Update

May 2010

The following provides more information on Waddell & Reed’s trading activity on May 6, 2010.

Did Waddell & Reed participate in hedging activity via derivatives trading on May 6?
On May 6, our flexible portfolio funds employed hedging strategies in an effort to protect shareholders from significant downward movement in the equity market. The hedging techniques deployed were consistent with those used in the past and were part of our normal management of the funds.

What was the intent of these hedging strategies?
Our flexible portfolio funds often purchase and trade futures contracts as a means to reduce equity exposure in times of market volatility. Portfolio managers employ this strategy while seeking to protect fund investors from exposure to excessive market declines. This is consistent with our longstanding practice in certain types of our investment portfolios.

On May 6th, when the portfolio managers reached the conclusion that the risk of the European sovereign crisis extending to the United States and our financial system was increasing, they decided to reduce the Funds’ equity exposure quickly. They used the e-mini S&P 500 Index futures contract as part of their equity hedging strategy. The e-mini is highly liquid and widely traded. They sold e-mini contracts to reduce equity exposure, and their trading was just 1% of overall trading volume on May 6 (75,000 of the 5.7 million contracts traded that day). We believe we were one of 250 firms engaging in e-mini trading during the period of the market selloff. Further, we believe that trades of the size we initiated normally are absorbed easily in the market.

What exactly is an “e-mini” futures contract?
The e-mini S&P 500 Index futures contract is a cash-settled contract based on the level of the S&P 500 Stock Index. It is by far the largest stock index futures contract available. E-mini futures account for more than 80 percent of the notional value of U.S. stock index futures open interest. E-mini futures trade on the CME Globex electronic trading system, which operates nearly 24 hours a day from Sunday evening to Friday afternoon. Our portfolio managers generally regard the e-mini S&P 500 Index futures contract as the deepest global liquidity pool that they can utilize to most effectively protect our shareholders’ investments.

Did your trades contribute to the rapid stock market drop?
By our calculations, our trading activity accounted for approximately 1% of the volume traded that day in the e-mini S&P 500 Index futures contract. While we executed a number of trades, the volume was not large relative to the overall depth of the market. We believe that the behavior both of the price of the e-mini and the bid/ask spread on the e-mini also do not suggest that our trades had a disruptive effect. The e-mini rallied during our trade, suggesting it was not causing the price movement. And the bid/ask spread widened during our trade for less than one second only.

In addition, congressional testimony from the CME Group, which analyzed trading activity on May 6, concluded:

- They identified no trading activity that appeared to be erroneous or contributed to the break in the cash equity market during this period. Moreover, no market participant found that trades were executed in error nor did the CME Exchanges cancel or re-price any transactions as a result of the activity on May 6th. (Page 1 of testimony, 5/11/10)

- Market Regulation staff ultimately concluded that there were no anomalies represented by the level of activity or the trading strategies employed by market participants. (Page 2 of testimony, 5/11/10)

- Moreover, quotes attributed to executives at the CME and the Commodity Futures Trading Commission (CFTC) note that Waddell & Reed has executed trades of this size previously, and indicate that we are a “bona fide hedger” and not someone intending to disrupt the markets.

Did the funds lose money?
Yes, the funds were negatively impacted by the market activity that day.

In summary
We believe that the activity of our flexible portfolio funds in the futures market was not the cause of any abnormal price action and that the funds are well positioned to continue protecting and investing shareholders’ capital. Our portfolio managers and the funds acted in a manner consistent with the interests of their fund shareholders – we did what our fund shareholders rightly would expect of us. Consistent with the views expressed by the CME and CFTC, there is no evidence to suggest that our trades disrupted the market on May 6, 2010.

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