TALIS ADVISORS

QUARTERLY INVESTMENT REVIEW

Fourth Quarter 2009

PERFORMANCE OVERVIEW

Fourth Quarter 2009

- With few exceptions, equity markets around the world continued their strong performance in the fourth quarter of 2009, and extended the remarkable market recovery that started in March 2009. However, there still remained a lot of uncertainty about the strength and timing of the economic and about the direction and timing of economic policy, especially in the United States, as economic and financial conditions continue to improve. Consequently, equity markets around the world continued to experience higher-than-average levels of volatility in the fourth quarter.
- In the United States, the broad market gained about 6% in the quarter, with most asset classes except micro caps delivering solid gains again. Aggregate returns in other developed countries were about average in the fourth quarter, although there was some dispersion in the returns of different countries and asset classes. The US dollar gained ground against the euro and the yen in the fourth quarter, which hurt the dollar-denominated returns of developed-market equities. Emerging markets had excellent performance in the fourth quarter, and were, once again, among the top-performing asset classes in the quarter. The solid gains of the fourth quarter along with the extraordinary returns of the second and third quarters made 2009 the best year on record for emerging markets. The US dollar lost ground against the main emerging market currencies in the fourth quarter and in 2009, which contributed to the dollar-denominated returns of emerging market equities.
- Value stocks underperformed growth stocks across most market capitalization segments in the US, in other developed markets, and in emerging markets. Along the market capitalization dimension, small caps underperformed large caps in the US and in other developed markets, but not in emerging markets.
- Most fixed income securities had flat performance in the fourth quarter. One exception was inflation-protected securities, which had excellent performance again in the fourth quarter, as investors sought protection against possible increases in future inflation.
- Real estate securities were the top performers in the fourth quarter in the US, but had a flat performance in other developed markets.

Three Years as of December 31, 2009

- With the exception of emerging markets, equity markets around the world suffered significant losses in the three years that ended in December. Emerging markets, on the other hand, managed to deliver solidly positive returns during that period. In US dollar terms, developed non-US equity markets performed a little better than the US equity market. In the US, the value effect was negative across all size categories. In developed non-US markets, the value effect was mixed: positive among small cap stocks and negative among large cap stocks. With regard to the size effect, small cap stocks underperformed large cap stocks in the US and in other developed markets. In emerging markets, the value and size effects were very strong in the three-year period that ended in December.
- The US dollar sharply depreciated against all major currencies except the British pound. The dollar's depreciation, which ranged from 8.2% against the euro to 27.6% against the yen in the three years ending in December, helped the dollar-denominated returns of developed market strategies. Indeed, the overall impact of currency fluctuations between the US dollar and developed country currencies was to increase the dollar-denominated returns of developed market equities by approximately 2.3% per year over the three-year period that ended in December. On the other hand, the US dollar had mixed performance against the main emerging markets' currencies, and the impact of currency fluctuations on the dollar-denominated returns of emerging markets strategies was slightly negative.
- Over the three years ending in December, fixed income securities delivered annual returns that ranged from 2.4% to 6.69%, and were among the best-performing asset classes.
- Real estate securities in the US and in other developed markets finished the three-year period that ended in December as the worst-performing asset class.

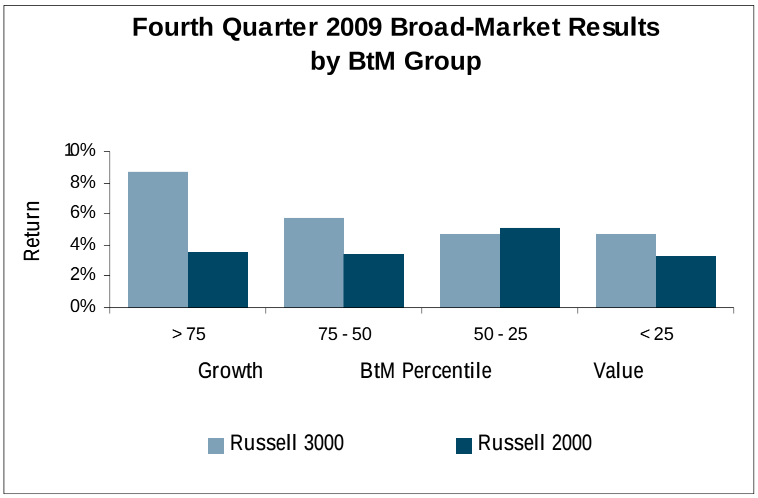
US STOCKS

- After two quarters of double-digit gains, the US equity market had once again above-average returns in the fourth quarter. The market recovery in 2009 since the low point of early March was one of the fastest in history, as investors' tolerance for risky assets increased and financial and economic conditions continued to improve throughout the year. However, equity prices remain well below their previous peaks of the fall of 2007, and there is still much uncertainty among market participants about the depth and speed of the economic recovery. That uncertainty contributed to the higher-than-normal percentage of trading days with big market movements (defined as days during which the broad US market moved by more than 1% in absolute value) that we saw in the fourth quarter. Indeed, although volatility and cross-sectional dispersion continued to moderate from the extraordinarily high levels reached in the fall of 2008 and in the first quarter of 2009, they still remained above the historical averages. As a result, small differences in portfolio weights between different strategies or between strategies and benchmarks often resulted in large differences in performance. The strongest sector in the quarter was information technology, while the weakest sector was financial services.
- Quarterly returns for the broad US market, as measured by the Russell 3000 Index, were 5.9%. Asset class returns ranged from 7.9% for large cap growth stocks to 3.6% for small cap value stocks.
- Using the Russell indices as proxies, small cap value stocks (Russell 2000 Value) underperformed small cap growth stocks (Russell 2000 Growth) by 0.5% in the quarter and by 13.9% in 2009, while large cap value stocks (Russell 1000 Value) underperformed large cap growth stocks (Russell 1000 Growth) by 3.7% in the quarter and by 17.5% in 2009. Over the three-year period through December 31, the Russell 2000 Value Index underperformed the Russell 2000 Growth Index by 4.2% annualized, while the Russell 1000 Value Index underperformed the Russell 1000 Growth Index by 7.1% annualized.
- Along the market capitalization dimension, small caps (Russell 2000) underperformed large caps (Russell 1000) by 2.2% in the quarter and by 1.3% in 2009. Over the three-year period that ended in December, small cap stocks underperformed large cap stocks by 0.7% annualized.

As of December 31, 2009	**Return (%)**		
Index Returns	**Fourth Quarter**	**One Year**	**Three Years Annualized**
Russell 3000	5.90	28.34	(5.42)
Russell 2500	5.07	34.38	(4.86)
Russell 2000	3.88	27.17	(6.06)
Russell 2000 Value	3.62	20.56	(8.22)
Russell 2000 Growth	4.14	34.47	(4.00)
Russell 1000	6.07	28.41	(5.36)
Russell 1000 Value	4.22	19.69	(8.96)
Russell 1000 Growth	7.94	37.20	(1.89)
S&P 500	6.04	26.46	(5.63)

US STOCKS

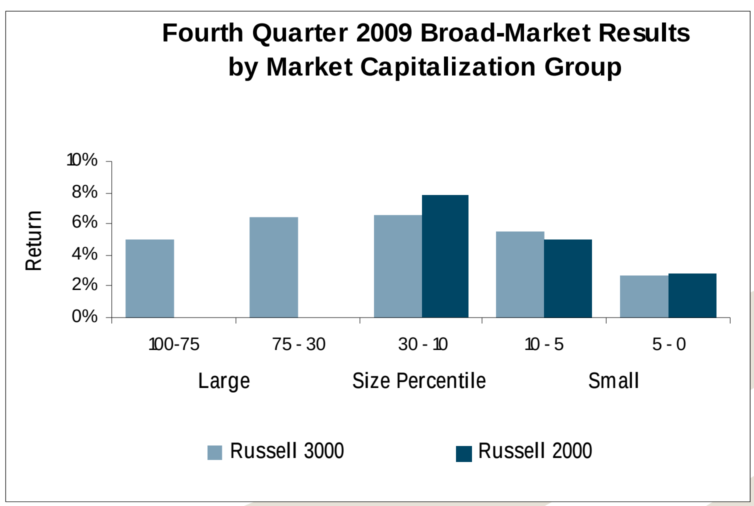
- A look at the determinants of stocks performance—relative price and market capitalization—provides some insight into the sources of returns. Historically, value stocks, as measured by the ratio of book-to-market equity (BtM), have outperformed growth stocks, while small stocks have experienced higher returns than large stocks.



Russell data copyright © Russell Investment Group 1995-2009

- Along the market capitalization dimension, small caps (Russell 2000) underperformed large caps (Russell 1000) by 0.17% in the quarter. Over the three-year period that ended in December, small cap stocks outperformed large cap stocks by 0.7% annualized.
- For the Russell 2000 Index the best relative performance as well as the largest contribution to performance came from value-oriented stocks in the 25th-50th BtM percentile range.

- In the fourth quarter for the Russell 3000 Index, the best relative performance as well as the largest contribution to performance (group return multiplied by group weight) came from deep growth stocks in the 75th-100th BtM percentile range.



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NON-US STOCKS

- After two quarters of double-digit gains, developed markets equities had average or slightly below-average returns in the fourth quarter.
- At the country level, there was a lot of variation in performance in the fourth quarter. For instance, commodity-rich countries such as Canada, Australia, and Norway had above-average returns for the quarter and the year. Indeed, the economic recovery in Australia and Norway was strong enough by the third quarter that their central banks started to raise their target interest rates in October. On the other hand, some European countries such as Portugal, Italy, Ireland, Spain, and Greece, which have been particularly hard hit by the recession and are dealing with very large fiscal deficits, had flat or sharply negative returns in the quarter. Japan, where the economic recovery is also expected to be fairly anemic, had sharply negative returns in the fourth quarter as well, and was by far the worst-performing developed market in 2009.
- With few exceptions, there still remained much uncertainty about the strength and timing of the economic recovery in most developed countries. That uncertainty was reflected in levels of volatility and cross-sectional dispersion that, although they continued to moderate from the extraordinarily high levels reached in the fall of 2008 and in the first quarter of 2009, still remained above the historical averages in the fourth quarter
- Developed market equity returns for US investors were hurt by the relative strength of the US dollar against the euro and the yen in the fourth quarter. The US dollar appreciated by 2.0% against the euro and by 3.6% against the yen in the quarter. On the other hand, the US dollar depreciated by 1.8% against the Australian dollar and by 1.9% against the Canadian dollar. The overall impact of currency fluctuations between the US dollar and developed country currencies was to decrease the dollar-denominated returns of developed market equities by approximately 0.8% in the fourth quarter.
- For 2009, however, the story was a different one. The US dollar depreciated against all major currencies except the yen. The US dollar's depreciation ranged from 3.1% against the euro to 28.8% against the Australian dollar, and the overall impact of currency fluctuations on the dollar-denominated returns of developed market equities was to increase those returns by over 8%. Materials and consumer staples the best-performing sectors in the quarter, while financials and information technology were the weakest sector in the fourth quarter. For 2009, the strongest sectors were materials, financials, and energy, while the weakest sectors were utilities, health care, and telecommunication services.

Non-US Equity Returns

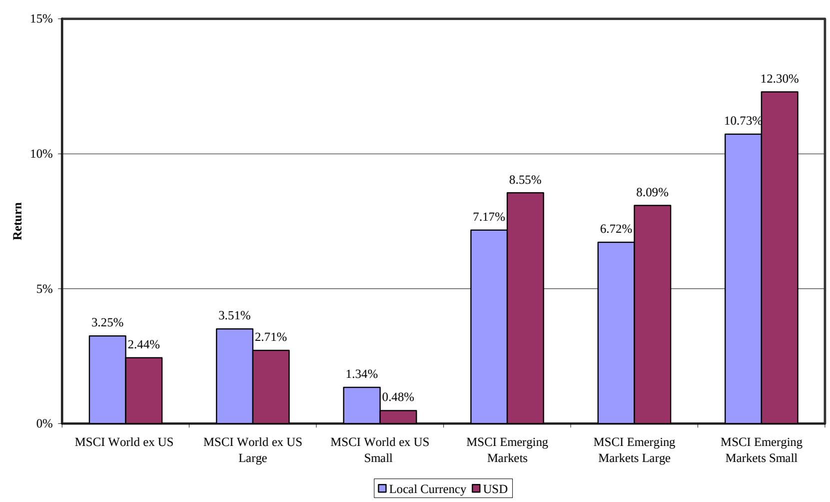
As of December 31, 2009	**Return (%)**		
Index Returns	**Fourth Quarter**	**One Year**	**Three Years Annualized**
MSCI EAFE Small Cap	(1.03)	46.78	(7.59)
MSCI World ex USA Small	0.48	50.82	(6.80)
MSCI EAFE	2.18	31.78	(6.04)
MSCI World ex USA	2.44	33.67	(5.34)
MSCI EAFE Value	0.28	34.23	(7.35)
MSCI EAFE Growth	4.17	29.36	(4.78)
MSCI Emerging Markets	8.55	78.51	5.11
MSCI Emerging Markets Small	12.30	113.79	8.30

MSCI indices are total returns net of foreign withholding taxes on dividends. MSCI data copyright MSCI 2009, all rights reserved. Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

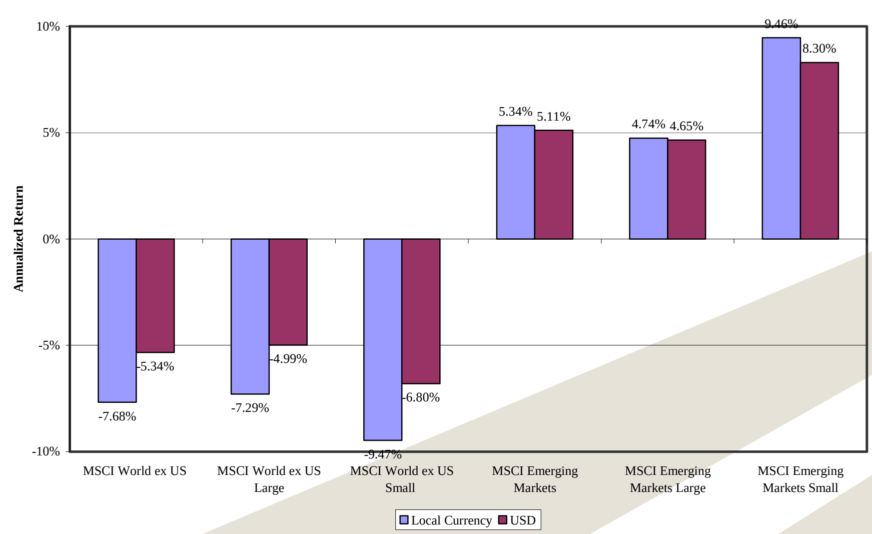
NON-US STOCKS

- Using the MSCI World ex USA Index and its sector and country segments as proxies, value stocks in developed markets greatly underperformed growth stocks across both size categories in the fourth quarter, but not in 2009.
- Small cap value stocks (MSCI World ex USA Small Cap Value) underperformed small cap growth stocks (MSCI World ex USA Small Cap Growth) by 4.4% in the quarter, while large cap value stocks (MSCI World ex USA Large Cap Value) underperformed large cap growth stocks (MSCI World ex USA Large Cap Growth) by 3.8% in the quarter.
- For 2009, small cap value stocks were 3.5% ahead of small cap growth stocks, while large cap value stocks were 6.5% ahead of large cap growth stocks. Over the three-year period through December 31, the value effect was negative in large cap stocks and positive in small cap stocks. Large cap value stocks underperformed large cap growth stocks by 3.8% on an annualized basis, while small cap value stocks outperformed small cap growth stocks by 1.7% annualized.
- Along the market capitalization dimension, small caps (MSCI World ex USA Small Cap) trailed large caps (MSCI World ex USA Large Cap) by 2.2% in the quarter, but ended 17.9% ahead of large caps in 2009. Over the three-year period that ended in December, however, small cap stocks trailed large cap stocks by 1.8% annualized.

Fourth Quarter Currency Effects on non-US Equity Returns
As of December 31, 2009

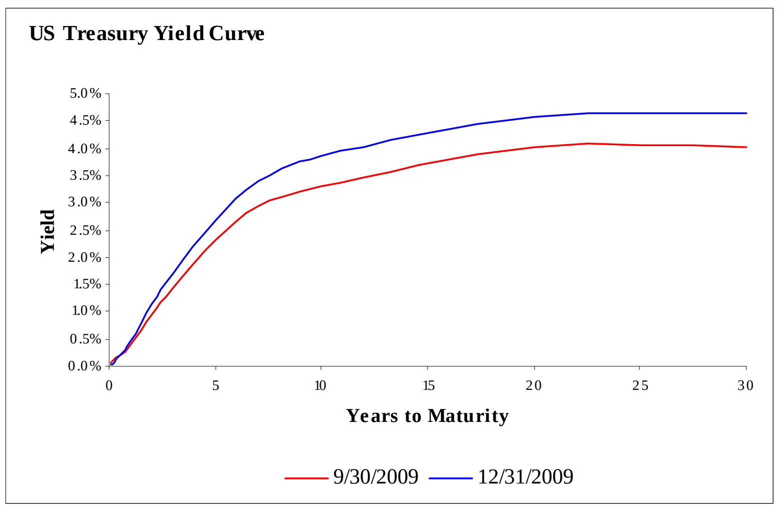


Three-Year Currency Effects on Non-US Equity Returns
As of December 31, 2009



BONDS

- The Federal Open Market Committee maintained its target range for the federal funds rate between zero and 0.25% in the fourth quarter, and reaffirmed its goal to maintain that target at very low levels for the foreseeable future. The Federal Reserve Board announced in late December that it would start offering offer interest-bearing term deposits to eligible financial institutions to drain excess reserves from the banking system, as it seeks to implement an orderly exit strategy from its current extraordinary policies. The Federal Reserve's balance sheet, currently the main focus of monetary policy actions, increased from about $2.2 trillion at the end of the third quarter to about $2.3 trillion at the end of the fourth quarter. Most of that increase was due to purchases of about $125 billion of agency mortgage-backed securities, part of a plan to buy up to $1.3 trillion of mortgage-backed securities by the end of March 2010 to support the housing markets. In contrast, most of the Fed's short-term emergency lending facilities continued to see reductions in assets, which reflects the gradual improvement in private lending markets.
- Credit markets remained stable in the fourth quarter, as indicated by the narrow spreads between, among others, high- and low-quality thirty-day nonfinancial commercial paper, the so-called A2P2 spread; the rates on three-month interbank loans and three-month Treasury bills, the so-called TED spread; and the yields on investment-grade and speculative-grade corporate bonds, on the one hand, and the yields on Treasury securities, on the other. Bid/ask spreads in most credit markets also continued to narrow relative to the levels reached in the fall of 2008, reflecting the improvement in liquidity in those markets throughout 2009.
- Yields on very short-term Treasury bills fell slightly in the fourth quarter relative to the end of the third quarter, while yields on long-term Treasury securities rose sharply in the fourth quarter. As a result, the yield curve steepened substantially over the quarter. The difference in yield between ten-year Treasury bonds and one-month US Treasury bills was 381 basis points at the end of the fourth quarter, compared to 325 basis points at the end of the third quarter.



As of December 31, 2009	Return (%)		
Index Returns	**Fourth Quarter**	**One Year**	**Three Years Annualized**
Merrill Lynch Three-Month US T-Bill	0.04	0.21	2.40
Merrill Lynch One-Year US Treasury Note	0.15	0.80	3.81
Citigroup World Government Bond 1-3 Years (hedged)	0.19	2.06	4.54
Barclays Capital US Government Bond Index	(1.00)	(2.20)	6.10
Merrill Lynch US Treasury/Agency 1-5 Years	0.00	0.91	5.67
Citigroup World Government Bond 1-5 Years (hedged)	0.26	2.29	5.05
Barclays Capital US TIPS Index	1.76	11.41	6.69