

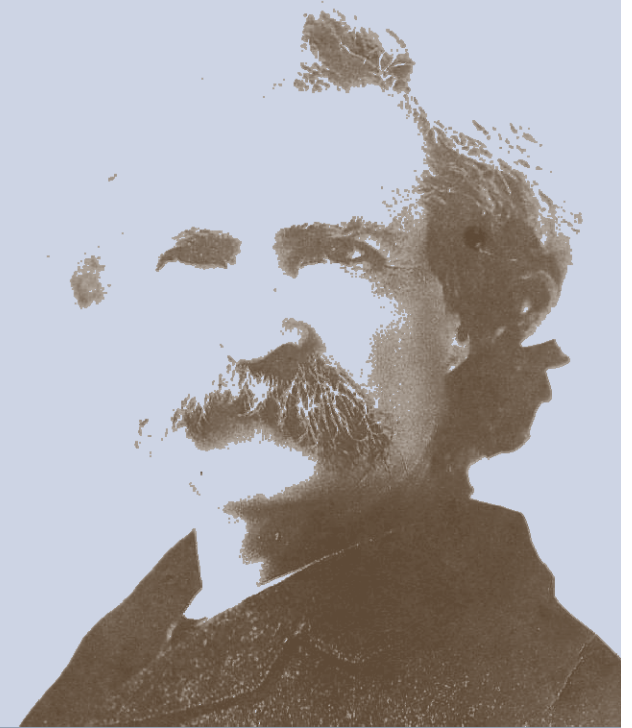
# “Yeah, but what if?!”

Doomsday scenarios Vs Investing for the long term

**Stephen P. Wood, Ph.D.**  
Senior Portfolio Strategist  
Russell Investment Group

“A man who carries a cat  
by the tail learns  
something he can learn  
in no other way.”

*Mark Twain Author, 1835-1910*



Yeah, but what if...?!

# Doomsday Scenarios

This document is not to be construed as advertising or marketing material.



# Yeah, but what if...?!

- ... is fear masquerading as formal analysis;
- ... erroneously interprets outliers as normal, this is terrible methodology;
- ... locks an investor in to an extremely low probability payoff structure;
- ... is a **layman's knowledge set**.

# Yeah, but what if...?!

Really ... what would it **actually take** to derail long-term market probabilities?

Markets have often been scary, but ...

# Yeah, but what if...?!

"... the only thing we have to fear is fear itself – nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance."

*Franklin D. Roosevelt 1933 Inaugural Address*



# Scary & Challenging Markets: The Last 77 Years

Years	Duration	Context
1929 – 1932	4 Years	Great Depression
1939 – 1941	3 Years	World War II
1973 – 1974	2 Years	Recession and Oil Crisis
2000 – 2002	3 Years	Internet Bubble

## Historical Reference Points

*(S&P 500\* negative two or more consecutive years)*

\* The S&P index debuted in 1923 but wasn't expanded to 500 companies until 1957.

# The Great Depression

## (1929—1932)

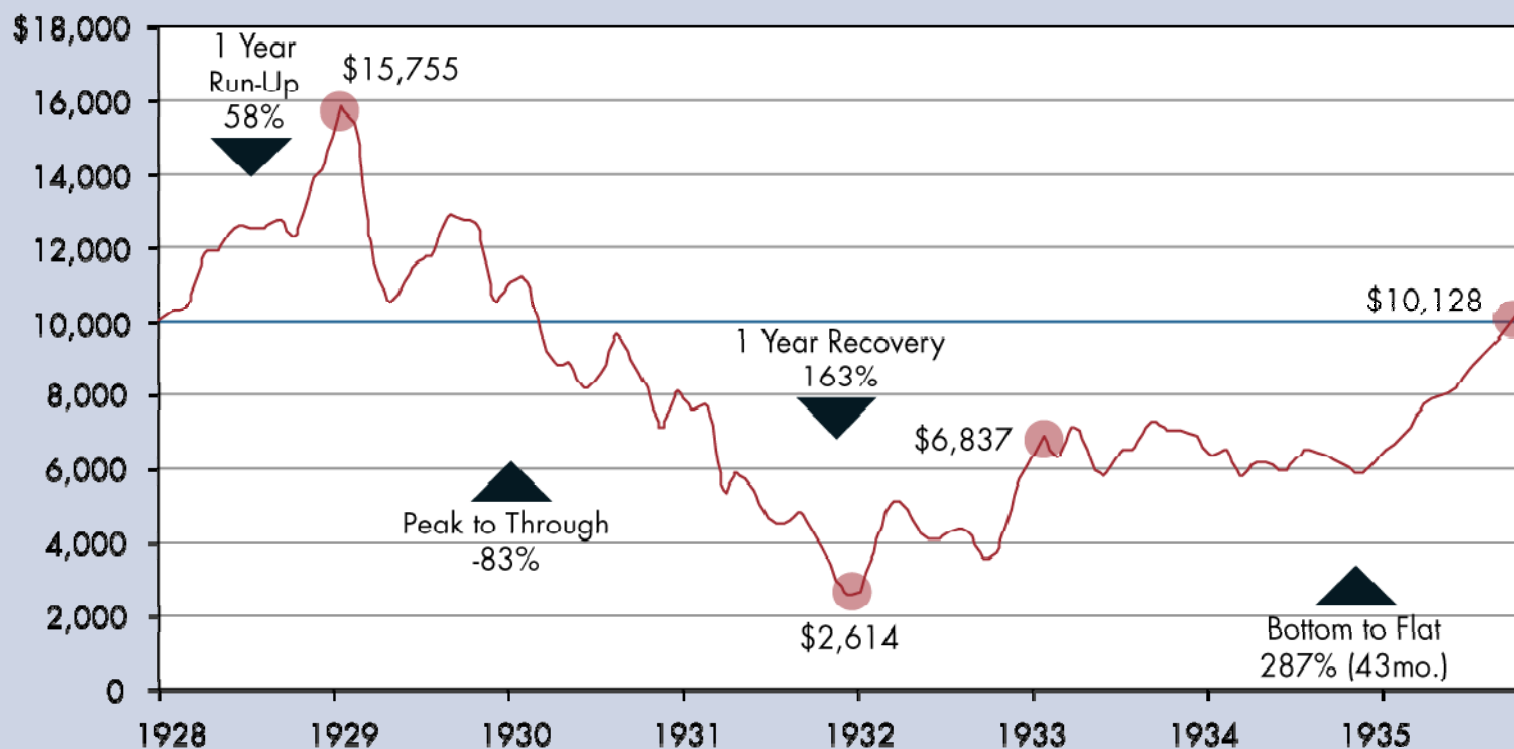
- Unemployment rate spikes from 3% in 1929 to 25% in 1933
- GDP contracts 29% from 1929 to 1933
- Number of open banks declined by 37% from 1929 to 1933
- Bank suspensions increased from 659 in 1929 to 4000 in 1933

Source: Historical Statistics of the United States; Economic Report of the President.

# The Patient Investor

## The Great Depression

\$10,000 invested in S&P 500 Index



Source: Ibbotson Associates.

# World War II (1939—1941)

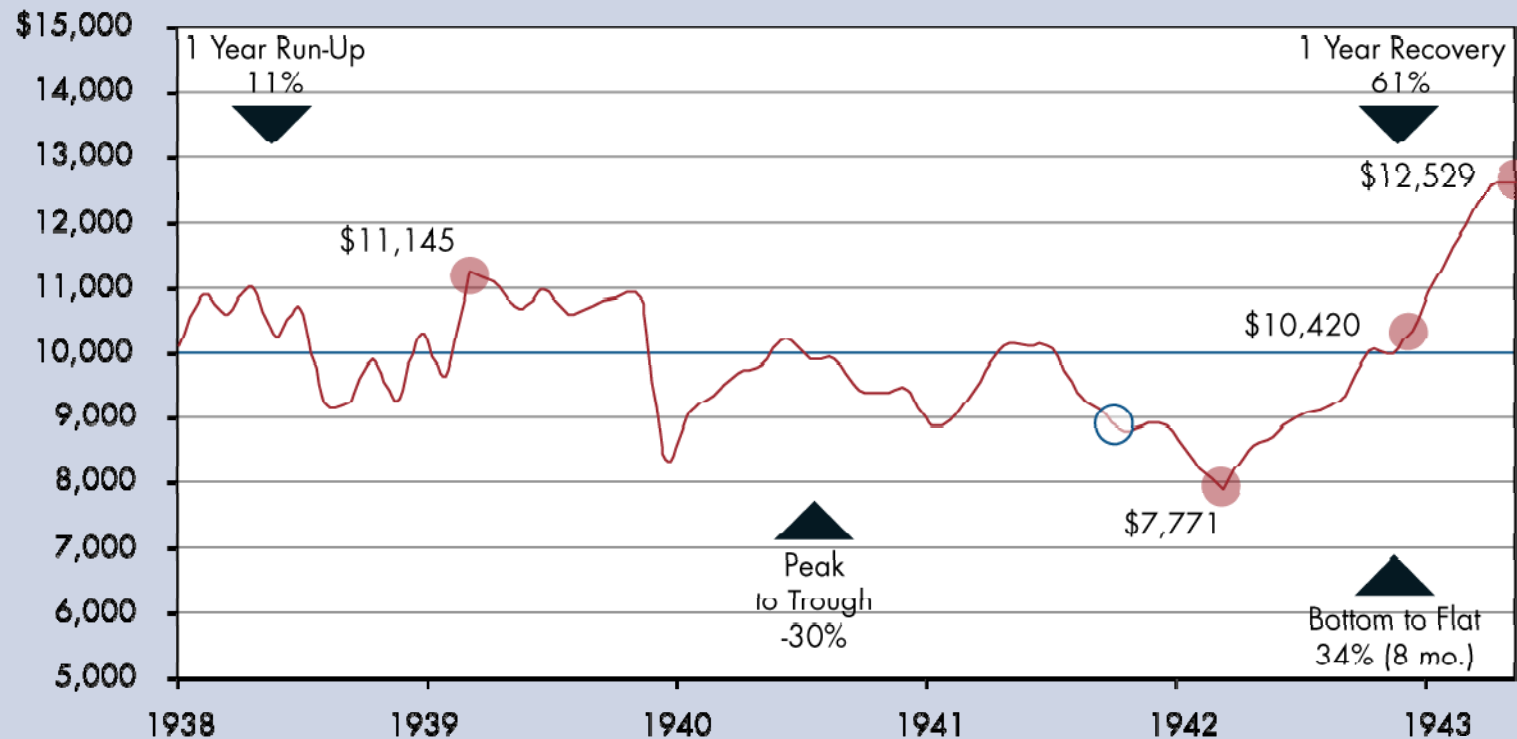
- Over 50 million dead worldwide
- More than 26 million Soviet citizens dead in USSR alone
- World economy in ruins: Japan, Germany, France, UK, Italy, Spain, Eastern Europe, Africa
- United States is last major economy left standing

Source: United Nations.

# The Patient Investor

## World War II

\$10,000 invested in S&P 500 Index



Source: Ibbotson Associates.

# Recession and Oil Crisis

(1973—1974)

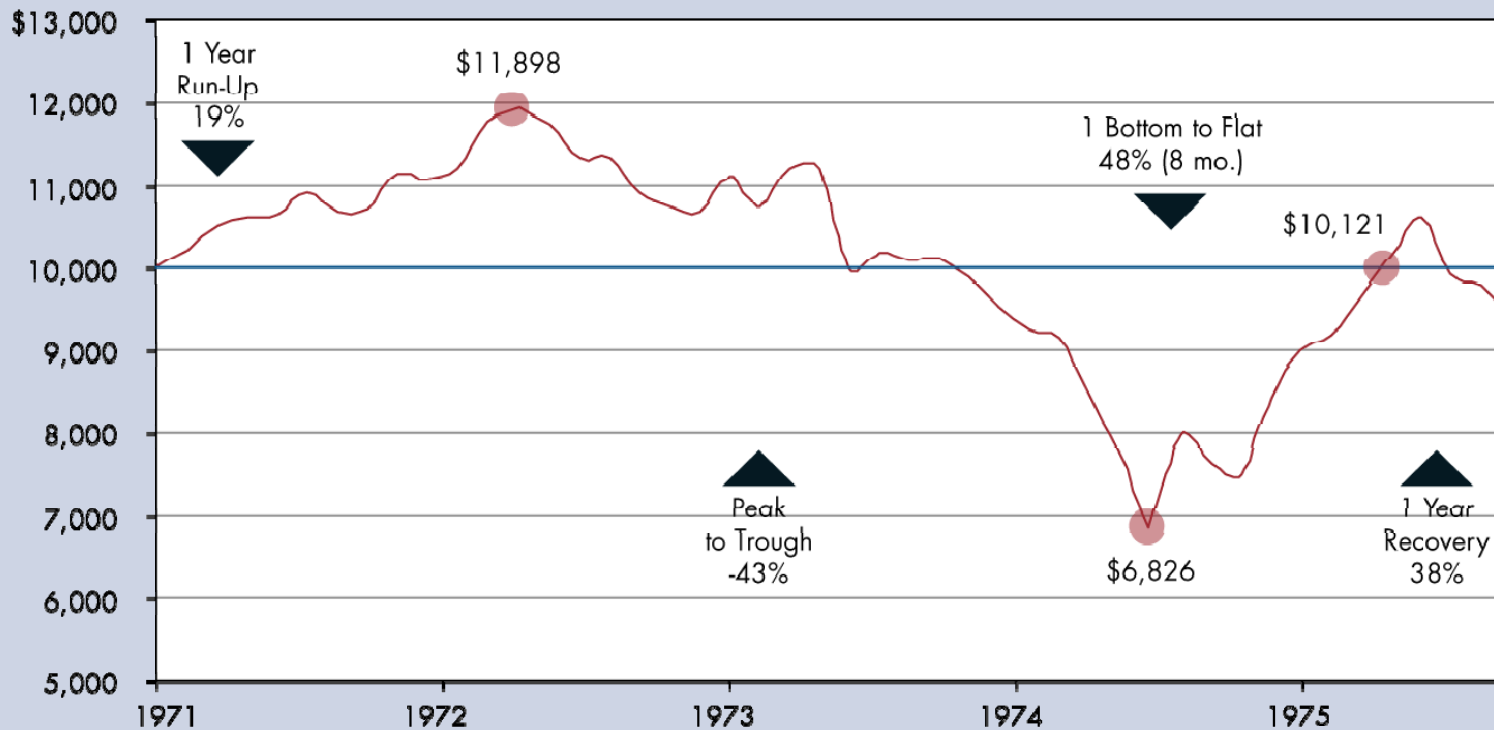
- Price of crude oil rose from about \$16 to about \$40 per barrel
- Unemployment rate reaches 9%
- Inflation rate in 1974 was over 12%

Source: BLS, Ibbotson Associates.

# The Patient Investor

## Recession and Oil Crisis

\$10,000 invested in S&P 500 Index



Source: Ibbotson Associates.

# The Internet Bubble (2000—2002)

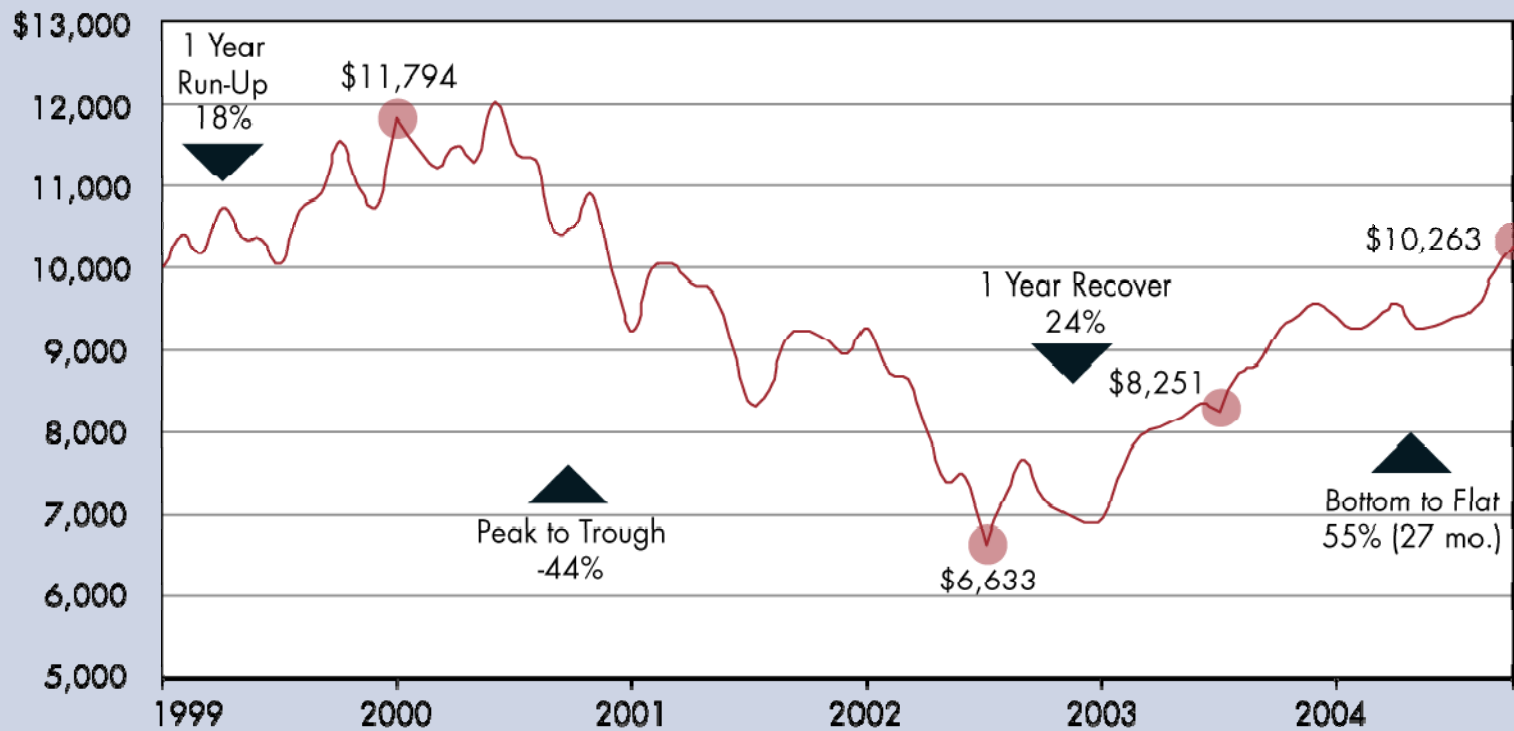
- By March 2000, tech sector was over 35% of S&P 500
- NASDAQ plummeted almost 80% from all-time high
- \$5 trillion in S&P 500 market cap vaporized
- US economy goes into recession

Source: Bloomberg. Factset.

# The Patient Investor

## The Internet Bubble

\$10,000 invested in S&P 500 Index



Source: Ibbotson Associates.

# Exact Timing Is Neither Possible – Nor Necessary

## Five Year Recovery Period

Starting	6 Months Before Bottom	At Bottom	6 Months After Bottom
Great Depression	+152%	+345%	+175%
World War II	+105%	+145%	+92%
Oil Crisis	+50%	+117%	+62%
Internet Bubble*	+26%	+76%	+68%

\*4 year period analyzed for Internet Bubble as 5 years have not yet been completed since respective market bottom.  
Source: Ibbotson Associates.

Yeah, but what if...?!

# Invest Using Long-Term Odds

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# Long Term Investing

## Focus on Long-Term Odds

“Avoiding danger is no safer in the long run than outright exposure. The fearful are caught as often as the bold.”

*Helen Keller, 1880 - 1968 Author*



# 1995 – 2006

We've Come Through a Disorienting Decade...

*So, Focus on Long-Term Odds*

# We've Come Through a Disorienting Decade ... Focus on Long-Term Odds

- 1995–1999: Stocks Beat Bonds by 20.3% Annualized\*  
*Boy, Do I Love Stocks!*
- 2000–2004: Bonds Beat Stocks by 10.0% Annualized\*  
*Man, I'll Never Own Another Stock Again!*

\*Russell 1000® minus Lehman Bros. Aggregate

Bonds = Lehman Brothers Aggregate Bond Index: An index, with income reinvested, generally representative of intermediate-term government bonds, investment grade corporate debt securities, and mortgage-backed securities. (Specifically: Lehman Brothers Government/Corporate Bond Index, the Asset-Backed Securities Index, and the Mortgage-Backed Securities Index.)

Stocks = Russell 1000® Index: Measures the performance of the 1,000 largest companies in the Russell 3000® Index, representative of the US large capitalization securities market.

Although stocks have historically outperformed bonds, they also have historically been more volatile. Investors should carefully consider their ability to invest during volatile periods in the market.

# We've Come Through a Disorienting Decade ... Focus on Long-Term Odds

## 1995–1999: How Good Were The Good Years?

- Taking all five-year periods from 1926 thru 2005: \*
  - Average '**worst**' year: -12%
  - 2nd highest '**worst**' year: +6%
  - '**Worst**' year return for 1995 to 1999: +21%

\*Source: S&P 500 Index

Performance quoted represents past performance and should not be viewed as a representation of future results. Indexes and/or benchmarks are unmanaged and cannot be invested in directly.

# We've Come Through a Disorienting Decade ... Focus on Long-Term Odds

## 1995–1999: How Good Were The Good Years?

- Taking all 36-month periods from 1926 thru 2005: \*

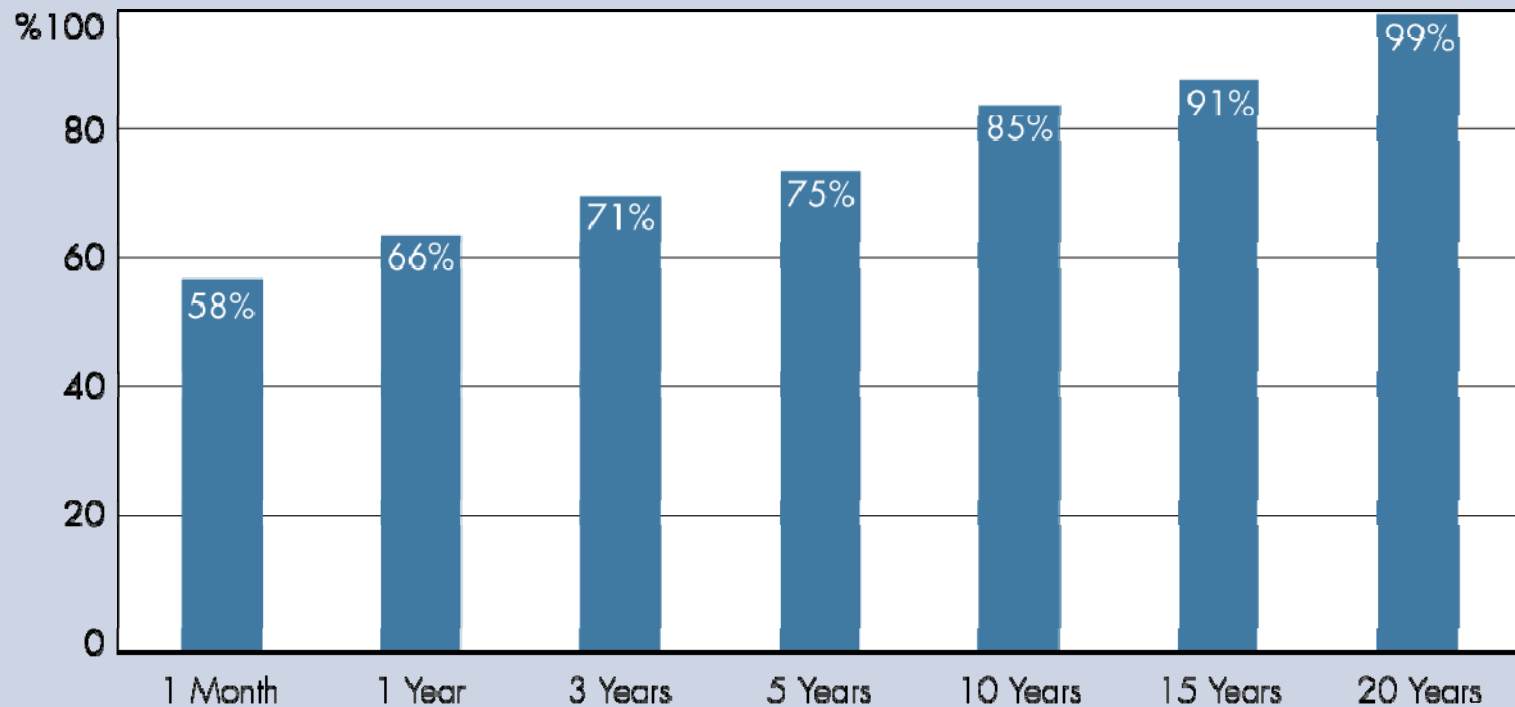
The 36 months *ending March 2003* were the **worst** for equities since **1933**

\*Source: S&P 500 Index

Performance quoted represents past performance and should not be viewed as a representation of future results.  
Indexes and/or benchmarks are unmanaged and cannot be invested in directly.

# Long-Term Investing Play the Odds

% Time Stocks Beat Bonds By Holding Period (1926 – 2005)



\*Source: Ibbotson Associates.

Monthly data from Jan 1926 through Dec 2005. Large cap US stocks is represented by the S&P 500 Composite and Intermediate bonds are represented by a 5 year maturity, one bond portfolio.

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# Long-Term Investing Play the Odds

Diversify: Invest Using  
Long-Term Odds

# Eroding Equity Risk Premium

- **Equity Risk Premium (ERP)**
  - What is it?
  - ERP is the long-run difference between the equity return and the intermediate Treasury Bond return\*
  - There is evidence of a decline in ERP over time & long-run averages overstate its expected value going forward\*\*

\* S&P 500® Index minus Intermediate Treasury Bonds (constructed as a one bond portfolio with an approximate 5-year maturity compounded annually. The index components are total return, income return, capital appreciation, and yield.)

\*\* Russell Investment Group 2005

# We've Come Through a Disorienting Decade ... Focus on Long-Term Odds

## 2007: Where Does That Leave Us?

- Equity Risk Premium (ERP): The long-run difference between Stocks and Bonds\*\*
- ERP from 1979 thru 1994\*: 4.4%
- ERP from 1995 thru Feb 2006\*: 4.5%
- ***Conclusion: Focus on Long Term Odds!***

\*Source: S&P 500 Index

\*\*S&P 500® Index minus Intermediate Treasury Bonds

Performance quoted represents past performance and should not be viewed as a representation of future results.  
Indexes and/or benchmarks are unmanaged and cannot be invested in directly.

# Historical Equity Risk Premium

## Equity Premium

*(S&P 500\* Index minus Intermediate Treasury Bonds)*

Years	Arithmetic Returns
1926 – 2004	6.5%
1946 – 2004	6.2%
1960 – 2004	3.9%
1975 – 1994	4.4%
1995 – 2006 (Feb)	4.5%

Source: Ibbotson Associates

**S&P 500® Index:** An index, with dividends reinvested, of 500 issues representative of the U.S. large cap securities market (representative sample of leading companies in leading industries).

**Intermediate Treasuries:** Debt securities issued by the U.S. government with maturities of 5 to 10 years at issuance. Fixed income investors should carefully consider risks such as interest rate risk, credit risk, securities lending, repurchase and reverse repurchase transaction risk.

Indexes and/or benchmarks 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.

Performance quotes represents past performance and should not be viewed as a representation of future results. The investment return and principal value of an investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted.

# Why is ERP Important?

- ERP drives the Asset Allocation choice between stocks and bonds
- Asset allocation determines about half of your performance (relative to a reasonably diversified portfolio)
- ERP is at its lowest level in over 30 years...  
...really, its lowest level since the 1920s
- Topping it all off? Fixed Income returns have dropped by 3% in last 20 years

Source: Russell

# Focus On Long-Term Odds

- Long-term strategies are best devised from long-term estimates
- In hindsight, over relatively short periods, there will always be asset classes that looked great and others that looked awful
- There's no guarantee that the great and awful performers won't change places from one period to the next.

# Focus On Long-Term Odds

We believe the best way to gain exposure to a period's best performers is to diversify into them all!

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

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# “Yeah, But What If ... !?”

## Focus On Long-Term Odds

### Conclusion:

- *Focus on Long-Term Odds!*
  - History shows that even the scariest markets of the last 77 years did not derail long-term market probabilities
  - Short term, markets can be disorienting – even deceiving – so focus on long-term probabilities

# Stephen Wood Biography

Senior Portfolio Strategist  
Russell Investment Group

B.A., History/International Relations/Political Science, University of Wisconsin-Madison, 1988

M.A., Comparative Politics, Iowa State University, 1990

M.A.I.P.E., International Political Economy, Claremont Graduate University, 1995

Ph.D., Political Science (International Political Economy), Claremont Graduate University 1997

Licensed Registered Representative, NASD Series 6, 63 and 65



Stephen Wood is senior portfolio strategist for Russell Investment Group where he conducts research on and acts as an external voice on the economy, capital markets, portfolio strategies as well as investor behavior. Steve also works with institutional clients and retail partners to communicate Russell's investment process and portfolio management. He is a frequent guest on CNBC, Bloomberg TV and PBS and is quoted often in national publications such as the Wall Street Journal and International Herald Tribune, as well as major daily newspapers. He is based in New York City and joined Russell in 2005.

Prior to joining Russell, Steve worked with institutional investment clients at Manning & Napier Advisors in Rochester, New York, as senior portfolio strategist. He gained significant experience with high net worth clients as vice president with Fisher Investments' private client group in San Francisco.

Previously, Steve was a senior equity portfolio strategist at Alliance-Bernstein in New York City. Representing the firm globally, he was a much sought-after spokesperson for both retail clients and financial professionals and was Alliance's voice on the economy, capital markets, securities research and portfolio management.

Steve began his career as a senior research associate and economist for the Milken Institute at the Milken Family Foundations. Before entering the financial services industry, he had extensive academic experience and was a professor in California in the 1990s. Steve's doctoral and academic work focused on the impact of institutional structures on decision making and how they influence behavioral outcomes.

Steve speaks fluent Spanish and has worked in Latin America and with Latin clients.

# Edward Schuck Biography

Managing Director  
Russell Investment Group— New Zealand

B.Sc. (Hons), Computer & Systems Engineering, Rensselaer Polytechnic Inst., 1982

M.B.A., Finance, London Business School, 1986

Ph.D., University of Auckland, 2002



Edward J. Schuck is the Managing Director of Russell Investment Group Limited. In this role he is responsible for the management of Russell's activities in New Zealand. These activities include the provision of investment advice to public and private sector institutions with collective assets of more than \$13 billion and multi-manager funds investing assets in excess of \$1 billion for New Zealand investors.

Prior to being appointed managing director, Ed was a senior consultant with Russell. His primary responsibilities involved managing the consulting practice, and supplying advice to a range of clients which included Crown financial institutions, local authorities and charitable trusts. Ed joined Russell in New Zealand in early 2000.

From 1992 to 1999, Ed was a senior lecturer in property finance at the University of Auckland. In this role, he pursued an active program of research, consulting and teaching. Ed's research has been published in internationally recognised journals and his PhD thesis investigated the investment risk of institutional property assets in Australia.

While at the University of Auckland, Ed consulted in the areas of property investment appraisal, portfolio management, and taught all undergraduate and graduate papers in the area of property investment and finance. He also lectured at a range of overseas institutions including the Swedish School of Economics, the Royal Institute of Technology in Stockholm, the Helsinki School of Economics, HEC-Geneva in Switzerland, and the Short Courses and Continuing Education programs at the University of Auckland.

Ed's experience prior to coming to New Zealand in 1992 was gained in the U.S. and U.K. After graduating from university, he was a systems analyst with a software consulting firm based in Washington, D.C. Upon completion of his M.B.A., Ed took up a senior position in the London Region of Prudential Property Services, a subsidiary of Prudential Corporation. He returned to the U.S. in 1989 to join a consultancy involved in the financing and management of investment property in the New York metropolitan area.

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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.

Stock/Equity investors should carefully consider risks such as market risk when investing. There are no guarantees when it comes to individual stocks. Any stock may go bankrupt, in which case your investment may be worth nothing.

Bond investors should carefully consider risks such as interest rate risk, credit risk, securities lending, repurchase and reverse repurchase transaction risk. Greater risk is inherent in portfolios that invest primarily in high yield bonds. They are subject to additional risks, such as limited liquidity and increased volatility.

Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and to political systems which can be expected to have less stability than those of more developed countries. Securities may be less liquid and more volatile than U.S. and longer-established non-U.S. markets.

Non-U.S. markets entail different risks than those typically associated with U.S. markets, including currency fluctuations, political and economic instability, accounting changes, and foreign taxation. Securities may be less liquid and more volatile. If applicable, please see a Prospectus for further detail.

Growth investments focus on stocks of companies whose earnings/profitability are accelerating in the short term or have grown consistently over the long term. Such investments may provide minimal dividends which could otherwise cushion stock prices in a market decline. Stock value may rise and fall significantly based, in part, on investors' perceptions of the company, rather than on fundamental analysis of the stocks. Investors should carefully consider the additional risks involved in growth investments.

Value investments focus on stocks of income-producing companies whose price is low relative to one or more valuation factors, such as earnings or book value. Such investments are subject to risks that their intrinsic values may never be realized by the market, or, such stock may turn out not to have been undervalued. Investors should carefully consider the additional risks involved in value investments.

S&P 500 Index: An index, with dividends reinvested, of 500 issues representative of leading companies in the U.S. large cap securities market (representative sample of leading companies in leading industries).

Performance quoted represents past performance and does not guarantee future results.

Date of first use: March 2007

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# Safety in Numbers

No.1

Global manager of managers

510

independent distribution partners offer Russell products in over 27 countries

\$259 billion

Russell's strength lies in multi-manager investing, with global assets under management of \$259 billion

2800

Russell provides investment solutions for 2800 institutional clients in 44 countries

\$2.5 trillion

Russell advises clients on the investment of \$2.5 trillion worth of assets worldwide

44

operating in 44 countries around the globe

20/70

over 20 years in Australia, 70 years in business

\*All dates are current as of 31 March 2007, except AUM current as of 30 June 2007 and assets under advice current as of 30 September 2006