

# **State of Illinois Stable Return Fund Credit Issues Q&A from Invesco Fixed Income September 2008**

## **What is a Stable Value Fund?**

Stable value funds are a unique investment vehicle available only to 401(k) and other savings type plans. Your Stable Return Fund is a stable value fund managed by Invesco, a leading participant in the stable value management business since 1985.

Your Stable Return Fund holds a diversified portfolio of high quality fixed income investments and investment contracts that is managed with a primary objective of principal preservation. These investment contracts are designed to help ensure that, while principal is not guaranteed, plan participant-initiated transactions are processed at book value (i.e., that for every dollar that you put in, a dollar is available for you to take out). The contracts (called "wrap contracts" within the stable value community) are unique to stable value funds and are not found in equity, bond or money market funds.

Other objectives of the Fund include providing a crediting rate or yield that is expected to adjust in the direction of prevailing market interest rates; and liquidity sufficient to meet participant requests for withdrawals and transfers to other plan investment options.

## **How does Invesco keep my Stable Value dollars safe?**

Invesco manages stable value funds through the use of several of their proprietary commingled funds reserved for use by their clients. These collective trust funds provide broad diversification compared to the results your plan could achieve by buying individual securities directly. These commingled funds provide exposure to securities across all sectors of the U.S. fixed income market. Typical Invesco stable value portfolios may contain positions in 2,500 or more distinct securities.

Invesco provides further diversification by using external fund managers in addition to their internal fixed income team. Thus, through the Stable Return Fund you are benefiting from the diversified management styles of PIMCO, BlackRock, Jennison and Western Asset Management in addition to Invesco.

We want to assure you that Invesco has been monitoring recent market events closely and that your Fund continues to be managed in accordance with its investment objectives and guidelines.

## **Newspapers said that AIG provides investment contracts for stable value funds. Does my Fund own any AIG contracts?**

AIG has a subsidiary that is a major provider of the investment contracts used by stable value funds. However, Invesco does not use AIG in this capacity.

## **I have heard that money market funds have lost money or have been closed down due to recent events. Has this happened in my stable value fund?**

Your Stable Value Fund has continued to process participant transactions at \$1.00 per unit. Both stable value and money market funds are designed to provide low volatility and generally a corresponding lower rate of return than other more aggressive investment choices. An important feature of stable value funds is the use of investment contracts which are designed to provide that typical plan participant directed redemptions are to be processed on a principal-plus-interest (i.e., "book value") basis instead of a market value basis. This feature helps to protect your principal balances.

The use of investment contracts in your Stable Value Fund has an important benefit with respect to investment returns that are credited to your account. The presence of the investment contracts in the Fund allows it to be accounted for on a book value basis routinely. Consequently, rather than reflecting daily market performance in your account, interest is posted to the account daily resulting in significantly less volatility than exhibited in the stock and bond markets.

### **My Stable Value Fund's underlying investments were invested in mortgage-backed securities. How safe are those investments?**

Invesco, and the other investment managers that they utilize, do invest in mortgage backed securities (MBS). The mortgages used, however, are of very high quality, are predominately securities issued by U.S. Government agencies, and are well diversified into a number of mortgage categories or sectors. Shown below is the breakdown of MBS in the Fund, with the exposures expressed as percentages of the entire Fund:

Agency MBS	38.46%
Non-Agency MBS	11.61%

The credit quality of the Agency MBS portion of the portfolio is higher than AAA, and is typically referred to as "Agency" credit. The non-Agency MBS securities are almost all AAA in credit rating.

### **How much of these securities are considered subprime?**

As of August 31, 2008, the Stable Return Fund had only 3.25% exposure to subprime securities. Stable value portfolios hold this exposure through units of highly diversified commingled funds that Invesco uses to construct stable value portfolios. This minimizes individual line item exposure.

### **What is meant by "subprime"?**

Subprime loans are loans to borrowers with higher credit risk than traditional prime borrowers.

### **What are the subprime securities rated?**

As of 8/31/08, of the 3.25% held in subprime, 3.10% are still rated AAA while the other .15% is rated AA. The rating agency is S&P.

### **How can a subprime security be rated AAA?**

Subprime loans are pooled and structured into deals. These deals are divided into tranches. Each tranche receives a different level of credit protection. For example, senior tranches

receive principal and interest before mezzanine and subordinate tranches. Losses are absorbed by the subordinate and mezzanine tranches before the senior tranche receives any losses. This allows more senior tranches to receive a higher credit rating.

**Does my Stable Value Fund invest in the financially troubled companies, like Lehman, that are in the news?**

Invesco's stable value accounts as a whole had relatively minimal (if any) exposure to the troubled companies that have been in the news. In all cases, these exposures were through units held of the highly diversified commingled funds mentioned above, which are used to construct Invesco's stable value accounts. The use of commingled funds in constructing portfolios minimizes individual line item exposure.

**What are the exposures to those companies?**

Please keep in mind that your Fund is actively managed and, accordingly, that portfolio composition can change on a daily basis as the result of changing market conditions. With respect to holdings by the Fund of securities issued by several of the companies that have been in the press lately, as of September 18, 2008, the Fund had the following approximate indirect exposures through the commingled funds in which it invests:

American International Group, Inc. (AIG)	0.15%
Goldman Sachs (GS)	0.51%
Lehman Brothers Holdings (LEH)	0.04%
Merrill Lynch & Co. Inc. (ML)	0.17%
Morgan Stanley (MS)	0.50%
Washington Mutual (WM)	0.00%

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