In today's global economy, events in one region can affect financial markets around the world. What should you do to help insulate your portfolio from market swings? The bedrock of your strategy is your asset allocation—and that depends on your stage in life.

Financial markets will always rise and fall, but short-term volatility should have relatively little influence on a long-term investment strategy. The bedrock of your plan is the appropriate mix of asset classes for your time horizon—the years remaining until you begin drawing on your investments and the amount of time you will need the money to last. This way you can balance the need for the growth potential of stocks against the risk of market declines.

**YOUR TIME HORIZON**
The appropriate allocation for your portfolio can help maximize your growth potential without exposing you to inappropriate levels of market risk or inflation risk. Investors who can wait 15 years or longer to begin drawing on their investments might consider pursuing growth through a portfolio of mostly stocks. On the other hand, investors who plan to start drawing on their investments within 10 years might consider a portfolio of 60% stocks, 30% bonds, and 10% money market/stable value investments. The longer your time horizon, the more you should hold in stock funds.

**YOUR GOALS**
Periods of market turmoil generally are not good times to make significant changes to an investment strategy because of the risk that emotions may interfere with decision-making. Investors too often make the mistake of selling in down markets and buying again after markets have rebounded, a prescription for poor performance.

For more information on asset allocation, visit [rps.troweprice.com/assetallocationcalc](http://rps.troweprice.com/assetallocationcalc).

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**WEATHERING VOLATILE MARKETS**

**INVESTING FOR RETIREMENT**
It is important to spread your savings among different categories of investments: stocks, bonds, and money market/stable value funds. The length of time you plan to invest your savings should determine how much money you allocate to each type of investment. As you grow older, your portfolio should move gradually from more aggressive (more stocks) to more conservative (fewer stocks). To find an investment mix for your time horizon, consider the following age-based asset allocations.

The allocation pie charts above are age-based only and do not take risk tolerance into account.

**DIVERSIFY YOUR STOCK ALLOCATION AMONG DIFFERENT TYPES OF STOCKS**
A typical mixture could include 55% large-cap (established companies), 15% mid-cap/small-cap (small to medium-sized companies), and 30% international (companies outside the U.S.) stocks. Diversification cannot assure a profit or protect against loss in a declining market.

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Continued on next page
returns. As shown in “The Benefit of Staying in the Market,” below, investors who remain committed to a sound investment strategy during inevitable market corrections typically fare better over the years than those who attempt to time a rebound—and that can mean a great chance of reaching or even surpassing their retirement savings goal.

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**VOLATILITY OVER THE YEARS HAS SHIFTED MY ASSET ALLOCATION. SHOULD I REBALANCE?**

Your mix of stocks, bonds, and money market/stable value investments likely has drifted from your original targets. Stuart Ritter, CFP®, a senior financial planner with T. Rowe Price, explains how rebalancing can provide significant long-term advantages.

**TARGET YOUR ASSET ALLOCATION**

Because financial markets are always rising and falling, it’s natural for your allocations to shift over time. When the stock market rises, the percentage of your portfolio held in stock funds typically is higher than your target, while the percentages in bonds and money market/stable value investments are lower. The reverse is true when the stock market declines. In most situations, rebalancing once a year should be sufficient to bring your asset allocation back in line with your targets.

**HOLD ENOUGH STOCKS**

Although it may seem appealing to maintain a smaller allocation to stocks to help reduce your exposure to short-term volatility, failing to own enough stock funds can decrease your portfolio’s long-term growth potential, risking your ability to have enough assets to fund your goals. In a down market, rebalancing could provide opportunities to purchase stocks at reduced prices—potentially boosting your portfolio’s returns over the long term.

**REGAIN BALANCE**

You can bring your portfolio back into balance by selling assets that have become an overly large percentage of your portfolio and buying funds in those asset classes that have declined. Rebalancing may put you back on track to potentially realize your short- and long-term financial goals because you’ll maintain the balance you need between stability and growth potential.

Want to rebalance your account? Visit rps.troweprice.com/changecurrentbalance and select Rebalance Entire Account. After logging in to your account, you will be directed to the appropriate page.

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**THE BENEFIT OF STAYING IN THE MARKET**

An effective tactic to address volatility is to remain invested through both up and down markets—and to contribute regularly to your savings plan. A systematic investment strategy with fixed regular contributions enables you to purchase more shares when the price is low and fewer shares when the price is high. That way you won’t experience potentially lower returns by missing the market’s best-performing days.

**THE DOWNSIDE OF MISSED DAYS**

An investor who stayed in the market over the 10-year period ended December 31, 2011,* would have an impressive gain. Missing even a small number of the market’s best-performing days can have negative consequences.

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Assumes a $100 initial investment on January 1, 2002. Data are based on cumulative returns of the S&P 500.

Source: Standard & Poor’s.

*For the period beginning January 1, 2002, through December 31, 2011. This is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results. It is not possible to invest directly in an index.
INTEREST RATES STAY LOW

The Federal Reserve’s decision to keep short-term rates at record lows signals its belief that economic growth will not be strong enough to cause inflation to rise.

The Federal Reserve’s policymaking committee voted on April 25 to keep short-term interest rates unchanged from its current target range of 0% to 0.25%. The Federal Open Market Committee (FOMC)—a 12-member board whose mission is to keep the U.S. economy, inflation, and employment on track—uses interest rates to help control economic growth. When the economy weakens, Fed policymakers cut interest rates or keep them low, in a way to encourage increased borrowing and spending by consumers and businesses. When the economy grows quickly enough to spur inflation, the Fed typically raises rates or keeps them high so it becomes costlier for people to get loans. The result is less borrowing and spending. Economic activity slows and inflation pressures ease.

The Fed’s Decision

In its statement in April, the FOMC stated that it “expects economic growth to remain moderate over coming quarters and then to pick up gradually.” While the committee anticipates the U.S. unemployment rate to decline gradually, it cited strains in the global financial markets—a reference to the economic slowdown in Europe—that, it believes, pose risks to U.S. growth. Given those factors, the policymakers reaffirmed a decision made last year to hold the federal funds rate—the overnight lending rate banks charge one another—at “exceptionally low” levels at least through late 2014.*

Keeping A Long-Term View

Decisions on interest rates typically are highly anticipated by the market because they are seen as indicators of future economic growth and the ability of businesses to borrow money to fund growth. That anticipation can sometimes result in near-term market shifts when the FOMC’s decision surprises market watchers. As an investor, you should remain committed to your long-term strategy and maintain an asset allocation appropriate to your time horizon.

WHAT DOES BEING ON THE “WATCH LIST” MEAN?

It is important that you understand what it means to be on the watch list and, perhaps more importantly, what it does not mean. Being on the watch list, as the name would imply, simply means we believe there is good reason to watch this fund more closely. Being on the watch list does not mean you should immediately sell your fund shares. It is not unusual for a fund to appear on the list from time to time. It does not mean the fund is necessarily a bad investment. If we believe the fund no longer represents a suitable investment option, we will remove the fund from the Plan.

Why are funds placed on the watch list?

Funds can be placed on the watch list for several reasons. Why a fund is on the watch list is more important than the mere fact that it is on the watch list. The most typical reasons are as follows:

1. Performance—The most common reason a fund is placed on the watch list is poor performance relative to its appropriate market benchmark and/or peer group. When signs of relative underperformance appear, we place a fund on the watch list.

2. Risk—Less obvious to many participants is the risk that a fund manager incurs. If a fund becomes too volatile, we will place it on the watch list.

3. Risk-Adjusted Returns—What returns has the fund manager been able to deliver relative to the risk the fund has incurred? If the manager is unable to deliver adequate returns for the risk taken, we will place the fund on the watch list.

4. Portfolio Construction/Style Drift—Is the fund manager investing the money in the way he or she said? If you invest part of your assets in an aggressive fund that is supposed to be investing in the stocks of small, growth-oriented companies, then you want the manager to do just that. We monitor the manager's portfolio and if the security holdings do not reflect what has been communicated, we place the fund on the watch list.

5. Operations—There are many operational reasons for placing a fund on the watch list. For example, the manager of the fund could leave. Remember, when you purchase shares of a mutual fund, what you are really doing is hiring a professional portfolio manager to invest your money. If that manager leaves, you should watch the fund closely. There could also be firm-level issues. These can include issues such as regulatory violations, turnover in senior management, or a merger or acquisition. Any of these operational issues will automatically place a fund on the watch list.

WATCH LIST—THE STATE OF ILLINOIS DEFERRED COMPENSATION PLAN

Current Watch List Summary

The following fund is on the watch list as of 6/30/2012:

Ariel Fund – The fund remains on watch list status due to longer-term underperformance. There has also been an investment team change. Ariel announced late last year that Kenneth Kuhrt will join John Miller as portfolio manager of their small- and mid-cap strategies including the Ariel Fund, with John Rogers maintaining the lead portfolio manager position. This change was announced in their separate accounts and will most likely change in the mutual funds this year. Kenneth has accumulated a seven-year working history at Ariel and is being promoted due to his contributions to the investment process. Kenneth also serves as portfolio manager on the micro-cap product and Ariel Discovery Fund. From a performance perspective, returns lagged in 2011 due to stock selection in the financials sector as well as an overweight to consumer names. However, performance improved in the first quarter of 2012 as many of the same names that lagged rebounded. Over the past several years, the fund's performance improved significantly in 2009, ranking in the 5th percentile of its peer group as well as a strong showing in the fourth quarter of 2010. The risk scores, however, are significantly higher than the peer group and the overall five-year return ranks in the 75th percentile of its peer group. Therefore, participants seeking a similar investment strategy also have access to the Northern Small-Cap Value Fund, which invests in a small-cap value equity style.