 12/31/2010



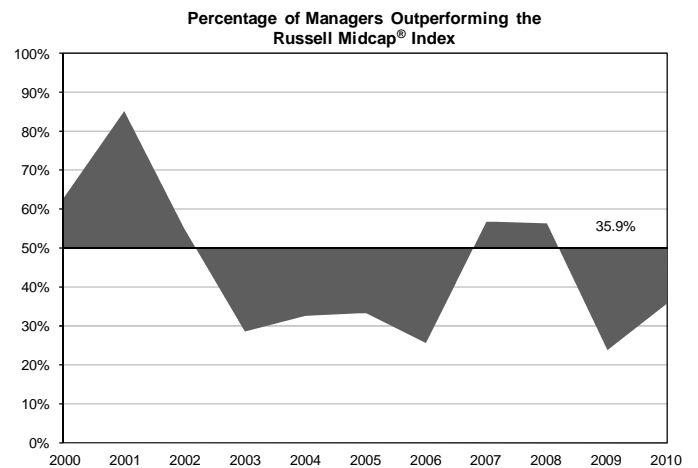
Mid Cap Market-Oriented

Approximately 28% of the managers in Russell's Midcap Market-Oriented universe outperformed the Russell Midcap Index during 2010. Approximately 36% of the managers in Russell's Midcap Market-Oriented universe outperformed the Russell Midcap Index during 2010. Exposure to larger stocks hurt mid-cap market-oriented managers.

Contributors: Consumer discretionary overweight
 Utilities underweight

Detractors: Exposure to larger market cap stocks and stocks with high returns on equity
 Health care overweight

Figure 14 / Data as of 12/31/2010



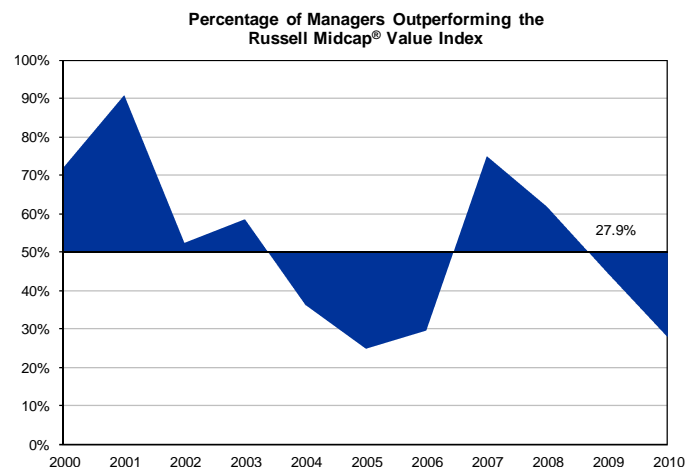
Mid Cap Value

Only 28% of the managers in Russell's Midcap Value universe outperformed the Russell Midcap Value Index during 2010. Exposure to larger, less volatile stocks and big overweights to technology and health care hurt mid-cap value managers.

Contributors: Consumer discretionary overweight

Detractors: Lower beta, exposure to larger market cap stocks
 Technology, health care overweight

Figure 15 / Data as of 12/31/2010



Small Cap

For the year ending December 31, 2010, small cap stocks outperformed all other capitalization tiers. Additionally, the average active manager within small cap did well. The average small cap growth manager underperformed the Russell 2000 Growth Index by 44 basis points. Conversely, the average small cap market-oriented manager beat the Russell 2000 Index by 165 basis points. The average small cap value manager outperformed the Russell 2000 Value Index by 256 basis points.

Figure 16 / Data as of 12/31/2010

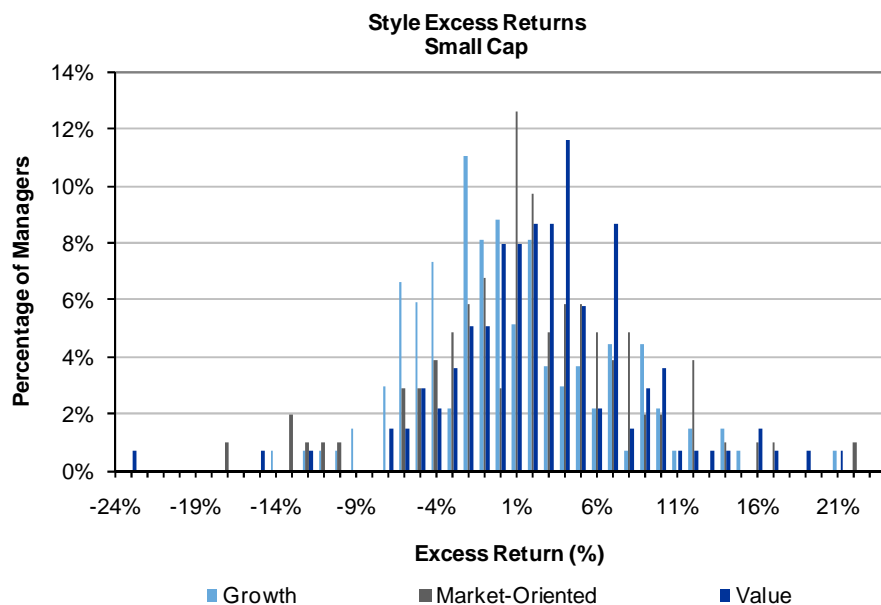


Table 3 / Data as of 12/31/2010

Universe	Mean Excess Return	Observations	Minimum Excess Return	Maximum Excess Return
Small Cap Growth	-0.44%	136	-13.99%	20.64%
Small Cap Market-Oriented	1.65	103	-17.03	21.59
Small Cap Value	2.56	138	-22.88	20.78

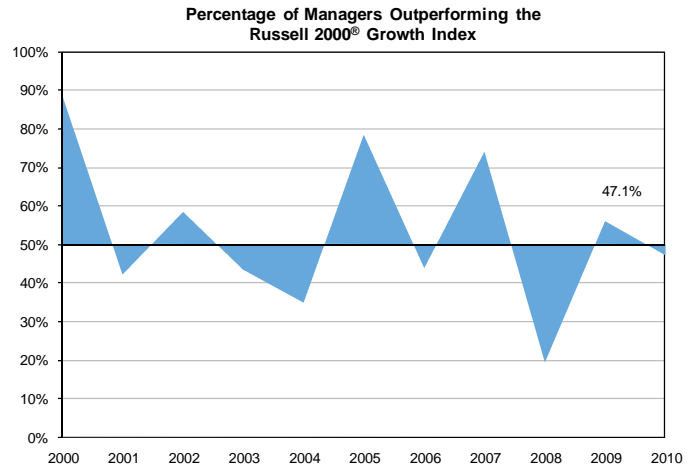
Small Cap Growth

Of the small cap styles, small cap growth managers had the greatest difficulty beating their benchmarks. Approximately 47% of the managers in Russell's Small Cap Growth universe outperformed the Russell 2000 Growth Index.

Contributors: Technology overweight
Health care underweight

Detractors: Materials underweight and momentum exposure.

Figure 17 / Data as of 12/31/2010



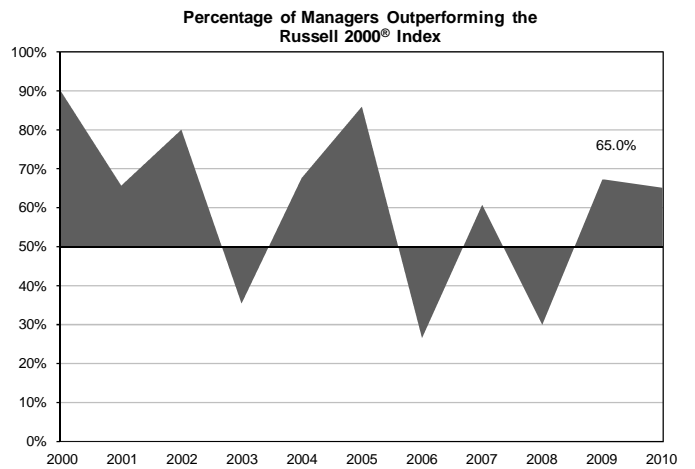
Small Cap Market-Oriented

Approximately 65% of the managers in Russell's Small Cap Market-Oriented universe outperformed the Russell 2000 Index.

Contributors: Utilities and financials underweight

Detractors: Consumer discretionary overweight

Figure 18 / Data as of 12/31/2010



Small Cap Value

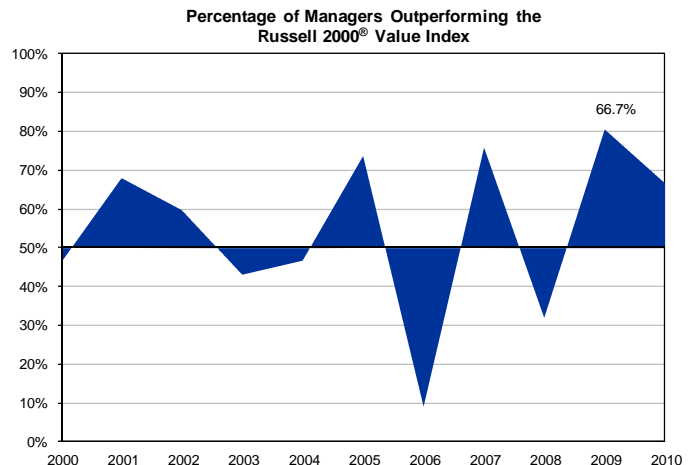
Approximately 67% of the managers in Russell's Small Cap Value universe outperformed the Russell 2000 Value Index. Overweight to cyclical sectors helped.

Contributors: Materials, consumer discretionary, and Materials overweight

Utilities and financials underweight

Detractors: Health care overweight

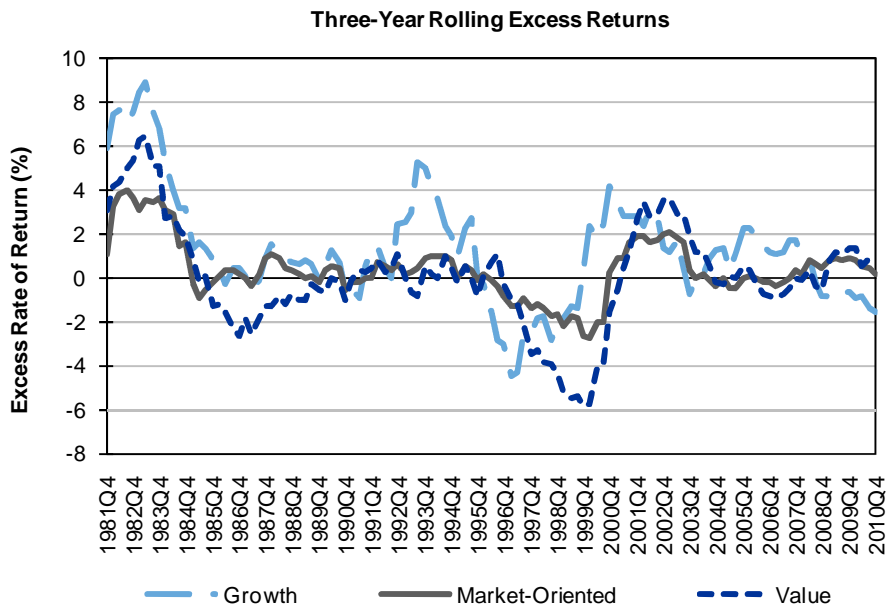
Figure 19 / Data as of 12/31/2010



Long-Term Performance Trends

Large cap value managers delivered the best benchmark-relative performance over the three years ended December 31, 2010. Value managers' strong relative performance is primarily attributable to returns in 2009, as managers were able to exploit opportunities provided by wide valuation spreads. Large cap market-oriented managers have delivered similar performance to the benchmark over the last three years. Poor performance in 2010 erased most of the average market-oriented manager's excess return generated in 2008 and 2009. The average manager in each substyle within Russell's Market Oriented universe underperformed in 2010, and managers in the Growth at a Reasonable Price and Value substyles particularly struggled. Large cap growth managers have been challenged over the last three years, on average, but managed to deliver positive performance versus the Russell 1000 Growth Index in 2010. Managers in the Momentum substyle of Russell's Growth universe were challenged during the volatile markets of 2008 and 2009, and the outperformance in 2010 was not enough to make the three-year excess returns positive.

Figure 20 / Data as of 12/31/2010



APPENDIX - Russell Universes

Asset Class	Universe Name	Universe Description
US Equity	Growth Equity Accounts	<p>Managers in this style try to identify large cap companies with above-average earnings growth prospects. In general, two basic categories of securities are owned</p> <ul style="list-style-type: none"> • Companies with consistent above-average historical and prospective profitability and growth • Those expected to generate above-average near-term earnings momentum based upon company, industry, or economic factors. <p>In this category, securities may not have exhibited above-average historical growth but they are expected to do so over the near future. This universe is comprised of large cap accounts.</p>
US Equity	Market Oriented Equity Accounts	<p>Managers in this style do not evidence a consistent preference for large cap companies emphasized in value or growth. However, two distinct types of organizations fall into this category</p> <ul style="list-style-type: none"> • Those that construct portfolios with growth and valuation characteristics similar to the broad market over a market cycle • Those willing to make meaningful bets in growth or value emphasis across time, but with no consistent preference.
US Equity	Value Equity Accounts	<p>Managers in this group are large cap "value investors." While differences exist in how managers in this style define "value," an issue's current market price is a critical variable. For example, some organizations focus on companies having low absolute or relative P/E ratios, while others stress issues with above-market dividend yields. Additional measures that are frequently used are price/book value and price/sales ratios. A stock whose price has declined because of adverse investor sentiment may also attract some of these managers. Historical growth and profitability characteristics frequently are well below market averages, and overall characteristics are in sharp contrast to those of Growth managers.</p>
US Equity	Midcap Growth Equity Accounts	<p>Managers in this substyle try to identify companies with above-average earnings growth prospects. These managers are willing to pay above-market multiples for the superior growth rate/profitability they anticipate. In general, two basic categories of securities are owned:</p> <ul style="list-style-type: none"> • Companies with consistent above-average historical and prospective profitability and growth. • Companies expected to generate above-average near-term earnings momentum based upon company, industry, or economic factors. In this category, securities may not have exhibited above-average historical growth but are expected to do so over the near future. <p>Other typical characteristics of this substyle include selection of higher quality companies; emphasis on consumer service, health care, and technology stocks; and light weightings in deep cyclicals and defensive stocks.</p> <p>Focus is on earnings growth and/or profitability, either above average or accelerating. In addition, dividend yield is frequently well below market averages, valuation statistics frequently are above market averages, volatility of returns is above that of the market, and beta is frequently above 1.0.</p>

Asset Class	Universe Name	Universe Description
US Equity	Midcap Market Oriented Equity Accounts	<p>These managers do not evidence a consistent preference for the types of companies emphasized in Midcap Value or Midcap Growth portfolios. However, two distinct types of organizations fall into this category:</p> <ul style="list-style-type: none"> • Those that construct portfolios with growth and value characteristics similar to the broad market over a market cycle; • and those willing to make meaningful bets in growth or value emphasis across time, but with no consistent preference. <p>Portfolios may either be well diversified or take meaningful sector/factor bets relative to the market toward both growth and value over time. Average growth and valuation characteristics over time are near those broad Midcap market indexes.</p>
US Equity	Midcap Value Equity Accounts	<p>While differences exist in how managers in this style define "value," an issue's current market price is a critical variable. For example, some organizations focus on companies having low absolute or relative P/E ratios, while others stress issues with above-market dividend yields. Additional measures that are frequently used are price/book value and price/sales ratios. A stock whose price has declined because of adverse investor sentiment may also attract some of these managers. Historical growth and profitability characteristics frequently are well below market averages, and overall characteristics are in sharp contrast to those of Midcap Growth managers.</p> <p>The focus is on buying securities at low valuations on an absolute basis or relative to the market and/or historical levels. Portfolios typically exhibit below-average price/book value ratios, below-average P/E ratios, and/or high dividend yields. Risk characteristics in terms of volatility and beta vary but frequently are below market averages.</p>
US Equity	Small Cap Growth Equity Accounts	<p>These managers emphasize less seasoned companies with above-average, long-term growth prospects. Portfolios typically display heavy concentrations in technology, health care, consumer, and service sectors and above-market valuation characteristics.</p>
US Equity	Small Cap Market Oriented Accounts	<p>These managers select from a broad cross-section of small companies, and exhibit growth and valuation characteristics similar to small stock indexes such as the Russell 2000 Index or Russell 2500 Index.</p>
US Equity	Small Cap Value Equity Accounts	<p>These managers select small, under-researched companies that are considered undervalued relative to earnings, assets, or revenues. Portfolios typically emphasize financial services, regulated industries, and industrial cyclicals, and exhibit below-average valuation and growth characteristics.</p>
US Equity	Market-Oriented – Growth at a Price Equity Accounts	<p>A subset of the Market Oriented Universe, Growth at a Price managers construct portfolios with above-average profitability and/or earnings growth selling at market level or lower P/E multiples. Portfolios are frequently concentrated in consumer, service, and financial services, and typically exhibit below-average earnings variability and strong balance sheet characteristics.</p>

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First use: March 2011.

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