

Insight



A QUARTERLY PERIODICAL DEDICATED TO HELPING YOU PREPARE FOR TOMORROW

IRS LIMITS FOR THE 2012 PLAN YEAR

To help you better prepare for the upcoming year, below is a summary of the 2012 salary deferral contributions you can make to your State of Illinois Deferred Compensation Plan (457 Plan):

- The IRS annual salary deferral dollar limit for before-tax contributions is \$17,000.
- For participants who will be age 50 and older, the age 50 catch-up provision allows you to defer up to \$22,500 in before-tax contributions. (This includes the \$17,000 maximum before-tax contribution allowed by the IRS plus an additional \$5,500.)
- The 457 special catch-up provision is \$34,000. (This provision can only be elected during the three years (consecutive) prior to, but not including, the year the participant attains normal retirement age, as defined by the 457 Plan.)

1099-Rs will be mailed by January 31, 2012.

REQUIRED MINIMUM DISTRIBUTIONS

If you turn age 70½ in 2012 and have left state service, you must receive your 2012 required minimum distribution (RMD) by April 1, 2013. To calculate your RMD, divide your account balance as of December 31, 2011, by 27.4 if you turn age 70 in 2012 or 26.5 if you turn age 71. This is the minimum amount that you must withdraw from your account.

Each year thereafter, you must receive your RMD by December 31.

DON'T PUT OFF NAMING OR UPDATING YOUR BENEFICIARY

It's always been important to name a beneficiary. By selecting someone, you're ensuring that your assets will be distributed as you intend in the event of your death. To make sure our records reflect your current wishes, visit the plan forms section on rps.troweprice.com to print out a beneficiary form.



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GOING ABROAD: INVESTING IN INTERNATIONAL MARKETS

A quickly evolving global economy makes it more important for investors to understand the connections between countries and companies—and to manage the inherent volatility of a complex world. To be properly diversified, investors may want to consider mutual funds with exposure to foreign markets.

Understanding Global Connections

Examples of the global economy are everywhere. To rein in costs and maximize production, manufacturers of goods ranging from toys to cars outsource much of the production cycle to suppliers around the globe. Smartphones, for example, may come from the U.S., Germany, Japan, and several other countries to be assembled in China, then shipped to countries around the globe for purchase.

But global outsourcing can have drawbacks. Interruptions in stretched supply chains can force companies to pay higher prices for materials or slow and even stop production. For example, the auto industry, which relies on factories in Japan for components, faced shortages of a variety of important materials—including computer chips and paint pigments—following that country's earthquake and tsunami last year.

The Big Picture

Although economies around the world face challenges, a fundamental principle of investing remains true: There is always opportunity somewhere. Developed economies have to conquer debt problems while controlling government spending. Emerging markets such as Brazil, Russia, India, and China have become world leaders in their own right and significant sources of growth, but they are trying to adjust fiscal and monetary policies to stave off inflation without slowing growth too quickly.

Emerging economies are developing infrastructure, deregulating industries, and pursuing democratization and social reform—trends that are broadening the distribution of wealth and expanding the middle classes necessary for self-sustaining domestic economies. These developments haven't gone unnoticed: Global companies increasingly are looking to Latin America, for example, to expand their businesses, and the region's low labor costs are a strong lure for capital investment.

The Mutual Fund Advantage

An interconnected global economy and the emergence of new economic powers in Asia and Latin America raise challenges for investors, who face both unprecedented opportunities for growth and potential risk from developments around the world. Spreading your investments around the world through international and global mutual funds can soften the impact of a problem in one nation or region. International mutual funds focus on investments outside the U.S., while global mutual funds include both U.S. and foreign companies. Funds that invest directly in assets in emerging markets can add additional exposure to markets outside the U.S. Diversification cannot

assure a profit or protect against loss in declining markets. Funds that invest in non-U.S. securities are subject to the unique risks of international investing, including currency fluctuation. Maintaining geographic diversification can help reduce the impact of an unforeseen event and enable you to potentially smooth the volatility of your portfolio.

THINKING GLOBALLY

According to the World Bank, the average annual global gross domestic product (GDP) growth rate between 2005 and 2020 is expected to be 3.1%. However, many nations are projected to far exceed that pace. In the next decade, the so-called emerging economies of Asia and Latin America are expected to grow significantly more rapidly than the more established economies of the U.S., Japan, and nations in Western Europe.

GROWTH RATES AROUND THE WORLD

Below are the projected average annual GDP rates extrapolated to 2020.



CHINA
6.6%



INDIA
5.5%



ARGENTINA
3.6%



BRAZIL
3.6%



U.S.
3.2%



WORLD
3.1%

Source: The World Bank. For Information on Global and International Mutual Funds, visit rps.troweprice.com.

INCOME TAX INFORMATION

Currently Deferring Participants

If you are actively deferring into the Plan, your taxable income was reduced thanks to your participation in the Deferred Compensation Plan. You will only report the wages shown in Box 1 of your W-2 statement on your income tax form. Your wages reported in Box 1 show your gross wages reduced by the total amount of your 2011 deferrals and any other tax-deferred and tax-exempt deductions.

Your W-2 statement will reflect contributions to the Deferred Compensation Plan (457). If the “Deferred Compensation” box in the lower right-hand corner of the W-2 is marked “X,” it means you contributed to the Deferred Compensation Plan in 2011; the amount of your deferral is indicated in Box 12 with a “G” coding. Remember, you do not report your deferred compensation anywhere on your income tax form.

For participants who took a distribution in 2011

If you received a payment from your account during the 2011 tax year, you will receive a separate 1099-R from our recordkeeper, T. Rowe Price, by January 31, 2012. Box 2a of your 1099-R will list the taxable amount of your distribution(s) you received during 2011 and should be entered on line 16b of your 1040 form. Box 7 of your 1099-R shows the distribution code for the type of distribution received. A code of “7” in this box indicates a normal distribution for a participant age 59½ or over. If you were under age 59½, box 7 will be coded with a “2” to indicate that your 457 plan distributions are not subject to the 10% additional tax on early distributions.

For federal income tax purposes, your deferred compensation, plus any earnings, is taxable as ordinary income when it is distributed. Deferred compensation distributions are reported along with other earnings on line 7 of your income tax Form 1040. Deferred compensation distributions are not subject to State of Illinois income tax. Report the distribution in the “federally taxed retirement and Social Security” subtraction section, line 5 of your Illinois return.

TELEPHONE NUMBERS

Deferred Compensation

Plan Rules/Options Information

800-442-1300/ 217-782-7006

TDD/TTY: 800-526-0844

Internet: <http://www.state.il.us/cms/employee/defcom>

Recordkeeper

T. Rowe Price Retirement Plan Services, Inc.

Account Value Information and Investment Changes:

888-457-5770 or TDD/TTY: 800-521-0325

Internet Access: 800-541-3022

Internet: <http://rps.troweprice.com>

TEST YOUR KNOWLEDGE OF EXCHANGE RATES

The American dollar is one of about 180 currencies in the world. Take this quiz to see how much you know about how currency values affect your investments.

1. CURRENCY IS GENERALLY ISSUED BY:

- A. Two countries as a way to settle trade disputes.
- B. Governments as a medium of exchange.
- C. Companies as a record of public disclosure filing.

2. AN EXCHANGE RATE REFERS TO:

- A. The speed with which shares of stock change ownership.
- B. How fast a financial transaction is settled.
- C. The value of one foreign currency compared to another.

3. CURRENCY FLUCTUATIONS WHEN CONVERTED TO DOLLARS LEAD TO:

- A. Greater savings rates.
- B. Increases or decreases in the overall return of a foreign security.
- C. Inflation.

ANSWERS

1. B. Although a currency can be any accepted form of money in public circulation, the term refers to the money issued by a government for the exchange of goods and services. Most countries have their own currencies—an exception being the euro, which is used by a group of European countries.

2. C. Because the value of the world's currencies is in constant flux—much like the price of stocks and bonds—the amount of foreign currency you can buy with your dollar varies.

3. B. The profit you make on a foreign security when it is sold and converted into dollars depends not only on the value of the asset itself, but also on the value of the dollar relative to the local currency. If the dollar loses value, the foreign asset is worth more.

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 funds are on the watch list as of 12/31/2011:

Ariel Fund: The fund remains on watch list status due to longer-term underperformance. Recent performance has lagged due to stock selection in the financial sector as well as an overweight to consumer names. 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. Over the five-year trailing period, the fund's return underperforms the benchmark and ranks in the 89th percentile of its peer group. Ariel recently announced that Kenneth Khurt will join John Miller as portfolio managers 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 early next year. Mr. Khurt 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. 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.

Invesco International Growth Fund: The fund remains on watch list status due to a recent change in portfolio management. On Friday, June 10, 2011, Invesco announced the departure of long-term co-lead portfolio manager, Barrett Sides. Mr. Sides had worked along-side his counterpart co-lead portfolio manager, Clas Olson, since 1994. Mr. Olson assumed full lead portfolio manager responsibilities and will maintain this structure going forward. Over the years, Invesco has added investment professionals to the team, which now has nine portfolio managers and four analysts. The only investment professional that changed their coverage responsibilities was Clas Olson. He has final decision-making authority on investing activities in the Asia/Pacific region. They do plan to hire an additional analyst for this specific region in the next year. Although the investment team lost a senior investment team member, the current team has extensive experience. The performance track record, however, has been strong both recently and over the long term. The fund's one-year annualized return ranks in the 15th percentile of its peer group. Due to the recent change in investment management, however, the fund will be closely monitored over the next year. An alternative fund for participants to select is the Janus Overseas Fund as it also invests in large-cap international stocks.

