

In a quarter once again marked by a high level of volatility, the Large-Cap Value strategy finished the quarter on a strong note and posted strong absolute performance, but trailed slightly behind its Russell 1000® Value benchmark for the three-month time period. All of the underperformance versus the benchmark came during the month of July. We thought it was notable that the strategy kept pace with its benchmark during the strong market rebound in September. As our high quality, lower volatility style might typically underperform during such a period, we are hopeful that this outperformance during a strong market is a sign that the shares of higher quality companies are poised for better days.

In contrast to the second quarter, all ten sectors of the Russell 1000® Value Index posted gains for the quarter, with all but two sectors up double-digits. The three strongest performing sectors were an odd combination: telecommunication services, materials and energy. In telecommunication services, the attractiveness of mid-to-high single-digit dividend yields, and strong growth in wireless data (from smart phones), were behind the gains. Rising commodity prices helped explain the strong performance of the materials sector. As for the energy sector, there was a rebound in many of the names that were negatively impacted by the oil spill in the Gulf of Mexico during the second quarter. Fears subsided as more clarity developed around many of the longer-term issues relating to the spill. Financial companies struggled the most in the third quarter, due to two primary factors. First, the higher capital standards that emerged for banks from the Basel III meetings dampened some expectations for longer-term return on equity. Second, the earnings of many financial stocks have been pressured by the absolute low levels of shorter-term interest rates and the prospect for a flattening yield curve (as the Federal Reserve may turn to more quantitative easing, pushing down longer-term rates) bodes poorly for future earnings prospects.

Turning to the Large-Cap Value strategy, the industrials, materials and utilities sectors had the strongest relative performance for the quarter. An overweighted position and good stock selection in the gas utilities segment was the primary factor behind relative strength.

In contrast to these positive factors, the strategy's energy, health care and consumer staples sectors showed relative weakness for the quarter. In the energy sector, the underperformance was concentrated in the strategy's exploration & production (E&P) holdings. Despite the focus on low-cost producers who are able to generate relatively higher returns during periods of low natural gas prices, the strategy's holdings underperformed during a weakening natural gas price environment. The underperformance in health care was primarily due to an underweight in the managed care industry and the weak performance of a few pharmaceutical stocks.

During the quarter, the strategy's holdings in the utilities, consumer staples and health care sectors were increased, partially due to the attractive dividend yields that were available in these sectors. Due to the low interest rate environment, changing demographics (retiring of the baby boomers), and the high level of economic, political and fiscal uncertainty, we believe that the demand for higher quality, lower volatility stocks, as well as relatively higher dividend yields, could remain for some time. As always, the Large-Cap Value strategy continues to focus on companies with attractive relative valuations, strong profitability and solid balance sheets that possess potential positive catalysts.

Past performance does not guarantee future results.

Reflects information for a portfolio that serves as the model against which each Large-Capitalization Value account is managed. The model portfolio is an actual account and the information provided will vary for other actual accounts. Portfolio holdings are subject to change.

The Russell 1000® Value Index measures the performance of those Russell 1000® companies (the 1,000 largest companies in the Russell 3000® Index, an index representing approximately 98% of the investable U.S. equity market) with lower price-to-book ratios and lower expected growth values. Index performance information was furnished by sources deemed reliable and is believed to be accurate, however, no warranty or representation is made as to the accuracy thereof and the information is subject to correction. You cannot invest directly in an index, securities in the Composite may not match those in the index and performance of the Composite will differ. Although reinvestment of dividend and interest payments is assumed, no expenses are netted against an index's returns.

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