First Quarter 2017 Market Review

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By Caves & Associates

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Dear Clients and Friends:

Your copy of Caves & Associates' Market Review for the first quarter of 2017 is enclosed, or you are viewing this communication via the Internet. A table accompanies the review and provides global returns for the first quarter of this year and for twelve months ending March 31, 2017. The global returns provide reference points against which to judge results for your investment accounts.

The review indicates outstanding results for global stocks and mixed but generally decent returns for global bonds during the first quarter. U.S. large company stocks significantly outperformed smaller company stocks. The absence of any significant action on trade protectionist policies contributed to the divergence because large companies are more likely to have major foreign operations. Strong risk appetite led investors to lower quality U.S. bonds. As a result, high yield bonds continued to outperform investment grade issues, and government bonds provided the lowest returns, though nonetheless in the black. After years of lackluster performance, returns of foreign developed and emerging markets stocks were impressive in local currencies and even better in dollar terms as the U.S. dollar weakened. Unhedged foreign developed bond returns were quite good; however, hedged results for developed country bonds were just below breakeven. Emerging markets bonds provided excellent returns, even for hedged investors. Alternative strategies, as a group, modestly underperformed an equal mix of stocks and bonds. For the quarter, the broad global diversification of including both U.S. and foreign stocks and bonds benefitted investors by providing considerable higher returns than a U.S.-centric, traditional portfolio while mitigating risk. Favorable non-traditional exposure included high yield and emerging markets bonds and all manner of foreign stocks.

The first quarter of 2017 marked the eighth anniversary of the current U.S. bull market. The U.S. stock market, represented by the Wilshire 5000 Total Market Index, rose 5.6% during the first quarter. Corporate earnings growth expectations and rising business confidence, along with anticipated Trump administration tax cuts, infrastructure spending, and reduced regulation, pushed U.S. stocks to a series of stock market highs by the end of February. Since the stock market's bottom on March 9, 2009, the S&P 500 Index has increased 314% on a cumulative basis including dividends. Equity markets reached another major milestone as the Dow Jones Industrial Average crossed the 20,000 mark for the first time in its history on January 25th. However, the equity market's upward momentum hit a stumbling block late in the quarter when the Trump Administration and Republican-controlled House of Representatives failed to repeal and replace the Affordable Care Act (commonly known as Obamacare). This led investors to doubt the Administration's future ability to pass fiscal stimulus measures. The rally stalled briefly, and the S&P 500 Index broke its streak of 110 trading days without a decline of more than 1% on March 21, 2017, the longest such streak since the mid-1990s. Further, the S&P 500 Index of U.S. large company stocks is now down about 2.3% since the February highs.

As per our usual declaration below, we discount short-term results, especially the U.S. stock market contraction over the last seven weeks at a rate well within typical historical ups and downs. Nonetheless, a couple of recent headlines were notable. A hedged but also strongly worded one dated April 19th on the MarketWatch website stated: "The market is beginning to price in the death of Trump's tax reform." On the same day, and website a second headline opined: "Welcome back to the Hillary Clinton stock market," referring to a so-so stock market defined by low interest rates and weak economic growth. The two headlines encapsulate the possibility that the November election will not change nearly as much as originally assessed when investors were optimistic based on the significant number of pro-business Trump policies.

The outcome of political jockeying in Washington is likely to remain at the heart of the markets' focus over the rest of this year. Markets have priced in neither the best nor the worst potential policy outcomes, and so risks remain both to the upside and downside. Nonetheless, while U.S. consumers and businesses are significantly more positive about the outlook than they were at this time last year, it remains to be seen whether sentiment translates to economic reality.

As you know, Caves & Associates discourages focusing much attention on short-term results because a broadly diversified portfolio is structured for the long-term. As we often state, there is no way to completely eliminate short-term risk from an investment portfolio. As you review the performance data, think in terms of market<u>s</u> (plural), not "the market." You will notice that typically at least some part of your portfolio is providing positive results. Further, we continue to believe that a disciplined investment approach utilizing a generally buy-and-hold approach, cost minimization, and rebalancing will provide sound long-term investment returns. Finally, it is crucial to maintain adequate cash reserves to avoid forced portfolio liquidations at cyclical market lows, bearing in mind that such lows are unpredictable.

A separate, full scope "Economic Review and Market Perspective" providing a longer-term interpretation of current data is normally presented only at mid-year and yearend and is omitted. Nonetheless, we are providing below: 1) a market commentary supplements the accompanying Market Review, 2) U.S. economic highlights for the first quarter, and 3) commentary on economic uncertainty caused by Great Britain's exit from the European Union. Additionally, we "touch base" on our market and economic outlook. Results for alternative strategies will be reported in more detail at mid-year. Finally, new "editions" of Timely Topics and the Blog Department are not presented at this time.

<u>What's Below</u>

- Market Commentary
- Economic Highlights

- Great Britain Exit ("Brexit") from the European Union Begins
- Updated Outlook
- Implications for Asset Allocation

Market Commentary

Perhaps the biggest story within global equity markets during the first quarter was not the strength of the U.S. market, but the robust returns from foreign investments. Foreign stocks, as measured by the MSCI All Country World excluding U.S. Index, rose 7.9% in dollar terms during the period. Significantly, nearly every country in the MSCI EAFE (developed countries) and MSCI Emerging Markets Indexes produced positive returns during the quarter. In Europe, business confidence is at its highest level in five years and European companies are finally starting to show broad-based earnings growth. This has helped European equities to keep up with the U.S. so far this year, having underperformed last year. Japan's economic data has also been reasonably positive; business surveys support expansion, and unemployment is down to 2.8%.

Emerging markets including China, Taiwan, Korea, and Mexico also benefited from the upturn in global growth, higher prices for raw materials, and a lack of protectionist trade policy action by the Trump administration. In addition, a weak U.S. dollar provided a tailwind to returns for the unhedged U.S. dollar investor. The MSCI Emerging Markets Index was up 11.5% in dollar terms.

Furthermore, European voters have so far rejected anti-euro politicians, with the results in both Austria and the Netherlands showing that the widely predicted break-up of the eurozone is probably not as imminent as some Euro-sceptics would like to believe. Over the coming quarter, all eyes will turn to France to see whether the nationalist candidate Marine Le Pen's anti-euro stance will also be rejected. We also provide below some discussion of the important related topic, "Brexit."

Against a backdrop of a strengthening global economy, synchronized global reflation (i.e., increase in the price levels to the long-term trend line), and possibility of less monetary stimulus by central banks, global credit, and especially riskier bond asset classes, outperformed government bonds. In the U.S., investment grade bonds, represented by the Barclays Aggregate Bond Index, rose 0.8% during the first quarter. Market reaction to the U.S. Fed's rate hike in March was relatively muted. Notably, yields on intermediate- and long-term government bonds barely budged over the quarter after seeing sharp increases over the second half of 2016, particularly after the election. The ten-year U.S. Treasury yield was 2.40% at quarter end, just a few basis points lower than at the end of 2016. Relatively stable longer-term yields, combined with a rise in short-term yields, which are most sensitive to Fed policy, led to a flattening yield curve. Notably, the yield on the ten-year U.S. Treasury has declined during April to about 2.2% as of Wednesday, which further increases the yield curve flattening. Municipal bonds outperformed their taxable counterparts in the first quarter, as a limited supply of the bonds more than offset uncertainty about the impact of potential tax reforms championed by the Trump administration. U.S. inflation-indexed bonds also produced solid returns. Strong risk appetite led to modestly tighter credit spreads for investment grade and high yield corporate issues. As a result, high yield bonds continued to outperform investment grade issues.

Foreign developed bonds were held down by a shift toward monetary policy normalization. The European Central Bank (ECB) signaled it sees less need for monetary stimulus programs. A reduction in bond purchases by the ECB would decrease bond prices and lead to higher long-term interest rates. Yields on French, Italian, and German government bonds rose during the quarter; but the yield on the U.K. sovereign fell as Britain began the process to exit the European Union. In addition, bond purchases by Japan's central bank remained below its stated annual pace for the current fiscal year. The Bloomberg Barclays Global Aggregate Ex USD (Hedged) Index and J.P Morgan Emerging Market Bond Index Global Diversified (Hedged), were up 0.1% and 3.9%, respectively. Currency gains caused by the U.S. Dollar weakening against most foreign currencies produced even higher results for the unhedged U.S. Dollar investor.

Real estate stocks faced various headwinds and delivered low returns in the first quarter. Crude oil prices declined 5.8% over the same period, with the bellwether NYMEX future closing at $50.60 at quarter end. Gold surged over the quarter, rising 8.5% to close at $1,251.20 per troy ounce.

Economic Highlights

The U.S. Federal Reserve (Fed) hiked short-term interest rates following the Federal Open Market Committee (FOMC) meeting in March, reflecting the Fed's aim to normalize monetary policy as the economy improves. The rate increase is the Fed's third quarter-point hike over a 16-month period and follows almost a decade of no increase. The increase in rates came as little surprise to Fed-watchers since Fed Chair Janet Yellen all but telegraphed the FOMC's intentions during her testimony to the Senate Banking Committee in February. Since the November election, investors have priced-in the favorable growth and inflation prospects of the Trump Administration's economic policy agenda, sending equity valuations higher. By contrast, the Fed was seemingly reluctant to increase their economic growth forecasts on as-yet-unfulfilled political promises of future fiscal stimulus. Instead, the Fed chose to take a wait-and-see approach pending political and economic developments.

U.S. labor markets remained generally healthy as the unemployment rate declined to 4.5%, and the economy added an average of 178,000 non-farm jobs per month over the quarter (the economy added on average 187,000 jobs per month for all of 2016). The growth was only 98,000 jobs in March, indicating possible weakness going forward. Nonetheless, improving data from the Institute for Supply Management's economic indices continued to indicate an expanding economy. The fourth quarter reading of real GDP indicated growth at an annual rate of 2.1%, down from the 3.5% pace set in the third quarter. Economic growth for all of 2016 was 1.6% versus 2.6% in 2015. The slower pace of GDP growth has been largely driven by lower net exports, which detract from GDP. Consumer spending in the first quarter was strong, and remains an important growth engine for the U.S. economy. Consumer confidence continued to improve and sits at its highest levels since 2001. First quarter profits are expected to grow at a 9.1% year-over-year rate and will mark the highest earnings growth rate since the fourth quarter of 2011. Corporate profits have rebounded in part because oil prices have stabilized; accordingly, energy companies are more profitable compared to a year ago.

Globally, central bank policy continued its divergence in the first quarter as the Fed raised rates while other major global central banks generally have been slower to reduce stimulus programs than the U.S. Fed. Nevertheless, global economic activity has trended positive as manufacturing sector purchasing manager indexes around the globe have registered significant improvement during the prior few months. The euro area saw rising inflation readings, but despite this, the European Central Bank decided to leave ultra-low rates unchanged and continued with its bond buying program, albeit at a lower amount per month. In the U.K., the Bank of England left rates unchanged even as they increased their expectations for economic growth in 2017. The Bank of Japan also left their policy rates unchanged and continued to target a zero percent yield for the 10-year Japanese government bond.

In conclusion, this assessment of the global economy is supportive of some optimism about global securities markets. Economists like to describe this as a "Goldilocks" level of economic activity: not too hot and not too cold.

Great Britain Exit ("Brexit") from the European Union Begins

On March 29, British Prime Minister Theresa May formally initiated a U.K. exit from the European Union (EU) which is to be completed by March 2019. Negotiations respecting the future relationship between the U.K. and the EU are unlikely to go smoothly. Continued cooperation on security and free trade in goods would seem to be in the interest of both the U.K. and the EU. However, it is not in the interest of the EU for Britain to make a resounding success out of Brexit. Some leaders in Europe will be afraid that if the U.K.'s exit from the EU is seen by those Europeans who blame the euro for their economic problems as carrying no cost, then the risk of another country following Britain out of the EU, but also this time out of the euro, could rise (note that U.K.'s currency is the pound, not the euro). For this reason, the political and economic imperative to sustain the Eurozone is likely to be at the forefront of the EU negotiators' minds when dealing with the U.K. The collapse of the euro would be a far more calamitous event for Europe than the exit of Britain from the EU without a trade deal. It could be a disaster for the prosperity of Europe. In this sense, the negotiations are about far more than just the relationship between Britain and the EU; they could have a very negative impact on the Eurozone economy, which is the largest in the world. It is this bigger picture that clouds, among other uncertainties, our ability to provide a focused outlook (see below).

Updated "Outlook"

Our "outlook" for 2017 was promulgated February 3, 2017. To summarize, we deferred preparing our usual detailed outlook due to the uncertainty of U.S. policies under the Trump administration. Nonetheless, our abbreviated outlook was relatively unchanged from a year earlier and remained cautious, hardly optimistic, but not pessimistic. We forecast continued improvement of the U.S. economy but a mixed and uncertain year for the global economy (including the "Brexit" uncertainty noted above). We also forecast muted results for both U.S. bonds and stocks due to 1) the expected moderate uptrend of interest rates, and 2) high stock valuations, respectively. Additionally, we forecast a volatile U.S. Dollar but a net negligible impact over the full year and muted U.S. and global inflation. Carrying over from the previous year's forecast were "the possibility of strong performance of foreign stocks in local currencies, and probable continued net losses for foreign bonds for unhedged U.S. Dollar investors."

So far this year, the global economy has generally performed according to our forecasts, but global securities returns and the U.S. Dollar have been at variance. For example, domestic stocks have significantly exceeded our low expectations, and weakness in the U.S. Dollar significantly boosted foreign stock results for the unhedged U.S. Dollar investor. Also, unhedged foreign bonds have enjoyed very good results. All these variances come with the qualifier **so far this year**, and the year is still relatively young.

We have noted 1) the fallibility of our forecasts, whether or not they agree with the consensus forecast at the time, and 2) the ensuing reality is typically significantly different from the consensus because the consensus is already factored into prices as of the start of the forecast year (this is sometimes described as the various positive and negative expectations being "already discounted" by the current level of the market). As we move deeper into the second quarter of 2017 and the balance of the year, the consensus forecast, as updated to the present, continues to be imbedded in current prices. It will be **new** information not accurately forecast and/or not presently knowable which will move markets in the future. Year-to-date, the most important new information that may have surprised investors has been 1) the failure of Congress to "repeal and replace" Obamacare, primarily due to disunity among Republicans and especially opposition by the deeply conservative wing of the Republican Party known as the Freedom Caucus (formerly, generally, the Tea Party wing), 2) the continuing lack of detail on the Trump administration's fiscal and trade policies and various stumbles during the President's first 100 days, 3) European election support for candidates favoring globalization over protectionist policies, 4) stability of the Chinese yuan versus foreign currencies, 5) decreasing oil prices, and 6) the weakening of the U.S. Dollar.

As mentioned near the beginning of this letter, and just above, the inability of the Republican-controlled Congress to "repeal and replace" Obamacare in March underscored divisions that might make it difficult to reach consensus on pro-business initiatives that could provide economic stimulus, such as lower corporate taxes or federal funding for infrastructure. By early April, economists had scaled back forecasts for U.S. economic growth, jobs creation, and consumer sentiment. Congressional action on a tax overhaul or infrastructure spending is no longer expected this year as doubts grow over the extent to which President Trump will be able to implement his agenda.

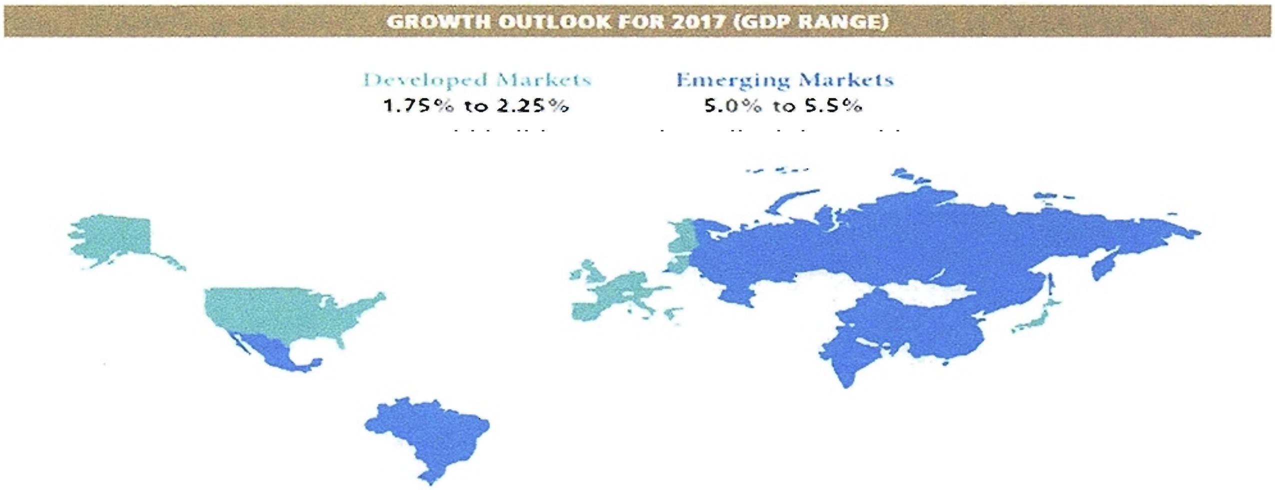
Looking forward into the balance 2017 and early 2018, PIMCO forecasts the path for the economy and markets will likely be determined by how three difficult transitions play out:

1) The transition **from monetary to fiscal policy**, which has gained speed with the European Central Bank (ECB) tapering the monthly run-rate of its asset purchases to €60 billion, the Bank of Japan (BOJ) abandoning its money supply target in favor of a yield target, and the Trump administration seeking to embark on a more expansionary fiscal policy;

2) The transition from **globalization to de-globalization,** as the acceleration of populism means protectionism is on the rise and many countries are likely to become more inward-looking.

3) **China's currency regime** transition from what was a U.S. dollar peg until August 2015, to the current quasi basket peg, to what may become a managed or even free float of the yuan.

Assuming all three transitions progress in an orderly and gradual fashion, the current eight-year old economic expansion should continue through 2017 per PIMCO. Of course, these transitions may be much bumpier or proceed more smoothly. The outcomes could be much uglier or happier if the transitions outcomes fall into the left or right tails of the PIMCO baseline projections. The table below shows PIMCO's updated growth and inflation projections under their March 2017 baseline scenario.



	REAL GDP GROWTH (% YOY)			CPI INFLATION (% YOY)		
	2015	2016	2017 FORECAST	2015	2016	2017 FORECAST
DM[1]	2.1	1.6	1.75-2.25	0.2	0.8	1.75-2.25
U.S.	2.6	1.6	2.0-2.5	0.1	1.3	2.0-2.5
Eurozone	2.0	1.7	1.5-2.0	0.0	0.2	1.25-1.75
UK	2.2	1.8	1.75-2.25	0.0	0.7	2.5-3.0
Japan	1.2	1.0	0.75-1.25	0.8	-0.1	0.25-0.75
EM[2]	4.7	4.8	5.0-5.5	3.8	3.5	3.0-3.5
China	6.9	6.7	6.0-6.5	1.4	2.0	2.25-2.75
Brazil	-3.8	-3.6	0.5-1.5	9.0	8.8	4.0-5.0
Russia	-2.8	-0.2	0.75-1.75	15.6	7.1	4.0-5.0
India	7.2	6.9	7.0-8.0	5.9	4.9	4.0-5.0
Mexico	2.6	2.3	1.25-1.75	2.7	2.8	5.0-5.5
World[3]	3.0	2.6	2.75-3.25	1.3	1.7	2.25-2.75

Note: All data for real GDP and headline inflation are year over year (YOY) percentage changes.
[1] DM is the GDP weighted average of U.S., eurozone, UK and Japan
[2] EM is the GDP weighted average of China, Brazil, Russia, India and Mexico
[3] World is the GDP weighted average of all countries listed in table above
Source: Bloomberg, PIMCO calculations

<u>Implications for Asset Allocation</u>

We have always maintained that an outlook is to a considerable degree an attempt to have a crystal ball, that the prognostications are very subject to error and need to be discounted. With indications of an orderly transition from monetary stimulus to fiscal stimulus by central banks in the U.S., Europe, and Japan, the somewhat lower odds for protectionist candidates in European elections, and the strong incentives for China to maintain financial and exchange rate stability ahead of their National Party

Congress in the fourth quarter of 2017, we are leaving our early 2017 outlook unchanged. We are continuing our emphasis on capital preservation, by insisting on maintenance of very adequate liquid reserves for short and intermediate term needs. We are keeping tactical adjustments to a minimum, and we are avoiding market timing by pursuing no significant departures from client policy allocations. Given our belief that the future is unknowable, we will position client portfolios in 2017 predicated upon 1) the need for bonds to hedge against stock volatility, and 2) careful selection of bond sectors and duration to manage interest rate risk. Strategies we are continuing from 2016 include 1) underweighting of alternative strategies due to relatively high fees in a potentially low return environment and historical underperformance, 2) use of low cost indexing for investment areas where active managers have a hard time adding value, 3) currency hedging with respect to foreign bond holdings, and 4) reliance on carefully selected, high-performing active bond and stock fund managers (who beat their benchmarks on a risk-adjusted basis) to navigate through the uncertainties of investing in 2017.

In Conclusion

We are providing these materials for your information and as a means to stay in touch. We hope you find this information helpful, and we would be pleased to hear your comments and questions. Also, you are welcome to share our views with your family and friends if you think they will benefit. Nonetheless, the information is of a general nature and should not be acted upon without further details and/or professional assistance.

Thank you for your continued support of Caves & Associates.

Thanks and credit must go to the many sources for this writing, including Managers and PIMCO mutual fund families, Wilshire Associates, Morningstar, the Wall Street Journal, and the Los Angeles Times.

There is no guarantee that the views and opinions expressed in this newsletter will come to pass, and they are not meant to provide investment advice. These views are as of April 21, 2017 and are subject to change based on subsequent developments.

Market Review First Quarter 2017

As measured by results of performance indexes, global equity markets rallied amid strong corporate earnings growth and improving economic data in the United States, Europe, and Japan; bond markets provided decent returns during the first quarter. Both developed country and emerging markets stocks generally moved together predicated on overall investor optimism and continued monetary stimulation overseas. The Fed's March interest rate hike was widely expected and had little impact on bond markets. Yield-hungry investors preferred riskier assets; quality domestic and foreign developed bonds significantly underperformed high yield and emerging market bonds. Our alternative strategies funds group provided bond-like returns for the period and were a drag on results.

Equity Review (All returns are non-annualized)

U.S. stock markets advanced to fresh all-time highs, supported by positive economic data and President Trump's plans to cut taxes, reduce regulations, and increase infrastructure spending. The average diversified U.S. stock fund returned 5.5% for the period. In a reversal from the previous quarter, investors preferred large company and growth stocks. The Russell 1000 (large cap) and Russell 2000 (small cap) indexes returned 6.0% and 2.5%, respectively. The Russell 3000 Growth index rose 8.6% and the Russell 3000 Value index gained "only" 3.0%. Based on mutual fund averages, technology and health were the best performing categories (double-digit returns). Energy stocks lagged the market, in line with the first quarter decline in crude oil prices.

Foreign developed country stock returns were generally excellent in both local currency and dollar terms. In dollar terms, the average diversified developed country stock fund (holding predominantly developed country stocks) gained 8.2%; the MSCI Europe Index rose 7.4% and the MSCI Japan Index was up 4.5%. Export-dependent emerging markets benefitted from the upturn in global growth, rising raw materials prices, and a lack of follow-through on protectionist trade policy from the Trump administration; the average emerging market stock fund was up 11.6% in dollar terms.

The U.S. dollar generally weakened during the quarter. It fell 1.6% versus 6 developed market currencies tracked by the U.S. Dollar Index. It also declined 4.8% versus 25 emerging market currencies tracked by the MSCI EM Currency (USD) Index. A weakening U.S. dollar increases returns of foreign stocks and bonds for unhedged U.S. dollar investors. It also increases foreign earnings of U.S. multinationals and decreases U.S. earnings of foreign multinationals.

Fixed Income Review (All returns are non-annualized)

U.S. fixed income markets generally provided positive but lackluster returns for the quarter. The Bloomberg Barclays (BB) U.S. Aggregate Bond Index of taxable, investment grade bonds returned 0.8%. Municipal bonds partially recovered fourth quarter losses; the average intermediate-term national municipal bond fund returned 1.3%. In addition, the BB Index for U.S. Treasury inflation-protected bonds rose 1.2% on higher inflation expectations. Quality (or the lack thereof) and maturity (from short to long) drove relative performance. Quality corporates and high yield bonds earned their usual premiums over governments. According to BB Indexes, intermediate-term Treasuries earned 0.5% versus 1.1% for intermediate credit, and high yield bonds returned 2.3%. The Federal funds rate increase in March primarily affected short-term bond prices. The yield on the 10-year Treasury bond, a proxy for inflation and global growth expectations, was virtually unchanged during the quarter; it fell from 2.45% to 2.40%.

Outside the U.S., developed countries fixed income markets returns were just below breakeven for hedged U.S. dollar investors (down 0.4%); euro- and yen-denominated bonds predominate. Emerging market bond funds experienced outstanding returns, rising 4.2% (on a typically hedged basis) in dollar terms for the quarter according to Morningstar.

First Quarter 2017 and Twelve Months
Table of Stock and Bond Returns

	Period Return* First Quarter	Period Return* 12 Months Ending 3/31/17
U.S. Stocks		
S&P 500 Index **	6.1%	17.2%
Average Diversified U.S. Equity Mutual Fund	5.5%	17.3%
Russell 2000 Index #	2.5%	26.2%
Sector Mutual Funds		
Financial	2.0%	28.0%
Communications	3.0%	9.2%
Technology	12.4%	27.2%
Health	10.8%	14.4%
Real Estate	1.0%	3.1%
Energy	-5.9%	19.0%
Commodities-Broad Basket	-2.0%	9.1%
Foreign Stocks		
MSCI Europe, Australasia & Far East (EAFE) Index ##	7.3%	11.7%
MSCI EAFE Local Currencies	4.7%	18.0%
Average Diversified Developed Country Stock Mutual Fund	8.2%	10.4%
Regional/Specialty Mutual Funds		
Europe	7.3%	8.7%
Japan	4.9%	13.8%
Diversified Pacific/Asia except Japan	13.0%	15.3%
Diversified Emerging Markets	11.6%	16.4%
Alternative Strategies		
Long-Short Mutual Funds	2.9%	6.4%
Average Option Writing Mutual Fund	2.2%	7.8%
Market Neutral Mutual Funds	0.6%	2.2%
U.S. Bonds		
Bloomberg Barclays Capital Intermediate Gov't Bond Index ***	0.5%	-0.7%
Bloomberg Barclays Capital Intermediate Credit Index δ	1.1%	2.1%
Intermediate Municipal Bond Mutual Funds (National)	1.3%	-0.3%
Intermediate Municipal Bond Mutual Funds (CA)	1.5%	-0.7%
Inflation-Protected Bond Mutual Funds	1.2%	2.1%
High Yield Bond Mutual Funds	2.3%	13.5%
Foreign Bonds		
Citigroup Non-U.S. World Gov't Bond Index (Unhedged) ###	2.0%	-4.8%
Citigroup Non-U.S. World Gov't Bond Index (Hedged) ###	-0.4%	0.6%
J.P. Morgan Global Bond Idx (GBI) Emg Mkt Index (Unhgd) ####	6.5%	5.5%
J.P. Morgan Emg Mkt Bond Idx (EMBI) Gbl Diversified (Hgd) ####	3.9%	8.9%
Emerging Market Bond Mutual Funds	4.2%	10.2%

* Mutual fund and index return data are from Morningstar.

** Capitalization-weighted index of 500 very large U.S. companies. The 500 are chosen to achieve a fair cross-section of U.S. industrial and service sectors. Recent median capitalization of approximately $85.7 billion.

*** Bloomberg Barclays Capital index of U.S. Treasury bond total returns (i.e., interest plus or minus change in price). Bonds in index have intermediate maturity of about 4-7 years. Includes returns of agency bonds but not mortgage-backed securities.

δ Bloomberg Barclays Capital index of U.S. investment grade corporate bond total returns (i.e., interest plus or minus change in price). Bonds in index have intermediate maturity of about 4-7 years.

\# Index of small U.S. companies. Recent median capitalization of approximately $1.8 billion.

\## International stock index indicating return of large foreign companies of 21 major developed countries (Japan, UK, and Germany have the highest weightings). Returns are converted to U.S. dollars. No emerging market stocks are included.

\### Citigroup index of total return of foreign government bonds issued by major developed foreign countries (Japan, Germany, France, and UK have the highest weightings). Returns are converted to U.S. dollars.

\#### J.P. Morgan index of total return of debt instruments issued by 13 emerging markets countries (Argentina, Brazil, and Chile have the highest weightings). Returns are converted to U.S. dollars.