



# Multi-Strategy Absolute Return Fund

Second Quarter 2011

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**Not FDIC Insured**

**Not Bank Guaranteed**

**May Lose Value**

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# Eaton Vance Company Profile

**Total AUM\*— \$200.0 billion as of 6/30/2011**

## Focus

- Investment management is our only business since 1924
- Executive Management team led by investment professionals
- Our clients' success is the foundation of our business philosophy

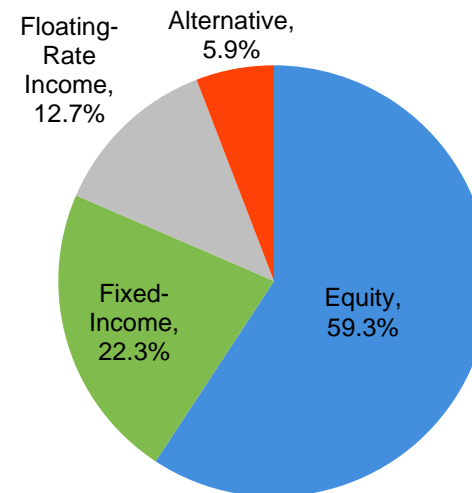
## Unique Organizational Structure

- Nineteen senior members control voting stock and strategic direction of firm
- Structure differentiates us and facilitates long-term perspective

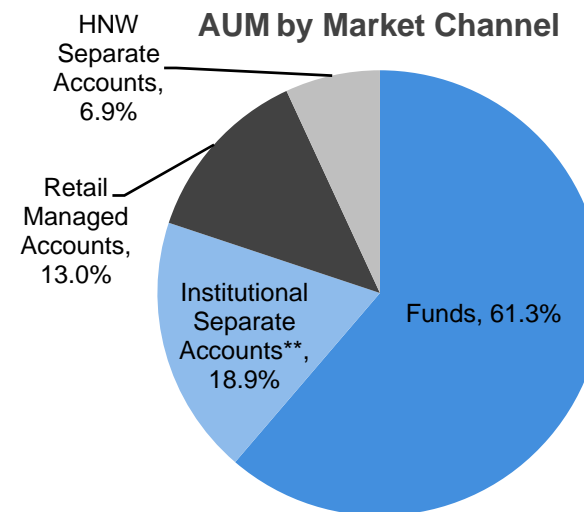
## Firm Stability

- Strong balance sheet, wide range of investment disciplines and distribution channels
- Risk management fundamental to our investment philosophy and business practices
- Long staff tenures, low turnover rates—engaged and committed workforce

**AUM by Asset Class**



**AUM by Market Channel**



\*Eaton Vance Management and its affiliates.

\*\*Institutional includes ISLF, DCIO, Commingled Trusts, International (Ireland) Funds and R shares. Eaton Vance Management's institutional assets represent 11.54% of the total firm assets, with the remaining percentage representing institutional assets of EVM affiliates.



# Multi-Strategy Absolute Return

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A flexible, tactically-managed asset allocation fund employing an absolute return investment approach.

- Formerly Diversified Income Fund
- **Eaton Vance Customized Solutions Group (CSG) took over management on 7/1/2009**
  - New name: Multi-Strategy Absolute Return Fund
  - New objective: Seeks total return
  - New primary benchmark: BofA Merrill Lynch 3-month U.S. Treasury Bill Index<sup>1</sup>
  - Tactically allocated “fund of funds” approach:
    - Broad array of EV portfolios available including CSG-run MSAR Completion Portfolio<sup>2</sup>
  - NOT a typical “fund of funds” pricing structure – invests at “portfolio” level
- Investment guidelines:
  - Duration: -5 to 5 years
  - Target annualized volatility<sup>3</sup>: 2% to 6.5%

Source: Eaton Vance. <sup>1</sup>BofA Merrill Lynch 3 Month U.S. Treasury Bill Index is an unmanaged index of U.S. Treasury securities maturing in 90 days. <sup>2</sup>Prior to 6/7/11, Portfolio was named Multi-Sector Option Strategy Portfolio. <sup>3</sup>Actual or realized volatility can and will differ from the target volatility described above.

# The Management Team

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- Jeffrey Rawlins and Dan Strelow, Vice-Presidents & Co-Directors
  - Worked together for over 22 years
  - 16 years at State Street Research
  - 6 years at Eaton Vance
  - Historically only available to institutional investors and platforms
  - Previously managed \$10 Billion in liability-driven investing (LDI) and free-to-roam strategies for major Fortune 500 corporations (Ford, MetLife, Wyeth, Boeing, General Dynamics)
- Justin Bourgette, Vice President and Senior Analyst
  - Portfolio optimization, allocation and risk management
- Tom Shively, Vice President and Portfolio Strategist
  - Worked with Jeff and Dan over the course of three decades
  - 17 years at State Street Research; Chief Fixed-Income Officer, 1991-2001
  - Worked as a consultant to Eaton Vance in recent years

Team focuses on asset allocation and relies on the firm's seasoned portfolio managers for security selection and sub-sector allocations

## Team Philosophy

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- Markets are inefficient at the asset class level, due to investor herding and policy interference.
- Price matters: asset returns are a function of the price paid for the asset, as well as the asset's fundamental characteristics.
- Risk is multi-dimensional: price volatility, permanent loss of capital, and true uncertainty.
- Effective risk management deals with all dimensions, both quantitatively and qualitatively.
- We seek to buy assets at prices that produce attractive risk-adjusted returns over a long-term horizon.
- We seek alternative strategies capable of producing alpha-based returns in all environments.

# Absolute Return Approach

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- Free-to-roam / unconstrained to a market-based benchmark:
  - Traditional market-based benchmarks are sub-optimal
  - Seek best available risk-adjusted returns
- Forward looking risk-budgeting and stress-testing:
  - Manage portfolios to strict volatility bands
  - Take a conservative approach to risk and stress calculations
- Over the course of the cycle:
  - Dial expected level of risk (volatility) in portfolio up/down
  - Change types of risk in portfolio: Alpha versus Beta
- When markets are undervalued:
  - Portfolios should have increased exposure to risky assets (Beta)
  - Manage expected volatility near the higher end of volatility band
  - High correlation to risky assets (S&P, High Yield...) is desirable
- When markets are overvalued:
  - Focus on Alpha driven investment strategies
  - Manage expected volatility near the low end of the volatility band
  - Possess the ability to short

## Process – Step One

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### **Risk-return model construction:**

- Data collection, stratification, and analysis
- Volatility metrics by asset and asset class; correlation matrices and regimes
- Valuation metrics driven by fundamental factors that have exhibited predictive power over time
- Forward-looking, macro-driven scenarios: base case and stress cases, better and worse

## Process – Step Two

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### **Scenario-driven portfolio optimization:**

- Risk acceptance based on incremental expected return – take more risk when markets appear undervalued
- Iterative portfolio construction process, qualitatively adjusting holdings relative to a diverse set of quantitative scenarios
- Include alpha-based strategies in the mix and manage both beta and alpha exposures
- Employ outright hedging strategies to manage volatility and help to limit specific downside risk

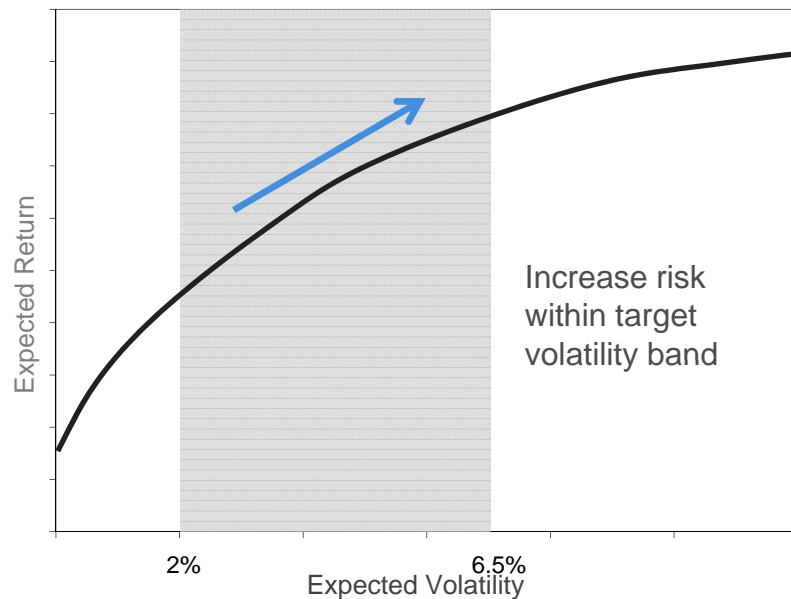


## Process – Step Three

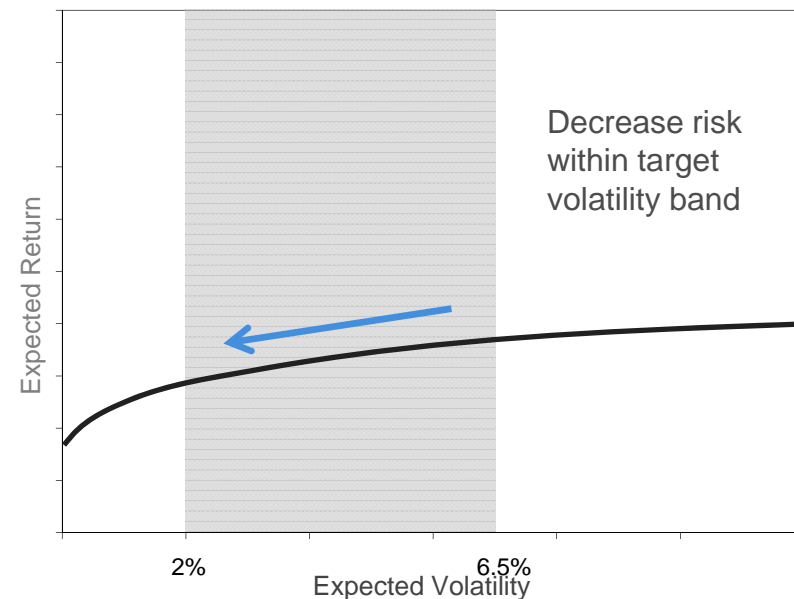
### Volatility-band portfolio management:

- When risky assets appear attractive, increase exposure (beta) to those assets, and move to higher end of portfolio volatility band.
- When risky assets appear less attractive, decrease exposure to those assets, focus on alpha-based strategies, and move to lower end of portfolio volatility band.

A steeper frontier, risky assets are attractive:



A flatter frontier, risky assets are less attractive:



9 Source: Eaton Vance. Hypothetical in nature. Not intended to represent any Eaton Vance product. Actual or realized volatility can and will differ from the target volatility described above.

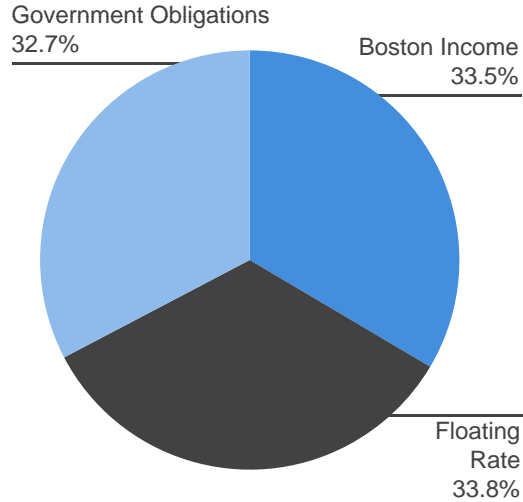
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# Tactical Allocations Over Time

Manager inception: 7/1/2009.

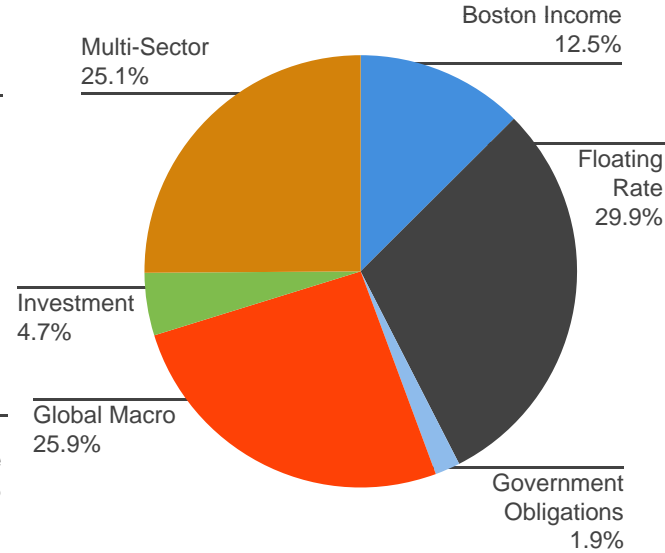
**6/30/2009**

Duration: 2.23 years  
Trailing 12-month volatility: 16.61%



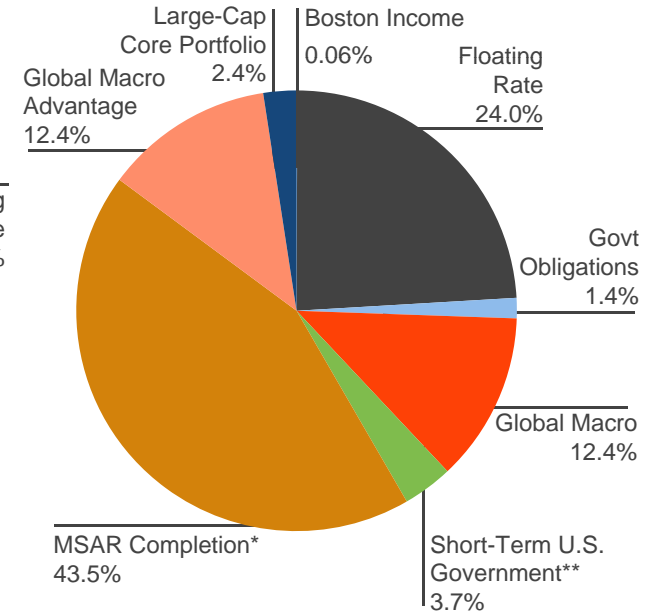
**6/30/2010**

Duration: 1.53 years  
Trailing 12-month volatility: 3.92%



**6/30/2011**

Duration: 0.38 years  
Trailing 12-month volatility: 1.05%



Source: Morningstar, Eaton Vance. By percentage of total net assets. The Fund may also invest directly in securities and derivative instruments. Portfolio information is subject to change due to active management. Fund statistics may not be representative of the Fund's current or future investments. Reflects the Fund allocable shares of the Portfolios it invests in. Volatility is represented by standard deviation of returns. Past performance is not a guarantee of future results. \*Prior to 6/7/11, Portfolio was named Multi-Sector Option Strategy Portfolio. \*\*Prior to 6/7/11, Portfolio was named Investment Portfolio

# Tailoring Multi-Strategy Absolute Return Fund

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## The MSAR Completion Portfolio.

- Gain exposure to asset classes not directly available in other Eaton Vance portfolios (e.g. CMBS)
- Tailor exposures (e.g. investment grade credit)
- Manage duration (e.g. U.S. Treasury futures and options)
- Manage tail risk (e.g. put options on the S&P 500)
- Hedge positions (e.g. buy equity portfolio and simultaneously sell S&P 500 futures)
- Option overlay (e.g. option absolute return strategy sub-advised by Parametric Risk Advisors, LLC)

# MSAR Completion Portfolio

As of 6/30/2011.

	% Completion Portfolio*	% Fund*	Rationale
Cash	66.5	28.8	Cash for entire Fund; collateral for OARS and “dry powder” for opportunities as they arise
IG Corporate Bonds	5.5	2.4	Ex-financials; haven’t owned a financial security since repeal of Glass-Steagall
CMBS	28.2	12.2	High quality**, senior, seasoned (underwritten before 2006), often Treasury defeasance
U.S. Treasury Futures	-7.2	-3.1	Manage duration
S&P 500 Futures	-5.3	-2.3	Hedging Large-Cap Core Research allocation
S&P 500 Put Options (varied strike prices)	19.1	8.3	Seeking tail risk protection for Floating-Rate
OARS	33.3	14.4	Another Alpha source

12 Source: Eaton Vance. MSAR Completion Portfolio was 43.3% of the Fund as of 6/30/11. \*Market value or economic value is shown depending upon relevance. \*\*As rated by Moody’s, S&P or Fitch.

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## Important Fund Characteristics as of 6/30/2011

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Duration	0.38 years
Distribution Rate (A-share)	1.96%
SEC 30-Day Yield (A-share)	1.31%

### Since manager inception annualized (7/1/2009)

Total Return	9.89%
Volatility (Std Dev.)	3.08%
Sharpe Ratio	3.17

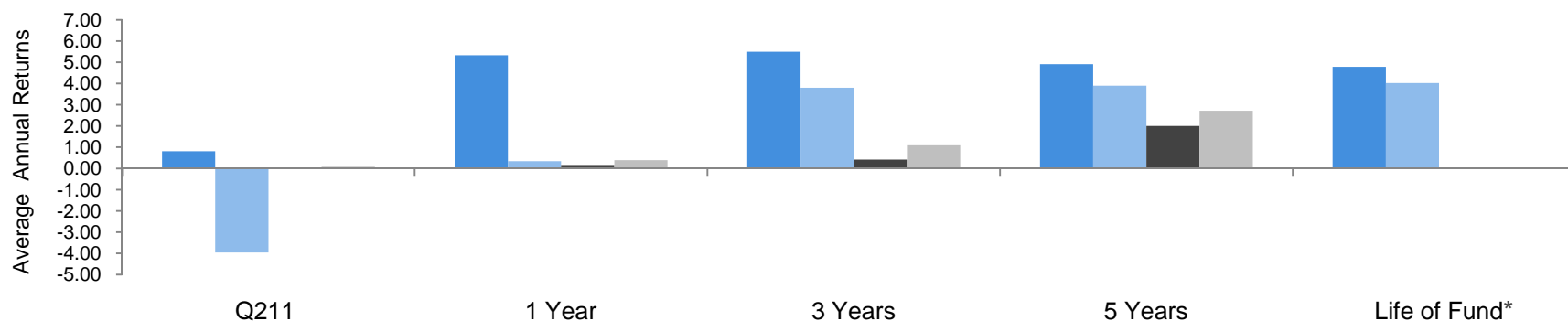
**Past performance is no guarantee of future results. Please refer to pages 14 and 35 for important information and disclosures.**

13 Source: Eaton Vance, Morningstar.

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# Multi-Strategy Absolute Return Fund (A)



% Average Annual Total Returns (A Shares as of 6/30/2011)		Q211	1 Year	3 Years	5 Years	Life of Fund*
■	Fund at NAV	0.81	5.33	5.50	4.91	4.79
■	Fund with Max. 4.75% Sales Charge	-3.96	0.34	3.80	3.90	4.02
■	BofA Merrill Lynch 3-Month U.S. Treasury Bill Index	0.04	0.16	0.42	2.00	--
■	BofA Merrill Lynch 3-Month LIBOR Constant Maturity Index	0.08	0.39	1.09	2.72	--

% Calendar Year Returns (Fund performance without sales charges)		2006	2007	2008	2009	2010	YTD as of 6/30/2011
	Fund at NAV	7.05	3.80	-19.40	33.14	7.25	0.81
	BofA Merrill Lynch 3-Month U.S. Treasury Bill Index	4.86	5.00	2.06	0.21	0.13	0.04
	BofA Merrill Lynch 3-Month LIBOR Constant Maturity Index	5.14	5.61	3.82	0.99	0.33	0.08

\*Performance inception date: December 7, 2004.

Past performance is no guarantee of future results. Investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Performance is for the stated time period only; due to market volatility, the Fund's current performance may be lower or higher than quoted. For the Fund's performance as of the most recent month end, please refer to [www.eatonvance.com](http://www.eatonvance.com). Returns are historical and are calculated by determining the percentage change in net asset value (NAV) with all distributions reinvested. Returns for other classes of shares offered by the Fund are different. Prior to 7/1/09, the Fund had a predetermined fixed allocation equally among asset classes investing in mortgage-backed securities, senior floating-rate loans and high-yield bonds. The Fund has changed its objective and investment strategy to permit investment in multiple Eaton Vance Portfolios and Funds.

BofA Merrill Lynch 3 Month U.S. Treasury Bill Index is an unmanaged index of U.S. Treasury securities maturing in 90 days. BofA Merrill Lynch 3-Month LIBOR Constant Maturity Index represents an unmanaged, high-quality base rate for 3-month, constant maturity, U.S. dollar-denominated deposits. It is not possible to invest directly in an index.



# Summary

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## A flexible, tactically managed strategy employing an absolute return approach.

- Management team led by Jeff Rawlins and Dan Strelow – over 22 years working together as of 6/30/2011
  - Conservative, long-term investors
  - Ran LDI and free-to-roam strategies at State Street for Fortune 500 pension plans  
Ford, MetLife, Wyeth, Boeing, General Dynamics
- Team makes allocation decisions, relies on individual EV managers' for security selection
  - Utilize MSAR Completion Portfolio\* to optimize desired exposures
- Forward-looking investment process
  - Not constrained to a traditional, market-based benchmark
  - Driven by fundamentals and valuations
  - Supported by quantitative tools (80+ years of data)
  - Identify market inefficiencies at the sector level
  - Calculate expected risks, returns and correlations - optimize the efficient frontier
- Risk-On, Risk-Off
  - When markets appear overvalued - take risk off:
    - Move towards the 2% low-end of the volatility range
    - Shift to more Alpha-seeking strategies (e.g. global macro, OARS, hedged equity)
  - When markets appear undervalued - put risk on:
    - Move towards the 6.5% high-end of the volatility range
    - Increase allocations to Beta-exposed strategies (e.g. high yield, floating-rate loans, investment-grade corporates)

# Appendix I

## Q2 2011 Economic Outlook



## Long-Term Trends – Q2 2011

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- Globalization of labor and product markets:
  - Outward supply shift of labor and tradable products from emerging economies
  - Widening gap between returns to labor and to capital; thus high profit margins
  - Income polarization and consequential political/populist reactions
- Global and regional systemic imbalances in savings, investment, and consumption:
  - Dysfunctional global monetary system: currency pegs/zones, no balancing mechanism
  - Export-driven surplus nations have financed excesses of spendthrift deficit nations
  - Private debt growth replaced by public debt growth – now a sovereign debt problem
  - Global rebalancing is inevitable but will be exceedingly difficult to achieve
- Political and philosophical contention and confusion:
  - Market-based capitalism vs. state capitalism
  - Individual rights and democracy vs. collective security and authoritarianism
  - Regulatory uncertainty, interference, and failure: moral hazard
  - The inherent inflationary bias of fiat currencies managed by political appointees
  - The Keynesian end game – what comes next? Trade protectionism?

## Intermediate-Term Outlook – Q2 2011

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- Global growth – unbalanced, muddling-along, and vulnerable to de-stabilizing shocks:
  - Deficit and surplus nations must simultaneously adjust their behavior to rebalance the global economy in order to maintain economic growth and price stability.
  - So far, most of the adjustment is being focused on deficit nations; we believe this cannot succeed.
  - Deflationary pressures of de-leveraging are being offset by extreme monetary ease.
- U.S. growth slowing, fiscal and monetary policies less supportive:
  - Weak income and employment growth; low consumer and business confidence
  - Higher ‘essentials’ inflation: food, energy, and now rent
  - Housing inventory hangover; regulatory hurdles to business formation/hiring/spending
  - Fiscal retrenchment: prospective spending cuts and/or tax hikes at all levels
  - Capital spending and export growth – positive but we think much more is needed

## Valuations – Q2 2011

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### – Credit Markets:

- Treasuries are priced for very weak growth or recession.
- Credit spreads have risen recently, even outpacing the deterioration in equities.
- European sovereign bond spreads now widening in the core as well as periphery.
- Emerging sovereign credits mostly reflect their lower leverage and higher reserves.

### – Equity Markets:

- U.S. market remains overvalued on normalized P/E and replacement costs.
- Profit margins are high, unlikely to rise further, and inevitably unsustainable.
- Global equity markets have benefited from global policy reflation, now ending.

## Investment Themes – Q2 2011

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- Positioned near low end of volatility band
- Low projected beta relative to equity risk and credit risk
- Focused on low volatility – both absolute return and alpha-based strategies, including Global Macro, Option Absolute Return Strategy and hedged equity

# Appendix II

## Model Framework

# Historical Data: Gather and Verify

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## Step 1: Stratify the investment universe into cells by:

- Fixed Income
  - Term structure (key rate durations and convexity)
  - Sector, quality & duration
- Equity
  - Market Capitalization
  - Style
  - Domicile

## Step 2: Collect historical data for each “stratified cell”:

- Fixed Income
  - Yield, OAS
  - Default, recovery, ratings transition
  - Total return & excess return to duration neutral treasuries
- Equity
  - Price, sales, earnings, dividends, P/E, profit margins, payout ratio
  - Total return

# Historical Data: Gather & Verify

## Fixed Income Stratified Cell Statistics: June 30, 2010

Stratified Cell	% Rank	YTE	1 DAY Change YTE	MTD Change YTE	QTD Change YTE	YTD Change YTE	Total Return % MTD	Total Return % QTD	Total Return % YTD	OAS	1 DAY Change OAS	MTD Change OAS	QTD Change OAS	YTD Change OAS	Excess Return % MTD	Excess Return % QTD	Excess Return % YTD	Excess SwapRn % MTD	Annual Implied YTE/OAS Volatility	Annual Return Volatility From Covar	Edur	Sdur	Convexity	Full Price	Market Value
<b>Key Rates</b>																									
Key Rate Curve/Cash	0%	0.25	0.00	0.00	0.00	0.00	0.02	0.06	0.12										1.18	0.59%	0.00	0.00	0.00		
Key Rate Curve/Key Rate 0.5	3%	0.20	0.00	-0.07	-0.03	-0.02	0.06	0.13	0.23										1.50	0.69%	0.50	0.50	0.00		
Key Rate Curve/Key Rate 1.0	1%	0.35	0.00	-0.11	-0.11	-0.19	0.16	0.29	0.54										1.07	1.03%	1.00	1.00	0.01		
Key Rate Curve/Key Rate 2.0	1%	0.64	0.02	-0.18	-0.39	-0.51	0.47	1.22	1.95										1.11	2.16%	1.99	1.99	0.05		
Key Rate Curve/Key Rate 3.0	1%	1.05	0.02	-0.25	-0.57	-0.69	0.92	2.38	3.52										1.16	3.40%	2.98	2.98	0.10		
Key Rate Curve/Key Rate 4.0	1%	1.45	0.01	-0.30	-0.61	-0.86	1.26	3.66	5.13										1.17	4.58%	3.97	3.97	0.18		
Key Rate Curve/Key Rate 5.0	1%	1.84	0.01	-0.33	-0.77	-0.86	1.97	4.96	6.67										1.16	5.68%	4.95	4.95	0.27		
Key Rate Curve/Key Rate 6.0	1%	2.20	0.00	-0.36	-0.83	-0.90	2.49	6.24	8.11										1.14	6.75%	5.93	5.93	0.38		
Key Rate Curve/Key Rate 7.0	1%	2.53	-0.01	-0.37	-0.86	-0.92	2.99	7.47	9.43										1.14	7.81%	6.91	6.91	0.51		
Key Rate Curve/Key Rate 8.0	1%	2.82	-0.01	-0.38	-0.88	-0.93	3.44	8.92	10.65										1.13	8.61%	7.89	7.89	0.66		
Key Rate Curve/Key Rate 9.0	1%	3.07	-0.01	-0.38	-0.89	-0.94	3.86	9.69	11.76										1.12	9.90%	8.86	8.86	0.83		
Key Rate Curve/Key Rate 10.0	1%	3.28	-0.02	-0.38	-0.90	-0.94	4.23	10.70	12.80										1.11	10.91%	9.84	9.84	1.02		
Key Rate Curve/Key Rate 15.0	1%	3.89	-0.03	-0.34	-0.87	-0.92	5.57	15.12	17.40										1.03	15.09%	14.71	14.71	2.24		
Key Rate Curve/Key Rate 20.0	2%	4.05	-0.04	-0.32	-0.85	-0.86	6.76	19.45	21.23										0.93	18.26%	19.60	19.60	3.94		
Key Rate Curve/Key Rate 25.0	3%	4.10	-0.05	-0.32	-0.84	-0.76	8.46	24.10	23.18										0.88	21.57%	24.50	24.50	5.12		
Key Rate Curve/Key Rate 30.0	4%	4.20	-0.05	-0.34	-0.82	-0.59	10.81	28.65	22.01										0.90	26.40%	29.39	29.39	8.78		
<b>US Treasury</b>																									
US Treasury   0-5	42%	0.94	0.01	-0.22	-0.49	-0.62	0.83	2.12	3.08	-1	0	1	1	0	0.02	1.32	2.28	-0.17	3	0.08%	2.64	2.64	0.10	104.726	3,066,372
US Treasury   5-8	73%	2.46	-0.01	-0.32	-0.80	-0.93	2.52	6.42	8.23	-1	0	0	0	-2	0.05	3.94	5.75	-0.17	5	0.31%	6.42	6.42	0.49	112.354	1,293,953
US Treasury   8+	18%	3.85	-0.03	-0.26	-0.72	-0.78	4.25	11.08	12.24	0	1	1	1	-3	-0.00	6.74	7.01	-0.34	5	0.63%	12.67	12.67	2.35	110.050	927,528
<b>US TIPS</b>																									
US TIPS   0-5	80%	0.25	0.02	-0.05	-0.17	-0.09	0.85	1.22	2.15	-128	-3	-13	44	27	0.18	0.54	1.48	0.14	108	4.31%	4.03	4.03	0.19	119.000	121,994
US TIPS   5-8	72%	0.75	0.00	-0.21	-0.42	-0.39	1.66	3.71	4.56	-166	-2	-13	46	49	0.19	2.23	3.09	0.16	99	6.26%	6.35	6.35	0.46	115.946	132,614
US TIPS   8+	83%	1.56	0.02	-0.14	-0.37	-0.38	2.68	7.39	7.03	-206	2	2	2	2	-0.66	4.85	4.59	-1.14	71	9.33%	13.14	13.14	2.12	129.700	230,480
<b>Municipal</b>																									
Municipal   0-5	97%	1.01	0.01	-0.05	-0.19	-0.04	1.52	4.00	3.72	-176	0	30	50	64	-1.59	2.08	1.38	-2.00	99	7.61%	7.76	7.76	0.11	98.738	854,789
Municipal   5-8	97%	3.11	0.02	0.04	-0.18	-0.16	0.08	1.88	2.81	111	-3	30	53	65	-1.76	0.04	0.98	-1.87	94	6.84%	7.32	7.32	0.15	102.814	552,035
Municipal   8+	90%	1.45	0.01	-0.02	-0.20	-0.15	0.32	1.26	1.58	47	-5	17	27	44	-0.27	0.67	0.99	-0.41	107	2.98%	2.82	2.82	-0.19	109.657	181,153
Municipal AAA 0-5	98%	3.03	-0.04	0.04	-0.15	-0.13	0.31	2.56	3.59	108	-7	35	66	75	-1.43	0.82	1.85	-1.54	94	6.08%	6.53	6.53	-0.02	111.224	116,386
Municipal AAA 5-8	98%	4.32	-0.02	0.07	-0.10	-0.11	-0.19	2.00	3.28	157	-3	36	67	76	-2.95	-0.77	0.52	-3.06	97	10.48%	10.88	10.88	0.47	95.286	254,496
Municipal AAA 8+	97%	4.30	0.04	0.08	0.04	0.01	-0.16	1.70	3.34	183	0	30	71	72	-2.24	-0.38	1.27	-2.34	104	8.62%	8.30	8.30	-0.06	102.104	225,338
Municipal A 0-5	97%	2.67	0.08	-0.01	0.07	0.02	0.22	1.13	1.97	161	1	18	41	45	-0.42	0.49	1.33	-0.52	115	3.23%	2.85	2.85	-0.78	106.791	53,581
Municipal A 5-8	98%	4.00	-0.04	0.03	-0.04	-0.08	0.16	2.24	3.53	197	0	1	1	1	0.15	3.72	6.30	0.00	28	1.96%	7.11	7.11	0.59	106.276	39,980
Municipal A 8+	97%	5.05	-0.03	0.09	0.01	-0.03	-0.43	1.76	3.77	150	-1	34	78	79	-3.22	-1.03	0.98	-3.32	108	11.82%	11.02	11.02	0.32	99.161	131,868
Municipal BBB	94%	5.56	0.01	0.11	0.30	0.24	-0.59	2.77	5.02	255	-1	28	94	94	-2.92	0.43	2.69	-3.03	123	11.36%	9.30	9.30	0.20	71.624	77,416
Municipal BBB 0-5	98%	3.62	-0.02	-0.01	0.39	0.40	0.28	1.81	3.00	263	11	7	98	105	-0.29	1.24	2.42	-0.39	134	3.35%	2.55	2.55	-1.28	104.980	12,441
Municipal BBB 5-8	94%	5.33	0.01	0.22	0.62	0.63	-0.12	6.21	4.25	260	-5	20	72	95	-1.89	0.85	2.49	-1.94	135	9.13%	6.81	6.81	-0.78	100.464	10,799
Municipal BBB 8+	94%	6.05	0.00	0.11	0.20	0.10	-0.88	3.03	5.67	255	2	35	98	92	-3.73	0.17	2.82	-3.88	123	13.87%	11.35	11.35	0.88	63.374	54,175
<b>LIBOR</b>																									
LIBOR Overnight	56%	0.31	0.01	0.01	0.08	0.14	0.03	0.97	0.12	16	1	1	8	26	0.01	0.06	0.10	0.00	113	0.04%	0.00	0.00	0.00		
LIBOR Month	43%	0.53	0.00	0.00	0.24	0.28	0.05	0.95	0.10	35	-5	-2	20	15	0.01	0.01	0.01	0.00	142	0.25%	0.25	0.25	0.00		
LIBOR 6Month	70%	0.75	0.00	0.00	0.31	0.32	0.06	0.00	0.00	53	-4	0	32	29	0.03	-0.03	0.07	0.00	96	0.44%	0.50	0.50	0.01		
Euro Dollar Swap  0-5	5%	1.48	0.01	-0.31	-0.42	-0.66	1.31	2.95	1.99	30	0	-7	13	0	0.22	1.36	3.00	0.00	27	0.86%	3.24	3.24	0.14		
Euro Dollar Swap  5-8	2%	2.72	0.00	-0.38	-0.76	-0.95	3.04	5.19	1	3	1	-3	6	-7	0.15	3.72	6.30	0.00	28	1.96%	7.11	7.11	0.59		
Euro Dollar Swap  8+	5%	3.53	-0.02	-0.34	-0.81	-0.87	5.06	12.58	14.68	20	-1	-3	-1	-7	0.36	7.88	9.98	0.00	39	5.40%	13.94	13.94	2.59		
<b>Agency</b>																									
Agency FFC	48%	1.69	0.01	-0.27	-0.45	-0.64	1.36	3.04	4.43	27	0	-5	6	-2	0.16	1.85	3.24	-0.02	34	1.23%	3.71	3.71	0.32	112.137	223,619
Agency FFC 0-5	4%	0.81	0.02	-0.28	-0.41	-0.67	0.62	1.20	2.68	20	1	-8	5	-4	0.17	0.75	1.84	0.00	61	1.10%	1.84	1.84	0.05	103.166	161,197
Agency FFC 5-8	96%	3.79	-0.02	-0.37	-0.87	-1.04	2.91	7.18	10.05	95	-1	0	1	-11	0.14	4.41	7.29	-0.03	35	2.46%	6.99	6.99	0.63	142.836	40,373
Agency FFC 8+	93%	4.23	-0.03	-0.34	-0.78	-0.77	4.11	10.11	11.24	63	0	-1	4	10	0.13	6.13	7.26	-0.17	26	2.88%	11.33	11.33	1.78	147.977	22,049
Agency Not FFC	7%	1.52	0.00	-0.31	-0.48	-0.61	1.08	2.66	3.80	25	0	-2	0	-2	0.02	1.60	2.74	-							

# Historical Data: Gather & Verify

## Fixed Income Stratified Cell Statistics: June 30, 2010

Stratified Cell	% Rank	YTE	1 DAY Change YTE	MTD Change YTE	QTD Change YTE	YTD Change YTE	Total Return % MTD	Total Return % QTD	Total Return % YTD	OAS	1 DAY Change OAS	MTD Change OAS	QTD Change OAS	YTD Change OAS	Excess Return % MTD	Excess Return % QTD	Excess Return % YTD	Excess SwapPtn % MTD	Annual Implied YTE/OAS Volatility	Annual Return Volatility From Covar	Edur	Sdur	Convexity	Full Price	Market Value
Corporate	64%	4.15	0.00	-0.22	-0.35	-0.56	2.17	4.19	6.69	177	0	9	38	20	-0.28	1.74	4.24	-0.51	92	6.36%	6.95	6.95	0.92	112.165	2,110,048
Corporate AAA/AA	55%	3.27	-0.17	-0.24	-0.48	-0.67	1.86	4.62	6.28	86	-24	-1	16	2	-0.67	2.09	3.76	-0.91	53	3.93%	7.45	7.45	1.07	112.199	201,900
Corporate AAA/AA 0-5	45%	1.78	-0.47	-0.32	-0.40	-0.73	-0.44	0.67	2.24	59	-51	-4	13	-7	-1.44	-0.33	1.24	-1.66	77	2.38%	3.15	3.15	0.13	107.404	83,931
Corporate AAA/AA 5-8	36%	3.51	-0.11	-0.35	-0.66	-0.93	1.85	5.17	7.79	83	-12	1	16	-4	-0.85	2.47	5.09	-1.05	63	4.23%	6.72	6.72	0.55	115.048	47,954
Corporate AAA/AA 8+	66%	4.89	-0.05	-0.37	-0.66	-0.66	5.12	9.84	10.73	121	0	-4	16	16	0.57	5.29	6.18	0.26	49	6.38%	13.10	13.10	2.56	116.455	70,016
Corporate A	64%	3.73	0.04	-0.24	-0.47	-0.59	2.69	5.33	7.36	134	5	7	26	15	0.16	2.80	4.83	-0.08	77	5.53%	7.22	7.22	1.01	113.138	849,877
Corporate A 0-5	64%	2.33	0.14	-0.10	-0.27	-0.53	0.98	2.17	4.05	117	12	15	31	11	0.04	1.23	3.11	-0.17	122	3.65%	3.03	3.03	0.12	109.532	328,625
Corporate A 5-8	59%	3.93	0.00	-0.32	-0.64	-0.81	2.68	5.77	8.41	131	2	4	21	11	-0.09	3.18	5.83	-0.11	83	5.45%	6.58	6.58	1.03	114.559	256,258
Corporate A 8+	68%	5.27	-0.05	-0.34	-0.57	-0.59	4.82	8.90	10.50	157	-1	-3	23	20	0.37	4.45	6.04	0.05	66	8.57%	13.03	13.03	2.58	116.502	264,794
Corporate BBB	70%	4.66	0.02	-0.18	-0.23	-0.51	1.84	3.23	6.26	229	2	13	52	27	-0.53	0.86	3.89	-0.76	116	7.65%	6.64	6.64	0.82	111.390	1,058,271
Corporate BBB 0-5	67%	3.39	0.05	-0.10	-0.03	-0.49	0.87	1.69	4.40	213	2	15	51	13	-0.12	1.70	3.40	-0.33	175	5.37%	3.11	3.11	0.12	109.769	394,305
Corporate BBB 5-8	71%	4.97	0.01	-0.25	-0.34	-0.66	2.03	3.61	7.31	234	1	11	50	25	-0.49	1.09	4.79	-0.69	130	8.28%	6.43	6.43	0.53	112.898	387,114
Corporate BBB 8+	70%	6.06	-0.03	-0.21	-0.28	-0.35	2.97	4.90	7.46	242	0	11	54	26	-1.16	0.73	3.50	-1.50	90	10.76%	11.98	11.98	2.22	111.653	276,761
Financial	82%	4.65	-0.01	-0.27	-0.03	-0.59	1.84	1.56	5.01	269	2	2	69	17	-0.03	-0.31	3.13	-0.25	148	7.82%	5.32	5.32	0.53	105.154	1,110,576
Financial AAA/AA	84%	3.37	0.01	-0.27	-0.21	-0.50	1.80	2.36	4.76	162	-1	0	47	24	0.12	0.68	3.08	-0.10	95	4.60%	4.89	4.89	0.48	107.137	384,607
Financial AAA/AA 0-5	84%	2.54	0.03	-0.23	-0.13	-0.43	0.96	1.34	3.22	143	-1	0	45	24	0.05	0.43	2.31	-0.16	116	3.36%	2.94	2.94	0.11	106.218	252,430
Financial AAA/AA 5-8	85%	4.51	-0.02	-0.38	-0.32	-0.62	2.85	3.47	6.66	190	-1	0	53	26	0.26	0.88	4.07	0.06	95	6.18%	6.54	6.54	0.53	108.902	88,495
Financial AAA/AA 8+	85%	5.85	-0.05	-0.32	-0.27	-0.47	4.68	6.01	9.81	214	-2	0	52	27	0.26	1.59	5.39	-0.06	80	10.26%	12.84	12.84	2.54	109.009	43,682
Financial A	87%	4.84	-0.01	-0.26	0.02	-0.38	1.90	1.37	4.38	279	-4	2	73	40	-0.05	-0.58	2.43	-0.27	166	9.07%	5.49	5.49	0.54	105.551	540,560
Financial A 0-5	85%	3.83	-0.01	-0.25	0.15	-0.36	1.19	0.75	3.50	262	-4	-2	69	25	0.21	-0.24	2.51	0.00	274	8.35%	3.09	3.09	0.11	105.379	269,653
Financial A 5-8	87%	5.56	-0.04	-0.29	-0.02	-0.33	2.22	1.49	4.85	301	-5	6	33	58	-0.20	-0.93	2.44	-0.40	151	9.32%	6.21	6.21	0.47	106.322	190,590
Financial A 8+	88%	6.50	-0.06	-0.26	-0.16	-0.31	3.54	3.17	6.22	286	-3	6	68	50	-0.55	-0.92	2.13	-0.86	106	12.53%	11.83	11.83	2.17	104.326	80,318
Financial BBB	83%	6.68	0.00	-0.25	0.24	-1.27	1.75	0.53	7.35	450	-2	5	98	64	-0.28	-1.50	5.32	-0.50	214	12.09%	5.69	5.69	0.61	100.425	194,409
Financial BBB 0-5	81%	6.13	0.01	-0.26	0.40	-1.93	1.37	0.84	6.95	479	1	1	99	135	0.30	-0.24	5.87	0.09	367	11.69%	3.23	3.23	0.15	101.111	94,373
Financial BBB 5-8	86%	6.96	0.01	-0.28	0.18	-0.73	2.21	0.30	8.02	438	1	9	100	13	-0.21	-2.12	5.80	-0.40	204	12.52%	6.19	6.19	0.49	101.808	62,161
Financial BBB 8+	87%	7.60	-0.07	-0.17	0.06	-0.48	1.97	0.37	7.60	401	-4	16	90	33	-1.85	-3.45	3.79	-2.13	143	15.75%	11.04	11.04	1.95	96.637	37,874
Non-Corporate	94%	3.12	0.01	-0.14	-0.13	-0.08	1.11	2.26	4.52	128	1	12	48	45	-0.68	0.47	2.74	-0.89	53	2.70%	5.10	5.10	0.52	107.650	856,763
Non-Corporate AAA/AA	93%	2.33	0.01	-0.16	-0.23	-0.26	1.01	2.42	4.33	83	1	10	35	27	-0.46	0.96	2.87	-0.67	31	1.33%	4.30	4.30	0.39	105.553	594,668
Non-Corporate AAA/AA 0-5	91%	1.70	0.02	-0.13	-0.16	-0.38	0.65	1.36	2.87	71	1	8	34	21	-0.18	0.54	2.04	-0.38	35	0.92%	2.70	2.70	0.10	104.493	445,073
Non-Corporate AAA/AA 5-8	88%	3.41	-0.01	-0.21	-0.48	-0.65	1.75	4.10	6.80	92	0	13	35	23	-0.70	1.65	4.35	-0.91	35	2.22%	6.33	6.33	0.48	112.831	74,551
Non-Corporate AAA/AA 8+	99%	5.02	-0.01	-0.14	-0.41	-0.26	2.36	7.05	10.71	144	2	19	40	48	-1.82	0.88	6.54	-2.10	37	4.31%	11.81	11.81	2.04	105.140	75,044
Non-Corporate A	93%	4.58	0.01	-0.08	0.25	0.68	0.25	1.36	3.27	238	-2	26	75	92	-1.99	-0.99	1.02	-2.22	74	4.62%	6.25	6.25	0.70	105.388	97,183
Non-Corporate A 0-5	92%	3.37	0.02	-0.14	-0.05	-0.10	0.84	0.75	2.32	216	1	14	56	64	-0.15	-0.24	1.33	-0.36	128	3.84%	3.04	3.04	-0.03	107.489	51,800
Non-Corporate A 5-8	92%	4.63	-0.01	-0.17	-0.25	-0.27	1.99	3.90	6.59	185	0	17	57	55	-0.62	1.20	3.99	-0.81	96	6.42%	6.69	6.69	0.56	112.305	14,855
Non-Corporate A 8+	99%	6.61	0.02	0.18	0.22	0.50	-1.56	2.00	4.21	302	6	54	102	136	-5.67	-2.10	0.11	-5.96	56	6.35%	11.49	11.49	2.02	99.132	30,538
Non-Corporate BBB	80%	5.08	-0.02	-0.23	-0.08	-0.12	1.98	2.21	5.88	227	0	8	73	68	-0.69	-0.46	1.33	-0.92	117	8.48%	7.30	7.30	0.82	118.624	163,902
Non-Corporate BBB 0-5	83%	3.94	-0.01	-0.25	0.32	0.06	1.09	0.84	3.93	230	-2	2	95	75	-0.04	-0.29	2.80	-0.24	139	4.46%	3.26	3.26	0.06	113.379	35,628
Non-Corporate BBB 5-8	74%	5.10	-0.03	-0.29	0.03	-0.14	2.09	0.56	1.59	228	-2	7	85	71	-0.40	-1.53	2.11	-0.58	143	9.05%	6.39	6.39	0.54	115.569	71,724
Non-Corporate BBB 8+	77%	6.78	-0.01	-0.19	-0.40	-0.27	2.41	4.72	9.11	223	2	14	44	58	-1.49	0.83	5.22	-1.77	102	11.13%	11.01	11.01	1.83	123.314	56,650
High Yield	68%	9.03	0.06	-0.07	0.53	-0.07	1.30	-0.03	4.71	714	8	24	129	74	-0.30	-1.63	3.11	-0.49	342	14.89%	4.40	4.40	0.20	97.896	881,613
High Yield BB Total	81%	7.41	0.10	-0.07	0.42	-0.12	1.59	0.63	5.25	530	5	18	112	60	-0.21	-1.18	3.44	-0.41	244	12.01%	4.97	4.97	0.30	101.304	364,177
High Yield B Total	71%	8.99	0.09	0.04	0.64	0.30	1.26	-0.08	3.47	711	8	30	135	109	-0.24	-1.58	1.97	-0.42	376	15.18%	4.08	4.08	0.09	100.104	354,780
High Yield <=CCC Total	45%	12.83	0.19	0.23	1.04	-0.08	0.68	-1.07	6.34	1,122	25	57	187	83	-0.65	-2.41	5.01	-0.84	601	22.14%	3.73	3.73	0.13	89.262	162,657
Bank Loan Total	72%	6.39	0.03	-0.10	-0.15	-0.59	-0.60	-1.27	3.01	511	2	13	56	-78	-0.61	-1.28	3.00	-0.64	153	6.00%	0.13	3.65	0.00	93.110	65,811
Bank Loan BB Total	72%	4.41	0.01	-0.22	-0.30	-0.37	0	0	0	281	0	8	40	-7	0	0	0	0	98	3.55%	0.13	4.10	0.00	93.211	22,002
Bank Loan BB 0-5	77%	5.39	0.01	-0.23	-0.13	-0.77	0	0	0	380	0	7	58	3	0	0	0	0	122	4					



# Build Risk Framework

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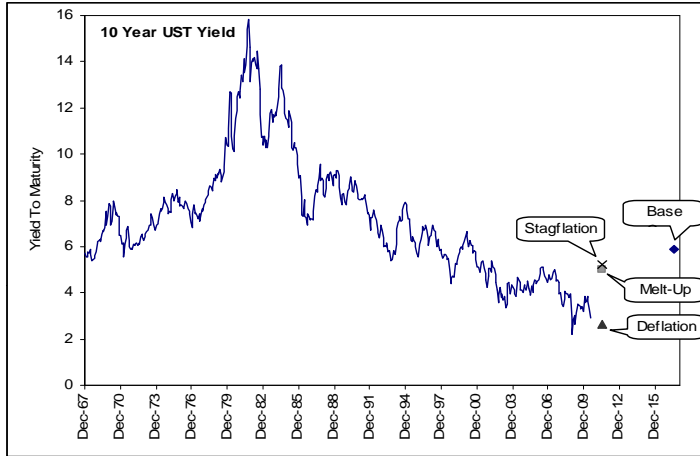
Goal: To build a forward-looking risk framework which adequately captures potential downside risk

- Step 1: Build correlation and risk regimes – segment history into scenarios:
  - Stress down (high correlation, high volatility)
  - Normal
  - Stress up (high correlation, low volatility)
- Step 2: Re-weight regime correlation matrices based on forward-looking views on risk
  - Advantages
    - Uses all available history
    - Ability to massage history to suit forward looking view

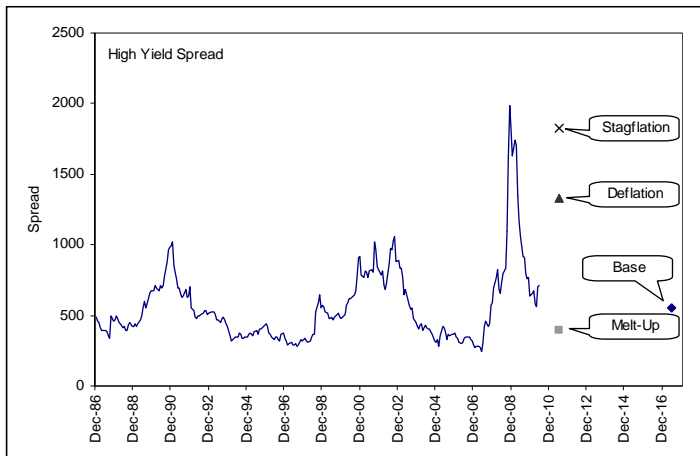
# Model Forward-Looking Return Assumptions

## Example: Forecasting Returns on High Yield

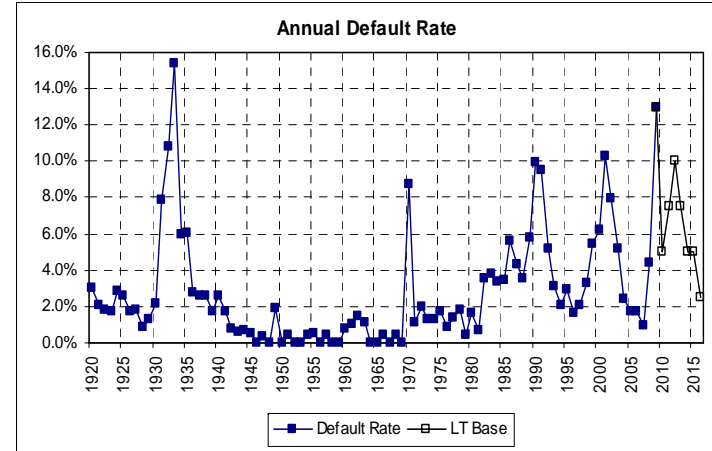
### 1- The horizon US Treasury yield curve



### 2- The horizon High Yield spread to UST yield curve



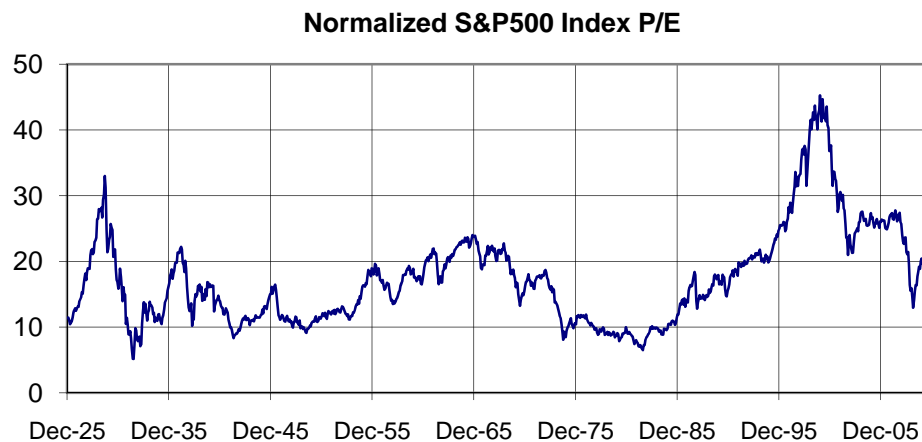
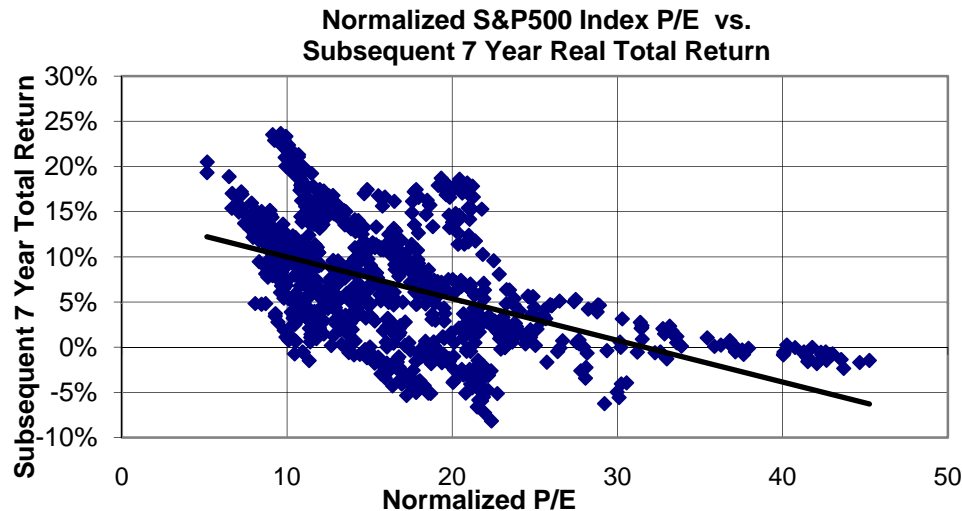
### 3- Defaults, recoveries and ratings transitions



- Develop expectations for:
  - Treasury yield curve
  - Spreads
  - Defaults and recoveries
- Run through multiple scenarios including:
  - Inflation
  - Stagflation
  - Melt-down
  - Melt-up
- Determine both short and long-term expectations for risk and returns

# Model Forward-Looking Return Assumptions

## Example: Forecasting Returns on S&P 500



### – Decomposition of Total Returns (Jan 1926 September 2010)

- Nominal Total Return = 9.8%
- Average Dividend Yield = 4.0%
- Dividend Reinvestment = 0.4%
- Real EPS Growth = 1.8%
- P/E Expansion = 0.5%
- Inflation = 3%

### – Current Environment

- Normal P/E's above long term average
- Low Dividend Yields
- Economic Headwinds

### – Forward-looking

- Sales Growth
- Profit Margins
- Payout Ratios
- Terminal P/E

# Build Stress Test Scenarios

Sample: June 30, 2010

Scenario #	1	2	3	4	5	6	7	8	9	10	11	
Name Horizon	Fair Value 7	Middle-Through 7	Middle-Through 3	Middle-Through 1	Deflation 3	Deflation 1	Stagflation 7	Stagflation 3	Stagflation 1	Melt-Up 3	Melt-Up 1	
GDP	3.00% 2.50%	2.50% 2.00%	2.50% 2.00%	2.50% 2.00%	1.00% 1.00%	1.00% 1.00%	2.00% 5.00%	2.00% 3.50%	2.00% 3.00%	3.00% 2.50%	3.50% 1.50%	
Nominal UST	Hypothetical Par YC FF@ 5.50% 90d 5.55% 2yr 5.60% 5yr 5.70% 10yr 5.90% 30yr 6.00%	Hypothetical Par YC FF@ 5.50% 90d 5.55% 2yr 5.60% 5yr 5.70% 10yr 5.90% 30yr 6.00%	Hypothetical Par YC FF@ 3.25% 90d 3.45% 2yr 4.10% 5yr 4.90% 10yr 5.40% 30yr 5.75%	Forward YC FF@ 1.00% 90d 1.09% 2yr 2.19% 5yr 3.49% 10yr 4.56% 30yr 4.98%	12/18/2008 Par YC FF@ 0.25% 90d 0.09% 2yr 0.48% 5yr 1.26% 10yr 2.62% 30yr 2.53%	12/18/2008 Par YC FF@ 0.25% 90d 0.09% 2yr 0.48% 5yr 1.26% 10yr 2.62% 30yr 2.53%	12/31/1991 Par YC FF@ 4.00% 90d 4.06% 2yr 4.81% 5yr 6.09% 10yr 6.88% 30yr 7.47%	Hypothetical Par YC FF@ 2.50% 90d 2.75% 2yr 3.50% 5yr 4.50% 10yr 5.50% 30yr 6.00%	Hypothetical Par YC FF@ 0.50% 90d 1.25% 2yr 3.00% 5yr 4.00% 10yr 5.00% 30yr 5.75%	Hypothetical Par YC FF@ 5.00% 90d 5.00% 2yr 5.10% 5yr 5.20% 10yr 5.40% 30yr 5.50%	Hypothetical Par YC FF@ 2.00% 90d 2.50% 2yr 3.25% 5yr 4.25% 10yr 5.00% 30yr 5.50%	
Labor	50th Percentile	50th Percentile	25th Percentile	Forward Yield Curve	12/18/2008 Spreads	12/18/2008 Spreads	75th Percentile	Hypothetical More "normal" Labor YC	Hypothetical More "normal" Labor YC	75th Percentile	Hypothetical More "normal" Labor YC	
Sector	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	Bank Loan Basic Credit Fin SF	
OAS/Price	50th 50th 50th 50th	50th 50th 60th 60th	50th 50th 60th 60th	50th 50th 60th 60th	96th 96th 96th 96th	96th 96th 96th 96th	75th 75th 75th 75th	75th 75th 75th 75th	03/06/2009 levels	20th 20th 20th 20th	30th 30th 30th 30th	
Notes	Amort. BL 1/5 of way to 50Th. MBS to 35th.											
Default Rate	1	5.0 5.0 5.0	5.0 5.0 5.0	5.0 5.0 5.0	5.0 5.0 5.0	7.5 7.5 7.5	7.5 7.5 7.5	7.5 7.5 7.5	7.5 7.5 7.5	7.5 7.5 7.5	5.0 5.0 5.0	5.0 5.0 5.0
	2	5.0 5.0 5.0	7.5 7.5 7.5	7.5 7.5 7.5	7.5 7.5 7.5	10.0 10.0 12.5	10.0 10.0 12.5	7.5 7.5 7.5	7.5 7.5 7.5	7.5 7.5 7.5	2.5 2.5 2.5	2.5 2.5 2.5
	3	5.0 5.0 5.0	10.0 10.0 12.5	10.0 10.0 12.5	10.0 10.0 12.5	12.5 12.5 15.0	12.5 12.5 15.0	7.5 7.5 7.5	7.5 7.5 7.5	7.5 7.5 7.5	2.5 2.5 2.5	2.5 2.5 2.5
	4	5.0 5.0 5.0	7.5 7.5 10.0					7.5 7.5 7.5	7.5 7.5 7.5			
	5	2.5 2.5 2.5	5.0 5.0 5.0					7.5 7.5 7.5	7.5 7.5 7.5			
	6	2.5 2.5 2.5	5.0 5.0 5.0					7.5 7.5 7.5	7.5 7.5 7.5			
	7	1.0 1.0 1.0	2.5 2.5 2.5					7.5 7.5 7.5	7.5 7.5 7.5			
	Cum.	26.0 26.0 26.0	42.5 42.5 47.5	22.5 22.5 25.0	5.0 5.0 5.0	30.0 30.0 35.0	7.5 7.5 7.5	52.5 52.5 52.5	22.5 22.5 22.5	7.5 7.5 7.5	10.0 10.0 10.0	5.0 5.0 5.0
Recovery Rate	1	70 45 45 0	70 45 45 0	70 45 45 0	70 45 45 0	65 40 40 0	65 40 40 0	65 40 40 0	65 40 40 0	65 40 40 0	70 45 45 0	70 45 45 0
	2	70 45 45 0	65 40 40 0	65 40 40 0	65 40 40 0	60 35 30 0	60 35 30 0	65 40 40 0	65 40 40 0	75 50 50 0	75 50 50 0	
	3	70 45 45 0	60 35 30 0	60 35 30 0	60 35 30 0	55 30 25 0	55 30 25 0	65 40 40 0	65 40 40 0	75 50 50 0	75 50 50 0	
	4	70 45 45 0	65 40 35 0					65 40 40 0	65 40 40 0			
	5	75 50 50 0	70 45 45 0					65 40 40 0	65 40 40 0			
	6	75 50 50 0	70 45 45 0					65 40 40 0	65 40 40 0			
	7	80 55 55 0	75 50 50 0					65 40 40 0	65 40 40 0			
EV Funds	Global Macro	4.00%	4.00%	4.00%	4.00%	-2.00%	-4.00%	0.00%	-2.00%	-4.00%	6.00%	8.00%
	OARS	6.00%	6.00%	6.00%	6.00%	-3.00%	-6.00%	0.00%	-3.00%	-6.00%	9.00%	12.00%
	Hedged LCCR	1.75%	1.75%	1.75%	1.75%	-1.00%	-4.00%	0.00%	-1.00%	-4.00%	2.63%	3.50%
Equity Market	Real Sales Growth	1.75%	1.60%	1.75%	1.75%	1.25%	1.25%	1.25%	1.25%		1.60%	
	Profit Margin	6.00%	6.00%	6.00%	6.00%	5.50%	5.50%	5.50%	5.50%		6.50%	
	Payout Ratio	50.00%	45.00%	45.00%	45.00%	50.00%	50.00%	50.00%	50.00%		45.00%	
	P/E	17.50	17.50	Unc	Unc	13.00	13.00	13.00	13.00		22.00	
Filename	Batch_FV-20100415.xls	Batch_MT7yr-20100415.xls	Batch_MT3yr-20100415.xls	Batch_MT1yr-20100415.xls	Batch_Def3yr-20100415.xls	Batch_Def1yr-20100415.xls	Batch_Stag7yr-20100415.xls	Batch_Stag3yr-20100415.xls	Batch_Stag1yr-20100415.xls	Batch_Up3yr-20100415.xls	Batch_Up1yr-20100415.xls	

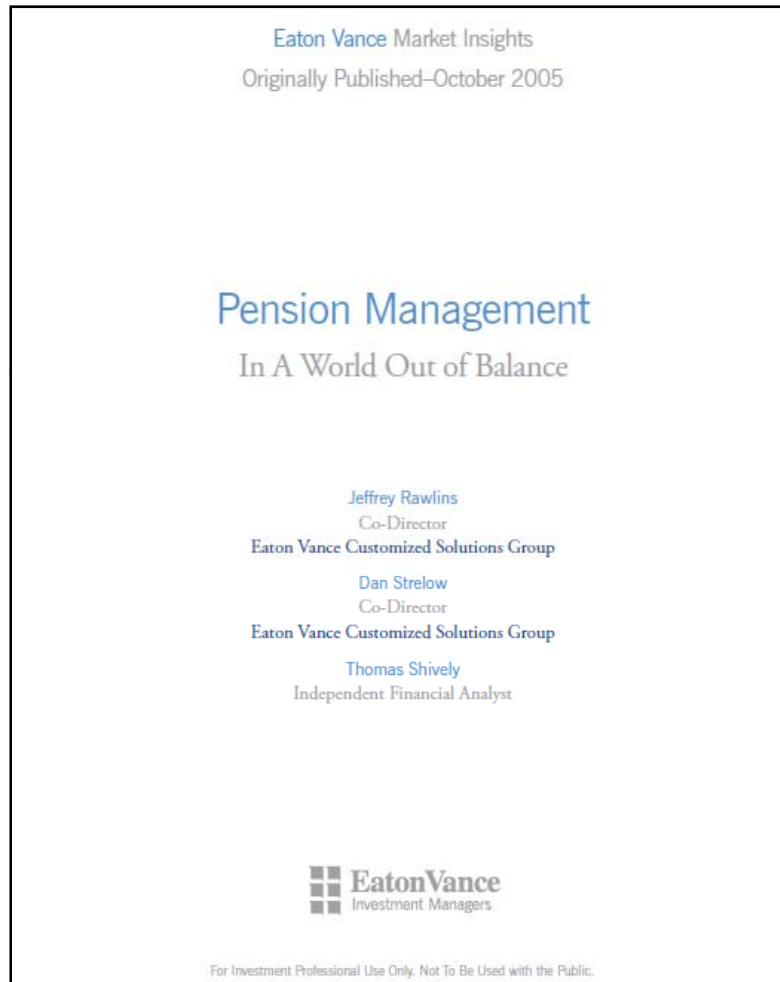
# Appendix III

## Whitepaper Review

# Pension Management In A World Out Of Balance - October 2005

## The Macro Environment

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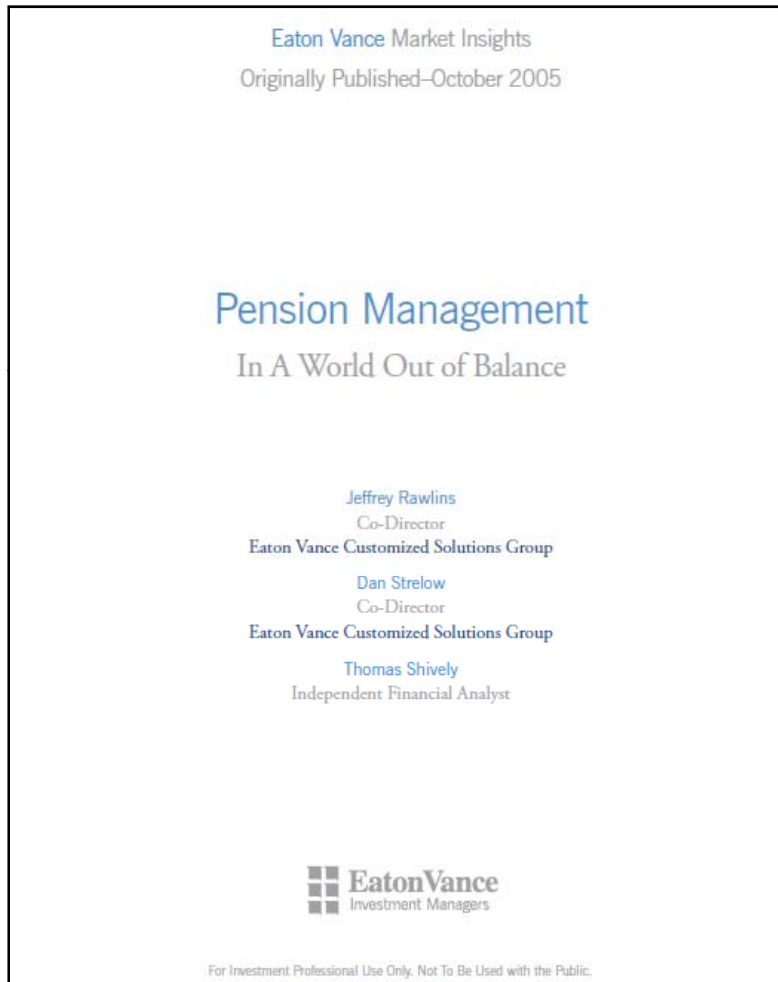


- Depicted “the US economy as being in an unconstrained credit cycle arising from the combination of pro-active, asymmetric U.S. monetary policies and modern Asian mercantilism.”
- Went on to argue that “real and financial asset prices [were] being seriously distorted,” that we live in “a world of asset bubbles of historic proportions and of unprecedented imbalances in global savings and consumption”, “fueled by an explosion of debt”
- Acknowledged that this critical state could exist for some indefinite period as the herd effect led investors and consumers to assume that credit expansion and asset inflation would continue, and low risk premiums were levered up.
- However, believed “the costs of being conservative [were] low, since rewards for risk- taking [were] low, and the benefits [would] be high if a liquidation of this leverage occur[ed].”

# Pension Management In A World Out Of Balance - October 2005

## Ramifications Of The Environment

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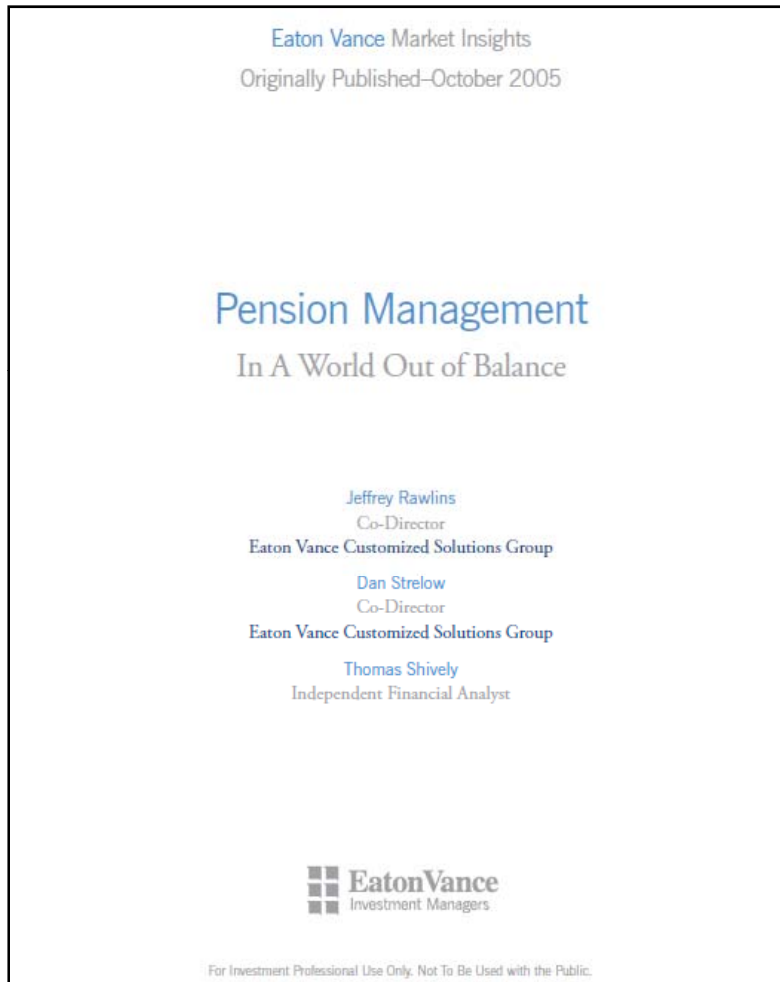


- “The high leverage of U.S. consumers makes them unable to continue indefinitely as global consumers of last resort.”
- Decoupling is a myth. Look for “an investment bust in China and other emerging economies”
- “The dollar is vulnerable.”
- “Low credit premiums are a reflection of ... factors likely to disappear. It doesn’t pay to take on credit risk in this environment.”
- “The equity risk premium is also quite low.”
- “As the asset environment transitions, asset volatility will increase, with downward price risk... We would be buyers of long-dated volatility.”
- “The combination of high debt levels, excess capacity and abundant liquidity raises the specter of both deflation and inflation. Central banks will continue to fear, and fight, deflation more than inflation. To indefinitely avoid both extremes, however, will require a true balancing act.”

# Pension Management In A World Out Of Balance - October 2005

## Conclusions

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- Recommended that plan sponsors should:
  - Fully fund their pension plans, if necessary by borrowing to fund at extremely attractive spreads.
  - Use the LDI framework to properly analyze the risk in pension plans by re-defining risk versus the liabilities
  - Decrease equity and increase high quality fixed income allocations.
- Our conclusion:
  - “The final chapter of the current era of money and investing is yet to be written... While we hope that the ending is a happy one, the prudent course for investors would be to prepare for something altogether different.”



# The Slow March to LDI - July 2007

## Conclusions

## Pension Management


### The Slow March to LDI

An Eaton Vance ViewPoint

July 2007

Still Mostly on Square One

For all the discussion, articles, conferences, and committee meetings over liability-driven investing (LDI) in recent years, it seems that little has changed on average in the way defined benefit pension plans are being managed. We can point to several reasons for this. First, the regulatory environment has been, and continues to be, changing both in terms of pension law and accounting rules. While it now seems pretty clear where these are headed, the laborious nature of the process has created its own inertia. Second, a fair amount of confusion remains about what LDI actually is, and how to implement it – who can help, first steps to take, how to manage it on an ongoing basis, how far to go with portfolio changes, and so on. Finally, and most importantly, it has simply not hurt to wait. The performance of the markets over the past few years, with strong equity returns and modestly rising interest rates, has done wonders for the funding status of plans with traditional asset allocations concentrated in equities with a bit of short-duration bonds. The misery of the perfect storm of falling stock prices and bond yields of the 2001-02 bust has faded far away, aren't we all glad we didn't panic back then and lock in our horrendous deficits! Which, of course, begs the question – if not then, why not now, given the dramatic improvement in funding status? See reasons one and two above...



KNOWLEDGE      INNOVATION      EXCELLENCE

- “Nevertheless, the funding status of most plans has dramatically improved in recent years, while at the same time regulatory and accounting wiggle room is being steadily reduced. Perhaps most importantly, we know that the herd has not yet stampeded. Hopefully it won't stampede, but herds can be funny sometimes.”
- “What we are suggesting is that this is not the time to sweat the small stuff, or the very large stuff. In other words, let's not get too caught up trying to develop or target a specific tracking error, or trying to articulate an all-encompassing investment philosophy. Rather, this is a time to be guided more by common sense than by complexity. If the conclusion is that LDI as a risk framework makes sense (assets evaluated relative to liabilities), why not now reduce, or even eliminate, the duration mismatch between assets and liabilities? Why not at the same time bring down the equity beta bet and seek out managers that offer diversified alpha strategies with reasonable performance fees? In sum, why not reconfigure and reduce risk, as imprecisely measured as it is?”
- “We don't know if the herd will stampede, or even eventually move, but we do know the direction they will run, if and when. We also know that financial markets have been very kind to pension funds for several years now, and that has not always been the case. Recent events in the markets may only be a hiccup in volatility due to isolated bets gone bad, or may signify the beginning of a more enduring change. Why wait any longer?”

# All Along the Watchtower – March 2011

## Highlights



- It is not so hard to identify the central issue underlying this crisis as the issue that we raised in our original paper, the flawed monetary underpinnings of the global economy.
- Monetary and fiscal policies have both been increasingly shortsighted, always responding to the most immediate problem in the economy without regard to the longer run consequences.
- Policymakers have now gotten “near the bottom of their bag of tricks” (QE2) but have yet to admit, or perhaps to notice, that they are now the problem and not the solution.
- One of the unfortunate consequences of just a little market manipulation is that it begets more manipulation over time, and distorts other markets.
- If real risk management is sleeping well, then the following principles will make sense for most investors most of the time:
  - Focus on maximizing intrinsic long-term value and avoiding permanent loss of capital.
  - Stay well diversified across asset classes, including domestic and foreign stocks and bonds, cash instruments, real estate, commodities, and reliable stores of value.
  - Stay well diversified within asset classes to limit sector risk, security risk, liquidity risk and investment-vehicle risk.
  - Rebalance when market movements dictate.
  - Don’t invest in products you don’t understand. As product complexity increases, liquidity is likely to decrease and ever greater due diligence is required. Be aware of the impact of leverage, in both directions. With strategies employing derivatives, counterparty risk should be a focus.
  - Have a tactical asset allocation component to take advantage of opportunities that arise.
  - Maintain a healthy skepticism of all conventional wisdom related to financial markets and government monetary and fiscal policies. If something seems too good to be true, it most likely is.

# Disclosures

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**Primary Risks:** An imbalance in supply and demand in the income market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads and a lack of price transparency in the market. Investments in foreign instruments or currencies can involve greater risk and volatility than U.S. investments because of adverse market, economic, political, regulatory, geopolitical or other conditions. Derivatives instruments can be used to take both long and short positions, be highly volatile, result in economic leverage (which can magnify losses), and involve risks in addition to the risks of the underlying instrument on which the derivative is based, such as counterparty, correlation and liquidity risk. If a counterparty is unable to honor its commitments, the value of Fund shares may decline and/or the Fund could experience delays in the return of collateral or other assets held by the counterparty. The effectiveness of the Fund's option strategy is dependent upon a general imbalance of natural buyers over natural sellers of index options. This imbalance could decrease or be eliminated, which could have an adverse effect on the Fund. There can be no assurance that the liquidation of collateral securing an investment will satisfy the issuer's obligation in the event of nonpayment or that collateral can be readily liquidated. The ability to realize the benefits of any collateral may be delayed or limited. Investments in income securities may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer's ability to make principal and interest payments. Investments rated below investment grade (typically referred to as "junk") are generally subject to greater price volatility and illiquidity than higher rated investments. Securities with longer durations tend to be more sensitive to interest rate changes than securities with shorter durations. A portfolio with negative duration generally incurs a loss when interest rates and yields fall. As interest rates rise, the value of certain income investments is likely to decline. Short sales risk includes, among other things, the potential loss of more money than the actual cost of the investment, and the risk that the third party to the short sale may fail to honor its contract, causing a loss to the fund. No Fund is a complete investment program and you may lose money investing in a Fund. The Fund may engage in other investment practices that may involve additional risks and you should review the Fund prospectus for a complete description.

*Before investing, investors should consider carefully the investment objective, risks, charges and expenses of a mutual fund. This and other important information is contained in the prospectus and summary prospectus, which can be obtained from a financial advisor. Prospective investors should read the prospectus carefully before investing.*



**Thank you.**

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