

# ASSET ALLOCATION

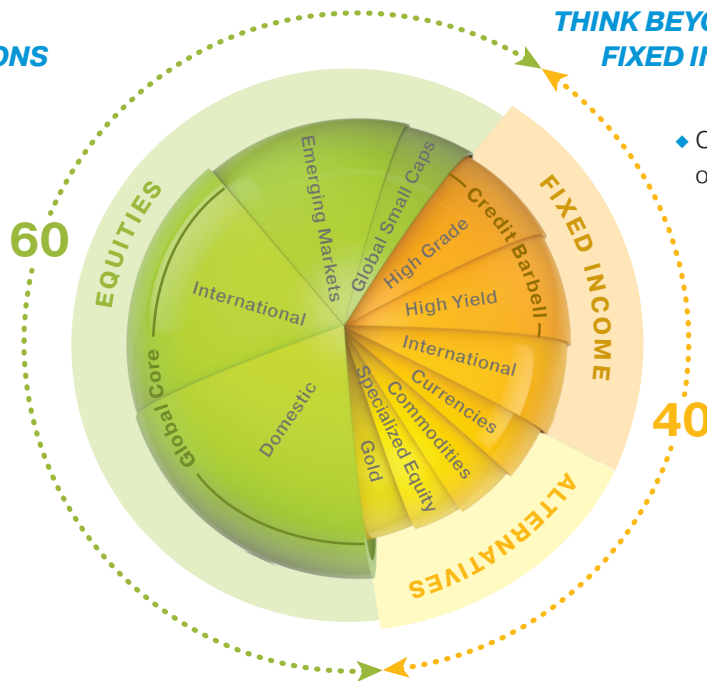
## DISCOVER THE NEW 60/40

**ART STEINMETZ**  
PRESIDENT

The world has changed, and the traditional portfolio of 60% domestic equities and 40% high grade bonds no longer reflects the best way to invest. We recommend investors adopt a New 60/40, one that seeks to expand the growth opportunity set, generate real income and protect against specific risks. In short, we recommend that investors should...

### GLOBALIZE THEIR EQUITY ALLOCATIONS

- ◆ Combine shares of large companies headquartered across developed markets.
- ◆ Add dedicated exposure to emerging market and global small-cap stocks.



### THINK BEYOND TRADITIONAL FIXED INCOME ALLOCATIONS

- ◆ Own a core "credit barbell" of U.S. Government and domestic high yield bonds and/or senior loans.
- ◆ Add exposure to developed and emerging market international bonds.
- ◆ Use alternative assets and specialized equity exposure to help protect against inflation and other risks.

## EXECUTIVE SUMMARY

Structural changes in the global economy are gradually rendering traditional portfolio construction strategies obsolete. A typical

allocation model of 60% domestic stocks and 40% high grade fixed income no longer reflects the breadth of opportunity in the

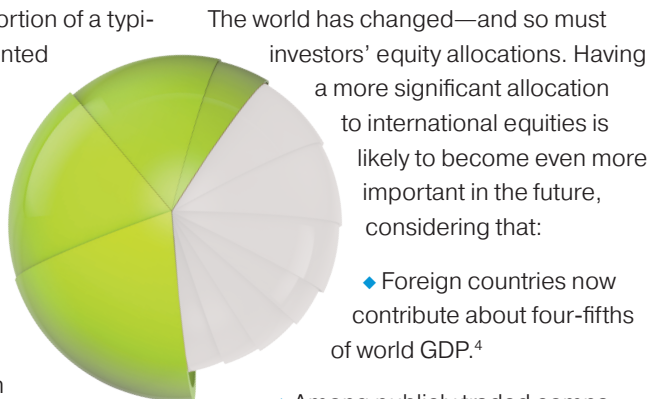
world—and is unlikely to provide many of the diversification benefits it once did. The **New 60/40** is a more globalized, diversified

and nimble approach that seeks to expand growth opportunities, generate real income, and help protect against inflation risks.

# The New 60%: A Globalized Equity Portfolio

Almost 80% of the equity portion of a typical portfolio today (represented by the Lipper Mixed-Asset Target Allocation Growth Funds Category)<sup>1</sup> is allocated to U.S. stocks, with the remainder in international equities.<sup>2</sup>

Such allocations might have been more appropriate in the early 1970s, when American companies constituted nearly 70% of global market capitalization. As of 2013, however, U.S. companies represent less than half of global market cap, with the rest of the developed world comprising 40.8% and emerging markets contributing 10.6%.<sup>3</sup>



The fact is, not all of the world's best or fastest growing companies are domiciled in the U.S. anymore. Investors must be willing to pursue investment opportunities globally—or risk missing them altogether.

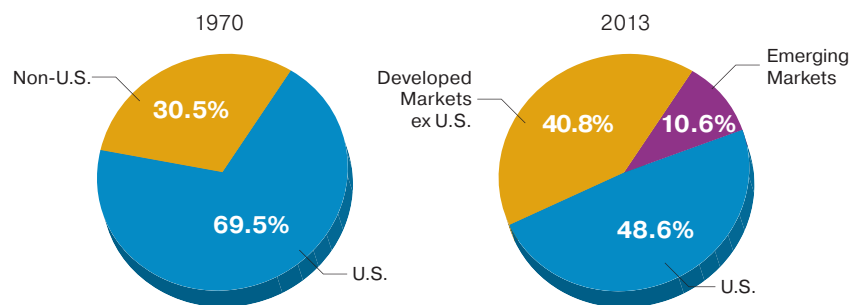
## COMBINE SHARES OF LARGE COMPANIES HEADQUARTERED ACROSS DEVELOPED MARKETS

The changing composition of the global economy implies that investors need greater international equity exposure. What's less clear, given the rising correlation between the S&P 500 Index and international stocks, is how best to get it.

### The "Global Core" Approach

We recommend that investors center their equity allocations on a "global core" holding, consisting mainly of shares in large companies headquartered across developed markets. This path should work best for investors who are funding a new portfolio or adding significant new assets to an existing portfolio. The idea is to gain comprehensive exposure to the world's prime corporate movers, and to evaluate companies against their competitors worldwide (not simply within regions).

CHART 1 ←  
Market Cap as a Percentage of the MSCI All-Country World Index\*



Source: MSCI Barra, 12/31/13.

\*Note: Data for the U.S. represents the market-capitalization weight of the MSCI U.S. Index within the MSCI World Index through 1987, and its weight in the MSCI ACWI Index thereafter.

1. Lipper defines this category as "Funds that, by portfolio practice, maintain a mix of between 60%–80% equity securities, with the remainder invested in bonds, cash and cash equivalents."

2. Source: Lipper, Inc. (fund data), Morningstar, Inc. (asset class data), 12/31/13.

3. Source: MSCI Barra, 12/31/13.

4. Source: International Monetary Fund, as of 4/8/14.

5. Source: Bloomberg, 3/31/14.

6. Source: Bloomberg, OppenheimerFunds research, Fortune Magazine, as of 3/31/14.

This flexible approach has demonstrated clear long-term advantages over simply combining U.S. and international mutual funds. On average, over the 10-year period ending December 31, 2013, active global managers outperformed both international (regional) managers and U.S. managers against the MSCI World Index, a common global benchmark.<sup>7</sup>

### **The Traditional Way: Domestic Plus International**

For investors who already have significant domestic equity holdings and do not want to unwind them completely, a more traditional, regionally segmented approach—appending an international allocation to an existing diversified domestic allocation—may also prove viable. In this case, we favor adding incremental assets to international investments to bring the overall global exposure more in line with global market capitalizations and economic activity.

### **ADD POSITIONS IN EMERGING MARKET AND GLOBAL SMALL-CAP STOCKS**

Regardless of whether one adopts the “global core” or “traditional” (domestic plus international) approach, two other equity categories offer distinct enough characteristics to warrant inclusion in a globalized equity portfolio: emerging market and small-cap stocks.

### **Emerging Market Stocks**

Broadly diversified global portfolios will, by definition, include exposure to emerging market stocks. Such stocks tend to be less correlated with developed market stocks than other asset classes. Moreover, emerging markets, while at times volatile, are undergoing powerful, long-term economic and demographic shifts. We expect these shifts to propel billions of people into the global middle class over the next several decades, revolutionizing growth and consumption patterns in the process.

Capitalizing on emerging market opportunities requires specialized portfolio management abilities, given the sheer number of countries in the category, each with different economic, political and regulatory characteristics. Other factors, such as generally low analyst coverage (which may render markets less efficient) and the abundance of tradable stocks, also make a specialized approach advantageous.

### **Small-Cap Stocks**

Because domestic and international small-cap stocks, like emerging market stocks, have relatively modest correlations to their large-cap counterparts, they also offer important potential diversification and growth benefits. However, they too may be relatively volatile.

The small-cap market is generally less efficient and liquid than the large- and mid-cap segments, and small-cap returns are often driven more by company-specific factors than are large-cap returns. With analyst coverage of small-cap stocks far thinner than for their larger counterparts, it is critical for small-cap managers to possess local, company-specific knowledge of a vast number of small-cap stocks in the country or region of their interest—in other words, to be specialists.

#### **WHAT IT MEANS FOR INVESTORS**

The globalization of financial markets and the explosion of opportunities beyond U.S. borders means that most U.S. investors’ equity allocations need a fresh approach. We recommend that:

- ◆ Investors seeking an alternative, potentially more efficient approach employ a “global core” allocation and add exposure to emerging markets and domestic and international small caps.
- ◆ Investors with an established portfolio built along “traditional” lines add meaningful exposure to international stocks—including emerging market equities—as well as domestic and international small-cap stocks.

7. Source: FactSet, as of 12/31/13. **Past performance does not guarantee future results.**

# The New 40%: Beyond Traditional Fixed Income

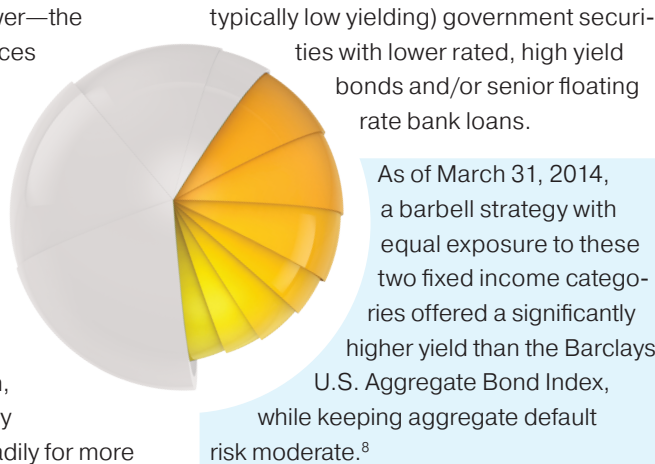
The loss of purchasing power—the amount of goods and services money can buy—is one of the most crucial risks to one’s wealth. Americans’ purchasing power faces threats as consumer needs get costlier while household incomes fail to keep pace.

Compounding the problem, interest rates on high quality U.S. bonds have fallen steadily for more than 30 years, reaching all-time lows in 2012 before rebounding slightly in 2013. As a result, investors now face the obvious problem of finding little “income” in “fixed income.” Moreover, as long as the rate of inflation exceeds yields on high quality bonds (consumer inflation has averaged about 4.5% since 1970), real returns will be negative—virtually guaranteeing a loss of wealth over time.

During the past three equity bear markets, a standard 40% allocation to high quality bonds would have mitigated much of the loss on the stock portion of a portfolio via steady income and capital gains. But in a low or rising rate environment, it is unlikely that the same 40% allocation would provide similar portfolio benefits.

## OWN A “CREDIT BARBELL” OF U.S. GOVERNMENT AND DOMESTIC HIGH YIELD BONDS AND/OR SENIOR LOANS

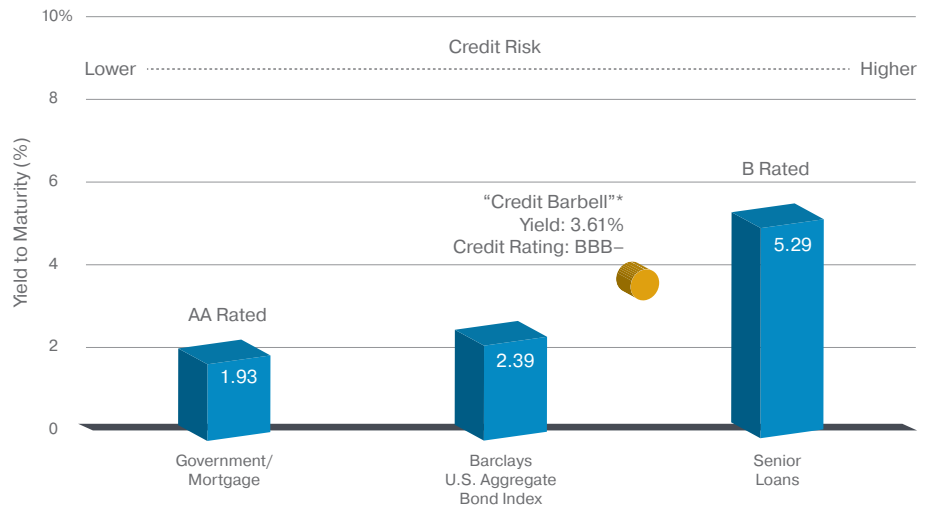
For the domestic fixed income allocation, we believe in using a “credit barbell” strategy that combines highly rated (but



Although there are risks associated with lending money to below-investment-grade companies, today’s generous yields appear to be compensating investors adequately to do so, and the smaller government bond position may still serve as a counterweight in the event of market duress. In addition, today’s low rate environment means that the upside to the Barclays U.S. Aggregate Bond Index is capped, while the potential downside risk in a rising rate environment could be considerable.

CHART 2

**Domestic Fixed Income Approach: “Credit Barbell”  
Potential Income Advantage Over Investment-Grade Bonds**



Source: Barclays and JPMorgan, as of 3/31/14. Government/Mortgage is represented by 70% Barclays U.S. Aggregate Government Bond Index and 30% Barclays MBS Index. Senior loans are represented by the Credit Suisse Leveraged Loan Index. \*Credit Barbell is a blend of 50% Government/Mortgage and 50% Senior Loans. The credit rating of the credit barbell is assigned based on historical average default trends of similarly rated securities. Senior loan yield is calculated by adding discount margin to maturity to 3-Month LIBOR. Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Oppenheimer fund. **Past performance does not guarantee future results.**

8. Source: Factset, 3/31/14. The indices used to represent government/mortgage categories are 70% Barclays U.S. Aggregate Government Bond Index and 30% Barclays MBS Index. Senior Loans are represented by the Credit Suisse Leveraged Loan Index. For illustrative purposes only and does not predict or depict the performance of any fund. Index definitions are located on page 7. **Past performance does not guarantee future results.**

Senior loans appear particularly well-suited to addressing the risk associated with rising interest rates, known as duration risk. Besides typically offering greater income than higher credit quality bonds of a comparable maturity, these loans' "floating" interest rates reset every 30 to 90 days, based on changes in common benchmarks such as the London InterBank Offered Rate (LIBOR). Unlike fixed rate bonds, these loans generate more income for investors if benchmark interest rates rise. Their relatively low sensitivity to interest rate changes also tends to keep their prices more stable than the prices on fixed coupon bonds. Keep in mind that senior loans are typically lower rated (more at risk of default) and may be illiquid investments (lacking a ready market).

### TALE OF THE TAPE: FIXED INCOME BARBELL VERSUS AGGREGATE INDEX

In periods of rising treasury rates dating back to 1990, the government securities/senior loans barbell approach would have outperformed the aggregate bond portfolio by an average of 950 basis points.<sup>9</sup> If interest rates hypothetically were to rise by 100 basis points from April 1, 2014, to March 31, 2015, with all else held equal, the government securities/senior loans barbell (with a 3.61% yield and 2.77 years duration) could potentially return 0.84%. In comparison, the Barclays U.S. Aggregate Bond Index (2.39% yield, 5.54 years duration) could potentially decline by 3.26%.<sup>10</sup> Investors expecting a "traditional" core bond holding to provide ballast in all market environments are likely to be disappointed.

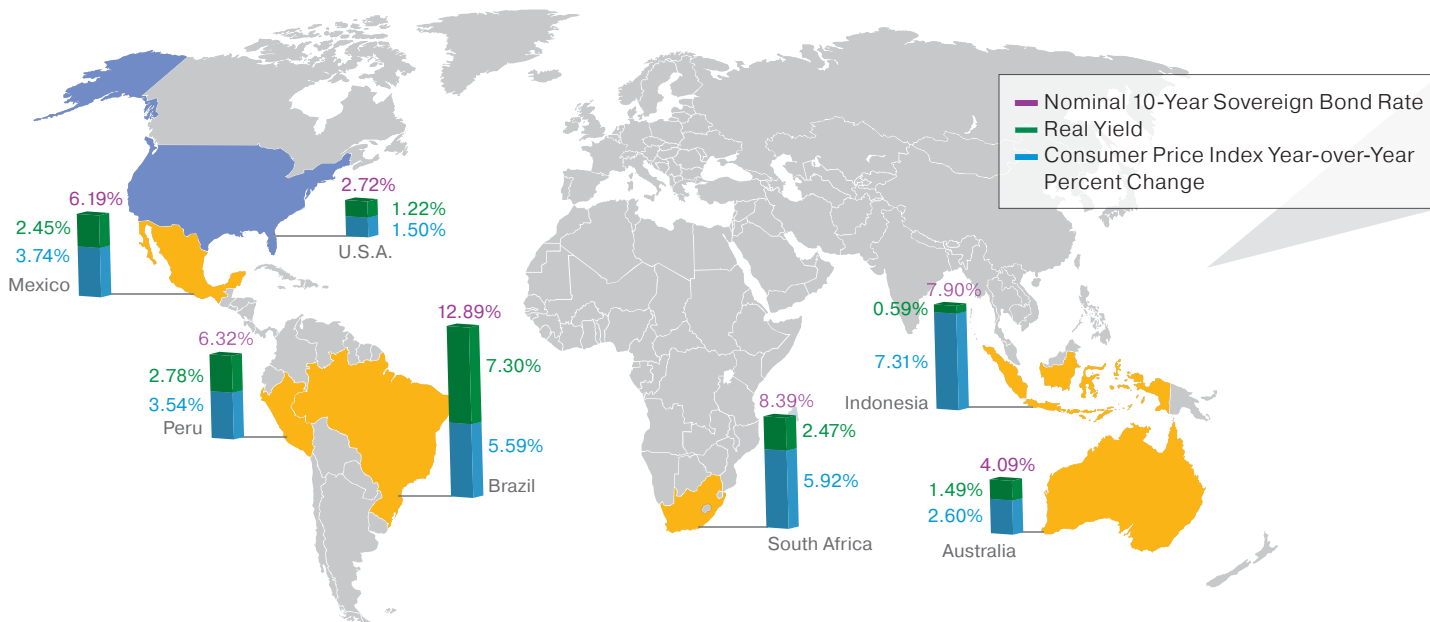
### ADD EXPOSURE TO DEVELOPED AND EMERGING MARKET INTERNATIONAL BONDS

We also strongly advocate including international exposure in a core fixed income allocation. International bonds offer potentially profound diversification benefits, given their low correlations to the Barclays U.S. Aggregate Bond Index.

Additionally, international bonds offer:

- ◆ A larger opportunity set than U.S. markets alone provide.
- ◆ Access to higher yields than are available domestically.
- ◆ Foreign exchange exposure, which can help offset swings in the value of the U.S. dollar versus other currencies.
- ◆ A potential hedge against the effects of import-price inflation.

CHART 3 ←  
Real Yields Abroad May Be More Attractive (as of 3/31/14)



Diversification does not guarantee profit or protect against loss. Source: FactSet, 3/31/14. CPI data is most recent available, as of 3/31/14, for all countries except Australia, which is as of 12/31/13. Nominal yields are that of each country's "on-the-run" (most recently issued) 10-year government bond. Real yield is equal to the country's 10-year sovereign bond rate minus the year-over-year change in the country's consumer price index. **Past performance does not guarantee future results.**

9. Source: Bloomberg, as of 3/31/14. The indices used to represent government securities/senior loans are 70% Barclays U.S. Aggregate Government Bond Index and 30% Barclays MBS Index. Senior loans are represented by the Credit Suisse Leveraged Loan Index. The aggregate bond portfolio is represented by the Barclays U.S. Aggregate Bond Index. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any fund. Index definitions are located on page 7. **Past performance does not guarantee future results.**  
 10. Duration measures a bond's sensitivity to a 1.00% change in interest rates, expressed in years. If a bond has a duration of 4.50, for example, and interest rates rise 1.00%, the bond will lose 4.50% in value. Adding back in the bond's yield provides the total return for the period. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any fund. **Past performance does not guarantee future results.**

Exposure to both developed and emerging market debt is critical, in our view, given that the global business cycle affects each area of the world differently. The full extent to which developed and emerging economies have “decoupled” is as yet unknown. It’s worth noting, however, that while emerging markets suffered to some degree along with developed markets in the 2008 global financial crisis, their increasingly domestically oriented economies proved very resilient. Emerging market growth rebounded quickly, while many developed economies still remain burdened by high debt levels, slow-to-negative growth and high unemployment. Strategic exposure to both developed and emerging market

historical correlations to equities. While there are times when some alternatives lag the broader market, small allocations have the potential to benefit a portfolio during periods of market stress. For example, modest allocations to gold and commodities would have helped investors during the past decade and provided substantial diversification benefits during the credit crisis, in particular. Diversification does not guarantee profit or protect against loss.

**Currencies**—Investors concerned about protecting their purchasing power often focus on the effects of consumer inflation and higher interest rates. But what if inflation comes from a different source?

international equities in environments of rising inflation. Despite their high correlation to consumer inflation over the past two decades, they have been poorly correlated to both U.S. stocks and investment-grade bonds, making them valuable diversifiers. Finally, commodities may help protect an investor against the effects of U.S. dollar weakness, since most commodities trade in dollars.

**Gold**—The yellow metal serves as a potential hedge against numerous tail risks, including geopolitical turmoil and the loss of purchasing power that can come from a weakening currency. The price of gold has historically been negatively correlated to U.S. equity indices, making it a potentially valuable diversifier.

Among the possible downsides to owning gold is that it has no yield, so it may carry an opportunity cost. But in an era of very low interest rates across the developed world and with central banks seemingly committed to keeping them that way for an extended period, this cost appears minimal.

“*It is essential that investors incorporate a mix of alternative assets and specialized equities.*”

bonds (and currencies) is an effective way, in our view, to seek to take advantage of the decoupling of the global economy.

### **USE ALTERNATIVE ASSETS AND SPECIALIZED EQUITY EXPOSURE TO HELP PROTECT AGAINST INFLATION AND OTHER RISKS**

The “traditional” companion to a portfolio’s equity allocation generally consists entirely of fixed income investments but, as we’ve seen, such a narrow approach faces increasing limitations. While fixed income will continue to play a dominant role in the New 40%, it is essential that investors incorporate a mix of alternative assets and specialized equities, like real estate investment trusts and master limited partnerships, to help address inflation and other risks.

#### **Alternative Investments**

Like “traditional” fixed income investments, many alternative asset classes have low

For several decades now, plentiful overseas labor, particularly in emerging countries such as China, has kept prices low for a range of goods imported into America. With wages rising in many of those economies and demand for commodities increasing, however, the era of importing deflation into the U.S. may be coming to an end, setting the stage for higher prices.

Historically, exposure to foreign currencies—either directly, or through locally denominated international bonds—has served as an effective way to offset import price inflation, and thus to help preserve purchasing power in dollar terms.

**Commodities**—Exposure to commodities or commodity-linked investments is another potential way to diversify a stock and bond portfolio and help protect purchasing power. Commodities represent an ownership claim on real assets, such as a barrel of oil or a bushel of wheat, and historically they have outperformed U.S. and

#### **Specialized Equity**

Investors may also diversify some of their fixed income allocations into specialized equity exposures like real estate investment trusts and master limited partnerships that currently provide an attractive income and may help manage future inflation.

**REITs**—Real estate investment trusts provide a potential hedge against rising prices through the inflation-sensitive cash flow stream inherent in the asset class. Costs for land, labor and materials are passed through to tenants in the form of more expensive leases—and therefore potentially higher dividends for investors.

Over the past 15 years, the FTSE NAREIT Equity REITs Index has tended to offer a higher yield than the Barclays U.S. Aggregate Bond Index<sup>11</sup> and dividend growth that has outpaced the Consumer Price Index (CPI)<sup>12</sup>—characteristics that

11. Source: FactSet, 3/31/14. 12/31/1997 through 12/31/2012. Index definitions are located on page 7. **Past performance does not guarantee future results.**

12. Source: Cornerstone Research, NAREIT, Bloomberg, 12/31/12. 12/31/1997 through 12/31/2012. Index definitions are located on page 7. **Past performance does not guarantee future results.**

have led to nearly zero correlation between the performance of REITs and high quality bonds. Investors should note that investments in real estate companies, including REITs, are subject to volatility and risk, including loss in value due to poor management, lowered credit ratings and other factors. Smaller real estate companies may also be subject to liquidity risk.

**MLPs**—Master limited partnerships (MLPs) have historically generated cash flows (and therefore distributions) that outpace inflation over time.<sup>13</sup> The energy infrastructure MLP sector consists of companies that own and operate long-lived, high value physical assets such as pipelines and terminals for the storage and transportation of oil and natural gas along the supply chain. Some MLPs are akin to toll roads, earning fees for the service of shipping such commodities. MLPs provide a potential hedge against rising prices because the government determines these fees in accordance with changes in the Producer Price Index, a measure of wholesale inflation.

Historically, the Alerian MLP Index has offered a higher yield than the Barclays U.S. Aggregate Bond Index, and its income growth has outpaced the CPI<sup>13</sup>—characteristics that have led to nearly zero correlation with asset categories like equities and high quality bonds. Energy infrastructure companies are subject to risks specific to the industry, such as reduced volumes of natural gas or other energy commodities, environmental hazards, changes in the regulatory environment and extreme weather.

## WHAT IT MEANS FOR INVESTORS

Traditional fixed income allocations consisting mainly of high quality domestic bonds increasingly appear ill-suited to the challenges of today's markets. We believe investors should consider:

- ◆ Using a “credit barbell” of U.S. Government bonds and domestic high yield bonds and/or senior loans as a core fixed income position.
- ◆ Supplementing this with exposure to developed and emerging market international bonds.
- ◆ Addressing inflation and other risks via exposure to select alternative investments and specialized equity instruments.

## INDEX DEFINITIONS

The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships (MLPs) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class.

The Barclays U.S. Aggregate Bond Index is an investment-grade domestic bond index.

The Barclays U.S. Credit/Corporate/Investment Grade Bond Index represents primarily investment-grade corporate bonds within the Barclays U.S. Aggregate Bond Index.

The Barclays U.S. Aggregate Government Bond Index is composed of all publicly issued non-convertible, domestic debt of the U.S. Government or any agency thereof, quasi-federal corporation or corporate debt guaranteed.

The Barclays MBS Index represents the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC).

The Consumer Price Index (CPI) program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

The Credit Suisse Leveraged Loan Index tracks the performance of senior loans.

The FTSE National Association of Real Estate Investment Trusts (NAREIT) Equity REITs Index consists of certain companies that own and operate income-producing real estate that have 75% or more of their respective gross invested assets in the equity or mortgage debt of commercial properties.

The Morgan Stanley Capital International (MSCI) All Country World Index (ACWI) is designed to measure the equity market performance of developed and emerging markets.

The MSCI EAFE (Europe, Australasia, Far East) Index is designed to measure developed market equity performance, excluding the U.S. and Canada.

The MSCI Emerging Markets (EM) Index is designed to measure global emerging market equity performance.

The MSCI U.S. Index is designed to measure U.S. equity market performance.

The MSCI World Index is designed to measure global developed market equity performance.

The S&P 500 Index is a broad-based measure of domestic stock market performance.

Each index is unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Oppenheimer fund. **Past performance does not guarantee future results.**

13. Source: Alerian, Bloomberg, 12/31/13. 12/31/1996 through 12/31/2013. See “Index Definitions.” **Past performance does not guarantee future results.**



**ART STEINMETZ**  
PRESIDENT

Art Steinmetz serves as President of OppenheimerFunds. He has been in the industry since 1986.

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- ◆ Find growth *Page 2*
- ◆ Generate income *Page 4*
- ◆ Protect against inflation and other risks *Page 6*

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A fund's performance depends largely upon the portfolio managers' skill in selecting the best mix of investments. The portfolio managers' evaluations and assumptions regarding the prospects of the global financial markets may be incorrect and a fund's performance may be adversely affected by their asset allocation decisions.

Foreign investments may be volatile and involve additional expenses and special risks, including currency fluctuations, foreign taxes and geopolitical risks. Emerging and developing market investments may be especially volatile.

Derivative instruments, investments whose values depend on the performance of an underlying security, asset, interest rate, index or currency, entail potentially higher volatility and risk of loss compared to traditional stock or bond investments. Currency derivative instruments may be particularly volatile and involve significant risks.

Short selling may increase volatility and risk of loss and is considered a speculative investment practice.

Fixed income investing entails credit risks and interest rate risks. When interest rates rise, bond prices generally fall, and the Fund's share prices can fall. Commodity-linked investments are considered speculative and have substantial risks, including the risk of loss of a significant portion of their principal value.

Small and mid-sized company stock is typically more volatile than that of larger, more established businesses, as these stocks tend to be more sensitive to changes in earnings expectations. It may take a substantial period of time to realize a gain on an investment in a small or mid-sized company, if any gain is realized at all.

Investments in securities of real estate companies may be especially volatile. Because they do not have an active trading market, shares of Real Estate Investment Trusts (REITs) may be illiquid. The lack of an active trading market may make it difficult to value or sell shares of REITs promptly at an acceptable price.

When interest rates rise, bond prices generally fall, and a fund's share prices can fall. A fund may invest in below-investment-grade ("high yield" or "junk") bonds, which are more at risk of default and are subject to liquidity risk. Senior loans are typically lower rated (more at risk of default) and may be illiquid investments (which may not have a ready market).

There is no guarantee that the issuers of stocks held by mutual funds will declare dividends in the future, or that if dividends are declared, they will remain at their current levels or increase over time.

Inflation-indexed debt securities (including TIPS) are bonds structured to seek to provide protection against inflation. If inflation declines, the principal amount or the interest rate of an inflation-indexed bond will be adjusted downward. This will result in reduced income and may result in a decline in the bond's price, which could cause losses. Interest payments on inflation-protected debt securities can be unpredictable and will vary as the principal or interest rate is adjusted for inflation. Inflation-indexed debt securities are also subject to the risks associated with investments in fixed income securities.

Investing in MLPs involves additional risks as compared to the risks of investing in common stock, including risks related to cash flow, dilution and voting rights. Each Fund's investments are concentrated in the energy infrastructure industry with an emphasis on securities issued by MLPs, which may increase volatility. Energy infrastructure companies are subject to risks specific to the industry such as fluctuations in commodity prices, reduced volumes of natural gas or other energy commodities, environmental hazards, changes in the macroeconomic or the regulatory environment or extreme weather. MLPs may trade less frequently than larger companies due to their smaller capitalizations which may result in erratic price movement or difficulty in buying or selling. Additional management fees and other expenses are associated with investing in MLP funds. The Oppenheimer SteelPath MLP Funds are subject to certain MLP tax risks. An investment in an Oppenheimer SteelPath MLP Fund does not offer the same tax benefits of a direct investment in an MLP. The Funds are organized as Subchapter "C" Corporations and are subject to U.S. federal income tax on taxable income at the corporate tax rate (currently as high as 35%) as well as state and local income taxes. The potential tax benefit of investing in MLPs depend on them being treated as partnerships for federal income tax purposes. If the MLP is deemed to be a corporation, its income would be subject to federal taxation at the entity level, reducing the amount of cash available for distribution which could result in a reduction of the fund's value. MLP funds accrue deferred income taxes for future tax liabilities associated with the portion of MLP distributions considered to be a tax-deferred return of capital and for any net operating gains as well as capital appreciation of its investments. This deferred tax liability is reflected in the daily NAV and as a result a MLP fund's after-tax performance could differ significantly from the underlying assets even if the pre-tax performance is closely tracked.

**Shares of Oppenheimer funds are not deposits or obligations of any bank, are not guaranteed by any bank, are not insured by the FDIC or any other agency, and involve investment risks, including the possible loss of the principal amount invested.**

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