Capital Market Review

Second Quarter, 2011

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Summary

Similar to last year, the U.S. economy has hit another period of economic weakness with growth being below economists' forecasts. Reasons include poor U.S. consumption and labor growth, a moribund housing market and supply-chain disruptions from the Japanese earthquake, Consumer and business confidence have also been shaken.

While economic growth will pick up in the second half of the year (compared to the first half), it will likely remain sub-par. The jobs market should improve, but not dramatically. Housing still has short-term headwinds as foreclosures are expected to peak during the second half of the year putting additional pressure on home prices.

While healing, the economy is still susceptible to exogenous events that could tip it back into recession. We do not expect changes to accommodative FED policies or interest rates until 2012.

We expect a deal to be reached on extending the debt limit. If a deal is not reached, we expect the U.S. government to pay bondholders and delay paying suppliers (technically avoiding a default). Regardless, rating agen-

cies would downgrade U.S. debt and another recession would start.

During the second quarter, U.S. stocks returned 0.0%, U.S. bonds were up 2.3%, commodities fell -6.7% and real estate increased 3.6%. Year-to-date, U.S. stocks are up 6.4%, U.S. bonds returned 2.7%, commodities declined -2.6% and real estate increased 10.3%.

Economic Conditions

Similar to the spring/summer of 2010, the U.S. economy has hit another "soft patch". Economic growth is continuing, but at sub-par levels and below economists' forecasts from the start of the year. There are several factors influencing the economic weakness including higher gas and food prices (impacting U.S. consumption), a labor market that has not produced enough jobs, a moribund housing market, supply chain disruptions due to the earthquake in Japan, and Eurozone debt and budgetary issues. In addition, consumer and business confidence has eroded. In short, the U.S. economy is experiencing a below-trend recovery that history tells us is typical of countries recovering from a financial crisis.

Two keys to an improved economy are jobs and a stable housing market. During the past 8 months, the economy has added 1.2 million jobs. This represents only 14% of the jobs lost during the recession. Factors such as slowing productivity growth and higher average workweeks suggest imply that companies will need to increase their hiring. While hiring will likely pickup, we do not expect it to be robust. Most economists believe second-half job growth will be between 150,000 to 200,000 jobs created each month. The unemployment rate will remain elevated for the foreseeable future.

With respect to real estate, many "experts" believe foreclosures and distressed real estate sales will peak during the fourth quarter and housing prices will hit bottom during the first half of 2012. At that time, housing will ideally start contributing to the recovery.

In sum, the economic recovery is not robust and an exogenous shock could tip it back into recession. We expect the FED to maintain its accommodative policies and to delay any interest rate changes until sometime during 2012.

Then there is the political theater going on in Washington about extending the debt limit. While we fully expect a deal to be reached by the August deadline, if a deal is not reached, a bond default is not assured. To our knowledge there are simply no hard rules about which creditors/suppliers and the order they would get paid. We expect the Treasury would pay the interest on the debt while delaying payment to others. Someone would go unpaid – it probably will not be the bondholders.

The consequences of a deal not being reached would still be severe (although technically not a default). The rating agencies would probably downgrade U.S. debt since the political will to make the difficult budgetary decisions could not be mustered (we have real financial problems that must be solved). Given the fragility of the U.S. recovery, a new recession would most likely start (since the economy's largest single employer would stop paying some of its bills).

Stock Market

Due to a strong late-quarter rally, stock returns were essentially flat for the second quarter. Stock returns had been negative for much of the quarter as the economic and political issues previously discussed weighed on the markets.

U.S. stocks returned 0.0% during the second quarter, lagging the 1.6% return of developed international stocks but outperforming the -2.1% returns of emerging market stocks. Year-to-date, the U.S. stock return of 6.4% has outperformed developed international and emerging market returns of 5.0% and -0.5%, respectively.

From a company size perspective, second quarter midcap stock returns of 0.4% were slightly ahead of the 0.1% large-cap return and outperformed the small stock return of -1.6%. Year to date, mid-cap stocks have returned 8.1% exceeding the large- and small-cap returns by nearly two percentage points.

Growth stocks have outperformed value stocks. During the second quarter, growth stocks returned 0.6% compared to the value stock return of -0.7%. Year to date, growth stocks returned 7.0% while value stocks have returned 5.7%.

Defensive sectors performed better during the second quarter as Healthcare, Utilities, and Consumer Staples returned 7.9%, 6.1%, and 5.3%, respectively. Finance, Energy, and Technology were the worst performing sectors with returns of -5.9%, -4.6%, and -1.4%. Year-to-date, Healthcare, Energy, and Utilities have performed the best while Finance, Materials, and Technology have lagged.

While the macro environment (broad economy) is challenging, the micro market (individual company) appears to be doing quite well. Profit margins remain elevated as corporations are quite lean (they have been slow to hire). Cash is piling up on many companies books. 2011 earnings growth is expected to be in the high teens and current forecasts predict strong 2012 earnings growth as well. In terms of valuation, the broad market (which is heavily influenced by larger companies) is reasonably priced – slightly over 14x this year's expected earnings. Overall, we believe the broad market remains near fair value.

Year-end S&P 500 price targets from 15 Wall Street analysts range from a low of 1,238 to a high of 1,550 with an average of 1,402. This implies a six month return range of -6.3% to 17.4% with an average expected return of 6.2% (using S&P 500 June 30th closing prices).

From a fundamental perspective, we believe large stocks remain the most attractively valued segment. Large-company stock valuation measures are lower vis-à-vis mid- and small-cap stocks and we have a higher degree of confidence that their earnings estimates will be reached. Yet, from a technical perspective, there has certainly not been a wholesale shift to large-cap stocks. Momentum can be a hard thing to break, but fundamentals and valuation will eventually prevail.

Bond Market

Interest rates remain extremely accommodative. During the second quarter, renewed anxiety about the stability of the economic recovery overcame rising inflation fears as interest rates fell across the maturity spectrum. The yield curve is quite steep as the yield on the 10 year bond is nearly 3% more than the 1 year bond. Longer-term inflation expectations remain in the 2% range. Real yields (bond yields after inflation), remain negative up until the 10-year maturity bond.

As scheduled, the FED's quantitative easing program (purchasing short- and intermediate-term bonds to keep bond yields low) ended toward the end of the second quarter. Given the economic softness, there has been discussion of a third program but, as of now, we believe the discussion is premature and do not expect an additional easing program. With that said, the economy is struggling to maintain momentum and the FED has indicated a willingness to consider additional policy measures should it become necessary. It would actually be healthier if the FED can stay out of the markets and allow the markets to start functioning normally.

Developed and emerging market bonds returned 3.7% and 3.9%, respectively during the second quarter, outperforming the U.S. bond market return of 2.3%. Year-to-date, developed international and emerging market bonds have returned 4.6% to 4.8%, nearly two percentage points greater than the U.S. bond market.

Long maturity bonds were the second quarter's best performing maturity segment with a return of 3.3% compared to the intermediate maturity return of 2.1% and short-term bond return of 0.9%. Returns for each maturity segment are nearly identical on a year-to-date basis.

Corporate bonds have been the best performing investment grade sector (followed by mortgage-backed bonds) during both the second quarter and on a year-to-date basis. Government bonds have lagged.

Inflation-protected bonds performed well returning 3.7% during the second quarter and 5.8% year-to-date. Municipal bonds had a strong second quarter returning 3.9%. High yield bonds had a subpar second quarter, but the year-to-date return of 5.0% is the second best returning bond category (behind inflation-protected bonds).

Stock Returns For Periods Ending June 30, 2011

	Qtr	Ytd	1 Year	3 Year	5 Year
Nationality					
U.S. Market	0.0%	6.4%	32.4%	4.0%	3.4%
Developed Intl	1.6	5.0	30.4	-1.8	1.5
Emerging Market	-2.1	-0.5	24.9	1.8	8.9
Size					
Large	0.1	6.4	31.9	3.7	3.3
Mid	0.4	8.1	38.5	6.5	5.3
Small	-1.6	6.2	37.4	7.8	4.1
Micro					
Approach					
Value	-0.7	5.7	29.1	2.7	1.2
Core	0.0	6.4	32.4	4.0	3.4
Growth	0.6	7.0	35.7	5.3	5.4
Sector					
Cons Discretionary	3.5	8.3	40.5	14.4	5.5
Cons Staples	5.3	7.9	26.7	8.9	8.4
Energy	-4.6	11.4	52.8	-3.0	7.9
Finance	-5.9	-3.1	12.8	-6.8	-11.7
Healthcare	7.9	13.9	28.5	7.4	5.3
Industrials	-0.7	8.0	38.1	4.8	3.4
Technology	-1.4	2.1	25.8	6.0	6.7
Materials	-0.9	3.6	45.3	0.3	6.8
Telecomm	2.1	7.1	39.0	5.3	5.4
Utilities	6.1	9.1	23.9	-2.0	4.8

	Qtr	1 Year	3 Year
Developed Country			
U.S.	0.0%	32.4%	4.0%
Canada	-5.2	27.8	-1.7
Europe	2.4	36.0	-2.0
France	2.2	38.0	-4.9
Germany	4.0	42.4	-3.4
Italy	-4.8	25.6	-13.4
United Kingdom	0.7	29.7	-5.2
Pacific	0.0	20.9	-1.0
Australia	-1.4	35.2	-0.1
Hong Kong	-2.0	22.7	3.5
Japan	0.1	10.8	-6.1
Emerging Market			
China	-3.6	9.9	2.0
India	-4.2	6.6	9.1
Korea	0.8	41.7	8.1
Czech Republic	1.4	31.3	-13.6
Hungary	0.1	38.5	-7.5
Poland	2.8	53.7	-5.0
Russia	-7.1	42.4	-12.5
Brazil	-5.3	20.0	-6.3
Chile	7.2	37.3	18.2
Mexico	-1.3	28.2	2.0

Stock Fundamentals As Of June 30, 2011

	United States		Developed		Emerging	
	Current	1 Year Ago	Current	1 Year Ago	Current	1 Year Ago
Price/Earnings Current	15.5	17.4	12.9	11.4	13.1	14.2
Price/Forecast Earnings	14.3	15.3	11.6	11.6	11.9	11.8
Price/Book	2.2	2.1	1.5	1.4	2.0	1.9
Price/Cash Flow	9.8	9.1	6.9	6.2	7.4	7.0
Price/Sales	1.3	1.3	0.9	0.8	1.3	1.2
Forecast LT EPS Growth	10.3	10.1	7.9	8.9	16.1	16.3

	Est. P/E Ratio		Est. EPS Growth		2011 Forecast Returns			2012 Forecast Returns		
	2011	2012	2011	2012	15x	20x	7% DR	15x	20x	7% DR
Large	13.4	11.7	17.5	14.7	11.8	49.0	6.4	28.2	71.0	22.1
Mid	18.3	14.4	21.7	27.0	-18.1	9.2	-22.0	4.0	38.7	-0.9
Small	19.5	15.3	34.1	27.1	-23.1	2.5	-26.8	-2.2	30.3	-6.9

Bond Returns And Characteristics For Periods Ending June 30, 2011

	Qtr	Ytd	1 Year	3 Year	5 Year
Nationality					
U.S. Market	2.3%	2.7%	3.9%	6.5%	6.5%
Developed Intl	3.7	4.6	13.9	7.0	8.2
Emerging Market	3.9	4.8	11.4	10.4	9.5
Maturity (Government/Credit)					
Cash	0.0	0.0	0.1	0.3	1.8
Short-Term	0.9	1.1	1.9	3.5	4.5
Intermediate-Term	2.1	2.5	3.8	5.8	6.1
Long-Term	3.3	3.3	3.2	8.2	7.7
Sector (Intermediate Maturity)					
Corporate	2.5	3.4	6.2	8.2	7.0
Government	2.2	2.1	2.3	5.1	6.1
Mortgage	2.3	2.9	3.8	6.9	7.0
Other					
High Yield	1.1	5.0	15.6	12.7	9.3
Inflation Protected	3.7	5.8	7.7	5.3	6.9
Municipal	3.9	4.4	3.5	5.6	4.9

U.S. Bond Yields	Qtr	Last Qtr	1 Year Ago
Fed Funds	0.07%	0.13%	0.15%
Prime Rate	3.25	3.25	3.25
3 Month Treasury	0.02	0.10	0.15
1 Year Treasury	0.19	0.30	0.31
3 Year Treasury	0.79	1.28	0.99
5 Year Treasury	1.70	2.21	1.78
5 Year TIP	-0.30	0.02	0.24
10 Year Treasury	3.14	3.47	2.97
30 Year Treasury	4.39	4.52	3.94
Aaa Corporate	5.13	5.16	4.71
Baa Corporate	5.89	6.06	6.09
Barclays Aggregate	3.39	3.45	3.68
Barclays Credit	4.40	4.51	4.71
Barclays Treasury	1.97	2.02	2.00
Barclays Mortgage	3.33	3.43	3.69
Barclays Municipal	3.44	3.58	3.71
Barclays High Yield	8.25	8.65	11.36
Citi Intl Treasury	2.36	2.26	2.51
JPM Emerging	5.0	5.1	5.4

10-Year Sovereign Bond Yields

Developed Mkts	Qtr	Last Qtr	June 2010
United States	3.14%	3.34%	3.11%
Canada	3.08	3.29	3.23
France	3.39	3.60	3.07
Germany	2.98	3.22	2.64
Italy	4.95	4.75	4.03
United Kingdom	3.24	3.54	3.43
Euro Zone	2.99	3.23	2.69
Australia	5.19	5.43	5.33
Hong Kong	1.96	2.44	2.31
Japan	1.10	1.19	1.15
Emerging			
Brazil	6.16	6.16	6.16
China	4.08	3.94	3.10
India	8.46	8.20	8.12
Russia	4.73	4.80	5.72

Spreads Versus 10-Year Treasury

	Qtr	Last Qtr	1 Year Ago
Aaa	1.99	1.69	1.74
Baa	2.75	2.59	3.12
Barclays Aggregate	0.25	-0.02	0.71
Barclays Credit	1.26	1.04	1.74
Barclays Treasury.	-1.17	-1.45	-0.97
Barclays Mortgage	0.19	-0.04	0.72
Barclays Municipal	0.3	0.11	0.74
Barclays High Yield	5.11	5.18	8.39
Barclays TIP	0.34	-0.98	0.01
Citi Intl Treasury	1.86	1.63	2.43
JPM Emerging	1.67	1.81	1.65
Maturity (10yr-1yr)	2.95	3.17	2.66
Implied Inflation	2.00	2.19	1.54

Commodity, Real Estate, & Currency Returns
For Periods Ending June 30, 2011

	Qtr	Ytd	1 Year	3 Year	5 Year
Commodity					
DJ UBS Commodity	-6.7%	-2.6%	25.9%	-11.9%	-0.1%
CRB Commodity Spot	-4.2	5.9	30.5	4.9	10.3
CRB Fat & Oils	2.8	21.4	53.2	2.7	19.5
CRB Foodstuffs	-4.4	10.1	36.2	3.1	13.1
CRB Livestock	4.4	23.0	37.4	5.7	12.9
CRB Metals	-4.2	3.4	44.6	7.9	10.7
CRB Raw Industrials	-4.0	3.1	26.7	6.2	8.3
CRB Textiles & Fibers	-9.8	-2.6	17.3	8.0	6.6
Agriculture					
Coffee	-5.7%	17.0%	43.5%	24.5%	22.4%
Corn	19.0	36.5	93.0	6.3	25.2
Soybean	4.7	14.7	40.7	0.3	18.8
Sugar	-2.7	-7.6	27.2	17.0	8.5
Wheat	4.1	21.7	88.7	1.0	14.6
Energy					
Oil	-6.5%	8.1%	27.8%	-10.4%	6.3%
Unleaded Gas	0.7	17.5	30.1	-4.0	4.3
Metals					
Aluminum	0.1%	8.5%	32.6%	-4.8%	0.5%
Copper	-4.6	-0.9	39.5	3.0	4.7
Gold	7.3	9.9	24.0	19.8	20.7
Nickel	-16.1	-7.0	15.5	-0.2	1.7
Zinc	-4.6	-2.3	27.9	5.4	-6.9
Real Estate					
MSCI U.S. Reit	3.6%	10.3%	34.1%	5.4%	2.4%
MSCI World Reit	2.2	4.7	33.2	0.7	0.5
Currency		**U.S. Dollar Return**			
Euro	-2.7%	-8.9%	-17.8%	2.5%	-2.6%
Japan	-1.5	-3.5	-11.4	-9.1	-6.8
U.K.	-0.4	-4.0	-9.8	6.2	2.5
Brazil	-4.2	-6.4	-12.0	-0.6	-6.7
China	-1.4	-2.6	-5.0	-2.1	-4.1
India	-0.2	-0.6	-3.6	1.6	-0.5
Mexico	-1.6	-4.7	-7.1	4.6	0.7

Summary of Current Economic & Financial Conditions

	Percent Change					
	3 Month % Change	3 Month % Change Annualized	6 Month % Change	6 Month % Change Annualized	1 Year % Change	Data As Of
Gross Domestic Product	0.48	1.91	1.25	2.51	2.33	March
Leading Economic Indicators	1.06	4.30	3.05	6.20	4.27	May
ECRI Weekly Leading Index	-2.67	-10.26	-1.76	-3.49	4.05	June
Personal Income	1.01	4.09	2.93	5.95	4.23	May
Retail Sales	0.78	3.16	3.51	7.14	8.03	May
Retail Sales Excluding Motor Vehicles	2.21	9.12	4.56	9.32	8.66	May
Industrial Production	0.68	2.75	1.73	3.48	3.42	May
Number of Unemployed	4.02	17.10	-2.75	-5.42	-3.47	June
Announced Layoffs	-0.23	-0.92	29.46	67.60	5.27	June
Output Per Person	0.03	0.13	0.75	1.50	1.98	March
CPI - All Urban Consumers	1.14	4.64	2.54	5.14	3.44	May
Personal Consumption Expenditures	0.53	2.16	1.53	3.08	2.69	March
PPI - Finished Goods	1.70	6.97	5.27	10.82	7.04	May
CRB Commodity Spot Index	-0.22	-0.89	16.66	36.10	32.89	May
Gold Price	10.03	46.58	10.26	21.57	25.30	May
Oil Price	13.12	63.72	20.43	45.03	37.23	May
Housing Starts	8.11	36.59	1.63	3.29	-3.45	May
New Single Family Home - Sales	13.52	66.09	11.15	23.54	13.52	May
New Single Family Home - Median Price	-0.31	-1.23	-0.66	-1.31	-3.60	May

	Actual Value / Diffusion Index				
	Current Value	3 Months Ago	6 Months Ago	1 Year Ago	
Phili Fed Survey - General Activity - 6 Months Ahead	2.50	63.00	55.40	34.30	June
Phili Fed Survey - New Orders - 6 Months Ahead	7.90	60.10	49.90	32.90	June
Consumer Sentiment	74.30	77.50	71.60	73.60	May
ISM Purchasing Managers Index	60.40	60.80	56.94	59.64	April
Capacity Utilization - Total	76.73	76.46	75.84	74.31	May
Unemployment Rate	9.20	8.80	9.40	9.50	June
AAII Percent Bullish Investor Sentiment 8 Week Average	30.31	39.18	51.60	36.92	June
AAII BullBear Investor Sentiment Spread	8.12	10.74	31.56	2.03	June
S&P 500 PE	17.32	17.21	16.58	15.72	July
S&P 500 PE Using 10 Year Average Earnings	23.45	23.71	23.29	19.66	July
VIX - Volatility Index	15.45	18.35	23.54	32.07	May
3 Month Treasury Yield	0.02	0.10	0.12	0.15	June
1 Year Treasury Yield	0.19	0.30	0.29	0.31	June
5 Year Treasury Yield	1.70	2.21	2.06	1.78	June
10 Year Treasury Yield	3.14	3.47	3.38	3.20	June
30 Year Treasury Yield	4.39	4.52	4.43	3.94	June
Aaa Corporate Bond Yield	5.13	5.16	4.96	4.71	June
Baa Corporate Bond Yield	5.89	6.06	6.05	6.09	June
Quality Spread (Baa - Aaa Bond Yield)	0.76	0.90	1.09	1.38	June
Term Spread (10 Year - 1 Year Treasury Yield)	2.95	3.17	3.09	2.89	June
Real Yield Spread (10 Yr TBond- 1 Yr Expected Infl)	0.44	0.77	0.68	0.40	June