STAIRWAY PARTNERS, LLC

2215 York Road, Suite 515 Oak Brook, IL 60523
www.stairwaypartners.com
630-371-2626 phone 630-371-2617 fax

MONTHLY

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EMERGING EQUITIES BY THE NUMBERS

Background

Emerging economies have greatly benefited from and contributed to a strong global economy. Global demand for cheap consumer oriented exports has boosted many of the Asian emerging economies, with China as the prime example. In addition, strength in commodity prices has helped countries rich in oil and minerals like Russia and Brazil. In general, most of the emerging countries have greatly improved their economic policies and at the same time improved transparency.

This in turn has led to outstanding performance of emerging equities over the last five years. Investors, who had all but forgotten the asset class after the Asian crisis and Russian default, have now reacquainted themselves by pouring record amounts of money into the sector.

This *Monthly* will serve to provide some basic information on emerging equities by reviewing the benchmark, examining the growth in market value and providing information about the economies.

The Benchmark

Benchmarks provide objective points of comparison for investors when assessing a market. The most widely accepted benchmark for emerging equities is the Morgan Stanley Capital International (MSCI) Emerging Markets Index. MSCI determines which countries are eligible for inclusion in its emerging equity index based on several factors including: GDP per capita, political stability, market liquidity and others. As a country emerges, it may at

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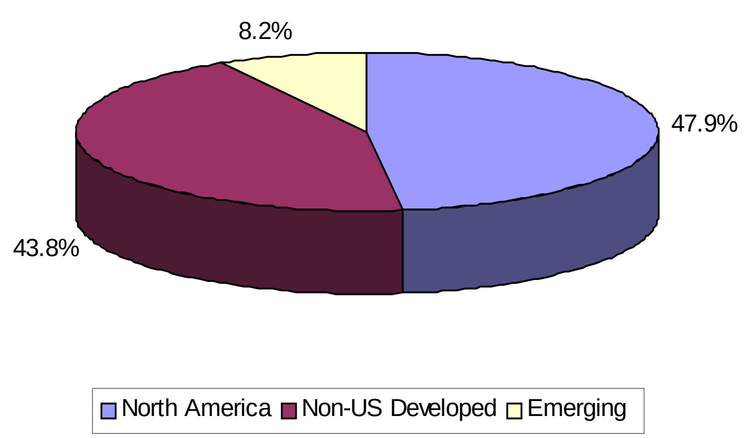
CURRENT TOPICS

STRATEGY CHANGE

On January 12th, we reduced exposure to emerging equities across portfolios. The strong advance in prices has raised once again our concerns that investors are largely ignoring potential risk as they chase returns.

Figure 1: Sector Weights of the Global Equity Market
$29.2 Trillion



Source: MSCI As of 12/31/2006

"AT THE END OF 2006, EMERGING MARKETS REPRESENTED 8.2% OF THE $29.2 TRILLION GLOBAL EQUITY MARKET"

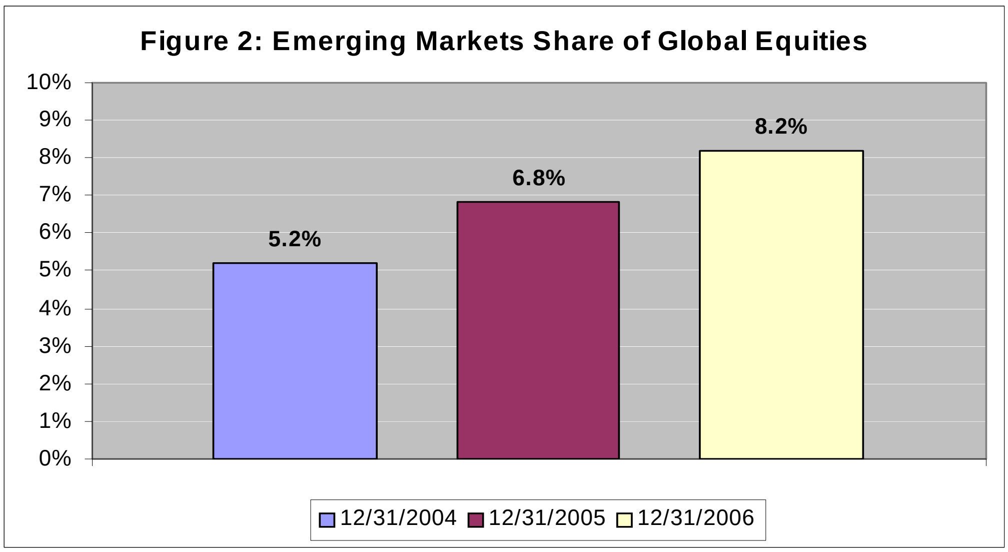
Emerging Equities by the numbers - cont'd

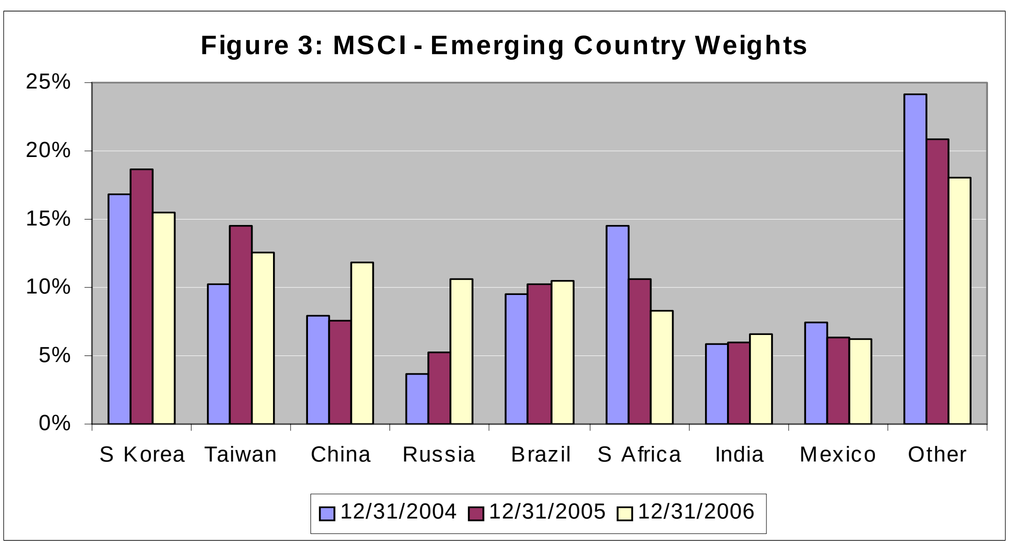
some point be "upgraded" and subsequently reassigned to the developed market indices. In the 1990s, Portugal and Greece moved from the emerging index to EAFE while Malaysia went in the opposite direction. Developed markets range from the US, Germany, France, UK and Japan to much smaller markets such as Austria and New Zealand.

In MSCI's own words, "The MSCI Emerging Markets Index is a capitalization weighted index that aims to capture 85% of the publicly available total market capitalization for emerging countries. Component companies are adjusted for float and must meet objective criteria for inclusion into the index." *Adjusted for float* means that, in determining market capitalization, MSCI excludes shares that are closely held or not freely tradable.

Growth and Change

At the end of 2006, emerging markets represented 8.2% of the global equity market (Figure 1). As of December 31, 2006, the market capitalization of emerging equities reached $2.4 trillion, which represents a doubling over the last two years. Figure 2 shows just how much this growth in market capitalization has increased emerging equities' share of the global equity market. This dramatic growth is due to two factors. One is the better performance of emerging equities compared to developed markets. The second is the substantial issuance of new stock in the emerging markets. A good example of a new issue is Rosneft, the Russian energy company, whose initial public offering raised over 10 billion dollars.





Source: MSCI

"AS OF DECEMBER 31, 2006, THE MARKET CAPITALIZATION OF EMERGING EQUITIES REACHED $2.4 TRILLION, WHICH REPRESENTS A DOUBLING OVER THE LAST 2 YEARS"

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"MARKETS THAT HAD LAGGING RELATIVE RETURNS AND LITTLE OR NO NEW ISSUANCE SHRANK AS A PERCENTAGE OF THE INDEX"

About Stairway Partners, LLC

Stairway Partners was formed to provide our clients (starting with ourselves) with an effective and comprehensive solution for managing their wealth. Our disciplined and rigorous approach comes from our collective knowledge in serving large institutional clients over many years.

Our core investment belief is that asset allocation is the single most important determinant of success in any investment plan. The dominant amount of risk and return comes not from your choice of individual investments but from your asset class mix. Stairway Partners focuses our resources on risk management and asset allocation. This includes building your custom blueprint (investment policy and benchmark) and aligning your portfolio with our investment strategy utilizing the global capital markets.

Figure 3 shows the top eight markets by size, over the last three years, within the emerging equity index. Markets that had lagging relative returns and little or no new issuance shrank as a percentage of the index. Examples are South Korea, South Africa and Mexico. On the other hand Russia, which had both excellent performance and large amounts of new issuance, jumped from 3.6% to 10.6%. It is interesting to note that, as of 12/31/2006, the largest holding in the iShares Emerging Markets ETF (symbol EEM) was OAO Gazprom at 4.52%. Two years ago OAO Gazprom was not listed in the top ten holdings.

More Numbers

Figure 4 shows data on the top eight countries comprising the MSCI emerging equity index. There are several interesting points to consider. One is that countries shown here, such as India and China, that have low GDP per capita have the highest growth rates. Countries that are removing constraints on labor, capital, and product markets are experiencing very high growth from a low base. As these emerging economies catch up to higher income countries, it will be more difficult for them to sustain this high rate of growth.

Another interesting point is that despite the high growth rates, inflation in general has been relatively low. This is particularly pronounced in Taiwan and China. Lastly, growth in Latin America has greatly lagged growth rates in Russia, India, and the Asian countries.

Strategy Update

Since we added emerging equity exposure to client portfolios last June, the asset class has rebounded incredibly - generating a return of about 40%. This strong advance in prices has raised once again the concerns we had at this time last year - primarily that investors are largely ignoring potential risks as they chase returns. We acknowledge that many emerging markets have very good growth prospects and over the last few years have made improvements to transparency, liquidity, and economic policy. However, risk has not disappeared; it is simply low at this time, although investors are pricing emerging markets as if risk will remain depressed indefinitely. We reduced the amount of target equity exposure significantly across portfolios.

Figure 4: Top 8 Countries of Emerging Index

Country	GDP USD $B	GDP Growth	Inflation	Pop. Millions	GDP per Capita
S Korea	768.5	5.1%	2.1%	48.8	15,748
Taiwan	353.9	4.4%	0.7%	23.0	15,387
China	2,512.0	10.5%	1.9%	1,314.0	1,912
Russia	733.0	6.6%	9.1%	142.9	5,129
Brazil	620.7	3.1%	3.1%	188.1	3,300
S Africa	200.5	4.5%	5.8%	44.2	4,536
India	796.1	8.5%	6.7%	1,095.4	727
Mexico	741.5	4.5%	4.1%	107.4	6,904
United States	13,220.0	3.4%	2.5%	298.0	44,362

Sources: CIA-World Fact Book, Bloomberg, Stairway Partners

Notes: GDP per capita is in US dollars, GDP is calculated at prevailing exchange rates, inflation is the most recent 12 months, all other numbers are estimated for 2006.

"Countries that are removing constraints on labor, capital, and product markets are experiencing very high growth from a low base"

Strategy

Asset Class	Expected Return	Hurdle Return	Strategy	Comment
Equities			small under	
US	3.0%	8.5%	small under	Exposure slightly below normal
Non-US Developed			small under	Moderately unattractive relative to risk
Eurozone	-1.6%	7.5%		
Japan	-10.5%	4.5%		
UK	4.3%	8.7%		
Emerging	-1.5%	11.6%	under	Asset class inadequately pricing risk
Fixed Income				
US Treasury Bonds			neutral	Shorter-term maturities are fairly priced
2-Year	4.9%	4.7%		
5-Year	4.8%	4.9%		
10-Year	4.4%	5.0%		
30-Year	3.7%	5.2%		
US Municipal Bonds			neutral	Sector is fairly priced
2-Year	3.6%	3.4%		
5-Year	3.8%	3.6%		
10-Year	4.0%	3.8%		
30-Year	6.4%	4.2%		
US High Yield	4.1%	6.9%	under	Spreads over US Treasuries remain too tight
Non-US Government Bonds			under	Yields generally insufficient compensation for risk
Euro 10-Year	3.1%	4.5%		
Japan 10-Year	0.6%	2.1%		
UK 10-Year	4.5%	5.2%		
Emerging Markets Debt	3.8%	7.2%	under	Spreads over US Treasuries remain too tight
Cash	4.7%	---	over	Allocation comes from overpriced asset classes

Currencies	Expected FX Change	Equity Return with Currency	10-Year Bond Return with Currency	
Euro	-4.0%	-5.6%	-0.9%	Euro is somewhat expensive
Japanese yen	6.5%	-4.1%	7.0%	Yen is slightly attractive
UK pound	-5.9%	-1.6%	-1.4%	Pound is somewhat expensive

Notes: **As of: 1/31/2007**

The expected return is our estimate of the annualized return likely to be generated over a 3-year horizon.
The expected returns are expressed in local currencies (e.g., Japanese equity return is stated in yen terms).
The hurdle rate represents the annualized return that an asset needs to generate in order to cover its risk.
Equity Return with Currency (in Currencies section) is the annual return we would expect a US dollar investor to earn from holding foreign equity markets.