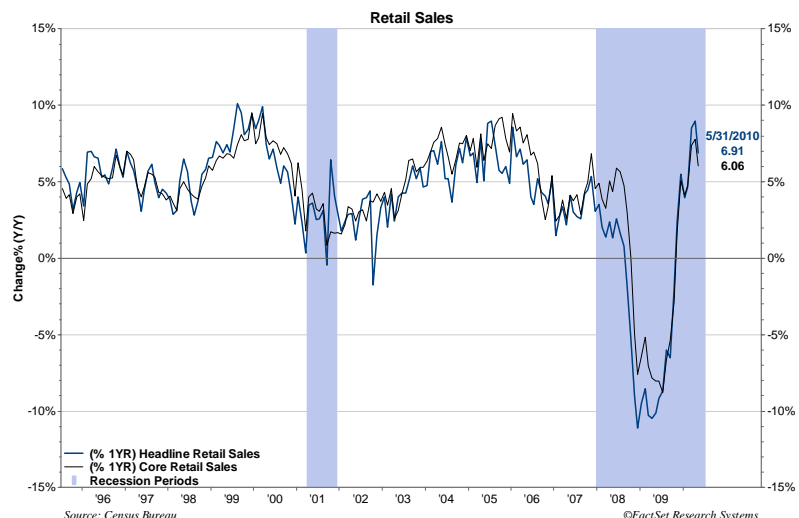
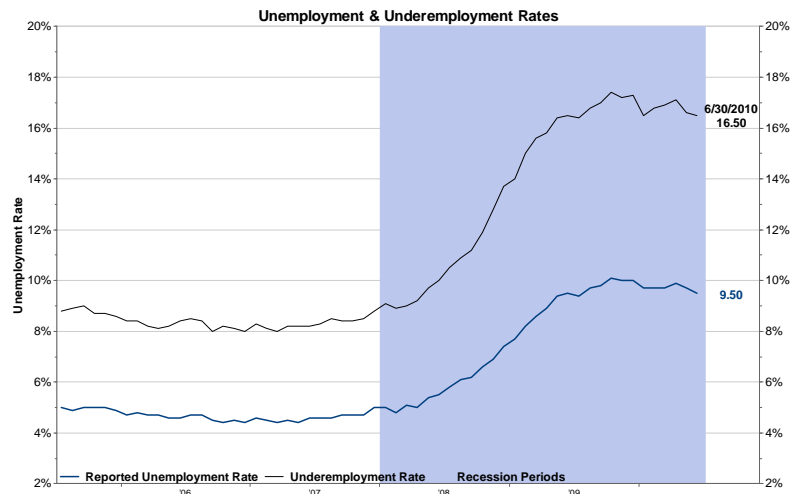


U.S. domestic growth decelerated as the quarter came to a close. Indeed, some economists have described growth as “hitting an invisible wall”. Nearly every housing market indicator (new and existing sales, pending sales, new starts, and purchase mortgage applications) weakened by quarter end as the homebuyers’ tax credit expired in April. Retail sales retrenched by over one percent in May, automobile sales downshifted in June by nearly five percent and the employment figures have been especially disappointing with both initial unemployment claims stalled at the same level since early Spring and private sector job growth unable to maintain airspeed in the past two months. The manufacturing sector has continued to expand with the export sector still showing strength at the moment despite the recent strength of the dollar vis-à-vis the euro. Unfortunately, the inventory rebuild, which has powered much of the growth spurt in the past few quarters, is coming to an end. Indeed, the manufacturing workweek declined by ½ hour in the most recent employment release and other manufacturing indicators, while still expanding, indicate a softer tone.

What is concerning in the current environment is the movement by many mature economies to enact austerity budgets when the economic recovery is in danger of stalling. While the European peripheral countries, including Portugal, Ireland, Italy, Greece, and Spain, need to shore up finances in the face of bond market rebellions, the core European countries of Germany, France and the UK have begun a similar austerity process without such bond market pressure. Indeed, the U.S. is facing similar austerity calls and further government expansion looks increasingly in doubt, as witnessed by the inability to pass emergency unemployment benefits extensions. Moreover, the Bush-era tax cuts are scheduled to expire at the end of 2010. Raising marginal tax rates while the economic expansion is wavering is a medicine that will exacerbate, not ameliorate, the disease. Such simultaneous, world-wide fiscal rectitude could push the developed countries, and possibly the world economy, into a deflationary trap for private demand.



We look for domestic economic growth in the 2 – 3% range during 2010. However, the economy needs to generate more jobs than what we are currently witnessing in order to have a self-sustaining recovery. The economy needs a combination of greater investment spending and a moderate increase in consumption in order to achieve a decent ‘airspeed’. Should they not be extended, the expiration of the Bush era tax cuts is starting to loom over aggregate demand expectations for 2011. Moreover, with the core inflation rate tracking near 1%, a meaningful economic slowdown might send the inflation rate into a deflationary mode – a situation Japan has been dealing with for well over a decade.

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The rally in equity markets that had been in place since March 2009 collapsed in the last two months of the second quarter, with most major indices posting double-digit losses.

Trailing one-year equity returns remain strong for domestic markets, though developed international markets have struggled.

Index Returns As of 6/30/2010	2Q10	Trailing One Year	Annualized Trailing 3 Year	Annualized Trailing 5 Year
Russell 1000	-11.4%	15.2%	-9.5%	-0.6%
Russell 1000 Growth	-11.7%	13.6%	-6.9%	0.4%
Russell 1000 Value	-11.2%	16.9%	-12.3%	-1.6%
Russell Midcap	-9.9%	25.1%	-8.2%	1.2%
Russell Midcap Growth	-10.2%	21.3%	-7.5%	1.4%
Russell Midcap Value	-9.6%	28.9%	-9.4%	0.7%
Russell 2000	-9.9%	21.5%	-8.6%	0.4%
Russell 2000 Growth	-9.2%	17.9%	-7.5%	1.1%
Russell 2000 Value	-10.6%	25.1%	-9.9%	-0.5%
Russell 3000	-11.3%	15.7%	-9.5%	-0.5%
S&P 500	-11.4%	14.4%	-9.8%	-0.8%
MSCI EAFE	-13.8%	6.4%	-12.9%	1.4%
MSCI EAFE Growth	-12.3%	9.0%	-11.4%	2.0%
MSCI EAFE Value	-15.2%	3.8%	-14.6%	0.6%
MSCI EAFE Small Cap	-11.2%	12.6%	-12.8%	1.4%
MSCI EM	-8.3%	23.5%	-2.2%	13.1%

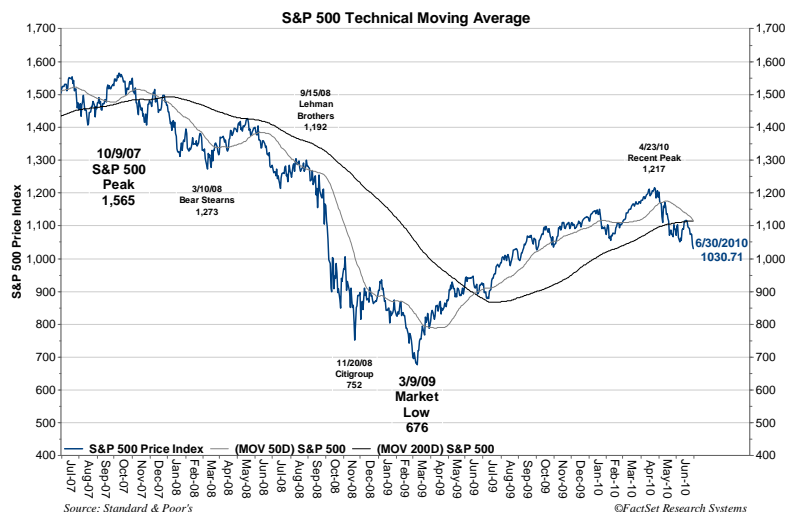
S&P 500: GICS	2Q10	Trailing One Year
Absolute Returns		
Consumer Discretionary	-10.9%	28.1%
Consumer Staples	-8.1%	13.7%
Energy	-12.7%	2.1%
Financials	-13.3%	16.9%
Health Care	-11.8%	9.0%
Industrials	-12.3%	27.5%
Information Technology	-12.3%	15.8%
Materials	-15.3%	13.7%
Telecommunications	-4.2%	3.9%
Utilities	-3.7%	5.7%
S&P 500	-11.4%	14.4%

Source: Bloomberg, Factset

- Small and mid cap stocks edged out large caps for the second quarter and remain firmly ahead for the one year period.
- Value outperformed growth in large and mid cap indices, but within small caps, growth led.

- All sectors posted negative returns in the second quarter, but defensive sectors including Utilities (-3.7%), Telecomm (-4.2%), and Consumer Staples (-8.1%) outperformed the benchmark S&P 500 Index.

Source: Factset



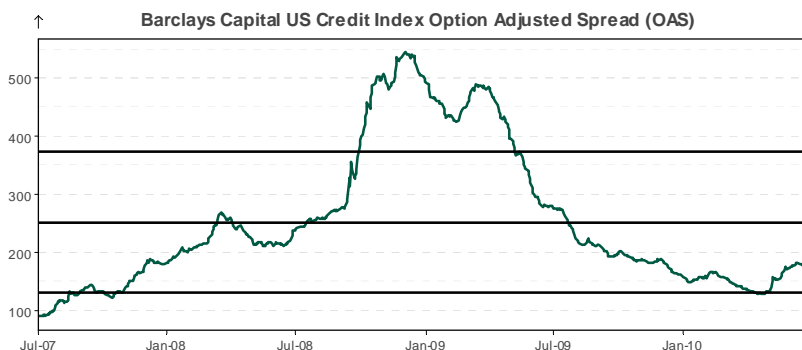
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Barclays Index Return As of 6/30/2010	2Q10	Trailing One Year	Annualized Trailing 3 Year	Annualized Trailing 5 Year
Aggregate	3.49%	9.50%	7.55%	5.57%
Intermediate Gov/Credit	2.97%	8.29%	6.97%	5.28%
Treasury	4.69%	6.67%	7.81%	5.42%
Agency	2.54%	5.82%	7.12%	5.42%
Corporates	3.42%	15.92%	7.41%	5.32%
MBS	2.87%	7.48%	8.23%	6.27%
ABS	2.54%	12.90%	4.72%	4.18%
CMBS	2.78%	30.52%	6.37%	4.74%
High Yield	-0.11%	26.77%	6.54%	7.19%
U.S. TIPS	3.82%	9.52%	7.62%	5.01%

With the exception of High Yield, all fixed income sectors posted positive returns in the second quarter, benefitting from the “risk off” trade.

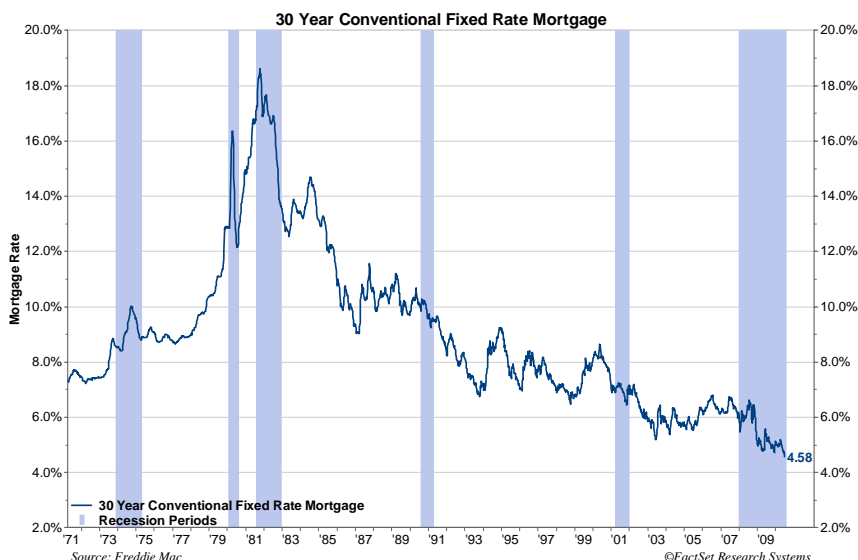
Source: Barclays

With renewed concern about risks to the economy, the Barclay’s Capital U.S. Credit Index option-adjusted yield spread moved wider by over 40bps, thus contributing to its underperformance relative to the Treasury market.



Key	Axis	Name	Last	Minimum	Maximum	Mean	SD	SD Change	
—	Left	U.S. Credit - OAS	179.218	89.559	07/06/2007	545.041	12/03/2008	251.579 122.286	4.030

Source: Barclays



While new originations have fallen off, refinancing of outstanding mortgages for credit worthy borrowers is ramping up. By quarter end, the Mortgage Bankers Association refinancing index jumped higher from April levels as the ten year Treasury yield fell below 3.5%. Indeed, the market may be in for a mini-refinancing boom, increasing prepayment speeds in what has generally been a slow prepay environment.

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