

Summary:

- While there are many challenges ahead, we do not believe that the US economy is likely to experience a severe double-dip recession.
- The US corporate sector remains strong and may lead the way to economic recovery.
- European officials have taken steps to mitigate the problems associated with sovereign debt. However, economic growth in the region is likely to remain subdued for an extended period of time.
- Many emerging economies are in better shape than developed world counterparts. Increasing consumer demand may benefit global economic growth.
- High quality US equities are likely to outperform lower quality firms, a trend reversal from March 2009.
- Foreign developed equities may continue to experience significant amounts of volatility due to problems in Europe.
- Emerging market equities may continue to outperform. However, they are still subject to systemic risks.
- The US fixed income market has benefited from investors chasing higher yield assets as Treasuries rallied.
- Dislocations in Europe are creating attractive opportunities in the Foreign Developed Debt space.
- Emerging market bonds remain very attractive but are still subject to large amounts of volatility.
- Commodities have fallen, but we believe they are reaching floor prices.
- The US dollar has strengthened as part of the flight to safety. It remains attractive relative to many large developed economy currencies.

World Economic Review and Outlook

World GDP	Actual						Forecast		
	2004	2005	2006	2007	2008	2009	2010	2011	2012
US	3.60	3.10	2.70	2.10	0.40	-2.40	3.10	2.80	3.00
Canada	3.12	3.02	2.83	2.20	0.53	-2.46	3.60	3.10	2.80
UK	3.00	2.20	2.80	2.70	-0.10	-4.90	1.20	2.00	2.45
France	2.50	1.90	2.20	2.40	0.20	-2.60	1.30	1.40	1.30
Germany	1.20	0.80	3.20	2.50	1.30	-4.90	1.90	1.60	1.90
Switzerland	2.53	2.63	3.68	3.60	1.80	-1.45	2.00	2.10	2.40
Australia	3.68	3.20	2.60	4.73	2.38	1.35	3.47	3.35	3.28
Japan	2.78	1.93	2.03	2.35	-1.18	-5.23	3.25	1.70	1.65
Brazil	5.71	3.16	3.97	6.08	5.17	-0.18	6.55	4.50	4.50
Russia	7.20	6.40	7.70	8.10	5.60	-7.90	4.05	4.20	4.50
India	7.25	9.23	9.83	9.50	7.48	6.73	N/A	N/A	N/A
China	10.10	10.40	11.60	13.00	9.60	8.70	10.10	9.25	N/A
South Korea	4.60	4.00	5.20	5.10	2.30	0.20	5.30	4.30	4.85
Mexico	4.00	3.20	4.90	3.30	1.50	-6.50	4.40	3.60	4.20

Current as of 7/12/10

Source: Bloomberg / Contributor Composite

US Economy

There has been a lot of talk recently about the possibility of a double dip recession. In fact, many have begun to cite that leading economic indicators are forecasting a more pessimistic outlook. However, these indicators are not crystal balls that foresee the future with 100% accuracy. While we do see significant threats to the US economy and a number of structural challenges going forward, we do not believe that the economy is likely to suffer the sharp decline in growth that unfolded during the financial crisis in 2008/2009. We acknowledge that the pace of the recovery has slowed and is likely to slow further in the future. Still, we remain optimistic that the economy is on a path to recovery.

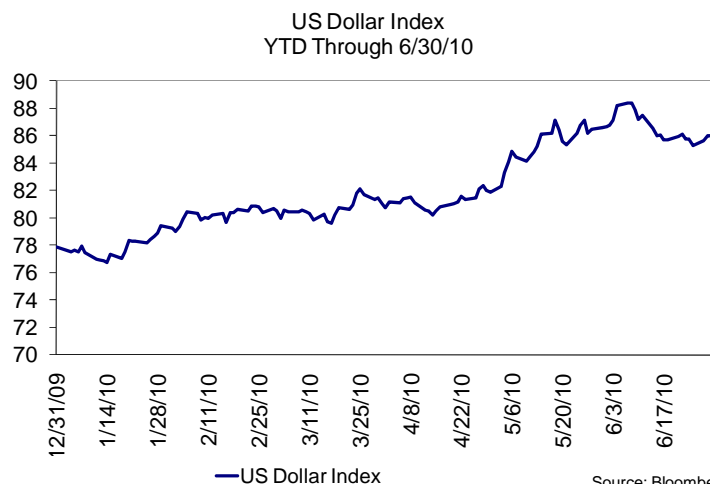
US Gross Domestic Product (GDP), a measure of economic growth, is composed of personal consumption, gross private investment, net exports, and government spending. Personal consumption accounts for roughly 70% of the economy and has historically led the recovery out of past recessions. With the challenges consumers are currently facing, it is highly unlikely that private consumption will lead the way out this time. Consumer balance sheets, while better than they were in 2008, are just not strong enough to maintain high levels of spending, especially given the low levels of job security and weak housing market. Moreover, consumer spending may actually weaken over the next few years as households gradually deleverage, which may weigh on growth numbers. We believe that this process, while negative in the short run, will eventually result in higher quality and more sustainable growth. Americans may divert their discretionary spending from frivolous items such as glow-in-the-dark suntan lotion and instead allocate their resources to higher utility expenditures. This adjustment would likely create volatility in how people earn their incomes, but the change will be for the better.

Real GDP (\$Billions)	Q1.2010	%
Personal Consumption	9,359	71%
Goods	3,231	24%
Services	6,128	46%
Gross Private Investment	1,683	13%
Fixed Investment	1,644	12%
Change in Inventories	41	0%
Net Exports	(373)	-3%
Exports	1,599	12%
Imports	1,972	15%
Government Spending	2,565	19%
Federal	1,046	8%
State and Local	1,522	11%
Net Other	5	0%
Total:	13,239	100%

Source: US Commerce Department

With regards to unemployment, we believe that some of jobs will slowly return as many corporations have reduced headcount below minimum operating levels. However, many of the jobs that were lost during the recent downturn are likely to be gone for good. There are price points at which companies will find it more efficient to invest in technology rather than employ individuals with all the associated benefits as well as fiduciary, tax and liability burdens. For example, data entry work can be replaced with scanners that are capable of reading words on documents and evaluating what type of field it is (such as business card scanners), albeit the technology is still evolving. Many workers will need to re-train. This structural change is necessary. It was just a matter of how, when, and what would finally force Americans to enhance themselves and adapt to a globally changing environment. This shift is likely to keep unemployment elevated for the next few years. On the more optimistic side, it is important to note that those who are employed have actually been seeing income growth and that home prices-to-wages are near historic lows.

Government spending may continue to grow, but it is already overextended, particularly given the existing budget gaps and accumulating pension obligations that both state and federal organizations have been facing. As a result, the US economy is increasingly dependent on investments and net exports to lead the recovery. Fortunately, these two areas are showing signs of potential strength. Private investments include expenditures by firms for equipment and software, buildings and factories, and inventories. Generally speaking, corporations have cut costs sharply and deleveraged their balance sheets or refinanced their debt to lower interest expenses. The net result has been an accumulation of cash reserves. Businesses have been cautious toward making any significant expenditures given the level of economic uncertainty. However, at some point, they are likely to implement these cash reserves at a greater pace in order to grow their businesses both organically and through acquisitions. This may boost the productive capacity of the economy. Moreover, US firms are likely to continue to invest more abroad to take advantage of global growth given the recent strength in the US dollar and declines in valuations, further strengthening this component of GDP. Net exports are unlikely to have much of an impact. Still, manufacturing activity has been picking up due to overseas demand for durable goods, particularly from emerging economies, albeit at a slower pace than in the second half of 2009. If private consumption becomes more efficient, thereby reducing the demand for frivolous imports, the net effect may add to GDP.⁶



We believe that these structural changes are likely to support the economic recovery. GDP growth is likely to fall below historical trends, but we believe that the growth will be of higher quality than previous years. A V-shaped recovery is unlikely, but we do not expect a complete meltdown of global growth, as many have been worried about recently. In addition, we do not expect the magnitude of any potential negative GDP growth numbers to be large considering that at the end of the day, there are people who have jobs, new homes are being sold, profitable companies are investing in the future, and government expenditures are expected to increase in the coming years, among other things.

Another topic that has emerged in the headlines is the threat of inflation and the risk of deflation. A strengthening dollar and subdued economic growth are likely to keep inflation under control for the time being. However, there are still significant long-term inflationary pressures aside from increasing demand for commodities around the world, such as the eventual reduction of the Federal Reserve's balance sheet and the massive government programs scheduled to go into effect over the next few years.

Doomsayers have been spreading fear about substantial deflation given the output gap between potential long-run real GDP and actual real GDP growth over the next few years. There are three basic types of deflation: a decrease in consumer prices, an increasing demand for cash, and a decline in bank credit supply or contraction of the money supply by the central bank. For consumer prices to decline significantly, average wages would need to be falling. However, personal income has been growing. With respect to the demand for cash, bank credit, and money supply, we have enough confidence in the Federal Reserve's ability to efficiently create programs that would mitigate overwhelming short-term deflationary risks. For instance, the board could easily restart special liquidity facilities that it created to support markets during the crisis, which they subsequently closed due to improved functioning of financial markets. With the bulk of US bank deleveraging completed, this may not be necessary going forward. Moreover, historic periods of significant deflation were largely due to policy mistakes. For instance, deflationary periods in the 1830s and 1930s were triggered by bank bankruptcies because the monetary policy was not accommodative enough to meet the sudden demand for cash. With the FDIC in place and the Federal Reserve's support for the banking sector, this is unlikely to be the driver for deflation. And Ben Bernanke, the Chairman of the Federal Reserve, has already indicated that in the absolute worst case scenario, the Fed could use its printing press and 'helicopter drop' money into the economy (hence the nickname 'Helicopter Ben'). Furthermore, the deflationary period from 1870 to 1890, possibly triggered by the return to the gold standard and the retiring of paper money printed during the Civil War, actually resulted in strong economic growth.⁴

As a result, we believe that the threats of significant deflation are minimal and instead believe that there are substantially more inflationary pressures in the long-run. The Fed has been testing various strategies to reduce the size of its balance sheet in a way to reduce the likelihood of hyperinflation and also tighten credit in a way that does not prohibit economic activity. We will continue to monitor the success of these initiatives and adjust our views and portfolios as circumstances change.⁷

Foreign Developed Economies

In contrast to the US, Europe faces significantly more headwinds in its path to recovery. In May, European officials announced an enormous bailout plan worth €750 billion to help Eurozone sovereigns service their debt. According to this plan, €440 would be used to set up a special fund to channel loans guaranteed by member nations. €60 billion is to come from the European Union's existing balance of payments facility (which has previously been used to support countries such as Latvia, Hungary, and Romania). €250 billion would be provided by the International Monetary Fund (IMF). In addition, the European Central Bank (ECB) has stepped in to purchase Eurozone government and private debt on secondary markets, similar to the quantitative easing employed by the Federal Reserve and the Bank of England. This move is unprecedented given the ECB's previous stance of refusing full-scale asset purchases and pressure from member nations. The ECB's primary objective has been to control inflation. This shift has indirectly broadened the ECB's responsibility to step in and ensure economic stability, similar to the Federal Reserve's mandate. However, they are now manipulating the market's risk pricing mechanisms, potentially helping to finance larger budget deficits. As part of this deal, European officials have begun to pressure countries to take on fiscal austerity measures such as raising taxes and cutting spending to partially mitigate the risks of default. These measures are likely to increase the likelihood of an economic contraction in Europe.

Despite the magnitude and breadth of this bailout program, it troubles us is that many of the initiatives taken to date have been focused on giving troubled nations more time to stabilize their financial situation. Our biggest concern is that they have already had plenty of time to adjust their position. It is not like these countries took on massive amounts of debt overnight, and no one noticed. Instead, many officials just avoided the problem, partially due to political ramifications. And, it seems as though they are doing the same thing now, pushing the problem out to be addressed another day. Some experts who have monitored the risks of European sovereigns and taken a look at historical precedents have even thrown around the words 'eventual default.' We do not believe those words are constructive and instead prefer to utilize the word 'restructure' because it is more inviting and opens the door for mutually beneficial outcomes for both borrowers and lenders. While we admit that it is not exactly an apples to apples comparison, Mexico, Brazil, and Argentina have all devalued and/or restructured their currency and debt considerably over the past decade. They acknowledged the fact that they could not possibly meet all their financial obligations and took steps to create a more realistic solution for the long-term. Although these three countries still have a number of challenges, they were able to consolidate, regroup, and export their way back to recovery. Similarly, if we look back a little further, we can reference the Asian financial crisis where questions arose about how certain countries would be able to pay down their large budget deficits given the high amounts of currency volatility. The initial policy responses to an escalating panic was to intervene in the foreign exchange market to keep pegs in place and raise domestic interest rates sharply. Once officials realized that this was futile, they allowed their currencies to float. Although this led to a series of bankruptcies and more pain, healthier economic growth returned to the region. Today, Asian economies have some of the strongest growth prospects in the world. Again, although not an exact comparison, there is a lesson to be learned: it is better to find solutions to problems today, as painful as they may be, so that growth and prosperity can return tomorrow. Hopefully, there are meaningful differences between what has happened in Asia and Latin America, and the policy responses are in fact the correct ones to be taking. We will continue to monitor the situation and adjust your investments accordingly.¹¹

Furthermore, there has been some speculation about either Greece or Germany leaving the European Union. We do not believe that either of these outcomes is likely. With respect to Greece, we do not believe that the country has enough credibility to issue its own currency considering the expectations that the government intends to devalue their monetary units relative to Euros and the real value of their debt burden. In addition, the country does not have enough systems in place to force transactions in the new currency. We suspect that people will continue to use Euros in this case despite any legal threats by the government. Even if Greece were to separate from the European Union, the transition would have severe implications for the rest of Europe, such as the potential fate of Portugal, Italy, Ireland, and Spain. It would completely undermine the foundation of the European Union and the progress the region has benefitted from over the years. The repercussions are potentially more expensive than keeping Greece in the EU.⁵

With respect to Germany, we believe that there is enough global confidence in the country for the government to re-establish their own central bank. However, given the strength of the German economy relative to the rest of Europe, we believe that there would be a substantial appreciation of a newly established currency relative to the Euro, which would negatively impact Germany's exports and competitiveness in the global economy. In addition, domestic banks with significant Euro exposure would be negatively impacted with the currency appreciation. Again, we believe that the repercussions are potentially more costly than Germany staying in the EU and supporting member nations. However, there may be increased political tensions between member nations in the future.⁵

Emerging Economies

Generally speaking, emerging economies have stronger fundamentals than their developed world counterparts. Many have smaller budget deficits, larger current account surpluses, healthy foreign exchange reserves, and healthier banking sectors. They have experienced strong export growth, capital inflows, and investments in infrastructure. In addition, a growing middle class is beginning to drive domestic demand, which may support their economies should weakness in the developed world result in reduced exports. Historically, US consumers have led the rest of the world out of recessionary periods. However, there is a general consensus that emerging economies will drive global growth going forward.

The word 'decoupling' was thrown around frequently in 2007/2008. While we do not believe emerging economies are decoupled from the developed world, we do believe that they are on the path. However, just because there is economic decoupling, it does not necessarily mean that financial securities, including equities and fixed income, will also be decoupled. A reduction in capital controls has made the global financial system much more integrated. As a result, they are likely to remain highly correlated to their respective asset classes. In fact, the low costs of borrowing in many developed regions has led to massive financial flows into emerging economies, raising the risks of inflation, currency volatility, and asset bubbles. While inflation and foreign currency volatility remain an ongoing concern, for the most part, the capacity to absorb capital inflows appears to still be high. The majority of capital has continued going into productivity-enhancing investments such as infrastructure projects.^{16,17}

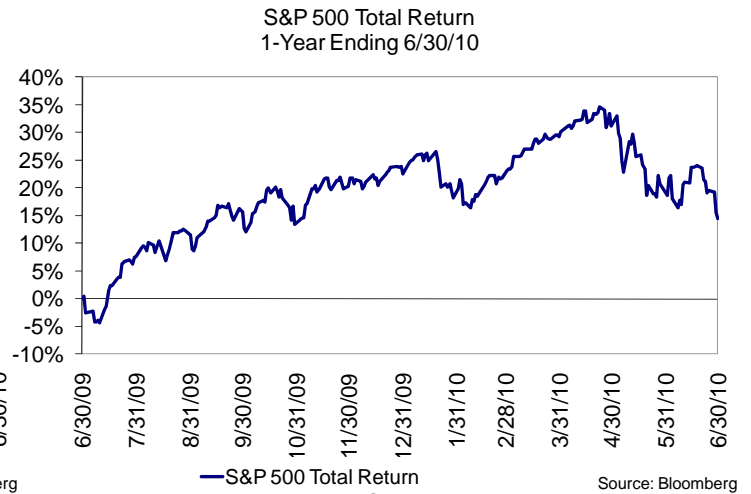
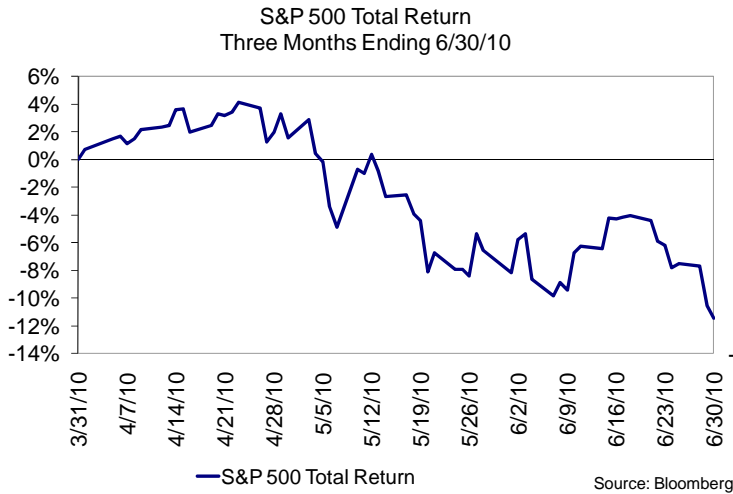
There has been some build up in real estate, particularly in sections of China. An increasing amount of real estate is being purchased for investment purposes, while commercial and residential vacancies have increased due to higher amounts of supply and reduced affordability within the country. Aggregate property prices have risen sharply over the years, but affordability has actually improved as wage inflation accelerated faster. Nevertheless, Prime Minister Wen Jiabo encouraged authorities to utilize land supply, financings, and the tax system in order to increase the supply of lower priced housing, suppress speculation, and bolster its supervision of the market. One specific program created limits the amount of residential properties a family can own. In addition, the People's Bank of China has methodologically taken steps to curb excessive money supply growth, such as progressively raising reserve requirements for banks, tightening monetary and fiscal policy to reverse stimulus measures enacted during the previous financial crisis, and marginally restricting the availability of mortgage credit. A slowdown in loan growth could mean some moderation in economic activity. However, an appreciation of the Chinese yuan may help stimulate domestic demand for imports further, which would result in more balanced global growth.¹²

World Equity Market Review and Outlook

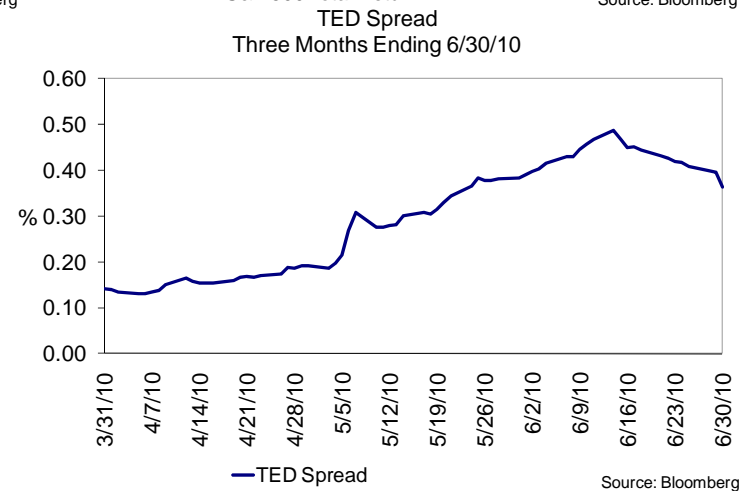
Equities	Cumulative				
	QTD	YTD	1 Year	3 Year	5 Year
S&P 500	-11.4%	-6.7%	14.4%	-26.6%	-3.9%
MSCI EAFE	-13.7%	-12.8%	6.6%	-33.9%	7.4%
MSCI EM	-8.3%	-6.1%	23.3%	-6.6%	83.1%

USD Total Return Source: Bloomberg

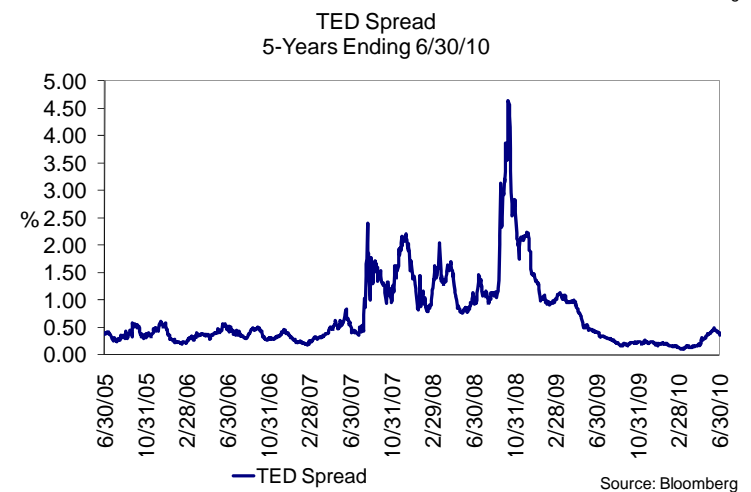
US Equities



During the quarter, the S&P 500 TR declined -11.4%. The decline brought year-to-date numbers down -6.7%, but the market still remains up +14.4% over the past year. We believe that investors have been looking for reasons to justify a market correction after the strength in equity markets since March 2009. They used the Greek debt crisis and potential contagion effect to substantiate a market selloff. Many began to spread fear that European bank insolvency would re-trigger a financial crisis in the US. To support this rhetoric, they referred to the rise in interbank lending rates. However, as shown to the right, the rise in the spread over T-bills is nowhere near the 2008 levels. In fact, it remains within the pre-crisis range. US banks are stronger, and they do trust one another, especially given the abundant support they have from the Federal Reserve.



Nevertheless, fear has spread, and equity volatility (measured by the VIX index, shown on the following page) has once again returned. Periods of volatility spikes are typically followed by periods of high volatility. As a result, the market may continue to decline, and we cannot accurately time when volatility will ease, nor can we predict the price levels that equities will not fall below. Many that have attempted to call market tops and bottoms have missed out on significant opportunities and in some cases, destroyed a substantial amount of their wealth.



Instead, we encourage investors to shape their portfolio today to meet their return objectives for tomorrow. Not everyone needs high equity exposure to meet their financial goals, and not everyone can afford the risks of being overly tactical or conservative with asset allocation.

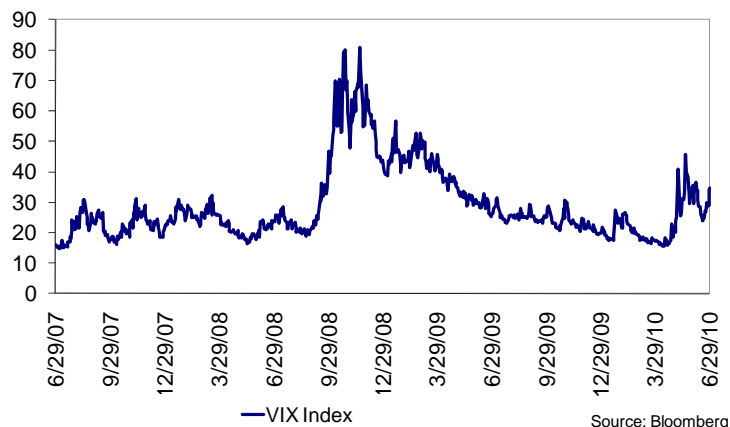
We encourage engaging in conversations with your relationship manager to ensure that your total wealth is positioned appropriately to meet your financial goals. We would recommend maintaining exposure to high quality US companies and riding out the short-term volatility.

Since March 2009, the equities that have outperformed the most have been those with low or negative earnings. We believe that, companies with strong balance sheets, positive revenue and earnings growth, and attractive profitability ratios are likely to outperform. As alluded to earlier, these firms may be able to navigate through slower growth, while utilizing their large cash balances to grow their businesses organically and through acquisitions. Currently, the most attractive sub-asset class to capitalize on this change in dynamics is likely US large cap equities. Furthermore, private equity funds have close to \$500 billion in committed capital that they need to deploy. As a result, mergers and acquisitions activity, both strategically and financially driven, may accelerate, supporting aggregate asset valuations.

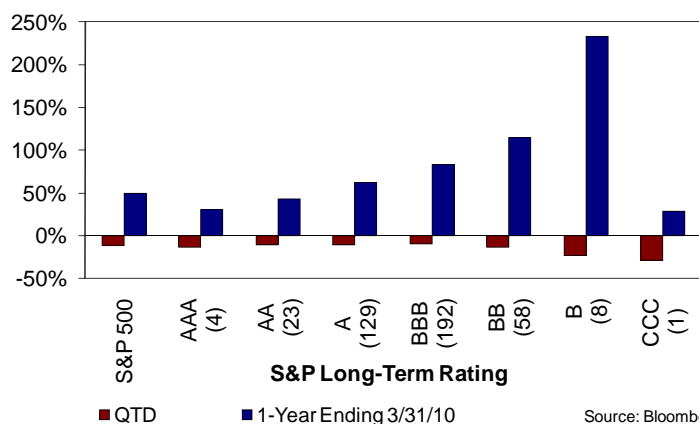
Large US banks have started to ease lending standards and terms on a wide range of business loans and some consumer loans, but many small and mid-sized companies are still having trouble obtaining credit to run and grow their businesses. As a result, we expect a significant dispersion of winners and losers amongst smaller companies in the future. We would like to see a more pronounced improvement in financing before making any bullish generalizations on small cap stocks.

Although US economic growth is likely to slow going forward, it is important to note that equities are not significantly correlated to GDP growth. As shown in the "GDP vs. Equity Returns" table, equity returns have been positive at least 30% of the time during periods of real economic contraction since Q2.1947. While we cannot predict if we already had our negative equity return quarter or if we will have negative equity return quarters in the months ahead, we believe that high quality firms are still attractive and would generally recommend staying invested through the volatility.

VIX Index
3-Years Ending 6/30/10



S&P 500 Estimated Average Return Distribution
Ratings as of 7/11/10; Sample Size: 415



GDP vs. Equity Returns	GDP Lag vs. S&P (Quarters)				
	0	1	2	3	4
Positive Quarterly GDP	212				
Negative Quarterly GDP	40				
Pos. S&P 500 Quarter	162				
Neg. S&P 500 Quarter	90				
Pos. GDP & Pos. S&P	142	149	148	146	137
Pos GDP & Neg. S&P	70	63	64	65	73
Neg. GDP & Pos. S&P	20	12	12	13	21
Neg. GDP & Neg. S&P	20	27	26	25	17
Correlation: GDP vs. S&P	0.11	0.26	0.35	0.16	0.09

Data since 3/31/1947 to 3/31/2010 Source: Bloomberg

US Equities	Cumulative				
	QTD	YTD	1 Year	3 Year	5 Year
Russell 1000	-11.4%	-6.4%	15.2%	-26.0%	-2.6%
Russell 2000	-9.9%	-1.9%	21.5%	-23.6%	2.0%
Russell 1000 Value	-11.1%	-5.1%	16.9%	-32.6%	-7.8%
Russell 1000 Growth	-11.7%	-7.6%	13.6%	-19.3%	2.0%
Russell 2000 Value	-10.6%	-1.6%	25.1%	-26.7%	-2.3%
Russell 2000 Growth	-9.2%	-2.3%	18.0%	-20.9%	5.9%

USD Total Return Source: Bloomberg

S&P 500 Sectors	Cumulative				
	QTD	YTD	1 Year	3 Year	5 Year
Consumer Discretionary	-10.9%	-1.6%	28.1%	-22.0%	-4.5%
Consumer Staples	-8.1%	-2.8%	13.7%	2.8%	28.1%
Energy	-12.7%	-12.2%	2.1%	-25.3%	19.1%
Financials	-13.3%	-3.7%	16.9%	-58.5%	-46.5%
Healthcare	-11.8%	-8.8%	9.0%	-14.9%	0.0%
Industrials	-12.3%	-0.9%	27.5%	-27.3%	-1.7%
Info. Technology	-12.2%	-10.6%	15.8%	-12.5%	11.0%
Materials	-15.3%	-12.9%	13.7%	-26.2%	16.5%
Telecom. Services	-4.2%	-8.4%	3.9%	-32.7%	5.2%
Utilities	-3.7%	-7.1%	5.7%	-19.1%	8.1%

USD Total Return Source: Bloomberg

Foreign Developed Equities

During the quarter, the MSCI EAFE (Europe, Australasia, and Far East) index was down -13.7%, wiping out year-to-date gains. There was broad based selling, particularly in commodity related areas, as investors reallocated to higher quality securities. Generally speaking, the returns were magnified by currency weakness relative to the US dollar, especially with respect to the Euro. For instance, German equities were only down -3.1% in local terms for the quarter. Conversely, the Japanese yen actually appreciated, and the equities index was actually down -15.4% in local terms.

Financial institution and sovereignty problems in Europe have raised equity risk premiums in the region. Consequently, some stable, high-quality firms with global revenue streams have been brought to very attractive valuations relative to the rest of the world. These corporations may very well be able to navigate their way successfully through higher borrowing costs, currency volatility, and an economic slowdown. For example, there are some pharmaceutical companies that derive most of their revenue from US demand. Because of the currency depreciation, these companies are actually able to translate higher profits, yet their share prices have fallen due to systemic fears. However, given the significant uncertainty about Europe's economic outlook, we are cautious investors in this space. We believe that there may be large moves in either direction due to swings in investor sentiment. As a result, we would tactically keep exposure to this area below targets until fears subside. We will continue to monitor risk appetite and reallocate back to target allocations opportunistically.¹¹

Emerging Market Equities

During the quarter, the MSCI Emerging Market index was down -8.3%. Notably, emerging market equities have outperformed developed equities in the second quarter, year-to-date, and past 1-, 3-, and 5- year periods. Similar to foreign developed equities, emerging market equities broadly sold off in US dollar terms, particularly in commodity related areas. In local terms, some indices, such as India, were actually up. India continues to be an interesting area for investments given the level of domestic demand, massive infrastructure investments beginning to accelerate, and well-regulated banking sector. The country is not nearly as dependent on foreign demand for growth as other nations are, and it also has a relatively young, well-educated workforce.

Over the past few years, one of the most cited risks to investing in emerging markets has been geopolitical risk. But, for the most part, what has actually materialized is headline risk. During the quarter, headlines such as 'North Korea torpedoing a South Korean naval ship' or 'political protesters rioting in Bangkok' created large amounts of volatility. However, these were isolated issues that did not develop into a full-blown crisis. In fact, during the quarter South Korea's KOSPI was actually up +0.3% in local currency, and Thailand's Bangkok SET gained +3.1% in local currency and +2.8% in USD. Nevertheless, corruption, predictability of investor rights, application of taxes and laws, foreign exchange and inflation management, and liquidity remain a concern. In addition, we believe that the growth story in many emerging economies and the lackluster growth story in many developed economies may eventually result in an abundant amount of capital flows into EM equities, potentially creating the next largest bubble. Therefore, we continue to keep this exposure relatively modest in our long-term asset allocation models.

Foreign Devlpd. Eq.	Cumulative				
	QTD	YTD	1 Year	3 Year	5 Year
S&P/TSE (Canada)	-9.6%	-4.0%	22.4%	-11.3%	50.8%
FTSE 100 (UK)	-13.8%	-14.0%	9.3%	-36.7%	-1.4%
CAC-40 (France)	-19.2%	-23.0%	-0.7%	-42.2%	-2.0%
DAX (Germany)	-12.2%	-14.4%	8.2%	-32.5%	31.8%
SMI (Switzerland)	-11.7%	-7.5%	17.6%	-17.9%	32.1%
S&P/ASX 200 (Australia)	-17.9%	-14.5%	20.2%	-18.5%	48.3%
Nikkei 225 (Japan)	-10.7%	-6.5%	3.9%	-24.6%	8.2%
USD Total Return					

Source: Bloomberg

MSCI EAFE	Cumulative				
	QTD	YTD	1 Year	3 Year	5 Year
Consumer Discretionary	-10.0%	-7.4%	10.2%	-33.3%	6.0%
Consumer Staples	-7.2%	-5.1%	19.7%	-3.6%	55.5%
Energy	-22.2%	-24.8%	-8.6%	-33.7%	-3.8%
Financials	-16.8%	-17.3%	1.1%	-51.5%	-20.5%
Healthcare	-9.6%	-10.6%	10.9%	-13.8%	15.1%
Industrials	-10.9%	-5.8%	13.9%	-32.3%	25.4%
Info. Technology	-14.7%	-4.5%	6.2%	-37.3%	-9.4%
Materials	-18.1%	-16.1%	13.7%	-29.2%	50.7%
Telecom. Services	-9.1%	-13.0%	4.8%	-19.5%	12.7%
Utilities	-12.5%	-15.9%	-3.9%	-27.4%	28.4%
USD Total Return					

Source: Bloomberg

Emerging Market Eq.	Cumulative				
	QTD	YTD	1 Year	3 Year	5 Year
Bovespa (Brazil)	-14.3%	-13.9%	29.4%	20.6%	219.4%
MICEX (Russia)	-14.0%	-7.1%	36.0%	-33.2%	93.3%
BSE SENSEX 30 (India)	-1.5%	2.4%	28.0%	10.0%	146.7%
Shanghai SE (China)	-21.5%	-25.5%	-17.1%	-26.5%	193.5%
KOSPI (South Korea)	-7.1%	-3.8%	27.3%	-25.3%	45.5%
TAIEX (Taiwan)	-8.5%	-10.8%	19.5%	-5.9%	39.6%
FTSE/JSE (South Africa)	-12.8%	-7.5%	23.2%	-6.7%	86.8%
IPC (Mexico)	-9.7%	-0.7%	33.3%	-11.0%	111.9%
USD Total Return					

Source: Bloomberg

MSCI EM	Cumulative				
	QTD	YTD	1 Year	3 Year	5 Year
Consumer Discretionary	-2.5%	-1.5%	42.4%	5.0%	80.2%
Consumer Staples	-0.1%	3.1%	43.4%	26.1%	144.4%
Energy	-11.4%	-12.0%	10.7%	-8.3%	86.2%
Financials	-7.9%	-5.6%	22.7%	-8.4%	90.5%
Healthcare	-8.5%	2.7%	24.5%	31.5%	86.5%
Industrials	-8.3%	-4.5%	15.7%	-29.4%	69.0%
Info. Technology	-9.8%	-9.8%	31.6%	-9.5%	30.5%
Materials	-14.0%	-9.3%	31.0%	-4.5%	131.4%
Telecom. Services	-3.1%	-1.3%	11.1%	-8.7%	87.3%
Utilities	-3.7%	-1.2%	17.0%	-1.0%	117.2%
USD Total Return					

Source: Bloomberg

World Fixed Income Review and Outlook

US Fixed Income

During the quarter, treasury yields fell across maturities as increased fears about Europe and potential contagion effect resulted in a flight to higher quality assets. Notably, the MOVE index, a measure of yield curve volatility, ticked up but has continued its downward trend. This may be a function of the limited room for yields to fall further, or it could indicate that equity investors are overreacting to European woes.

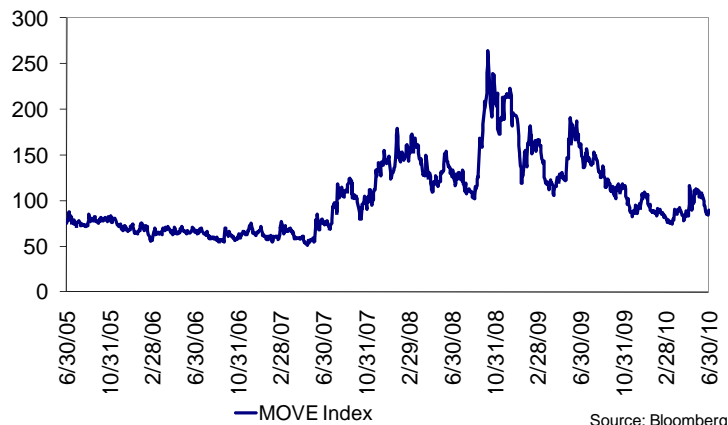
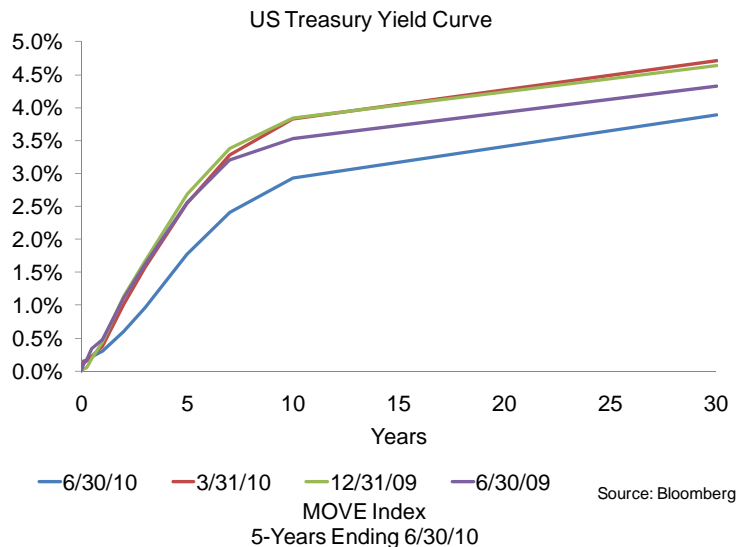
Yields on 10-year treasuries closed below 3% at the end of the quarter. Although this is largely fear-driven, and they may not realize it, investors are essentially betting that the Federal Reserve will be able to keep inflation below 3% for the next decade. Their implied inflation expectations would be even lower if they are taxable investors. Although we believe that short-rates are likely to remain low for some time, we expect long-rates to gradually rise over time and see little justification for long-dated treasuries to fall much further.¹⁰

The Federal Reserve is likely to keep the Fed Funds rate below 0.25% even longer than market participants expect given low levels of resource utilization, subdued inflation trends, and stable inflation expectations. When the Fed does begin to tighten, there may be a sharp rise in yields as it would signal a restoration of confidence in economic and financial systems. Moreover, the drop in value of government bonds may encourage banks to reduce their treasury holdings and replace them with higher yielding loans. However, the Fed may be very reluctant to do this given the historic lessons learned from the Great Depression.

Treasury Inflation-Protected Securities (TIPS) also gained in the quarter but to a lesser degree due to the change in break even inflation expectations. Since inflation fears have subsided in the near term, we may let this allocation fall below target levels tactically until we see some signs of inflation actually creeping into the general economy. Depending on the client, we intend to maintain at least some exposure to these securities given that there is a relatively small market for TIPS, and attractive valuations are quickly brought to fair value even with small shifts in inflation expectations.

Investment grade and high yield bonds underperformed treasuries due to the flight to quality. Nevertheless, they remain attractively valued given that treasury yields are likely to remain low for even longer than previously expected and the potential for a disinflationary environment in the foreseeable future. Depending on the strategy and level of customization for client risk profiles, we may even consider increasing the duration in portfolios slightly. With respect to investment grade bonds, the key driver for future returns is the credit health of the corporate market, which strengthened due to strong gains in earnings and accumulation of cash on balance sheets. With respect to high yield, corporate default rates have come down meaningfully from 2009 peak levels. In addition, many firms were able to refinance at lower costs and get back on the path to profitability. One major area of caution for us is the amount of bonds and loans maturing over the next few years. US nonfinancial corporate borrowers have over \$1.7 trillion in S&P rated debt maturing between 2011 and 2014. An increasing amount of this debt will be high yield bonds, particularly those tied to leveraged buyout transactions prior to the financial crisis. The amount of debt that needs to be rolled over will require the financial markets to continue to function well and for banks to boost lending. As mentioned earlier, many firms will not be able to obtain credit given tighter lending standards. As a result, depending on the strategy and client risk profile, we intend to keep high yield exposure relatively modest in portfolios. We will continue to advise clients to stay diversified in this space and leave security selection to professionals, as opposed to building portfolios with a handful of individual name securities.^{13,14}

Also, it is important to note that fixed income returns over the past year were largely due to a recovery in prices from depressed levels. In the future, these sectors are likely to generate attractive income and outperformance relative to government bonds as the economy slowly recovers. But we cannot continue to expect double digit total returns from these holdings.



Source: Bloomberg

Source: Bloomberg

With regards to the mortgage market, the Federal Reserve ended a program designed to purchase mortgage backed securities, which would artificially reduce borrowing costs and stimulate demand for property. Many had expected the Fed to extend this program and even feared that mortgage rates would rise sharply as the subsidy is removed from the market. However, 30-year mortgage rates remain near their lowest levels ever. This is partially due to the yield chasing appetite, limited supply, and low-risk view that many investors have regarding agency MBS. Despite low rates, home purchases did slow, largely due to the end of the fiscal stimulus targeting first-time homebuyers.¹²

Foreign Developed Fixed Income

Core Eurozone bonds performed well during the quarter as investors sold riskier assets and flocked to sovereign credits with relatively sound fiscal conditions, such as Germany. Similarly, yields fell in the UK and Japan.

As a result of the recent market volatility, there have been a number of dislocations that may provide attractive investment opportunities going forward. For instance, it has yet to be determined how much exposure each financial firm has to southern European countries. However, there exists bank debt with state guarantees that offer higher yields than sovereigns. On the other hand, there are pockets of the market that are becoming riskier. Generally speaking, European banks have used large amounts of the liquidity they received from central banks to repair their balance sheets or reinvest them in high quality securities. As a result, the European high yield market has not been receiving as much support as it has received in the US. It seems unlikely that this will change, particularly as banks are likely to face difficulties offsetting this exposure to others.

In line with our economic views, we have no exposure to bonds from Greece, Portugal, Ireland, Italy, or Spain in our core strategies. While there may be large swings in prices and potential profits to be made due to changes in investor sentiment, our managers have prudently allocated to higher quality areas. The German economy is strong and stands to benefit from a falling Euro; as such, German sovereign and corporate bonds constitute a large percentage of our exposure to Eurozone debt. Again, we will continue to advise clients to stay diversified in this space and leave security selection up to professionals as opposed to building portfolios with a handful of individual name securities.

Emerging Market Fixed Income

During the quarter, credit premiums widened out across the board based on increased global risk aversion. However, emerging market debt continues to look attractive. Generally speaking, the combination of credible monetary policy, fiscal consolidation, and reserve accumulation has left emerging markets better positioned to combat financial crises than larger developed world economies. Debt-to-GDP ratios are less than 40% versus many developed world economies with ratios approaching or well in excess of 100%. Similarly, as opposed to larger developed economies, many emerging market economies are already taking on a tighter monetary policy to combat inflation. Many of them have even introduced programs to control speculative fund flows and reduce foreign exchange volatility. The net effect should be a gradual reduction of the risk premium demanded by investors. In addition, continued strategic, long-term foreign direct investments are likely to keep bond prices buoyant. While we are predominately exposed to emerging market sovereign debt, opportunities have gradually been developing for emerging market corporates as fundamentals improve. Depending on the strategy and client, we intend to gradually increase the exposure modestly over time as emerging economies take a larger share of the global economy. In addition, we may strategically expose clients with higher risk tolerances to unhedged emerging market debt to benefit from the appreciation of EM currencies with respect to the US dollar. Again, we will continue to advise clients to stay diversified in this space and leave security selection up to professionals as opposed to building portfolios with a handful of individual name securities.^{12,17}

Commodities Review and Outlook

Oil

In addition to a strengthening US dollar, crude oil prices fell nearly -10% due to fears about Europe’s slowdown, a contagion effect that would result in a double-dip recession within the US and potentially less demand from China during the quarter. We believe that as evidence continues to mount that the US is not heading into a severe double-dip recession, the price of oil will gradually rise with demand. In addition, we believe that spot prices are getting close to the cost of production. If prices fall much further, it would actually become unprofitable for many groups to extract and distribute oil. We believe that this creates some sort of ‘fundamental’ floor on prices. In addition, we believe that the BP spill is likely to have a serious impact on deepwater drilling in the Gulf of Mexico for years. To put the severity of the spill in context, in 2009, the US Gulf of Mexico accounted for over 25% of US crude supply. Higher taxes and tighter regulations are likely to raise the overall cost of production, raising this potential ‘fundamental’ floor price. However, we are becoming concerned with the increasing correlation of the S&P 500 and oil, raising concerns about portfolio diversification benefits.^{8,9}

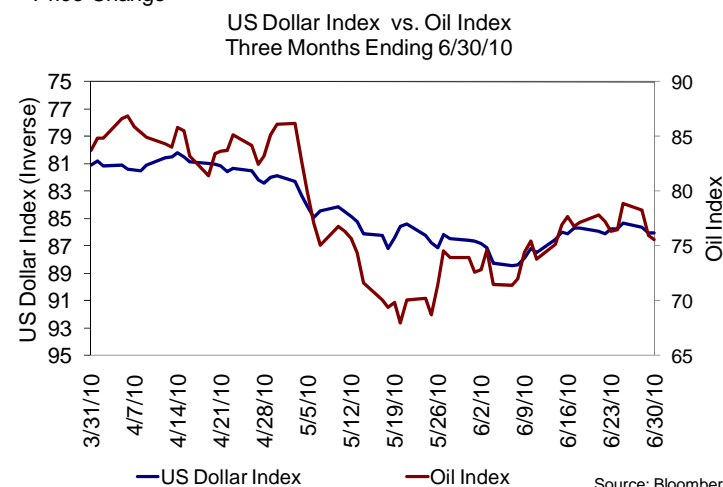
Gold

We clearly see the benefits of having some exposure to gold given the long-term inflationary pressures, increased risk in the global economy, and mounting pressures on the US dollar. However, signs of rampant inflation are not yet visible in the developed world, and the US dollar appears to be one of the most attractive major world currencies in this environment. In addition, we fear that there may be a bubble slowly building in this market as other investors flock to this commodity based on the same thesis. Our caution builds every time we see a commercial to buy or sell gold on television. Therefore, we have intentionally kept the allocation to precious metals in our core portfolios relatively modest.

Commodities	Cumulative				
	QTD	YTD	1 Year	3 Year	5 Year
*Energy	-12.6%	-11.4%	-8.8%	-38.3%	-48.2%
**NYMEX Crude Oil	-9.7%	-4.7%	8.2%	7.0%	33.9%
**NYMEX Natural Gas	19.3%	-17.2%	20.4%	-31.8%	-33.9%
*Precious Metals	11.1%	13.0%	33.7%	80.0%	168.2%
**COMEX Gold	11.9%	13.7%	34.3%	91.4%	185.0%
**Silver Composite	6.5%	10.3%	36.8%	49.9%	164.2%
*Industrial Metals	-18.0%	-14.3%	20.4%	-32.0%	64.0%
*Agriculture	-0.3%	-18.2%	-10.7%	-21.5%	-12.3%
*Livestock	-2.8%	4.0%	0.9%	-41.6%	-37.9%

* S&P GSCI Official Close Indices TR Source: Bloomberg

** Price Change



Currencies

During the quarter, the US dollar generally strengthened due to increased risk aversion in the global financial markets. The appreciation was exacerbated by the limited availability of US dollars. To address this problem, the Federal Reserve reopened select swap lines to provide dollar funded liquidity.

Another notable event in the quarter was the announcement that China will once again allow the yuan to gradually appreciate from its current peg to the US dollar. While there is a lot of politics that play into this announcement, we do believe that they will let rates rise over time, albeit at a slower pace than many would like to see. Many have joined the bandwagon of calling China a currency manipulator, but we would argue that there are very few strong economies that do not intervene in foreign exchange markets in an effort to promote their domestic agendas. In addition, there has been a great deal of rhetoric focused on pressuring China to allow their currency to float freely. The general consensus is that the yuan would appreciate considerably against the US dollar and help to readjust trade balances. However, we believe that there is actually a risk of yuan depreciation if this were allowed to happen. Over the years, there have been massive amounts of capital inflows into the country; those inflows are currently tied up in various different investments. Eliminating the capital controls currently in place may actually result in a rush to convert out of yuan. There may be significant asset sales to take advantage of finally being able to move money out of the country freely, which may add to pressures on all asset classes in China, creating a downward deflationary spiral.¹⁸

Euro

Europe is in the midst of a profound economic and financial crisis so severe that it has raised questions over the future viability of the euro. While we do not believe that the European Union is likely to break apart, we do believe that there will be significant downward pressure on the euro. Stronger member

FX Rates	6/30/10	3/31/10	12/31/09	9/30/09	6/30/09	3/31/09
EURUSD	1.22	1.35	1.43	1.46	1.40	1.33
USDJPY	88.43	93.47	93.02	89.70	96.36	98.96
GBPUSD	1.49	1.52	1.62	1.60	1.65	1.43
USDCAD	1.06	1.02	1.05	1.07	1.16	1.26
AUDUSD	0.84	0.92	0.90	0.88	0.81	0.69
USDCHF	1.08	1.05	1.04	1.04	1.09	1.14
USDMXN	12.94	12.37	13.09	13.51	13.19	14.17

Source: Bloomberg

nations have pressured weaker countries to adopt fiscal austerity initiatives and cut spending while raising taxes in hopes to convince investors that they will be able to service their debt obligations. This is likely to prohibit economic recovery and may actually send the region back into a recession. At the same time, monetary policy is likely to be ultra accommodative in an effort to shore up balance sheets, promote growth, and subsidize the cost of debt for troubled members given the ECB's new direction (previously the central bank only had one objective: maintain control of inflation). The net impact of these policies is likely to result in a weaker currency, particularly if commodity prices begin to recover and the central bank does not act appropriately to conform to its original mandate. Over the next few months, there may be large swings in either direction due to changes in sentiment.

Japanese Yen

Japan has so far been spared from the major contagion risk attributable to the Greek fiscal crisis and has in fact benefited from increased demand for Japanese government bonds due to its safe-haven appeal. As a result, the government has been able to roll over its debt obligations easily and cheaply despite the debt-to-GDP ratio approaching 200%. However, these levels are unsustainable in perpetuity. On the fiscal front, the government has had limited success consolidating the government's finances, partially due to promises not to raise the consumption tax or other politically sensitive duties in the near term. The new Japanese Prime Minister, Naoto Kan, is known as a fiscal hawk, which may increase the chances of progressive reform. On the monetary policy side, the Bank of Japan is still fighting deflationary pressures, and as a result, they may keep rates near zero. We expect growth to be supported by Chinese demand. We believe that this is a fundamental difference between the euro and the yen. And that, as a result, we believe the yen is likely to continue trading in a relatively tight range to the US dollar in the near term as both are viewed as safe-haven currencies.^{15,20}

British Pound

The UK entered the recession with a very large structural deficit. During the crisis, public sector borrowing and debt rose dramatically. As a result, the general government deficit widened to UK's largest-ever peacetime deficit. Should the new government tighten the nation's fiscal policy, they run the risk of destroying the fragile signs of recovery and triggering a sharp deterioration in industrial relations. Should they do too little, they run the risk of upward pressure on government borrowing costs, downward pressure on the GBP, and a potential downgrade in UK's AAA rating, especially since the banking sector continues to face headwinds despite massive state-backed financial support. And, credit availability is likely to continue to be constrained as the capital positions of private-sector balance sheets are gradually rebuilt and strengthened. We believe that these factors are likely to result in significant amounts of currency volatility. The pound

may continue to weaken relative to the US dollar, largely due to the dollar's safe-haven status. Relative to the euro, the pound may actually fare better.^{15,21}

Canadian Dollar

Prior to the start of the financial crisis, Canadian banks were amongst the safest and strongest banks in the world. As a result, the drop in interest rates actually stimulated loan growth as opposed to larger developed world economies that used the extra liquidity to hoard cash and repair their balance sheets. In addition, fiscal stimulus programs, both domestically and in the US, are likely to result in strong 2010 growth numbers. However, the pace of growth may actually slow due to weakness in the US. The Bank of Canada remains conscious of this but has started to raise interest rates cautiously anyway as inflation is gradually creeping into the economy. Furthermore, public finances remain relatively healthy compared to many other developed world economies. The only major headwind that the country faces is volatility in commodity prices, particularly oil prices. Given our views on long-term commodity prices, we expect the Canadian dollar to strengthen in the future.^{15,22}

Australian Dollar

In 2009, China became Australia's largest trading partner. As a result of strong exports to China and swift stimulus measures, Australia was able to largely avoid a recession. The relatively muted economic slowdown led the Reserve Bank of Australia to start raising interest rates in October of last year, and the government is on track to withdraw fiscal stimulus. In addition, the country's public finances remain in a much healthier position than larger developed economies. In fact, the government expects a fiscal surplus of A\$1 billion in 2012/13, three years earlier than expected. We expect the Australian dollar to appreciate, which may help keep inflation relatively muted. However, higher than expected inflation may result in weakness as the central bank balances fighting inflation while accommodating for interest-rate sensitive households who are still reducing their high levels of debt. In addition, increased global risk aversion may result in currency weakness as investors flock to safe-haven assets.^{15,23}

Swiss Franc

Growth has been supported by strong private consumption, public investments, and exports, recovering from weak 2009 levels. The Swiss economy is recovering faster than most European counterparts and public finances are also in a considerably better shape. Going forward, private consumption may play a lesser role as unemployment is expected to edge up this year, but investments and exports are likely to expand into next year. The strength in the Swiss franc relative to the euro has resulted in muted inflationary pressures. However, the Swiss National Bank has intervened in currency markets to prevent the franc from appreciating, given the impact it would have on exports. This has led to an accumulation of high foreign currency reserves, which may become overwhelming, further supporting the appreciation of the franc.^{15,24}

Mexican Peso

Economic growth is on track for a modest recovery following a sharp contraction in 2009. The growth has been driven by a strong rebound in manufacturing exports, while private consumption and investments have remained relatively muted. Banxico is likely to keep monetary policy relatively accommodative in an effort to support growth, which will hopefully increase employment and boost domestic demand. Inflationary pressures have remained subdued to date and are expected to remain low in the foreseeable future, giving Banxico the flexibility to keep rates low for a prolonged period without damaging the credibility of the central bank. The country's minimal reserves accumulation leaves the peso vulnerable to volatility. Although there is medium term support from the IMF, Banxico needs to engage in a policy to build reserves. Until that happens, volatility is likely to persist, but capital inflows and China's gradual appreciation of the yuan (as Mexico and China compete for the US market) are likely to result in a stronger currency.^{15,19,25}

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