International Allocation Views

October 20, 2006

- This month, we are raising our allocation to emerging markets, to large-cap value stocks in the developed markets, and to international REITs. Despite these moves we are still underweighted in emerging market and large-cap value stocks, though we are now up to neutral in REITs.

- Volatility in the emerging markets has fallen recently, and flows into emerging market equity mutual funds have begun to stabilize, pointing to a more hospitable climate for those markets. Accordingly, we are raising our allocation to emerging market funds, though remaining modestly underweighted. Enough uncertainty still exists about the global outlook to warrant some caution.

- While we continue to favor growth stocks in the large-cap universe, we are raising our allocation to international value stocks. Our international fund managers are finding some bargains among value stocks, and need to make room to buy them by lightening up on growth stocks.

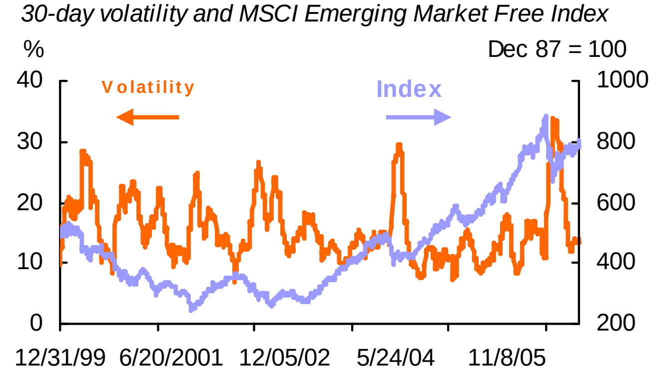
- In July we added international real estate investment trusts (REITs) as an asset class, with an initial underweighting. This month we are moving our REIT position to neutral. Moderate growth abroad and still-low interest rates are favorable for REITs, and valuations are, by some measures, still attractive in several markets. We would like to have a substantial allocation to REITs for diversification purposes and believe this is a reasonable entry point.

Current Positions

	Neutral (%)	Recommended Allocation	Change from Last Month
Large-Cap Developed Markets			
EAFE core stocks	40	Overweight	Unchanged
EAFE growth stocks	15	Overweight	*Reduced*
EAFE value stocks	15	Underweight	Unchanged
Total large-cap	*70*		
Small-Cap Developed Markets			
EAFE small-cap stocks	10	Underweight	*Reduced*
Emerging Markets			
Emerging market stocks	17	Underweight	*Raised*
International Real Estate			
International REITs	3	Neutral	*Raised*

Volatility in the emerging markets has declined since the May-June sell-off

30-day volatility and MSCI Emerging Market Free Index



Source: MSCI and ING IIM estimates

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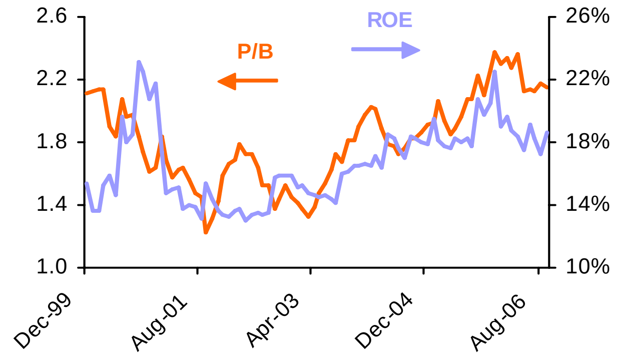
Reducing our Defensive Position in International Equities

In late May, in the midst of a sharp, correlated downturn in global equity and commodity markets, we moved to reduce risk in our portfolios by underweighting developed-market small-caps and the emerging markets. Although the markets have rallied since then, we stayed underweighted in those asset classes on a concern that they would underperform in a global environment of decelerating growth and less liquidity. In recent weeks, however, evidence has appeared that the global slowdown is likely to be mild, and that global inflation may remain under control. Moreover, valuations in the emerging markets, which had been close to their all-time highs in May, are now lower. In addition, volatility in the emerging markets has subsided, flows into emerging market equity funds have begun to stabilize – both good signs for future performance. Taken together, these developments, in our view, warrant a less defensive stance, which we have adopted by raising our allocation to emerging markets, though not all the way up to our fairly aggressive strategic neutral of 17% of the portfolio. Why not a more aggressive stance? Because there is still some risk that the global economy will decelerate by more than we expect, possibly because central banks around the world are not as close to being finished with their monetary tightening.

Raising our international REIT Allocation to Neutral

In July we added REITs to our international portfolios, but underweighted them relative to their strategic neutral allocation of 3%. We have long wanted to add REITs because their return-risk performance has been attractive, and because correlation of their returns with those on international equities suggest material diversification benefits. We were reluctant to add them at an overweighted or neutral weighting, however, because most central banks around the world were still hiking interest rates, which raised the prospect of a global downturn in growth. REITs had outperformed international equities for over five years, and we did not want to be buying near the peak. Since then our concerns have abated. First, the Federal Reserve has paused in its tightening, and in our view will be on hold for several months. This means less upward pressure on global interest rates as borrowers compete for funding worldwide. Second, the global economy is showing signs of resilience in the face of earlier evidence, such as a downturn in leading indicators, that pointed to slower growth. Low interest rates and moderate growth are favorable for REITs. While REITs are trading at a premium to NAV in some markets, they are trading at a discount in others. Taken together, these considerations suggest that raising the allocation to REITs, to neutral but not beyond, is appropriate. We have financed the move to neutral by reducing our allocation to small caps, to which REIT returns are highly correlated.

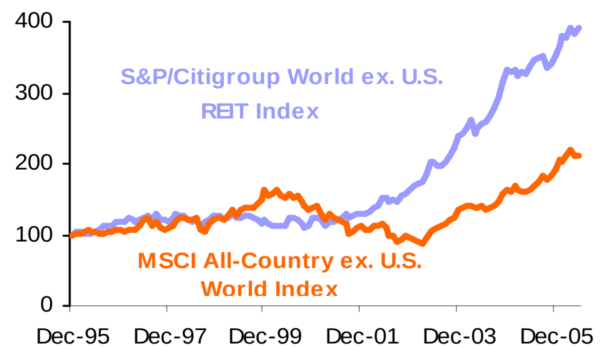
ROE in the emerging markets is below its peak, but so are valuations



Source: MSCI and I/B/E/S

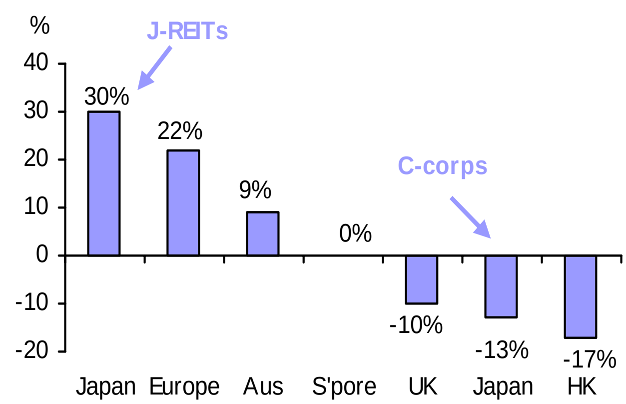
International REITs have outperformed stocks by a wide margin

Indices, Dec 95 = 100



Source: S&P, Citigroup, and MSCI

REITs are trading at a premium to NAV in some markets but at a discount in others.



Source: ING Clarion and UBS; 6/30/06