

by Gregory G. Moore, CFA

MARKET OVERVIEW

During the fourth quarter of 2010, the Retire Funds generated strong absolute returns that ranged from +2.5% for the Income Fund to +6.7% for the 2055 Fund. The 2015, 2025, 2035, and 2045 Funds had returns within this range. This quarter, most bond asset class's generated negative absolute returns and stocks performed exceptionally well, particularly in the U.S. As such, the higher the equity allocation, and to U.S. equity in particular, the better one's target date fund performed. As a result, we underperformed most other target date funds this quarter as we tend to have higher allocations to fixed income than our peers and our equity allocations are usually more evenly spread across the world as opposed to being dominated by the U.S. For 2010, the Retire Funds generated returns that ranged from +10.7% for the Income Fund to +15.8% for the 2055 Fund; peer group performance was mixed, but the fund's outperformed their benchmarks by an average of +239 basis points after fees. Since inception (September 2, 2007), five funds placed in the top 15% and one in the third quartile and the fund's outperformed their benchmarks by an average of +65 basis points after fees¹.

The objective of this review is to provide a brief overview of the markets and how your portfolio is performing. As always, the funds reflect Rogerscasey's best research ideas with regard to long-term, strategic asset allocation and investment manager selection. We thank you for your interest and welcome the opportunity to discuss further.

MARKET EQUITY

Equity markets rallied in 4Q10 as investors gained more confidence in the global economic recovery and embraced risk-oriented assets. The U.S. stock market was a top performer (Wilshire 5000 Index returned +11.6%) and was driven by additional government intervention via QE2, tax cuts, and improved economic data. During the quarter, economically sensitive sectors outperformed defensive; small caps outpaced large; and growth modestly led

value. Non-U.S. equity markets generally lagged the U.S., but generated strong absolute returns (MSCI EAFE Index, +6.7%), though regional performance was mixed. Similar to the U.S., cyclical sectors outperformed non-cyclical, small beat large, and growth led value. Regionally, Japan and Asia led as a result of more favorable economic conditions, government assistance, and appreciating currencies; the sovereign debt crisis weighed on growth expectations for Europe, and the U.K. also lagged. Emerging market equities also generated strong absolute returns (MSCI Emerging Markets Index, +7.4%) based on strong and healthy growth prospects and increasing commodity prices.

The improved outlook for growth in the U.S. and abroad, however, led to higher yields and thus negative absolute returns for most fixed income markets in 4Q10. In the U.S., the 10-year Treasury yield rose 78 bps and generated a return of -5.6% for the quarter. But as investors preferred riskier assets, most spread sectors outperformed (declined less than) duration-neutral Treasuries. For example, the Barclays U.S. Aggregate Index returned -1.3%, Barclays U.S. Credit returned -1.9%, and the Barclays MBS Index returned +0.3%. The exception was U.S. high yield, which returned +3.1%. Internationally, bond returns were similar to that of the U.S., e.g. Citigroup Non-US WGFI returned -1.5%. European bond markets declined and those countries within that region with debt and downgrade issues declined more; the Euro currency also depreciated 1.7% versus the dollar and took returns down further. While bond returns were negative in Japan, Australia, Canada, and Switzerland, currency appreciation led to positive absolute returns for un-hedged U.S.-based investors. Lastly, while emerging market debt was the second best performing spread sector, the asset class also generated negative absolute returns due to rising rates; local currency bonds (-0.4%) outperformed dollar denominated bonds (-1.9%).

PORTFOLIO UPDATES

There were no changes to the portfolios this quarter.

FIXED INCOME

In the core fixed income space, Dodge & Cox returned +0.2% in the fourth quarter and outperformed the benchmark by 149 bps.

This outperformance was attributable to a significant overweight to corporate bonds (46.5% vs. 18.8%) and MBS (42.7% vs. 32.7%). This was partially offset by poor performance from taxable municipal holdings, particularly Build America Bonds. In addition, financial holdings in the portfolio such as Bank of

¹ Source: Investment Metrics, LLC. Investment Metrics constructs target date fund peer groups by using mutual fund data provided by Lipper, A Thomson Reuters Company, and categorizing mutual funds by the targeted date of retirement. For example, the Retire 2015 Fund is compared to the "Mixed Asset Target 2015 Funds" peer group, which is comprised of all 2015 target date mutual funds; other peer groups constructed and utilized that correspond to the appropriate Retire Fund include "Mixed Asset Target 2025 Funds," "Mixed Asset Target 2035 Funds," "Mixed Asset Target 2045 Funds," "Mixed Asset Target 2050+ Funds," and "Mixed Asset Target Allocation Conservative Funds."

America and HSBC underperformed. For 2010, Dodge & Cox returned +7.2% versus +6.5% for its benchmark. The fund's other sub-advisor, Goldman Sachs, returned -0.9% and outperformed its benchmark by 36 bps. These results were also helped by an overweight to agency MBS and corporates but partially offset by a longer duration as the 10-year treasury yield increased. For 2010, Goldman Sachs returned +7.8% versus +6.5% for its benchmark. In high yield, Shenkman Capital Management returned +2.5% and underperformed the benchmark by 54bps. Relative results continue to be impacted by the portfolio's conservative positioning, particularly with regard to bonds priced below \$80. At quarter-end, the portfolio had a current yield of approximately 7.5%. For 2010, Shenkman returned +12.4% versus +15.2 for its benchmark. In global developed bonds, Brandywine Global Investment Management returned +0.5% and outperformed the benchmark by 229 bps. The portfolio benefitted from its tactical overweight to U.S. non-agency collateralized mortgage obligations as well as avoiding the bonds of Japan, Spain, and France. Currency decisions added value as a significant underweight to the Euro along with an overweight to commodity linked currencies such as the Australian dollar (which rose 5.8% versus the U.S. Dollar) and New Zealand dollar (+6.3%) positively contributed to performance. For 2010 Brandywine returned +13.1% versus +5.2% for its benchmark. Fidelity Investments, the fund's emerging market debt sub-advisor, returned -1.4% and outperformed the benchmark by 40 bps primarily due to an overweight to Argentina. In addition, an underweight to Brazil and Mexico aided performance as these bonds lagged due to rising interest rates. Lastly, the portfolios exposure to Venezuelan bonds helped as those bonds rose in the "risk-on" environment, particularly in December. For 2010, Fidelity returned +10.9% versus +12.1% for its benchmark. The inflation-linked bond segment's sub-advisor, PIMCO, returned -1.1% and underperformed the index by 46 bps primarily due to the portfolios longer duration and yield curve positioning as rates rose. Similarly, the top-down, interest rate-oriented decision to own money market futures also hurt as rates rose. Lastly, portfolio holdings of Australian inflation-linked bonds hurt as those bonds sold off. For 2010, PIMCO returned +7.8% versus +6.3% for its benchmark. Lastly, with regard to stable value, Galliard Capital Management returned +0.7% and outperformed 90-Day U.S. Treasury Bills by 70 bps. The portfolio is yielding 2.9% with an average quality of AA-. Galliard returned 3.0% for 2010 versus +0.1% for T-Bills.


EQUITIES

U.S. value equity enhanced index sub-advisor LSV Asset Management returned +9.3% and underperformed the benchmark by 124 bps. For 2010, LSV returned +13.7% versus +15.5% for its benchmark.

U.S. growth equity sub-advisor, T. Rowe Price, returned +12.2% and outperformed its benchmark by 41 bps primarily as a result of holdings in the healthcare and consumer discretionary sectors (e.g., Las Vegas Sands rose 31.4% and Edwards Lifesciences, +24.1%). For 2010, T. Rowe returned +16.3% versus +16.7% for its benchmark. The remainder of the U.S. Equity allocation was invested in two index funds: we utilize a Fidelity Investments fund that tracks the Wilshire 5000 Index and returned +11.7% for the quarter and +17.4% for 2010 and a Vanguard fund that tracks the MSCI U.S. REIT Index and returned +7.4% for the quarter and +28.3% for 2010.

In Non-U.S. equities, the fund's value-oriented sub-advisor Dodge & Cox returned +8.0% in the fourth quarter and outperformed the benchmark by 131 bps. Driving performance was an overweight to and strong performance in the information technology sector, e.g., Germany's Infineon Technologies rose 35%. In addition, other European holdings such as France's Arkema (up 41%) and Germany's Lanxess (up 45%) added value. For 2010, Dodge & Cox returned +13.7% versus +8.2% for its benchmark. The fund's growth-oriented sub-advisor, Schroders Investment Management, returned +7.7% and outperformed its benchmark by 104 bps as a result of favorable stock selection in and an overweight to the materials, industrials, and consumer discretionary sectors. For 2010, Schroders returned +15.3% versus +8.2% for its benchmark. In global equities, T. Rowe Price returned +7.9% and underperformed its benchmark by 120 bps. These relative results were driven by a significant underweight to Japan and overweight to the U.K., China and India. Stock selection within these regions also detracted, particularly in the energy and industrial sectors, e.g., Rolls Royce, Dongfeng Motor, and GMR Infrastructure. For 2010, T. Rowe returned +12.5% versus +12.3% for its benchmark. Lastly, in emerging markets equities, Aberdeen returned +5.9% and underperformed the benchmark by 147 bps. The largest single detractor came from an underweight to and portfolio holdings in Russia as the country was one of the best performing in the quarter at +16.5%. Holdings in Hungary (Richter Gedeon, -9.5%) and South Africa (MassMart, -0.7%) detracted as well. For 2010, Aberdeen returned +27.6% versus +19.2% for its benchmark.

As always, we welcome your feedback and would enjoy the opportunity to provide a deeper review of the portfolios and answer any questions that you may have.



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