RUSSELL INVESTMENTS

2014 Annual Global Outlook

Equity markets appear likely to experience a year of validation more than appreciation—to validate the significant P/E expansion that has taken place in 2013.

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Outlook 2014: The year of living actively

The G-3 economies are headed toward synchronized (albeit moderate) growth in 2014. This positive news, however, is already priced into most equity markets. There are still good returns to be made, but achieving these will require the full arsenal of multi-asset, multi-strategy investing.

EXECUTIVE SUMMARY

By **Jeff Hussey**
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It seems like we've been talking about the low-return world forever, but it keeps getting delayed. Low returns didn't materialize in 2013, but the inevitable can only be delayed for so long. The uncomfortable reality is that global bond yields have further to rise, credit spreads have little room to narrow, and equity markets are trading at fairly full valuations along a variety of different metrics.

That doesn't make us pessimistic: We still think risk will be rewarded and well-structured portfolios can achieve realistic investment goals. It does, however, sharpen our focus on managing downside risks, searching for additional return opportunities across and within asset classes, and dynamically managing portfolios over the year to achieve desired outcomes.

Russell's investment strategists first started talking about the square-root shaped recovery for the U.S. economy in 2009—one where an initial growth rebound would be followed by a prolonged period of modest growth as imbalances were slowly worked through. The implication was that inflation would stay low despite rounds of money printing and that investors would be steadily pushed further up the risk spectrum. As a result of this squeeze play, some investors may feel that they have been getting their pockets picked by a Fed intent on forcing them into risk assets.

This process looks like it will continue in 2014 with the added twist that the Fed seems set to begin the process of withdrawing from money printing during the year. We can't be sure of the consequences, but extra volatility seems a good bet.

The signs of economic healing in Europe and Japan along with the improved growth outlook for the U.S. should keep equity markets moving slightly higher with some fits and starts over significant tax policy changes in Japan and still a less than perfectly unified Europe which will create occasional tension. These incidences will continue to remind investors to be cautious and avoid over-exuberance.

The headwinds for fixed income investments are likely to continue as government bond yields trend slowly higher. In an uncertain world, the role of fixed income as a diversifier to equities should not be underestimated, but the challenge will be to seek out pockets of return while actively managing interest rate exposure.

One area that stands out in a world with few attractive valuation options are emerging market equities. Uncertainties over credit conditions in China and the impact of Fed tapering on current account deficit financing are reasons to be cautious for now, but this is an opportunity that warrants close attention. On the other end of the spectrum, we believe that small cap, particularly in the US, has run hard and also bears close watching for cutting risk. Finally, we think that alternatives, particularly hedge funds that are less correlated with equity markets should be considered, funded out of a mix of both bonds and equities.

The challenge for investors in the coming low return world is to achieve their required rate of return at a level of risk they can survive. The best way to do this, in our opinion, is through the use of actively managed, globally diversified, multi-asset strategies. Set it and forget it won't cut-it any more. In a low-return world, every basis point counts. ■

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[1] G-3: The world's three leading economic blocs—the US, Japan and the EU. G-3 bonds mean bonds issued in US dollars, yen and euros.

Investment cornerstones for 2014: Validating the rally

2014 should see moderate growth and moderate returns, but there are credible upside- and downside-risk scenarios that require careful monitoring.

Expectations for 2014:

- Equities to modestly outperform fixed income and cash
- U.S. economic growth of 2.9%
- Jobs gains that average 230,000 per month
- Modest inflation of just 1.9%
- U.S. Federal Reserve (Fed) tapering to begin in the first half, but no rise in the Fed funds rate until late 2015
- U.S. 10-year treasury yield at 3.2% by year end
- Single-digit growth in corporate earnings to drive U.S. equity returns. Price/ Earnings (P/E) multiples to remain broadly unchanged.
- Our target for the U.S. large-cap Russell 1000® Index at year-end 2014 is 1,060, while for the S&P500® Index it is 1,900.

The squeeze play continues

In last year's annual outlook, we argued that investors would be squeezed out of safe-haven assets and forced further up the risk curve. In our view, the combination of low interest rates, low inflation, moderate economic growth, and moderately attractive equity market valuations would leave few viable alternatives. We got the direction right, but the magnitude outstripped our expectations. As you will see in the chart on the next page, investors fleeing bonds is an example of what helped propel the Russell Global Index to gain around 20% in 2013 while global fixed income seems likely to deliver a small negative return.

The forces behind the squeeze play are still in place – ultra-expansionary monetary policy, low risk-free returns, low inflation, and moderate corporate profit growth. The differences heading into 2014 are that equity markets are now less attractively valued after 2013's big gains and the Fed is likely to start winding down its Quantitative Easing (QE) program at some stage during the year.

We think global equities will outperform cash and fixed income over 2014, but there are a couple of risky scenarios we'll be on the alert for. One is that global equity markets move into speculative overdrive. Asset markets have a history of overshooting, and global equity markets could become outright expensive if confidence in the economic outlook takes hold.

The alternative scenario is that economic growth disappoints and investors conclude that monetary policy has reached its limits. The equity market gains in 2013 largely reflect confidence that the global economy, and in particular the United States, is returning to more normal growth rates. U.S. economic growth of between 2.5%–3.0% in 2014 is needed to validate the market gains of 2013. GDP growth that significantly disappoints expectations could see equity markets give up a large portion of their 2013 gains.

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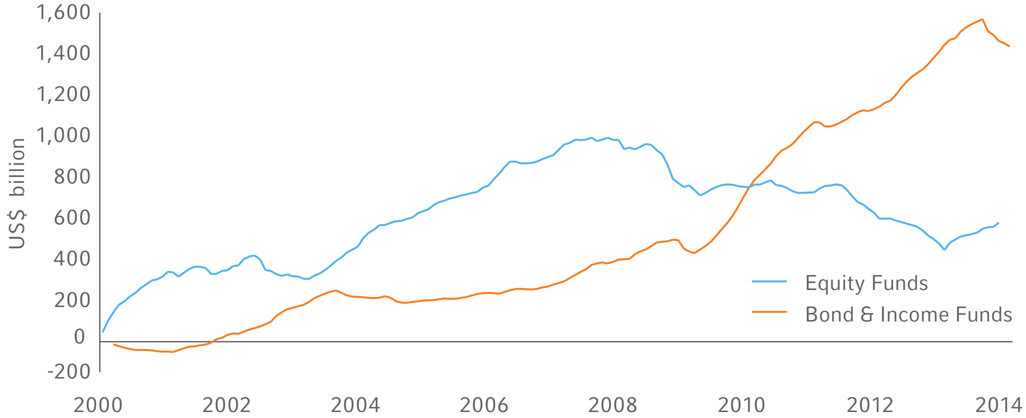
Cumulative new mutual fund cash flow since 2000



Source: Investment Company Institute

Each month, ICI conducts a unique, comprehensive survey of the U.S. mutual fund industry—currently consisting of more than 8,200 mutual funds—to collect and compile the dollar value of investors' purchases, redemptions, and exchanges of fund shares. Also gathered in the survey are fund assets and certain portfolio investment activities.

As of November 30, 2013.

Value, cycle, sentiment

In formulating investment strategy, our process focuses on three building blocks – valuation, the business cycle, and investor sentiment. Applying this to U.S. and global developed equities we get:

Value: neutral. Our valuation models are moderately positive on equities, and our qualitative assessment is slightly negative (for example, the cyclically adjusted P/E for the U.S. is now over 20 times earnings).

Cycle: moderately positive. Russell's business cycle models predict stronger growth in the U.S. and Europe over the next year. Our analysis also shows that Japan's growth momentum will continue. 2014 should see synchronized (albeit moderate) growth in the G-3 developed economies for the first time since 2010.

Sentiment: moderately negative. We track a range of indicators on momentum, positioning, fund flows, technicals and investor confidence to judge if a market is over-bought and in danger of a significant pull-back. Momentum is still a strong positive driver of equity markets. Many of the other indicators are flashing "amber," as would be expected after a solid market run. That said, our signals do not suggest that investors have become over-exuberant in a manner that typically precedes significant market reversals. In short, global equities are close to, but have not yet reached over-bought levels.

Across developed equities, we have moderate preferences for Europe and Japan. We continue to have good conviction in emerging markets (EM) equities for the longer term. We think that value there remains strong, and the prospect of increasing export demand from developed economies will support EM growth. Tactically, we are merely neutral on EM due to the prospect of Fed tapering in the next few months, which would undermine our near-term score for the asset class.

Equity markets could become outright expensive

The rotation out of fixed income investments and into equities has been gathering pace over 2013 (see previous chart). A lot of investors have missed out on the rally, held back by fears over governance in Europe, U.S. fiscal showdowns, and the impact of the unwinding of QE. The influx of money chasing performance, much of it a late-cycle inflow from retail investors (especially after they notice the negative returns from the fixed income benchmarks), could push equity markets into overdrive.

This would be an uncomfortable scenario for fundamentally focused investors like us. It would involve valuations heading to unsustainable levels before the inevitable correction as growth and earnings failed to live up to over-optimistic expectations.

However, we think this scenario is unlikely because:

› Economic growth and corporate profits are unlikely to be strong enough to generate bubble-like conditions
› Enough worry factors around Europe and the medium term growth outlook (i.e. the debate on 'secular stagnation[2]') exist to prevent overconfidence.

Ultimately, we'd like to think that investors still remember recent history. The scars from the two major bear markets in the last 13 years should limit the extent to which investors push equity prices further to unsustainable levels.

But if growth disappoints…

We believe equity markets are now 'priced for perfection' after the big gains in 2013. Any disappointment could see at least some of these gains given up. Topping the list of potential negatives would be the outbreak of another crisis in Europe. Markets would also be disappointed if U.S. policy makers fail to reach agreement on fiscal policy. This could deliver a recovery-stopping level of fiscal tightening. More generally, there is still the risk that growth in the developed economies fails to take hold as businesses and households remain cautious and deleveraging resumes.

A less discussed risk is that the U.S. economy hits capacity constraints earlier than anyone expects. The consensus assumption of industry analysts appears to be that the labor participation rate will rise as employment growth picks up, slowing the decline in the unemployment rate and allowing the U.S. a longer period of low inflation growth. However, there is a chance that the amount of labor market slack is smaller than commonly thought, as workers who have dropped out of the labor force take early retirement or don't have the skills to gain employment. If so, 2.5–3% U.S. GDP growth could trigger inflation fears and a rise in treasury yields that would send equity markets lower.

Not a set and forget year

Our models and strategy process tell us that 2014 will be a more moderate, but still positive year for investment returns. It's also likely to be a volatile year. Equity markets are near the top of their valuation ranges, and bond yields are still relatively low. The rotation from bonds into equities could easily gather pace. It could also abruptly reverse if fears about growth being too strong or weak take hold. We haven't seen a 10% correction in the U.S. equity market for more than two years. It would be surprising if markets didn't pull-back at some time during 2014.

This means that 2014 is likely to be a year where top-down active management of multi-asset portfolios becomes even more important. We may be heading towards a low-return world, but market over- and undershoots could provide opportunities for astute investors. ■

[2] Secular stagnation - the theory that a chronic shortfall of investment relative to saving causes weak demand and sluggish economic growth

Canada: Restrained resurgence

Canadian economic growth is expected to accelerate in 2014 relative to the lackluster pace of 2013. However, we are less sanguine about the impact a strengthening U.S. economy may have on Canada over the coming year, as we expect it to have broad implications on the Canadian dollar, bond yields and domestic equities.

2014 Canadian forecast summary†:

- We expect Canadian economic growth of 2.0%–2.3%, below our forecasted growth for the U.S. economy of 2.9%.
- Improved, but not robust, growth is expected to keep the Bank of Canada (BoC) sidelined, holding their target rate at 1%. Although the BoC have removed their tightening bias, growth is not expected to be weak enough to prompt a cut in their target interest rate.
- Growth, however, should be strong enough to lead bond yields modestly higher, with the Canada 10-year yield reaching 3%–3.25% by year-end 2014.
- The loonie is no longer tilted towards parity. We expect the CAD/USD exchange rate to stay within a range of $0.90–$0.98 (USD per CAD), but biased towards the lower end of that range.
- With a strong finish to 2013, Canadian equities will only have modest upside. Our 2014 year-end target for the S&P/TSX Composite Index is 13,800.

Canadian economy – crawling higher

Canadian economic growth is expected to improve in 2014, though we are less optimistic about the impact a strengthening U.S. economy may have. Our forecast for U.S. economic growth is 2.9%. That should naturally lead us to a more positive outlook for the Canadian economy. However, trends such as U.S. onshoring of higher-end manufacturing, as well as greater energy independence, will weigh on momentum on this side of the border. The declining contribution from housing and households in 2014 will also be a headwind. While the domestic housing market has been remarkably resilient, consumer debt-to-income levels in excess of 160% give us pause. Private consumption accounts for roughly 50%–60% of the Canadian economy, so even some moderation of household consumption will affect growth.

A positive factor for the economy is that business investment is primed to accelerate. Canadian energy companies may be in the initial stages of increasing investment spending to improve infrastructure. Anecdotally, announcements from Suncor and TransCanada regarding increased spending are encouraging. Enhancement to Canada's energy infrastructure is central to alleviating the volatility of Western Canada Select (WCS) crude oil relative to its U.S. counterpart West Texas Intermediate (WTI). Additional benefits from the build-up of pipeline infrastructure are jobs. We anticipate construction-related jobs to decline as housing slows. The potential increase in employment from infrastructure spending within the energy sector is expected to partially offset this trend.

Collectively, we feel there will be enough momentum from the improving U.S. and global economies which should positively contribute to growth; however, the headwinds highlighted

† The closing values as of 12/10/2013: S&P/TSX Composite Index was at 13,324, the Canada 10-year bond yield was at 2.61%.

keep us guarded. Thus, we expect the Canadian economy to grow a relatively modest 2%–2.3% in 2014.

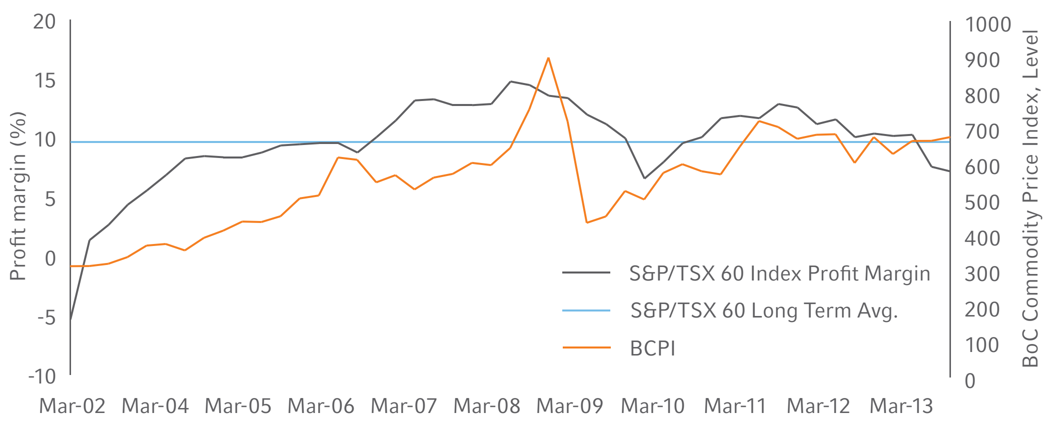
With only modest momentum in the economy, the BoC is expected to stay true to their increasingly "dovish" bias but hold the target rate at 1%. We expect BoC Governor Stephen Poloz to continue to hint about a rate reduction, but without the actual intent to do so. BoC rhetoric will be targeted to contain the Canadian dollar, for a dual purpose: building positive momentum for manufacturing and eliciting inflation, which has been absent. This means short-term rates are likely to remain stable; however, longer-term bond yields are expected to rise as the economy gradually improves. This will lead to a further steepening of the yield curve as the Canadian 10-year bond yield is forecasted to reach 3%–3.25% by year-end 2014.

Canadian equities – shift in leadership

The discount in the price of Canadian crude oil relative to U.S. crude, along with declining base and precious metal prices, have weighed heavily on the profitability of domestic equities. The chart below highlights profit margins narrowing for much of 2011–2012 as commodity prices, represented by the BoC Commodity Price Index (BCPI), declined. The stabilization of commodities since 2013 is encouraging as we anticipate profit margins bottomed in the second half of 2013. This would be a positive development. However, without a significant increase in commodity prices expected over the next year, a meaningful acceleration of margins may be limited (see section on Real Assets for additional views on commodities). Bank profitability is expected to be impacted by a trend likely to enter the initial stages in 2014: household de-leveraging. Household debt levels in Canada are not sustainable and may be the biggest impediment to consumption, the housing market, and in turn, loan growth for banks. Of the three largest sectors within the S&P/TSX Composite Index, it has been financials, led by banks, which has been the top performer since the start of 2011; we believe this winning streak will end in 2014.

Still, we expect domestic economic growth to improve from 2013 levels. This, along with stabilizing corporate profit margins and Earnings Per Share (EPS) growth in the 4%–6% range (an improvement from 1%–3% expected in 2013), should bolster sentiment towards Canadian equities. We forecast a modest increase in the S&P/TSX Composite Index, reaching 13,800 by year-end 2014.

Canada profit margin analysis



Source: Russell Investments, Bloomberg, FactSet.

Based on quarterly data as of Sept. 2013.

BCPI = Bank of Canada Commodity Price Index

U.S. economic & market outlook: Growth uptick largely priced in equities

For 2014, we project U.S. economic growth above the Blue Chip consensus forecasts. Even then, equity markets appear likely to experience a year of validation more than appreciation—to validate the significant re-pricing that has taken place in 2013.

The equity risk premium has shrunk; long live the equity premium

If the economy evolves as we expect next year, dire talk of a moribund economy will fade. Moreover, equity price increases through 2013 suggest that the market is not putting much credence in talk of economic stagnation, as one of 2013's Nobel Prize winners in Economics, Eugene Fama[3], would attest to the wisdom inherent in market prices.

Today's stock market appears to be confident about the economic outlook for 2014.

What did equity prices tell us at the end of 2013? The market appears to be communicating that the economy is poised for a lengthy period of expansion. Before we present the basis for this conclusion, we'll evaluate the counter-argument of negative scenarios: One is the "stall speed" story of frequent recessions and the other is long-term stagnation à la Japan.

The last two U.S. recessions have been triggered by popping asset bubbles. Our view is that much of the equity market re-pricing we have seen in 2013 is the result of perceptions of reduced recession risks, especially after markets experienced two false-alarm recession scares since the Great Recession in 2010 and 2011. The equity premium depends on the nature of the economic environment and, in particular, the risk of recession. The 1990s economic expansion that lasted 10 years—from March 1991 to March 2001—broke records, and it was followed by a recession that was about as short as can be—eight months. After the 2001 recession, when the U.S. unemployment rate peaked at only 6.3 percent, there was little reason to expect another 10-year expansion. Tax-cutting fever and a post-9/11 federal spending binge caused a sea change from projections of massive federal surpluses to then-record deficits. Also the "ownership society" led not only to a rise in the home ownership rate but to too many examples of modest wage earners with $400,000-plus mortgages. Economic imbalances—most notably in housing investment—were taking shape that would eventually lead to the downfall of the economic expansion. We soon learned that the imbalances were severe enough to cause a doozy of a recession.

Which type of economic expansion is underway now in the United States? The answer depends to a great degree on one's view of what causes recessions. Some observers of the economy put credence in the notion of stall speed, such that shocks large enough to tip the economy into recession would pose a persistent danger. In this case, we would expect fairly frequent recessions, given today's relatively low trend rate of growth.

In our view, recessions are not the result of a few missed strokes in the economic engine that cause a dip below stall speed. Instead, recessions result from a shift in economic gears, and a lower cruising speed does not necessarily mean things are at risk of coming to a halt. Such shifts in gear take place when economic imbalances that take the form of over-investment in key sectors that come home to roost in the form of disappointing rates of return.

Thus, we should look for evidence of over-investment to determine the level of recession risk in the economy. Given the paucity of investment in general since the recession ended

The Blue Chip consensus forecast is the average of about 50 private-sector economic forecasts compiled and published monthly by Aspen Publishers.

[3] "Eugene F. Fama - Facts". Nobelprize.org. Nobel Media AB 2013. Web. 11 Dec. 2013.

in 2009, it would appear that the U.S. economy is remarkably free of economic imbalances today. Potential cycle-ending imbalances seem to be absent.

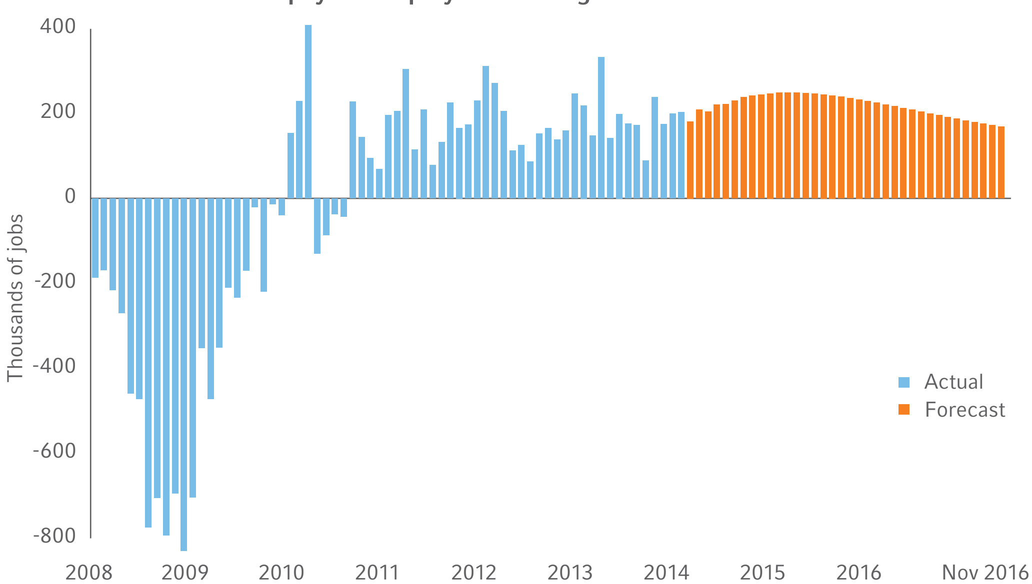
Stagnation and Japan disease

Former U.S. Secretary of the Treasury Larry Summers gave a speech[4] on Nov. 8, 2013, in which he noted that we generally think that recessions—fluctuations around the mean level of Gross Domestic Product (GDP)—pose the biggest risk. What if, he asks, 'secular stagnation' has taken hold? Summers reminds us that Japan's real GDP today is only about half as large as long-run projections 20 years ago suggested it would be. What evidence to date does Summers see of stagnation in the U.S. economy after the Great Recession? First, the share of adults employed is still close to the level shortly after the recession when the unemployment rate hit double-digits. Second, with two percent inflation and short-term interest rates near zero, not even minus two percent real short-term rates of interest, in combination with QE, have been able to jump-start the economy…until now.

But we believe investors need to keep one thing in mind: Much of the current high value in equities comes from anticipation of better economic growth in 2014. Stocks have risen in 2013 on the expectation of better things to come. So 2014 needs to be a year in which we see those expectations for growth validated. Thus, our base case for equity markets is that 2014 will be more a year of validation than appreciation. Overall, we anticipate modestly positive equity price appreciation of around 5 percent during 2014 –depending, of course, on actual corporate performance.

Clearly the equity risk premium would be larger (stock price multiples would be smaller) if the threat of prolonged economic stagnation or stall-speed recessions were serious. Our expectation, however, is that nominal GDP growth will increase from 3.2 percent in 2013 to 4.6 percent in 2014 on a year-on-year basis. At the same time, we expect a nice plateau in monthly jobs gains, with a lengthy string of gains near 230,000 jobs per month in 2014, which is noticeably above the Blue Chip consensus forecast of 194,000 jobs per month. Thus, we expect to raise a glass at the end of 2014 and toast a year of healthy economic growth that justifies a more modest equity risk premium.

Forecasts of nonfarm payroll employment changes as of November 2013



[4] To read this speech visit larrysummers.com

Source: Federal Reserve Bank of St. Louis for data through November 2013. Out of sample forecasts were calculated by simulating a time-series model into the future. The value shown is the median of the simulated values for the month.

Data shown is historical and not an indicator of future results.

Data as of November 30, 2013

The euro zone: The ice is thinning

The euro zone is on thin ice. As deflationary forces gather strength, the pressure builds and cracks appear. Our biggest worry for 2014 is the weak condition of banks, their toxic connection to governments, and the negative impact on growth from a lack of credit. On the other side of the equation, reflationary policies in the form of less austerity and continued support from the European Central Bank (ECB) should keep the ice from breaking.

The euro zone won't go under

Even though deflationary forces are building, we think reflationary policies still have the upper hand. This view is predicated on four developments:

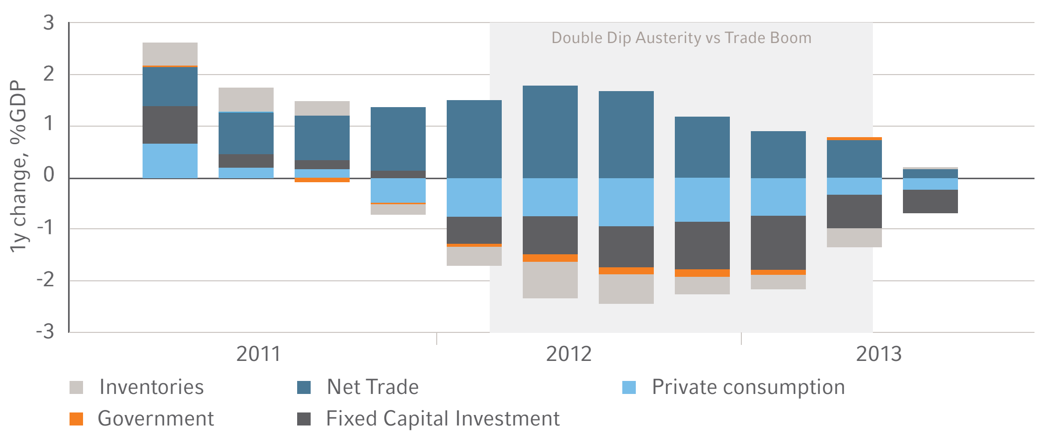
- Less austerity will provide a tailwind for growth
- The ECB will provide support where and when it can
- Valuations are still attractive relative to other regions
- Trade is turning into a formidable growth engine

> Even though deflationary forces are building, we think reflationary policies still have the upper hand.

Looking at the chart below, it is clear which two factors kept euro-zone growth down in its recent double-dip recession: a collapse in private consumption and a shortfall in fixed capital investment. In contrast to the great recession in 2009, this weakness in demand was not partially offset by increased government spending. In fact, Germany's insistence on pro-cyclical austerity meant that government spending detracted from growth. Only net trade has consistently added to growth, by virtue of a huge improvement in the trade balances of the periphery and continued German exporting prowess. In 2014 we expect a gradual and modest recovery in demand, combined with less austerity and continued strength in trade, will allow for growth of 0.5% - 1.0%.

The ECB has an important role to play in this scenario. It is crucial that it continues to provide as much support as possible—with an accommodative monetary policy—and do more if needed. We expect it will do so. ECB President Mario Draghi is clearly concerned about deflation, and he has a proven willingness to act unconventionally when required. Another rate cut and a new long-term refinancing operation (LTRO) are most likely. We do not foresee outright quantitative easing (QE), with or without the use of QE's more insurance-like cousin,

Eurozone contributions to GDP growth



Source: Thomson Rueters datastream.

the outright monetary transaction mechanism. That road is too politically fraught. The ECB will, however, continue to ensure break-up risk is low.

Buy and hold?

Despite sporting relatively attractive valuations, the euro zone is not safe enough to buy and hold. There are four problems that underpin this lack of safety:

- Weak banks are throttling an already weak recovery
- Divergence between markets elevates socio-political risk
- The periphery remains stuck in its debt trap, elevating deflation risk
- Structural reforms are lacking

The first two problems are most important for 2014. Regarding the banking sector, we expect the negative impact from weak credit growth to continue throughout 2014. With banks preparing for the ECB's Asset Quality Review and successive bank stress test, we see little upside potential. In fact, even the recent improvement in sovereign funding conditions can come under pressure if the ECB signals it will demand banks to haircut their government bond holdings. At the same time, we do not believe either the ECB or European politicians will allow a new banking crisis to emerge. First, capital shortfalls will be kept within an acceptable range and they will be plugged one way or another. Second, in the absence of a European resolution mechanism, policymakers will ensure that the banks that fail the stress test will be small enough to be unwound by their respective governments. And third, the ECB will vigilantly make certain that the excess cash in the banking system does not fall below €100bn.

With respect to divergence, we worry most about the divide opening up between France and Germany. If France cannot compete with Germany within the euro zone, it could turn against the EU, and lash out at Brussels. With German politicians unwilling to compromise on issues such as deposit insurance, or fiscal and political union, that is not a good situation. Without Germany and France, the euro zone cannot move forward.

Given these economic and political risks, we believe investors should keep a close eye on the region and might want to consider adjusting their allocations according to the latest developments. A positive development would be decisive ECB action while a negative catalyst would be a slide back into recession. Neither is in our base case scenario.

Strategy outlook:

- **Valuation:** The euro zone no longer maintains a margin of safety against socio-political risk, but valuations are still attractive relative to the U.S. The dividend yield at 3.5% and a forward PE of 13.2—two points below the 15.2 in the U.S.[5]—attest to that. Earnings have declined for 30 months but with growth returning to positive territory and profit margins below their historical average, we think earnings growth will turn positive. A small increase in revenue as well as profit margins should make 5-10% growth possible.
- **Business cycle:** The ECB and credit growth will be key to keeping growth positive. The fragility of the recovery means we cannot rule out a triple dip recession in the second half of 2014.
- **Sentiment:** Neutral for now although some indicators are flashing amber.
- **Conclusion:** We believe 2014 will be a year to remain invested, but not to just buy and hold. With respect to bond yields, we think the core countries will participate in the rising rate environment of the developed world, however, at a slower pace because of lackluster growth and low inflation. In the periphery we believe spread contraction has run its course, and one should not buy these bonds expecting capital appreciation. The carry appears still attractive but here also, we do not suggest a buy and hold approach. ■

[5] According to the Russell Eurozone Index and Russell 3000® Index

Asia Pacific: Set to gallop in year of the horse

Asia-Pacific economies will be major beneficiaries from a synchronized uplift in world trade in 2014. More than that, however, the two major nations of China and Japan both have strong internal growth dynamics of their own. We favor Chinese, Japanese, and emerging Asian equities, but see Japanese government bonds as high risk.

- Credible economic reform processes in both China and Japan
- Emerging Asia well-placed to leverage global recovery
- Australia's "safe haven" status is fading
- Equity markets and hard-currency EM debt attractive
- Acceptable levels of economic, market and political risk

Economic Prospects

The economic prospects for the Asia-Pacific economies are good. Very substantive reform agendas in both China and Japan, while not without risks, credible, in our view, and broadly speaking, running to plan. We see industry 2014 GDP growth expectations in the 7-8% range for China, which may face some challenges in the wake of monetary tightness and the disruptions of reform; but in our view, this target is not materially at risk. Market expectations for Japanese growth of 1.6% look undemanding in the light of strong momentum in that economy. We also believe that concerns surrounding a scheduled increase in the consumption tax in April are overdone.

The major Asia-Pacific nations will likely contribute more than their "fair share" to the global economic recovery that we expect for 2014.

Economies elsewhere in the region offer less idiosyncratic growth drivers that are specific to their internal markets. In line with the general trend, these countries will benefit significantly from any uplift in global trade.

Equity Markets

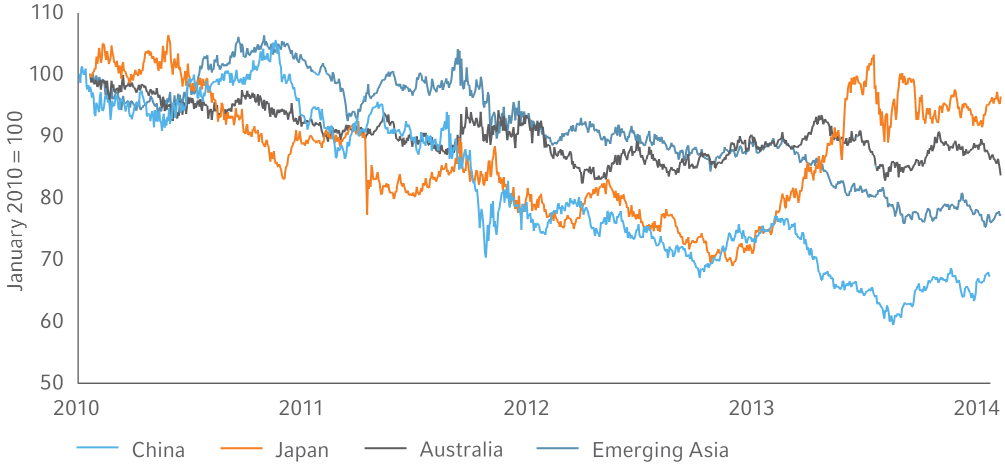
Prospects are positive for most Asia-Pacific equity markets, although the mix of drivers varies somewhat from country to country.

In a global equity market currently beset by earnings downgrades, Japan is a stand-out pocket of upgrades and growth. We expect 20% earnings-per-share (EPS) growth in 2014, following a major rebound over 2013. A cyclically adjusted price-to-earnings ratio (P/E) in the mid-20s is challenging, but we see upside for profit margins and, with a headline P/E in the mid-teens, there is headroom for further rises.

Emerging Asia (of which nearly a third is China) is currently out of favor and, even after addressing for sector biases, cheap. The 2014 P/E is 9x for China and 10x for the region.

Australia looks expensive in a global context, with its valuation unjustified either by its sector composition or its economic prospects. Overall, the Australian market is trading at a P/E premium around 5%, but its dominant sectors, finance and resources, would ordinarily be considered low-multiple sectors. That said, a dividend yield close to 5% could attract fund flows from domestic cash and bond funds. We are circumspect but not overtly negative.

Asia-Pacific equities, local currency, relative to the Russell Global Index



Data as of December 6, 2013

Data shown is historical and not an indicator of future results.

Source: Russell China Index, Russell Japan Index, Russell Australia Index, Russell Emerging Asia Index.

Fixed Income

In stark contrast to the strong performance of Japanese equities in 2013, that country's government bonds have yet to respond at all. They've shrugged off the combination of stimulatory monetary and fiscal policies, a weak yen, and a return to strong GDP growth to do…nothing. They remain the outlier of the developed world, with the 10-year rate, in mid-December 2013, trading at a skinny 0.7%. If our expectations are correct, and 2014 sees a second year of meaningful recovery in Japanese growth and inflation, then rates can move higher, notwithstanding the "anchor" of a 0.1% cash rate.

We believe better value can be found in Australia, where 10-year government bonds are trading at 4.4% as of December 6, 2013, and where growth rates are beginning to lag northern hemisphere counterparts for the first time in a decade. Weaker economic growth would be a positive for Australian bonds. On the other hand, foreign holdings of Australian debt rose to record highs through the years of global crisis. As Australia's "safe haven" status fades, there is some risk of a rush for the exits. Hedging costs are also high, and we regard the Australian dollar as overpriced.

Hard currency emerging market debt is trading at attractive spreads, as discussed later in the fixed income section of this report.

Risks

We would rate the risks to the Asian growth story in 2014 as "low"—in contrast to a "moderate" risk rating to the prospects for Europe. Key watch points begin with Chinese credit markets, which will be tested by rising rates, structural change, and question-marks over loan quality. In Japan, we believe the government bond market is a vulnerable asset class and as a result, any significant sell-off by these institutions could place the financial system under stress. Finally, there's geo-political risk stemming from the diplomatic skirmishes in late 2013, as China asserts new claims to territorial rights. We believe this is more a public relations campaign aimed at the internal population, rather than a real international threat. Our net assessment is that geo-political risk in the region is still low.

Conclusion

The major Asia-Pacific nations will likely contribute more than their "fair share" to the global economic recovery that we expect for 2014. Asian equity markets are preferred, both to Asian-region bonds and to developed market equities. ■

Global Equities: A gently rising tide in 2014?

2014 is likely to be a year of more modest returns, but with greater correlation across markets. Active allocation across regions, sectors and styles will be important to achieve risk adjusted performance goals.

Asset allocation will matter; but perhaps differently in 2014

Compared to a year ago, there are now less valuation advantages for equities relative to fixed income or cash. The trailing price-to-earnings (P/E) ratio for global developed equities has lifted from 13.8 times at the end of 2012 to 16.4 times at the end of November 2013. The yield gap between U.S. equities and 10-year Treasury bonds is now the smallest in over three years.

Table A shows equity returns in the world's largest developed markets. With only a few exceptions, these returns were well above historical averages. In fact, global equities in 2013 experienced one of their best years in a decade. Dynamic allocation strategies had numerous opportunities to take advantage of misvaluations between and within regional equities.

In 2014, we anticipate lower returns with higher correlations between developed equity markets. The G-3 developed economies are likely to experience synchronized growth for the first time since 2010. We think that P/E ratios are unlikely to rise much more. This means that equity market returns will be driven by modest earnings growth. In U.S. Large Cap equities we anticipate earnings growth in the range of 4%–5% with a dividend yield near 1.7% (and our dividend expectation would scale up to 2.4% for the Russell Global Index). To achieve outcomes, returns will need to be generated by timing risk-on/risk-off choices, as well as through active allocations across regional equities as well as within regions on cap-tier, style, and other equity risk factors.

> There may be some volatility along the way to 2014's moderate returns. This calls for prudent downside risk protection married with informed active allocation both between and within regional equities.

Table A: 2013 Equity Market Returns

Country	Large Cap Index	Small Cap Index
US	29.6%	34.8%
UK	17.5%	32.9%
GER	21.7%	30.2%
FRA	18.8%	27.3%
JPN	47%	46.4%
AUS	19.3%	3.0%
CAN	6.8%	-0.7%
EM	-1.0%	4.9%

Source: Russell Indexes (Total returns through Dec. 6, 2013, in local currency).

Indexes represented: Russell 1000 Index, Russell 2000® Index, Russell UK Large Cap Index, Russell UK Small Cap Index, Russell Germany Large Cap, Russell Germany Small Cap, Russell France Large Cap Index, Russell France Small Cap Index, Russell Japan Large Cap Index, Russell Japan Small Cap Index, Russell Australia Large Cap Index, Russell Australia Small Cap Index, Russell Canada Large Cap Index, Russell Canada Small Cap Index and Russell Emerging Markets Index. EM returns in USD.

Data shown is historical and not an indicator of future results.

Indexes are unmanaged and can not be invested in directly.

Fewer regional valuation differentials

In Table B, we present a simplified snapshot of the modeling that underpins Russell's Enhanced Asset Allocation (EAA) capability. Our analysis shows a far more neutral valuation story than one year earlier. Some of the key points for 2014 include:

› A rotation toward U.S. large cap equities within global equities

› Decreased but still modest preferences for European and Japanese equities from a fully hedged perspective.

› The most persistent and significant valuation advantages lie in emerging markets (EM).

These markets should be boosted in 2014 by export demand from improving developed market economies. Timing is the challenge for EM. When to take action in EM will be predicated on decisions by the U.S. Fed surrounding the pace and scale of the curtailing of its asset purchase program.

Table B: Equity vs. Equity valuations (based on Russell models)

	US	UK	Europe*	JPN	AUS	CAN	EM
US		-	+ (EUR)	+ (JPN)	-	-	+ (EM)
UK	-		-	+ (JPN)	-	-	+ (EM)
Europe*	+ (EUR)	-		-	-	-	-
JPN	+ (JPN)	+ (JPN)	-		+ (JPN)	+ (JPN)	-
AUS	-	-	-	+ (JPN)		-	+ (EM)
CAN	-	-	-	+ (JPN)	-		+ (EM)
EM	+ (EM)	-	+ (EM)	-	+ (EM)	+ (EM)	

* Continental Europe

\+ denotes a preference for the region in a pair listed in parenthesis

\- denotes a neutral signal

Based on an average signal from Russell proprietary valuation models; 12 mo. momentum, P/E ratio of ratio, P/B ratio of ratio, P/S ratio of ratio, Long term mean reversion, and regression of fundamental aggregates.

(Signals through 30 November 13, from a fully hedged currency perspective)

Background on Table B: Enhanced Asset Allocation (EAA) is a capability that builds on Strategic Asset Allocation (SAA) by incorporating views from Russell's proprietary asset class valuation models. EAA is based on the concept that sizable market movements away from long-term average valuations create opportunities for incremental returns.

In assessing the attractiveness of asset classes relative to one another, Russell's EAA capability uses a pair-wise modeling construct with asset classes shared across multiple pairs, each with independent valuations. At present, the capability includes over 120 pairs leveraging signals from greater than 400 models.

Cap tier and style

2014 should be a year where more synchronized global developed market business cycles leads to higher correlations between those markets. This will make allocation choices within regional equity exposures all the more material. As Table A highlights, small cap markets almost universally outperformed large cap markets. The only significant exceptions were the resource and commodity-driven markets in Australia and Canada (and a near neutral outcome in Japan). We think the period of small-cap outperformance is coming to a close.

› Our valuation suite holds either a neutral or slight large cap preference in the majority of regions, with the exception of a slight small cap preference in Australia and Japan. We're wary of Australian small-caps given the high weighting of mining stocks. The yen devaluation has mostly benefited large-cap exporters in Japan. The next phase of Abenomics, which boosts domestic inflation, could help small-cap firms lift their margins and earnings as well as create an environment that more likely can be successfully navigated by more nimble small-cap firms.

› In the near term, momentum may support small cap equities relative to large cap. Our long-term mean reversion modeling as well as P/E and price-to-sales (P/S) ratio comparisons lead us to conclude that the small cap run may be winding down.

› We don't see any outsized advantages to style selection yet for 2014. A slight value preference exists in Europe and the U.K., but for the most part, these signals are broadly neutral.

What to anticipate

Industry consensus expectations for 2014 appear to be for mid-to-slightly-higher single-digit equity market returns amid a rising rate environment; our central scenario doesn't deviate too far. There may, however, be some volatility along the way to these moderate returns. This calls for prudent downside risk protection married with informed active allocation both between and within regional equities. ■

Global fixed income: A lackluster year?

2014 is likely to prove a lackluster year for government bond investments. The likely onset of tapering and the emergence of synchronized world economic growth for the first time in several years may spell bad news for the asset class. We expect a total return of 1%-2% from bellwether 10-year U.S. Treasuries.

Expectations for 2014:

- Cash will have significant tactical value
- Developed market 10-year sovereign bond returns likely around 1%-2%
- Diversification benefits of government bonds are likely to be substantial
- Fed tapering to begin in the first half, but no rise in the Fed funds rate until late 2015.
- U.S. 10-year treasury yield at 3.2% by year end
- Hard currency emerging markets debt (EMD) is preferred over local currency
- Shorter-duration exposures such as high yield credit and bank loans, offer attractive risk-return alternatives both to long sovereign bonds and to equities.

Policy rates

Pending confirmation by the full Senate, Janet Yellen will take the reins as new Chair of the U.S. Federal Reserve in the first quarter of 2014. Her expected bias is towards leaving rates "lower for longer" –that is, a "dovish" attitude to monetary policy. This leaves us confident that official interest rates on U.S. cash will remain effectively at zero in 2014, and most likely until late 2015. Meanwhile in Europe and Japan—both of which are earlier in the economic recovery cycle than the U.S.—a continuation of cash rates near zero seems even more likely.

Despite its discouraging zero rate of return, we believe cash will play a key role in portfolio management through 2014. Far from being a "set and forget" year, we expect volatility in the stock and bond markets to be greater in 2014 than in 2013. In addition, the trend rates of return will be more modest. In this environment, we're reminding our clients that cash can be the "powder", in the expression "keep some powder dry." Rather than moving underweight, we believe it is prudent to maintain some cash weighting with a view to opportunistic deployment after the dips in stocks and bonds have occurred.

Our central case is that the expected bond market decline will be orderly, with rate rises constrained by the dual anchors of a zero policy rate, and low inflation. However, the skew of risk is to the upside on rates (i.e. downside on returns).

Government bonds

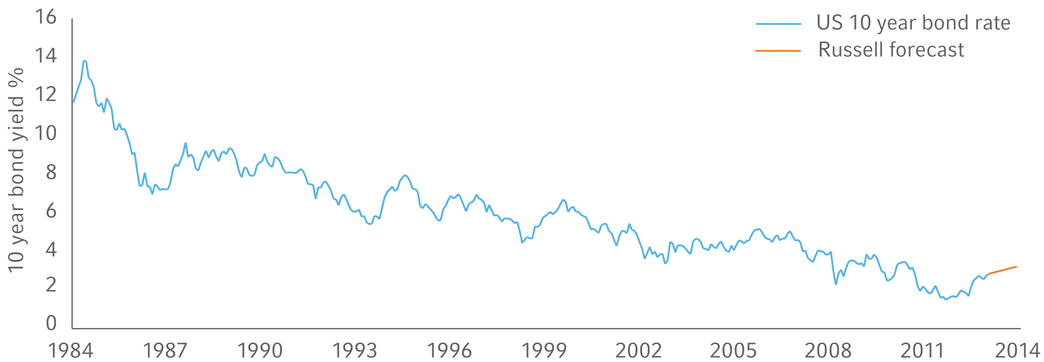
As you can see in the following graph, rates for 10-year U.S. Treasury bonds bottomed out at just under 1.5% in July 2012 and have been tracing a zig-zag upward path over the past 18 months. We believe that yields will continue to move higher, albeit modestly, to 3.2% by year-end. Continued accommodative monetary policy combined with low inflation will keep rates low. That said, the onset of tapering in quantitative easing (QE) is likely to cause some volatility and could provide a tactical buying opportunity.

In Japan the economic recovery is at an earlier stage of the cycle than in the U.S., which is a positive factor for Japanese bonds. This positive is, however, offset by a couple of negatives:

lower bond yields and a worse sovereign fiscal position. With Japanese government bond yields at 0.65% and a reflationary economic policy gaining traction, we believe the Japanese sovereign bond market is high risk.

The euro zone is also behind the U.S. in the cycle and is experiencing larger deflationary pressures. This will keep the bond yields in the core countries low. Given their lower yields relative to the U.S., the expected return is about 1-2%. With respect to the periphery, we

U.S. 10-year Treasury bond rate and Russell forecast



Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.

Source: Russell Investments

are of the opinion that spreads are on the low side and are more likely to widen than tighten. As such, the investment case for these bonds is judged mostly on their carry[6], which we feel provides only a slender margin of safety. As long as the European Central Bank (ECB) stands ready, investors are likely to earn the carry, but the political and economic risks provide a noteworthy downside skew.

Corporate bonds, EM debt, and other opportunities

Investment grade corporate bonds are not exactly expensive, but they are definitely not cheap. Current spreads versus treasuries are unlikely to tighten much, but they do provide more than adequate protection against the relatively low risk of default that's currently the case in this sector of the bond market. That means we like investment grade corporate bonds as a short duration alternative to government bonds.

High yield corporate bonds also do not have much scope for capital appreciation. But their yields are high enough to make them attractive—even relative to equities. Again, the default cycle is expected to be very sanguine in 2014, and their relatively short duration is beneficial in a rising rate environment.

EM debt. We prefer hard currency EMD—priced in dollars or in euros—over local currency EMD in 2014. That's because we perceive downside risks around the impact of QE tapering on emerging market currencies in the coming months. Also, the commodity cycle is turning for the worse for large developing countries like Brazil and Russia, which depend on exporting their natural resources. As a result, we prefer the relative safety of hard currency EMD, and judge their yield attractive in a low-return world. After QE tapering, we will revisit our investment stance on local currency EMD.

Other fixed income opportunities. With cash rates at zero, bond rates likely rising, and equities facing a year of heightened risk, fixed income opportunities with shorter duration and with higher running yields (or yield to maturity) are an attractive proposition. In that respect we are positive on asset classes such as bank loans, asset backed securities, non-agency mortgages and distressed debt. The liquidity profile of these assets warrants careful consideration about how to access them. As alternative assets, they are thinly traded, but their yields are attractive and spreads have a moderate capacity to tighten further. ■

[6] Carry: The return from holding the bond.

Currency: The U.S. dollar holds on

Since 2007, simultaneous growth across developed market economies—the U.S., Europe and Japan—has been elusive. However, in 2014 we expect increasing global growth in a low-inflation environment. This scenario should be slightly favorable to the U.S. dollar—even if U.S. interest rates are slow to rise and the Federal Reserve remains very accommodative.

U.S. dollar expected to hold its own in 2014 based on improved growth, free from immediate inflation threats

The Blue Chip consensus forecast, which polls America's top business analysts, predicts as of November 30, 2013 that the U.S. dollar will appreciate by about 1.5 % against other major currencies between 2013Q4 and 2014Q4. Our general currency outlook agrees with this view, not least because it conforms with our expectation that commodity price inflation will be relatively low for a year of improving economic growth.

The chart below uses a proprietary Russell model to estimate a EUR-USD valuation gap since the inception of the euro in 1999. Negative values indicate EUR undervaluation in a long-run time frame, so the slightly positive value at the end of November 2013 indicates that the EUR is slightly overvalued at present.

Other parts of the world face much greater policy uncertainty in 2014, as peripheral euro-zone countries still have to address the large gap between their long-term government borrowing costs and their nominal GDP growth rates. These countries continue to exhibit debt-to-GDP ratios that are on an upward spiral. Japan is struggling to get nominal GDP growth up to 3 percent, while simultaneously instituting consumption-based tax reform that could be disruptive in the short run. (This may remind some readers of Japan's counter-productive experience in 1997 with an increase in the value-added tax.)

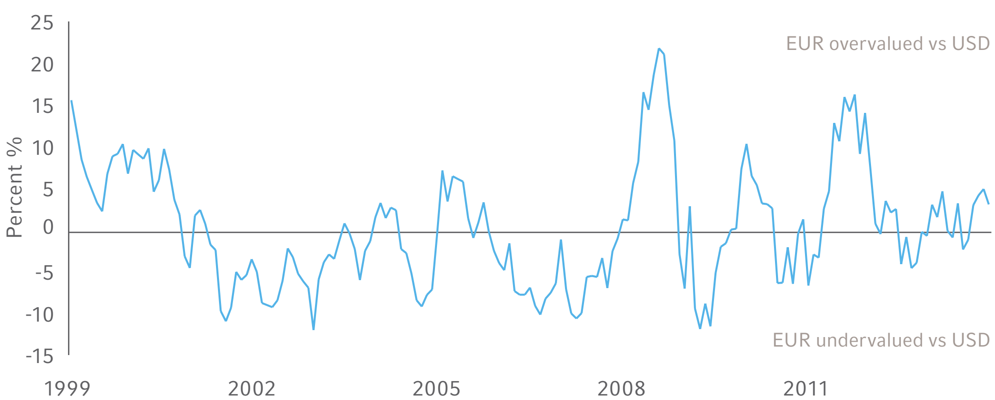
Back in the U.S., the outlook is relatively good, as it appears both sides of the political aisle in Congress are ready to step back from the budgetary brinksmanship we saw from 2011 through October 2013. Relatively strong economic growth in the United States and a lesser degree of policy uncertainty should help the U.S. dollar hold its own against other major currencies in 2014. ■

Our pair-wise views are:

- USD-CAD: flat to slight CAD depreciation
- USD-JPY: yen depreciation
- GBP-USD: flat to slight GBP appreciation
- AUD-USD: flat to slight AUD depreciation
- EUR-USD: flat to moderate EUR depreciation

USD = U.S. Dollar
CAD = Canadian Dollar
JPY = Japanese Yen
GBP = Great British Pound
AUD = Australian Dollar
EUR = Euro

EUR-USD valuation gap



Source: Russell calculations based on data from Factset.

Real assets: Divergent trends

Real assets should benefit from the "great rotation" theme in 2014, as bond investors seek other sources for yield. However, not all real assets will benefit similarly. The synchronized upturn in the global economy is favorable for listed infrastructure and, to a lesser degree, Real Estate Investment Trusts (REITs). Commodities may be challenged by the surge in North American energy and industrial metals supply as well as by less capital-intensive growth in China.

Listed infrastructure & Listed real estate[7]

Yield enhancement is a major theme that we believe benefits both listed infrastructure and listed real estate. As seen in the chart below, global bonds yielding less than 3% versus dividend yields of 4% and 3.5%, respectively, for infrastructure and real estate draw attention to both asset classes. Our preference is tilted toward infrastructure in 2014 as it is better positioned to benefit from a synchronized global economic upturn.

Listed Infrastructure (neutral to positive)

First, we note that valuations are high, but acceptable. EV/EBITA[8], also known as the "enterprise value multiple," is trending above the longer-term average, though below pre-recession peak achieved in October 2007.

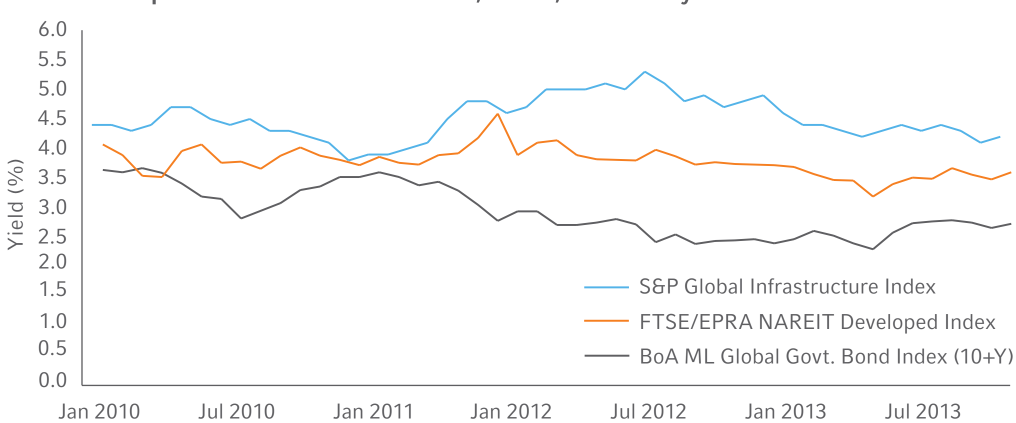
Also, our positive outlook on the business cycle is good for the cash flow of infrastructure companies in two respects: More business and leisure travel means more revenue from increased traffic (i.e. tolls and airports). And better growth means infrastructure companies can raise prices. While listed infrastructure is not a bond substitute, it does generally have lower volatility than traditional equities and often may provide a healthy dividend yield. Both attributes play into two key trends related to risk aversion: Structurally, the aging population in developed economies will naturally lead asset allocation strategies to shift towards risk aversion. Cyclically, as part of the "great rotation" into "riskier" asset classes, investors may come to embrace listed infrastructure as a source of higher returns than bonds, but with "defensive" attributes relative to equities.

Our preference is tilted toward infrastructure in 2014 as it is better positioned to benefit from a synchronized global economic upturn.

REITs (neutral)

The rise in bond yields at the time of the 2013 mid-year downturn on Fed taper concerns hurt real estate investment trusts' (REITs) performance. The risk is that bond yields (and borrowing

Yield comparison: listed infrastructure, REITs, and bond yields



[7] Comments related to infrastructure and real estate in this section is in relation to listed securities of the respective asset classes.

[8] EV/EBITDA = enterprise value to earnings before interest, tax, depreciation and amortization.

As of 10/31/13. Based on the S&P Global Infrastructure Index and FTSE/EPRA NAREIT Developed Index, respectively.

Indexes shown here and on subsequent pages are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment.

costs for property owners) will rise faster than property values; this would be a negative for an asset class that tends to be highly levered. We expect a gradual rise in U.S. bond yields to be a headwind for REITs.

Valuation in terms of price-to-book (P/B) ratios versus longer-term averages shows most geographic regions globally are broadly neutral. REITs' dividend yield of 3.5% is their most compelling valuation measure. Overall, broadly neutral valuations and equity-like volatility may limit the attractiveness of REITs relative to infrastructure assets.

Commodities

Normally, improvements in the global economy should flow through to commodity prices as aggregate demand increases. However, commodities over the coming year are likely to be held back by new supplies of energy and industrial metals as well as by lower demand from China. A stronger U.S. dollar (USD) could be an additional headwind. In the aggregate, we are neutral to slightly negative on commodities over the coming year.

Energy

Energy production in the U.S. is up more than 18% year over year, while imports of crude oil are down more than 12%[9]. Although China is the marginal buyer, the U.S. has historically been the largest importer of crude. The surge in North American energy, coupled with reduced import demand from the U.S. will be a theme affecting oil and natural gas prices over the coming year.

With no anticipated surge in demand for crude oil, we expect both the West Texas Intermediate (WTI) and Brent crude prices to remain range-bound (WTI $85-$105 & Brent $90-$120).

However, there's always the risk for a spike in crude oil prices for two reasons: pipelines and geopolitics. Pipeline disruptions are seemingly the norm and may place episodic upward pressure on prices. However, so long as these disruptions are temporary, their impact will be transitory. As of this writing, some of the geopolitical risks situated in the Middle East have subsided—though a flare-up of such risks cannot be underestimated.

Industrial Metals

Our expectation of stronger global growth should be positive for base metals; however, several trends keep us cautious.

Chinese growth has moved into a "new normal" range of 7%-8%. The makeup of this growth will be less capital intensive as Chinese authorities work to promote domestic consumption and contain housing-related inflation. Although we expect improving economies in North America, Europe and Japan, their respective demand for base metals is not likely to make up for the loss of momentum from China. We also note that the rising supply, resulting from the large mining industry capital expenditures over the past few years, should work to dampen any upward pressure on prices.

Precious Metals

The most negative trend for precious metals is the gradual rise in bond yields. The opportunity cost of holding precious metals, especially gold, has been rising over the previous year, and this trend is expected to continue in 2014. Outside of a geopolitical shock, we believe precious metals will struggle to rally. The principal downside risk to gold prices may come when the Fed commences tapering its bond buying activity. Gold reacted violently in May 2013 after the Fed's initial comments on potential tapering, declining by over $250/tOz over a two-month span. The reaction to actual tapering may not be as pronounced. However, a move below $1,200/tOz. cannot be ruled out. That said, fear of higher future inflation from recovering economies might be the wildcard that places a floor under the price of gold. Thus, we expect gold to remain in a wide trading-range of $1,000-$1,500/tOz. ■

[9] U.S. crude oil information based on U.S. Energy Information Administration data as of 30 September 2013.

IMPORTANT INFORMATION

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Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Investment in Global, International or Emerging markets may be significantly affected by political or economic conditions and regulatory requirements in a particular country. Investments in non-U.S. markets can involve risks of currency fluctuation, political and economic instability, different accounting standards and foreign taxation. Such securities may be less liquid and more volatile. Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and political systems with less stability than in more developed countries.

Currency investing involves risks including fluctuations in currency values, whether the home currency or the foreign currency. They can either enhance or reduce the returns associated with foreign investments.

Investments in non-U.S. markets can involve risks of currency fluctuation, political and economic instability, different accounting standards and foreign taxation.

Bond investors should carefully consider risks such as interest rate, credit, repurchase and reverse repurchase transaction risks. Greater risk, such as increased volatility, limited liquidity, prepayment, non-payment and increased default risk, is inherent in portfolios that invest in high yield ("junk") bonds or mortgage backed securities, especially mortgage backed securities with exposure to sub-prime mortgages.

Diversification: strategic asset allocation and multi-asset investing do not assure profit or protect against loss in declining markets.

The Russell 1000® Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The Russell Global Index measures the performance of the global equity market based on all investable equity securities. The index includes approximately 10,000 securities in 63 countries and covers 98% of the investable global market. All securities in the Russell Global Index are classified according to size, region, country, and sector, as a result the Index can be segmented into more than 300 distinct benchmarks.

The Russell Europe Index measures the performance of the equity markets across Europe represented in the Russell

Global Index based on all investable equity securities.

The S&P Global Infrastructure Index provides liquid and tradable exposure to 75 companies from around the world that represent the listed infrastructure universe. To create diversified exposure, the index includes three distinct infrastructure clusters: utilities, transportation, and energy. FTSE EPRA/NAREIT Developed Index (formerly named FTSE EPRA/ NAREIT Global Real Estate Index) is a global market capitalization weighted index composed of listed real estate securities from developed market countries in North America, Europe, and Asia.

BofA Merrill Lynch Global Government Bond Index tracks the performance of public debt of investment-grade sovereign issuers, issued and denominated in their own domestic market and currency. It is a market value-weighted measure of these bonds.

The S&P 500, or the Standard & Poor's 500, is a stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ.

The Russell UK Large Cap Index measures the performance of the largest UK securities in the Russell Global Index, based on market capitalization, while the Russell UK Small Cap Index measures the performance of the smallest UK securities.

The Russell Germany Large Cap Index measures the performance of the largest Germany securities in the Russell Global Index, based on market capitalization, while the Russell Germany Small Cap Index measures the performance of the smallest German securities.

The Russell France Large Cap Index measures the performance of the largest French securities in the Russell Global Index, based on market capitalization, while the Russell France Small Cap Index measures the performance of the smallest French securities.

The Russell Japan Large Cap Index measures the performance of the largest Japanese securities in the Russell Global Index, based on market capitalization, while the Russell Japan Small Cap Index measures the performance of the smallest Japanese securities. Both are subcomponents of the Russell Japan Index, which measures the performance of all Japanese securities in the Russell Global Index.

The Russell Australia Large Cap Index measures the performance of the largest Australian securities in the Russell Global Index, based on market capitalization, while the Russell Australia Small Cap Index measures the performance of the smallest Australian securities. Both are subcomponents of the Russell Australia Index, which measures the performance of all Australian securities in the Russell Global Index.

The Russell Canada Large Cap Index measures the performance of the largest Canadian securities in the Russell Global Index, based on market capitalization, while the Russell Canada Small Cap Index measures the performance of the smallest Canadian securities.

The Russell Emerging Markets Large Cap Index measures the performance of the largest securities from emerging markets in the Russell Global Index, based on market capitalization, while the Russell Emerging Markets Small Cap Index measures the performance of the smallest securities from emerging markets.

The Russell China Index measures the performance of the Chinese securities in the Russell Global Index, based on market capitalization.

The Russell Emerging Asia Index measures the performance of the securities from emerging Asian countries in the Russell Global Index, based on market capitalization.

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