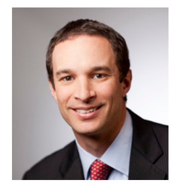
Portfolio Management

Protecting Your Purchasing Power

"…Inflation can confiscate, secretly and unobserved, an important part of the wealth of citizens… and does it in a manner that not one man in a million can diagnose."—John Maynard Keynes

Lori Heinel
Chief Investment Strategist



Brian Levitt
Senior Economist

Loss of purchasing power threatens the wealth of many Americans whose household incomes aren't keeping pace with the rising cost of goods and services. Prices are rising for a variety of reasons, including a weaker dollar, higher wages in emerging markets and rising commodity prices. Compounding the problem, savers face low-to-zero real yields on U.S. Treasuries and savings accounts. This paper explains how investors may be able to offset these threats to purchasing power through exposure to asset classes that offer

- Ownership of real assets or claims on real earnings
- Potential hedges against dollar weakness and imported price inflation
- Income growth opportunities that historically have outpaced inflation or rising interest rates

Virtually everyone can sense when they're losing purchasing power. They notice that gasoline prices keep getting higher. Items they've been buying for years at the grocery store cost more or come in smaller packages for the same price. Salary raises don't keep up with the rising cost of healthcare, rents or education. People feel as if, bit by bit, their standard of living is on the decline, even though they're potentially earning more money.

The loss of purchasing power—the amount of goods and services a quantity of money can buy—is one of the most crucial risks to one's wealth, and Americans' purchasing power today faces threats from a variety of interrelated sources:

- Consumer needs are generally getting costlier but household incomes aren't keeping pace
- Real yields in perceived "risk-free" fixed income securities are minimal, with bank deposit rates having trended close to zero as treasury bond rates flirt with multi-decade lows
- Inflation is coming from a variety of different sources: weakness in the U.S. dollar, combined with rising wages and prices in emerging markets, threatens to make imported goods and services more expensive, and may contribute (along with supply and demand dynamics and geopolitical concerns) to upward pressure on commodity prices

This combination of factors points to the potential likelihood that a dollar will buy fewer and fewer goods and services as time goes on. Fortunately, however, investors have a number of tools at their disposal that may help counteract this risk. In this paper, we closely examine the forces that may cause purchasing power to gradually erode, and explain what types of asset classes may help investors counteract this erosion over time.

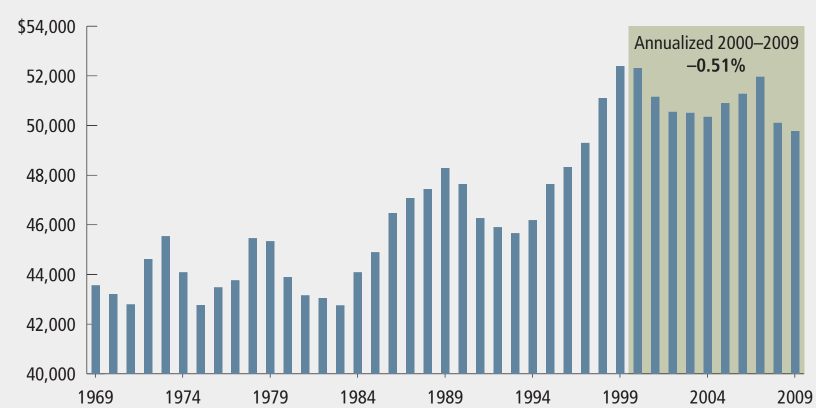
Consumer Needs Are Getting Costlier but Household Incomes Aren't Keeping Pace

The problem for American households today is that while the cost of living is on the rise, real wages are having a hard time keeping up—especially for the things people need the most. We feel poorer even as our policymakers inform us that inflation is under control. Technically, for what it's worth, these officials are correct. Inflation is a generalized rise in the prices of goods and services in an economy, and U.S. consumers have not experienced it since the 1970s. In fact, the prices of many components of the U.S. consumer basket, including apparel, household furnishings and technology, have actually *declined* in recent years.

However, U.S. consumers have not sidestepped pricing pressures completely. The Consumer Price Index (CPI), which tracks prices for 80,000 items on a monthly basis, increased only 2.4% annually in the past decade, but prices for certain categories of goods and services increased at a much higher rate than that, including medical care (4.0% annualized) and gasoline (9.1% annualized).[1] This is problematic; although your wardrobe and sofa might be in dire need of replacement from a style perspective, your ability to heat your home in winter, drive to work and treat illness, are simply higher on the list of immediate priorities. In effect, most people are experiencing big price increases for these and other basic necessities, even while inflation remains modest in the aggregate.

CHART 1

Real Median Household Income



Source of chart data: U.S. Census Bureau, as of 12/31/09. Data only available through 2009.

Almost all of us spend the lion's share of our paychecks on the necessities. Consider the Bureau of Labor Statistics' typical basket of consumer spending for an "average" 45–54-year-old in 2009—the latest year such data are available. Together, food, housing (including fuel oil), transportation (including gasoline) and education made up fully 66.5% of the total—and prices for all of these categories rose far faster than the overall rate of inflation did the following year.[2]

Household incomes aren't keeping pace. The U.S. Census Bureau reports that in nominal terms the median household income rose an average of 2.03% annually from 2000 to the end of 2009 but when adjusted for inflation, the median household income actually declined an average of 0.51% annually over that time period: The real median household income in 2009 was $49,777, while the real median household income in 1999 was $52,748 (see Chart 1).[3]
A look back at the historical series on real median household income suggests that incomes always fall during recessions and continue to do so for a year or two afterwards. Still, the last decade was particularly harsh for U.S. households. Incomes only rose in three years—the credit-induced binge years of 2005–2007. Even at the cyclical peak in 2007, income was below the levels of 1999 and 2000.

Zero Interest Rates Can Make Matters Worse

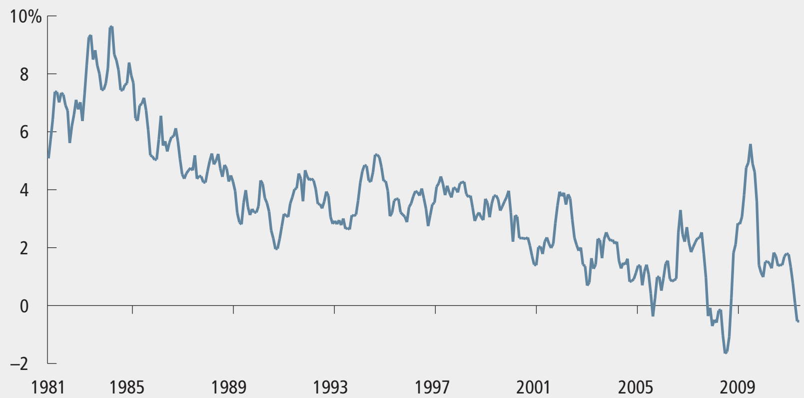
Today's low interest rates only compound the problem. Traditional fixed income investments no longer generate enough real income for savers to maintain their lifestyles. As of 5/31/11, the national average yield on a retail savings account in the U.S. was 0.4%.[4] If inflation continues to hover around the 10-year average of 2.4%,[5] then savings deposits currently offer investors a real (inflation-adjusted) yield of *negative* 2.0%. Given that total deposits in U.S. banks, according to the Federal Deposit Insurance Corporation, amount to $8.2 trillion, a negative 2.0% real yield equates to $164 billion in lost purchasing power for the nation's "savers." Investing in higher yielding 10-year U.S. Treasuries, rather than shorter term government bonds, isn't the answer either. Real yields on U.S. Treasuries have been ranging from flat to slightly positive.

How did we arrive at this point? Since former Federal Reserve Chairman Paul Volcker declared war on inflation in the 1970s, the U.S. has experienced a 30-year bull market in bonds. Once Volcker managed to curtail a wage-price spiral by ratcheting up short-term interest rates to curb credit, bond yields have steadily declined—despite a few temporary moves higher (see Chart 2). Today's low interest rates are unlikely to significantly rise in the near term, since economic growth remains below trend and the Federal Reserve Board has signaled an accommodative policy for an extended period.

What about TIPS (Treasury Inflation Protected Securities)? TIPS compensate investors for certain inflation risks by changing the principal amount of the bond according to the Consumer Price Index. If the CPI rises 3% while an investor is holding TIPS, that 3% will be added to the principal amount of the bond to make up for a loss of purchasing power.

CHART 2

10-Year Real U.S. Treasury Yield



Source of chart data: Bloomberg and Bureau of Labor Statistics, as of 5/31/11. Real U.S. Treasury yield is the nominal 10-year treasury yield minus the annual change in the Consumer Price Index.

Interest is then calculated based on the new higher principal amount. However, the investor will not be compensated for any rise in yields (such as when the Federal Reserve hikes interest rates) and concomitant fall in prices. Finally, as of 6/30/11, TIPS yields were very unattractive outright, with the yield on the 5-year TIPS actually negative.[6]

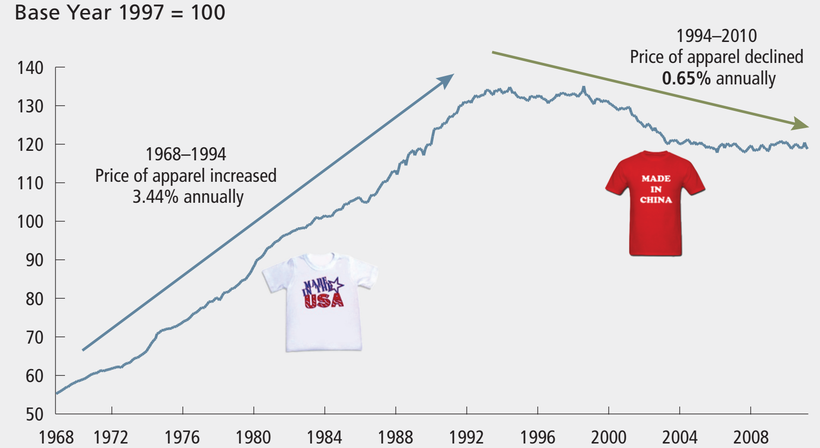
In sum, for fixed income investors, the current environment creates two problems. First, such investors find it increasingly difficult to generate enough cash flow to contribute adequately to their lifestyle needs. Second, given that treasury yields are effectively zero at present, they ultimately have nowhere to go but up. The current environment offers little protection against eventually rising yields and corresponding price declines.

Inflation Is Coming from a Variety of Sources

To many Americans, the mere mention of the word "inflation" harkens back to the infamous wage-price spiral of the 1970s. But at present, with unemployment high, it is hard to find workers demanding higher wages, let alone employers willing to accept those demands. There is little risk that the country will return to the decade of bell-bottoms and disco dancing. Nonetheless, inflation is creeping in from a variety of different sources, potentially putting Americans' purchasing power at risk.

CHART 3

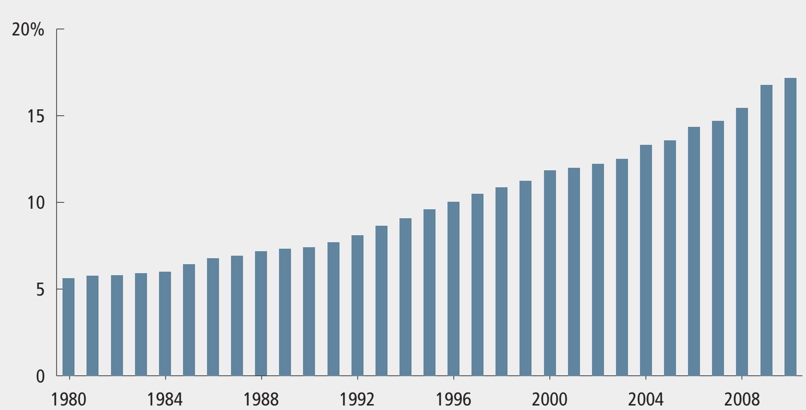
U.S. Consumer Price Index Apparel
Seasonally Adjusted
Base Year 1997 = 100



Source of chart data: Bloomberg and Bureau of Labor Statistics, as of 3/31/11.

CHART 4

Percent of World Oil Demand in Select EM Countries
Brazil, India & China % of World Demand



Source of chart data: U.S. Energy Information Administration and the OECD, as of 12/31/10.

The days of importing deflation are likely over

For several decades now, plentiful overseas labor, particularly in emerging countries such as China, kept prices low for a range of goods bought by American consumers. The Middle Kingdom exports roughly $1 billion in goods to the U.S. *every day.*[7] The Boston Consulting Group figures that exporting work to China and other places reduced the costs of some goods for U.S. consumers by as much as 20% to 30%.[8] For example, the cost of apparel for U.S. consumers has actually *decreased* 0.7% per year (almost 11% cumulative) since 1994. By contrast, between 1968 and 1994, when American-made clothing and footwear still dominated the U.S. market, apparel prices *increased* 3.4% per year (see Chart 3).[9]

The era of importing goods deflation into the U.S. may, however, be coming to an end, setting the stage for higher prices. China is a good example of this trend: During the past decade, Chinese wages have increased more than fourfold.[10] The Chinese government has supported higher wages, in part to address labor unrest, but also as a way to support the government's new five-year plan to shift some of the composition of Chinese growth away from exports and towards domestic consumption. To promote the plan, China will allow its currency to slowly appreciate in value, making it cheaper for the country to import the energy and raw materials that it needs, but making its goods more expensive for other countries to buy. Demographics will also play a part, as China's vast labor force will begin to decline in the coming years as a result of its one-child policy.

China still has cheap labor further inland from the rapidly growing coastal cities, but the costs of shipping goods from the interior to the ports could outweigh the lower upfront labor costs. Low end manufacturing may find its way to other parts of the world, but wage growth is not just a Chinese phenomenon. Compensation is climbing across many of the emerging markets, and prices for U.S. consumers are likely to increase as a result.

Rising commodity costs

Growing wealth among emerging market workers has promoted increased consumerism and greater demand for the crude materials that are eventually turned into finished products. In 2010, China overtook the U.S. as the world's largest consumer of energy, while the total global consumption growth rate rose to its highest level in decades (see Chart 4).[11] Prices have surged for energy, as well as agricultural and industrial commodities. Many analysts predict continued strong demand and major uncertainty surrounding supply and future spare capacity of a number of key commodities, most notably oil, copper and corn. Such a scenario again points to higher prices for U.S. consumers.

The secular decline of the U.S. dollar

Adding to these pressures is a secular decline in the value of the U.S. dollar versus the currencies of major commodity producers and other strongly growing countries. A weaker dollar makes imports of both raw materials and finished goods into the U.S. more expensive. The relative value of a country's currency generally reflects its economic strength compared to other countries; although the U.S. remains the world's largest economy, U.S. gross domestic product (GDP) as a percentage of global GDP has been in decline since the late 1960s, as the shares of other areas of the world have grown.[12] Although together the G3 countries—the U.S., Japan and Germany—currently represent half of the world's total output, emerging economies are growing in importance. Many economists predict that the output of emerging economies will surpass that of the developed world by 2035, when countries such as China, India and Brazil will represent more than 40% of world growth.

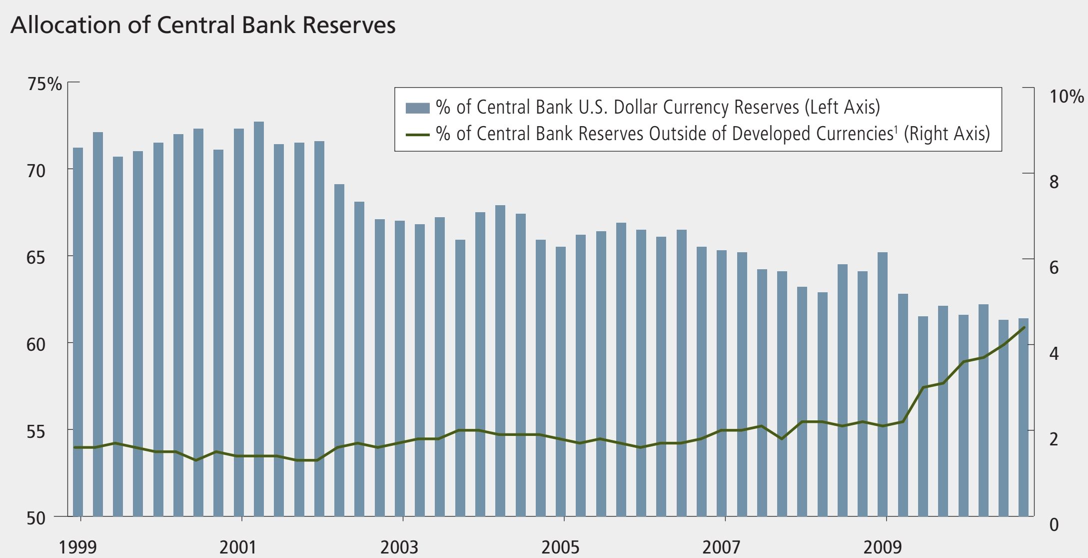
The End of the Great Moderation

The so-called Great Moderation, the stunning respite (1984–2007) from the kind of financial and pricing uncertainty that typically prevails in the financial world, was likely a one-off anomaly. In a famed 2004 speech—from the title of which the Great Moderation got its name—Federal Reserve then-Governor Ben S. Bernanke examined the substantial decline in macroeconomic volatility and inflationary pressures over the previous 20 years. Perhaps optimistically, he attributed the drop in volatility to structural changes, including improved management of business inventories and advancements in computation, as well as to the improved performance of monetary policy.

In his defense, Bernanke did raise the possibility that luck might have played a part. Four years after Bernanke's speech and almost three decades after his predecessor, Paul Volcker, successfully broke the back of inflation, the U.S. suffered its greatest contraction in economic activity since the Great Depression.

In retrospect, the global economy's "good luck" was likely derived from a variety of different factors including, but not limited to, increased business competition amid a groundswell of pro-business policies such as deregulation of industries and lower tax rates, plus greater labor market competition, particularly from low cost workers in the emerging world. Over the course of the Great Moderation, the U.S. remained the world's leading manufacturer in terms of the value of goods produced, but the nation simply moved up the value chain. Today, heavy equipment and high-end tech components are likely to be "Made in America," while consumer items such as clothes, televisions and toys are more likely to be made overseas. As for the prospects of enjoying another two decades of low macroeconomic volatility and inflation? We would need some very good luck, indeed.

CHART 5



Source of chart data: OppenheimerFunds Proprietary Research, as of 12/31/10.
1. Developed currencies are the euro, yen, pound and Swiss franc.

Recognizing the trend, foreign central bank reserves are potentially beginning to be allocated accordingly. The proportion of central bank reserves held in currencies from outside of the developed world has doubled over the past two years to more than 4%.[13] As a result, reserves held in U.S. dollars have fallen from more than 70% a decade ago, to less than 65% today. We expect that central banks will continue this reallocation of capital to the currencies of higher yielding, stronger growth countries (see Chart 5). These changes in reserves have contributed to the steady fall in the value of the U.S. dollar and the rise in price of imported goods for American consumers.

Strategies to Help Preserve Purchasing Power

To potentially offset the effects of these varied threats, investors need exposure to diversified vehicles that offer:

1. Ownership of real assets or claims on real earnings.
2. Potential hedges against dollar weakness and import price inflation.
3. Income growth opportunities that have historically outpaced inflation and rising interest rates.

Chart 6 shows a range of investments that may offer attractive potential returns and may help offset particular sources of inflation.

1. Ownership of real assets or claims on real earnings

Owning commodities (or commodity-linked investments) and stocks provides the investor with a claim on real assets, such as a barrel of oil or an ownership stake in a potentially growing company. Investments in such asset classes have a history of retaining or increasing their value during periods of contained and rising prices (see Chart 7).

Global Equities

A share of stock gives its owner a claim to the earnings of a company, and stock prices, being a leveraged play on corporate earnings, typically have

CHART 6

What It Means for Investors: How to Protect Your Purchasing Power

Asset Class	Own Real Assets or Claims on Real Earnings	Hedge Against Dollar Weakness, Protect Against Import Price Inflation	Generate Growing Income from Sources that Typically Outpace CPI
Global Equities	✔	✔	
Dividend Growth Equities	✔		✔
Commodities	✔	✔	
Currencies		✔	
Senior Floating Rate Loans			✔
Real Estate	✔		✔

CHART 7

Real Assets or Claims on Real Earnings Post Strong Returns in Periods of Contained and Rising Inflation

	Contained and Rising CPI < 4.5%[1] and More than Prior Month	High and Rising CPI > 4.5%[1] and More than Prior Month
S&P 500 Index	15.42%	–9.26%
MSCI EAFE Index	20.82	–4.92
S&P Goldman Sachs Commodity Index	32.84	31.36
NCREIF Property Index[2]	13.54	10.20

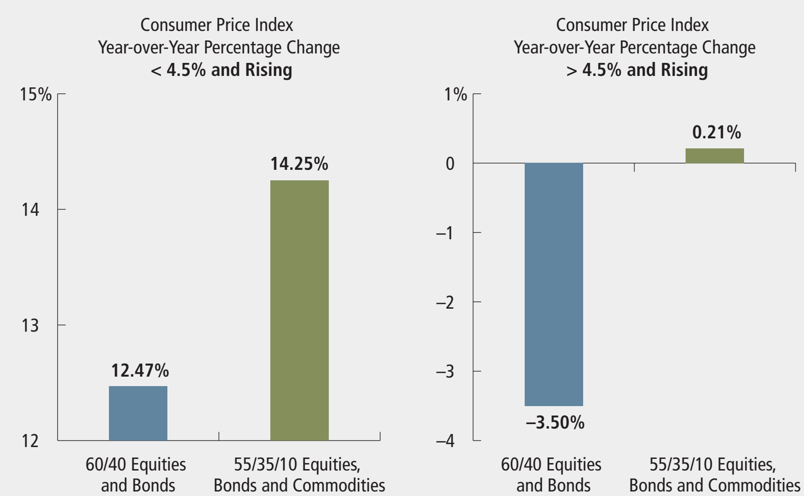
1. Average U.S. inflation (1970–2010) = 4.5%
2. Based on quarterly data.

Source of chart data: OppenheimerFunds Proprietary Research, as of 12/31/10. Returns are nominal and do not include the impact of inflation on a portfolio. The S&P 500 Index is a capitalization-weighted index of 500 stocks representing all major industries. The MSCI EAFE Index is a capitalization-weighted index that monitors the performance of stocks from Europe, Australasia and the Far East. The S&P Goldman Sachs Commodity Index is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The National Council of Real Estate Investment Fiduciaries Property Index is a quarterly time series composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only. Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Fund. **Past performance does not guarantee of future results.**

outpaced inflation over the long term. During the past four decades, U.S. corporate earnings growth has significantly outpaced the rate of U.S. consumer inflation. While global equities suffered during the 2000s as the global economy battled two recessions and a bout with deflation, they have served to protect purchasing power during periods of contained and rising inflation (when the 12-month percent change in CPI is higher than the prior month but below the 40-year average of 4.5%). From 1970 to 2010, the S&P 500 Index returned 15.4% and the MSCI EAFE Index 20.8% in nominal terms during such periods. Price stability does matter, though. Although well-positioned, high quality companies generally can pass higher costs onto consumers, they can do so only up to a point. In periods of high and rising inflation, equity investments have historically come under pressure.

CHART 8

Commodities Outperform When Prices Are Rising



Source of chart data: OppenheimerFunds Proprietary Research as of 12/31/10. Returns are nominal and do not include the impact of inflation on a portfolio. Equities are represented by the S&P 500 Index, a capitalization-weighted index of 500 stocks representing all major industries. Bonds are represented by the Barclays Capital U.S. Long-Term Treasury Index, a benchmark index including all publicly issued U.S. Treasury securities that have a remaining maturity of 10 or more years, are rated investment grade, and have $250 million or more of outstanding face value. Commodities are represented by the S&P GSCI Commodities Index, a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Fund. **Past performance does not guarantee of future results**.

Commodities

Strong economic growth can lead to higher demand for commodities, pushing up prices globally. The blistering pace of development in emerging markets has had just this effect in recent years, making raw materials and the goods from which they are made more expensive for American consumers. Exposure to commodities in a portfolio may help offset this source of inflation and protect investors' purchasing power, while also providing potential diversification benefits with respect to traditional stocks and bonds. In the past, commodities have not only performed well in periods of contained and rising inflation but have also posted outsized returns in less-stable, higher inflationary environments (see Chart 8). Commodities may also serve as a hedge against dollar weakness given that most commodities trade in U.S. dollars.

Real Estate

Real Estate Investment Trusts (REITs) may help protect the purchasing power of a dollar through their direct exposure to real assets and through the inflation-sensitive cash flow stream inherent in the asset class. In a typical economic recovery, rents rise as older structures become unusable and expensive new construction is justified. Ultimately, all of the costs for land, labor and materials are passed through to tenants in the form of more expensive leases, which actually help REITs increase their dividends—historically a major portion of their total returns. Over the long term, dividend growth from REITs has soundly outpaced the CPI (and REITs have outperformed most other major asset classes over a wide range of historical time frames, as well).

2. Potential hedges against dollar weakness and import price inflation

We believe the best way to protect against an erosion of purchasing power from import price inflation is to own assets that may appreciate in dollar terms when inflation rises overseas. These assets include foreign currencies, international bonds and international equities.

Foreign Currencies

For a U.S. investor, currency exposure means being "short" on the U.S. dollar and "long" multiple foreign currencies. Unlike other asset categories, currencies are a zero-sum game. If the U.S. dollar is, in fact, in a secular decline against the currencies of the stronger growth countries of the world, then these, by definition, will be appreciating versus the dollar. Currency exposure serves as a specific type of potential inflation hedge in that it may offset a consequent rise in import inflation. For example, in 2005 an American consumer could exchange $0.26 for 1 Malaysian ringgit; today that same ringgit would cost roughly $0.33, making a dress shirt imported from Malaysia 27% more expensive for that consumer. Exposure to the Malaysian ringgit could have helped to offset this price rise.

Historically, currency exposure has correlated strongly with both the Import Price Index, which measures the price of goods that are imported into the U.S., and the goods component of the CPI (see Chart 9).[14] It has also been weakly correlated to traditional fixed income asset classes.

International Fixed Income

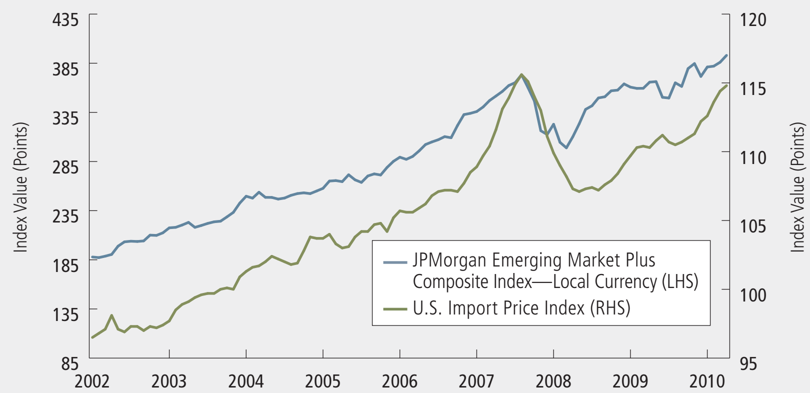
Investing in international bonds is another way to obtain exposure to foreign currencies, since their interest and principal payments are made in the currency of the country in which they are issued. For this reason, foreign-currency-denominated bonds may help offset the effects of imported inflation on a U.S. investors' purchasing power. International bonds, particularly local emerging market debt, have generally offered higher yields than U.S. and other developed-market debt in recent years. They have also offered attractive real yields in their own right (see Chart 10).

Global Equities

In addition to providing investors a claim on real earnings, global equities—particularly those with sales exposure to rapidly growing markets—offer the potential to grow at a rate that outpaces inflation. A long-term decline in the U.S. dollar would likely

CHART 9

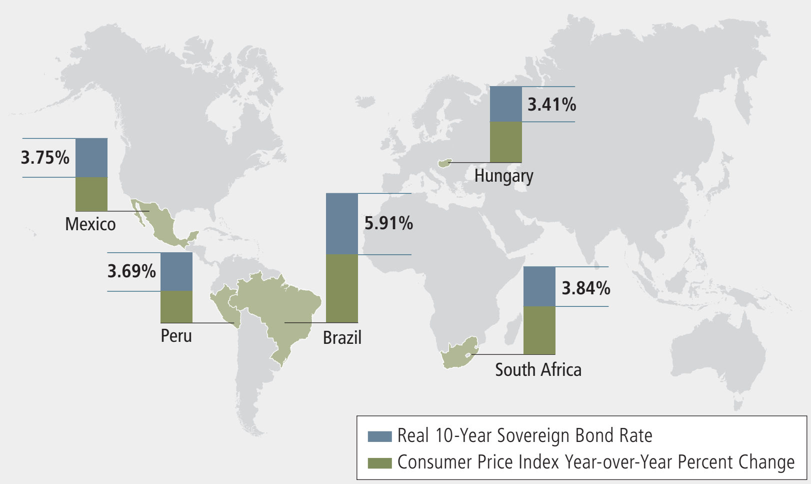
Currencies Protect Against Rising Import Prices



Source of chart data: Bloomberg, 3/31/11. The JPMorgan Emerging Market Plus Composite Index tracks total returns for local-currency-denominated debt instruments in the emerging markets. U.S. Import Price Index is a measure of the average change in import prices of a fixed market basket of goods. Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Fund. **Past performance does not guarantee future results.**

CHART 10

Real Yields Abroad May Be More Attractive



Source of chart data: Bloomberg and Banco de Mexico, Instituto Nacional De Estadistica E Informatica De Peru, Banco Central do Brasil, Hungarian Statistical Office, Statistics South Africa, as of 5/31/11. Yields are that of each country's "on the run" (most recently issued) 10-year government bond. Real yield is equal to the country's 10-year sovereign bond rate minus the year-over-year change in the country's consumer price index. **Past performance does not guarantee future results.**

benefit well-positioned U.S. exporters by making the prices of their goods or services cheaper in the final market. A secular decline in the U.S. dollar, however, should not preclude U.S. investors from scouring the world for the best companies regardless of where they are domiciled. Rather, investors may benefit by looking for companies generating earnings in the local currencies of rapidly appreciating economies and then translating those earnings back into dollars.

3. Income growth opportunities that have historically outpaced inflation and rising interest rates

Income-focused investors are often at particular risk from the effects of inflation, since as prices rise across the economy over time, the real value of investors' income stream tends to decline. Income investors may find senior floating rate loans and dividend-paying U.S. stocks potentially attractive.

Senior Floating Rate Loans

Senior floating rate loans offer several potential benefits for investors today as benchmark interest rates hover near zero. Most often issued by lower rated companies, senior loans typically offer a yield premium, which has generated more income than higher credit quality bonds of a comparable maturity. Moreover, these loans offer a floating interest rate, which resets every 30 to 90 days based on changes to common benchmarks such as the London InterBank Offered Rate (LIBOR). Unlike fixed rate bonds, bank loans can generate more income for investors if benchmark interest rates rise, as they often do when inflation picks up.

Their potential for rising total returns in an inflationary environment may make loans a better alternative to conventional bonds, which instead see lower real income levels and falling prices.

CHART 11

Senior Floating Rate Loans Performance in Rising Rate Environments
Annualized Returns

Periods of Rising Treasury Yields	Credit Suisse Leveraged Loan Index	Barclays Capital U.S. Long-Term Treasury Index
Sep 93–Nov 94	10.70%	(3.70%)
Dec 95–Aug 96	6.81	(2.70)
Sep 98–Jan 00	3.25	(1.84)
May 03–Jun 06	6.57	0.93
Dec 08–Dec 09	41.47	(3.57)
Average	13.76	(2.18)

Periods of Rising Fed Funds Rate	Credit Suisse Leveraged Loan Index	Barclays Capital U.S. Long-Term Treasury Index
Jan 94–Feb 95	8.97%	(0.79%)
May 99–May 00	4.56	2.20
May 04–Jun 06	5.74	2.69
Average	6.42	1.36

Source of chart data: Bloomberg, as of 12/31/10. The Credit Suisse Leveraged Loan Index represents tradable, senior-secured, U.S.-dollar-denominated non-investment-grade loans. The Barclays Capital U.S. Long-Term Treasury Index is a benchmark index including all publicly issued, U.S. Treasury securities that have a remaining maturity of 10 or more years, are rated investment grade, and have $250 million or more of outstanding face value. Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Fund. **Past performance does not guarantee future results.**

Historically, senior floating rate loans outperformed treasuries during several recent periods of rising treasury yields and/or Fed Funds Rate (see Chart 11).

Dividend Growth Equities

Dividend-paying U.S. stocks may help preserve investors' purchasing power in several ways. Traditionally, treasury yields significantly exceeded equities' average dividend yields, creating a current income disadvantage to owning dividend-paying stocks. With treasury yields now near historic lows, however, dividends have become a potentially more attractive source of current income by comparison. Dividend-paying stocks may help preserve purchasing power not only because they may generate more income than low yielding treasuries, but also because unlike most bonds, their prices won't automatically fall when interest rates eventually move higher.

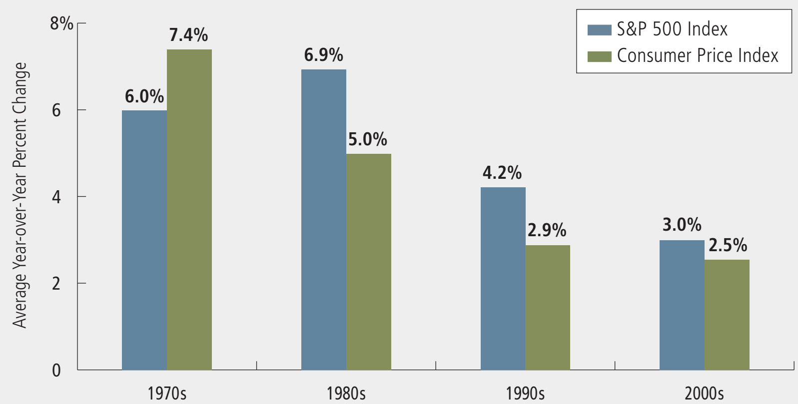
Since the 1980s, the rate of dividend growth in the S&P 500 Index has outpaced increases in the CPI (this was not the case in the 1970s when inflation was unusually high) (see Chart 12).[15] Additionally, since 1973, dividend-paying stocks (as represented in the S&P 500 Index) have significantly outperformed non-dividend payers, and done so with lower volatility. Dividend payers that also consistently *grow* their payouts have an even better record in this regard.

Summing Up

The loss of purchasing power presents one of the greatest and perhaps most poorly understood risks to investors over time. Many factors can erode the real value of one's money, including consumer inflation outstripping wage growth, low real yields, rising costs overseas, higher commodity prices and a falling dollar. For most investors, we believe the best strategy is to invest in a mix of asset classes that may not only counteract but may actually benefit from these phenomena.

CHART 12

S&P 500 Index Average Change in Dividend vs. Consumer Price Index



Source of chart data: Ned Davis Research, as of 12/31/09. The S&P 500 Index is a capitalization-weighted index of 500 stocks representing all major industries. There is no guarantee that the issuers of stocks held by mutual funds will declare dividends in the future or if dividends are declared, that they will remain at their current levels or increase over time. The index is unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Fund. **Past performance does not guarantee future results.**

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1. Source of data: Bureau of Labor Statistics, 3/31/11.
2. Source of data: Bureau of Labor Statistics, 5/31/11.
3. Source of data: U.S. Census Bureau, as of 12/31/09. Data only available through 12/31/09.
4. Source of data: Bureau of Labor Statistics, 5/31/11; Federal Deposit Insurance Corporation, 12/31/10.
5. Source of data: Bureau of Labor Statistics, 5/31/11.
6. Source of data: Bloomberg, 6/30/11.
7. Source of data: U.S. Census Bureau, as of 4/30/11.
8. Source of data: Boston Consulting Group, *Made in the USA, Again: Manufacturing Is Expected to Return to America as China's Rising Labor Costs Erase Most Savings from Offshoring,* May 5, 2011.
9. Source of data: Bloomberg and the Bureau of Labor Statistics, as of 5/31/11.
10. Source of data: Bureau of Labor Statistics and the IMF, as of 12/31/09.
11. Source of data: U.S. Energy Information Administration and the OECD, as of 12/31/10.
12. Source of data: Bloomberg and Bureau of Labor Statistics, as of 3/31/11.
13. Source of data: OppenheimerFunds Proprietary Research, as of 12/31/10. The developed currencies are the euro, yen, pound and Swiss franc.
14. Source of data: Bloomberg, 3/31/11; Bureau of Labor Statistics, 6/16/11.
15. Source of data: Ned Davis Research, 9/30/10. Based on equal-weighted geometric average of total return of dividend-paying and non-dividend-paying historical S&P 500 Index stocks, rebalanced annually.

Investing in fixed income securities involves credit and interest rate risk. When interest rates rise, bond prices generally fall and a Fund's share price can fall.

Investing in foreign securities (especially those in emerging and developing markets) involves additional expenses and special risks, such as currency fluctuations, foreign taxes and political and economic volatility. Investments in emerging and developing markets are subject to greater volatility and risks. Investments in securities of growth companies may be volatile.

Senior loans are typically lower rated (more at risk of default) and may be illiquid investments (which may not have a ready market).

Investing in commodity markets is speculative and involves potentially higher volatility and greater risk of loss of principal than traditional equity or debt securities.

Large sector holdings (such as real estate) may expose investors to greater volatility and special risks associated with that sector. Investments in securities of real estate and small-cap companies may be especially volatile. Because they do not have an active trading market, shares of Real Estate Investment Trusts (REITs) may be illiquid. The lack of an active trading market may make it difficult to value or sell shares of REITs promptly at an acceptable price. Diversification does not guarantee profit or protect against loss.

There is no guarantee that the issuers of the stocks held in mutual funds will declare dividends in the future or that if dividends are declared, they will remain in their current levels or increase over time.

Inflation-indexed debt securities are bonds structured to seek to provide protection against inflation. If inflation declines, the principal amount or the interest rate of an inflation-indexed bond will be adjusted downward. This will result in reduced income and may result in a decline in the bond's price which could cause losses for the Fund. Interest payments on inflation-protected debt securities can be unpredictable and will vary as the principal or interest rate is adjusted for inflation. Inflation-indexed debt securities are also subject to the risks associated with investments in fixed income securities.

The S&P 500 Index is a broad-based measure of domestic stock market performance that includes the reinvestment of dividends. The index is unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict performance of any particular investment.

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DS0001.118.0611 August 1, 2011

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