

December 2011

Ibbotson Associates Dynamic Allocation Update

Summary

On December 20, 2011, the Investment Policy Committee ("IPC") decided to remove the following allocation from the dynamic asset allocation positions:

- Overweight of investment-grade debt relative to high-yield debt.

In addition, the IPC decided to keep in place the following bets:

- Overweight of U.S. large-cap equities relative to U.S. REITs.
- Overweight of U.S. large-cap equities relative to U.S. small-cap equities.
- Overweight of global equities relative to U.S. dollar-denominated cash (or cash-equivalent) assets.

(These last three allocations were discussed in our September 2011 update.)

Removal of the overweight of U.S. investment-grade debt relative to high-yield debt

Spreads on high-yield (HY) bonds relative to investment-grade (IG) bonds have increased over the last few months, as concerns over a potential European financial crisis and a potential U.S. recession weighed on risky assets globally. This has helped the performance of this allocation, but moving forward it has increased the penalty of holding lower yield investment-grade debt rather than high-yield debt.

The underlying fundamentals of U.S. nonfinancial corporations appear to be relatively strong: high cash levels, low leverage, high Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) margins, and high interest coverage. The relatively strong financial health of corporations should leave them well prepared, from a credit quality standpoint, in the event of an economic or financial downturn.

High-yield bonds suffered large outflows from mutual fund and ETF investors in the last few months, which led to a sharp increase in yields and spreads. While investment-grade spreads suffered outflows, the magnitude was much lower than for high-yield bonds.

Some members of the IPC believe that high yield spreads are now wide enough to reasonably compensate investors for the risk of potential losses through a number of default scenarios. While spreads are not as wide as the levels reached in 2008/2009, the financial fundamental picture is now better for corporations than it was then. Moreover, the re-financing profile has improved (although it will still present challenges), and the potential for large forced liquidations of leveraged investors has diminished, since the investor base is dominated by institutional investors, such as pension funds, that are not generally unlevered and with longer time horizons.

While we acknowledge the potential underperformance of high-yield relative to investment-grade should we enter a recession, the position has performed well recently. Given the increase in the relative spread, the outflows from high yield funds, and the good fundamentals, the IPC has less confidence in this relative position and therefore is removing the allocation.



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The Ibbotson ETF Allocation Series Portfolios are not Exchange Traded Funds (ETFs), instead they consist of five risk-based asset allocation portfolios that invest in underlying ETFs, which are typically open-end investment companies or unit investment trusts.

Shares of the Portfolios are offered only to participating insurance companies and their separate accounts to fund the benefits of Variable Contracts, and to qualified pension and retirement plans and registered and unregistered separate accounts.

ALPS Advisors, Inc. is the investment adviser to the Portfolio and Ibbotson Associates, Inc. is the investment sub-adviser to the Portfolio. ALPS and Ibbotson Associates are unaffiliated entities.

Investing involves risk including loss of principle.

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This commentary contains certain forward-looking statements. We use words such as "expects", "anticipates", "believes", "estimates", "Forecasts", and similar expressions to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results to differ materially and/or substantially from any future results, performance or achievements expressed or implied by those projected in the forward-looking statements for any reason. Past performance does not guarantee future results.

About Ibbotson

Ibbotson Associates is a leading independent provider of asset allocation, manager selection, and portfolio construction services. The company leverages its innovative academic research to create customized investment advisory solutions that help investors meet their goals.

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