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 If we believe the fund no longer represents a suitable investment option, we will remove the fund from the Plan.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 9/30/2010:

Ariel Fund: The fund's performance in both 2009 and 2010 has improved significantly both versus its benchmarks and peer group. For the first nine months of 2010, the fund returned +20% versus +11% for the benchmark and ranked in the 5th percentile of its peer group. As the fund's top five largest holdings have a significant weight in the overall portfolio, strong returns from the third and fifth largest holding, Jones Lang LaSalle (+43%) and Interpublic Group of Companies (+36%), have fueled superior results this year. The fund's longer-term performance as measured by the five year annualized return, however, lags its benchmark and its peer group coupled with higher risk as measured by standard deviation and beta. Participants also have access to the Northern Small-Cap Value Fund which invests in a small-cap value equity style. This fund will remain on the watch list due to longer term underperformance but the recent outperformance is noteworthy.

Janus Adviser International Growth: The fund's performance track record over both recent and longer term periods has been stellar, outperforming its benchmark and peer group across all annualized time periods measured as of September 30, 2010. The fund has ranked in the top decile of its peer group over the three, five, and ten year annualized periods. The fund's watch status is not based on performance, but rather a result of organizational changes. In July of 2009, the Janus Capital Group Board announced the departure of Chief Executive Officer Gary Black. Mr. Black was credited with bringing about several changes to the firm including a move towards best practices in the investment group. Janus announced a replacement and new Chief Executive Officer, Mr. Richard Weil, earlier this year. Mr. Weil was formerly the Global Head of PIMCO Advisory, a large investment services organization. He began his new role with Janus on February 1, 2010. The fund will remain on watch list for the near term. However, minimal professional turnover or instability at the firm have resulted from the change and the fund's watch list status is under review. An alternative fund for participants to choose is the Invesco International Growth Fund as it also invests in large-cap international stocks.

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THIRD QUARTER 2010 | PAT QUINN, GOVERNOR

Insight

A QUARTERLY PERIODICAL DEDICATED TO HELPING YOU PREPARE FOR TOMORROW

HOW TO TELL IF YOUR INVESTMENTS ARE DOING WELL

How can you tell if your investments are doing well? Most people measure investment performance by changes in share price—but that's only part of the story. You should also focus on the long-term return of your investments. Here are a few more things to consider.

Calculate your investment return

Investment return is made up of two parts:

1. How much a fund's share price changed (up or down) over a particular time period, plus
2. Any income your money may have earned for that same period. (Stock funds generally pay dividends quarterly or annually, if at all, and bond funds generally pay dividends monthly. Both types can earn capital gains when the fund makes money by selling stocks or bonds it owns.)

Investment return is expressed as a percentage rate. For example, one year a fund might have an annual return of 8%. This means that if your investment was worth $5,000 on January 1, it would be worth $5,400 on December 31. (Remember that changes in the value of an investment are only on paper until you sell that investment. Long-term investors are likely to experience both "paper losses" and "paper gains" at different periods.)

January 1		December 31
$5,000	⟶	$5,400
	8% Return	

Look for longer-term results

Common periods used for measuring average return are annual, five-year, 10-year, and since-inception (i.e., since the fund began) periods. For a retirement investor with long-term goals, a fund's performance since inception or for five or 10 years is more meaningful. How it does today, next quarter, or even this year is less important because you don't need the money yet.

Use benchmarks for "apples to apples" comparison

To see how your fund measures up, don't compare apples to oranges. For example, don't think that the 10-year, 6.5% average annual return of your bond fund is poor because you're comparing it with the 14% average annual return for your stock fund. To be fair, make an "apples to apples" comparison.

One way to do this is by comparing your fund's performance to the average performance of similar funds. You can do this by consulting a benchmark index—an average for a particular investment type (like short-term bonds, small-cap stocks, or international stocks).

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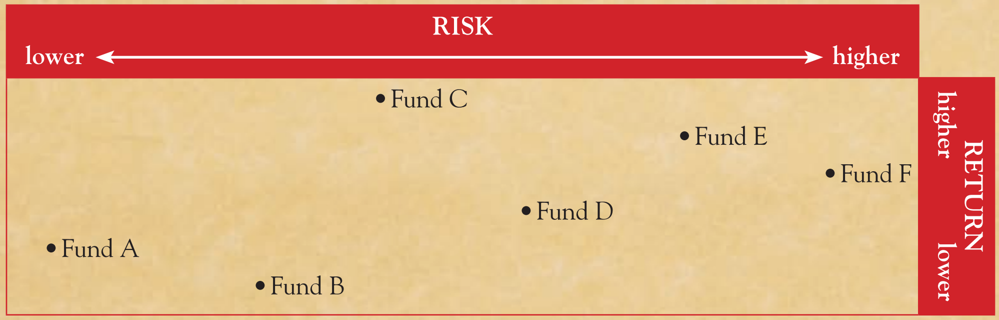
Consider risk-adjusted performance

When evaluating the appropriateness of an investment, it may be important to consider both risk and performance together. Many companies that evaluate funds for investors rate them according to risk-adjusted performance. A high rating means a fund has been able to get good investment return without undue investment risk. Consider the chart below: Fund C has a higher return and, when compared to other funds with similar returns (such as Funds E and F), has the least amount of risk.



A "hot" fund—one that's listed in a monthly financial magazine list of "top performers"—won't necessarily earn a high rating. That's because "hot" funds are generally singled out only because they've had high short-term returns, regardless of risk.

When you have a long-term retirement investment strategy, success is not measured daily or monthly or yearly. Success can come with making a plan and sticking with it—choosing and holding onto funds that have the potential to deliver consistently good risk-adjusted performance over time.

Would you like more information?

If you have questions or would like more information, visit the website at rps.troweprice.com. Or call your plan's toll-free phone number. T. Rowe Price representatives are available during business days between 7 a.m. and 10 p.m. eastern time.

Call 1-800-922-9945 to request a prospectus, which includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

TELEPHONE NUMBERS

Deferred Compensation

Plan Rules/Options Information:
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TDD/TTY: 800-526-0844
Internet: http://www.state.il.us/cms/employee/defcom

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T. Rowe Price Retirement Plan Services, Inc.
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WHY EUROPE MATTERS

When Greece and other European countries experienced a debt crisis in April, markets around the world declined steeply. To what extent is the deficit in the United States similar—and what lessons can individual investors learn from the European event?

The crisis began over fears that governments in the Europe Union (EU) might not be able to repay huge loans after years of spending far more than they earned through taxes. To some economists, the United States debt situation looks similar—a budget deficit of more than 1.4 trillion that requires our government to borrow 41 cents of every dollar it spends.[1] However, our economy is the largest in the world, and other countries are much more willing to lend us money. Plus, the Federal Reserve can act more quickly and decisively on economic matters than the EU's collection of 27 governments.

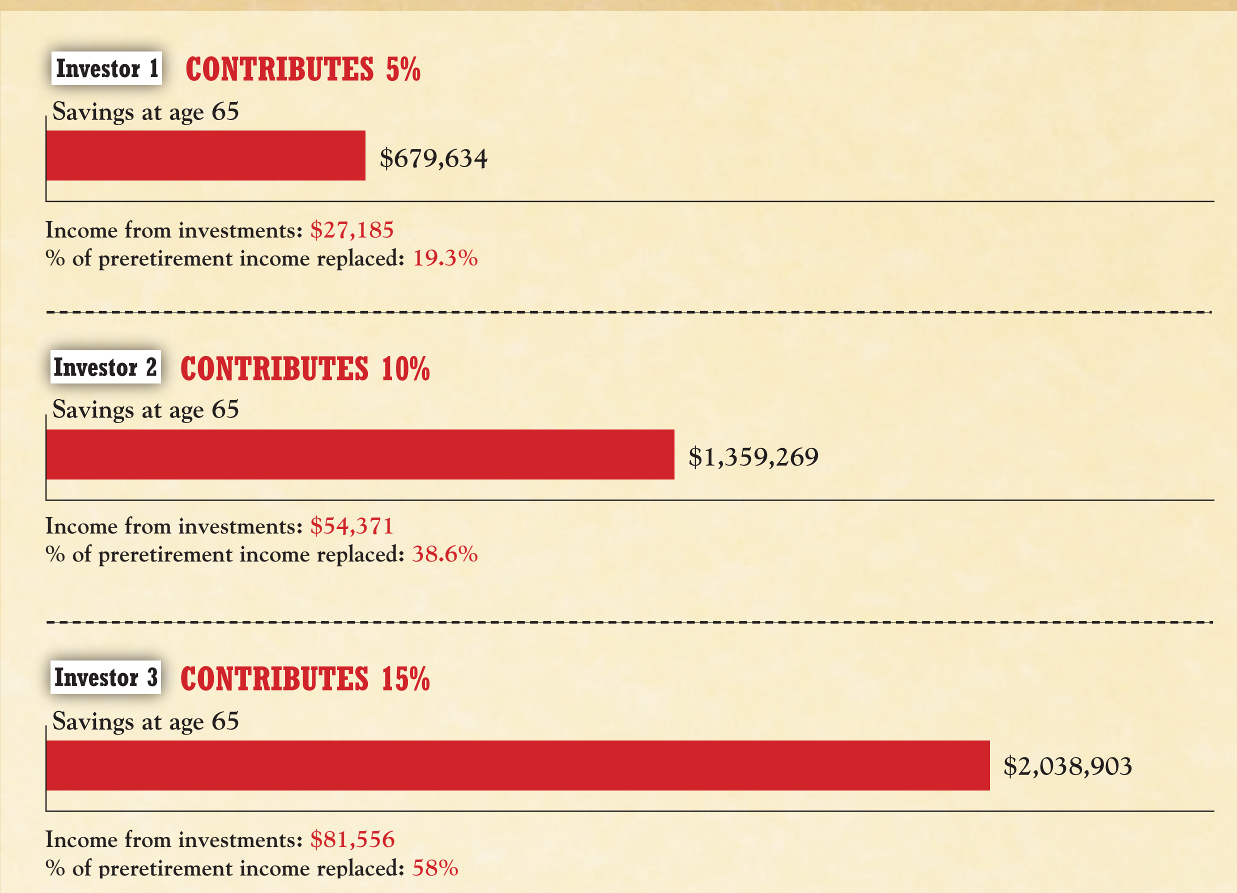
Your debt

Like countries, individuals can run into Greek-style problems if they overextend their credit card debt or take out loans that are too large. You may avoid these troubles with two clear steps: (1) Establish an emergency fund with six months of expenses in a money market/short-term investment account; and (2) keep your discretionary spending well within your means. Another lesson to take away from this recent turmoil is the importance of staying invested in the market through its ups and downs, as the fundamental strength of Europe is likely to emerge again.

[1]White House, Office of Management and Budget, July 2010.

FOCUS ON RETIREMENT INCOME: THE POWER OF PERCENTAGES

Three 30-year-old investors earning a $50,000 salary end up with radically different incomes when they reach age 65—and for the 30 years they may spend in retirement—depending on their savings rates.* Their goal should be to replace 50% of their preretirement income, which will be $140,693 at age 65. Below we see the income their investments provide in their first year of retirement.



* Assumes a 3% annual pay increase and an average annual return of 8%. It does not take into account pension-funded retirement income. The above example is for illustrative purposes only and is not meant to represent the performance of any specific investment option.