

ECONOMIC TRENDS

Economy	The U.S. economic recovery continues to be sub-par, with positive growth in corporate profits being offset by weak consumer demand and an employment picture that refuses to improve. Much of the weak demand is due to the ongoing improvement in personal balance sheets as families increase their savings rates and reduce outstanding debt. The lack of new job creation is a more complex problem, though increased regulations and uncertainty caused by our rapidly accumulating national debt weigh negatively on corporate sentiment.
Inflation	The rapid increase in commodity prices has led to some acceleration in inflation during the first quarter of 2011. Many commodity prices have declined during the second quarter, however, as the supply and demand imbalances have improved for several energy and agriculture products. Our view is that core inflation is not likely to be a problem this year due to sluggish labor markets, a weak housing sector and relatively low loan demand. With monetary policy extremely loose, we are closely watching for any increase in the velocity of money, which would elevate inflation risk.
U.S. Dollar	U.S. fiscal policy and rising indebtedness have re-emerged as key concerns for the foreign exchange markets and the dollar. The long-term performance of the economy and monetary policy are tied to the U.S. dollar outlook.

ASSET CLASS

Cash/Money Market Instruments	In light of a slower-than-expected first half 2011 economic growth, we expect the Federal Reserve's zero interest rate policy will remain in place through year-end. Cash and money market returns will continue to reflect this policy.
Intermediate Govt/Credit Bonds	We expect the bond market to experience a period of volatility over the short-term due to a number of macroeconomic issues, political budget negotiations and credit agency warnings overhanging U.S. Treasury bonds. As a result, we continue to forecast interest rates to slowly drift higher as uncertainty moderates and inflation expectations build. However, below-normal economic growth and the dynamic of strong demand/moderate supply will restrain any significant rise in rates. This market environment requires a cautious approach. As such, we are focusing on short-to-intermediate maturities and favoring industrial corporate bonds.
Tax-Exempt Municipal Bonds	We have seen renewed investor confidence in state and local bonds following the alarmist warnings made in late 2010. We have been encouraged by the steps municipalities have taken to contain costs and stabilize revenues. Issuance of new state and local municipal bonds has been approximately 50% below average and issuance will likely remain scarce into the second half of 2011. The reduction of supply will continue to hold yields close to today's levels. We favor state general obligation bonds, strong and diverse local governments and essential service revenue bonds in the AA to AAA range. In addition, we are avoiding what we view as riskier sectors: healthcare, lease revenue, industrial development and airport bonds.
U.S. Equity	We expect the stock market to move higher, supported by low interest rates and a continuation of the economic recovery. Strong earnings growth, high profit margins, and healthy corporate balance sheets should also support higher equity prices. However, lower than normal economic growth, a broad array of newly created regulations, a sluggish employment market and ongoing concerns about sovereign debt levels may limit upside gains. In this environment, international markets are generally providing more robust growth opportunities, thus we favor multinational corporations as nearly one-third of their revenues are being generated outside of the U.S.
International Equity	International equities will likely outperform their domestic counterparts as faster economic growth rates drive stock prices higher. Exporting companies in Europe, notably from Germany, are producing record results as demand from developing countries remains strong. The developing countries are expected to show strong economic growth through the balance of 2011, even as governments such as China and India work to temper growth and control inflation.
Commodity	A continuation of the global economic recovery, coupled with supply constraints in some commodities, will be supportive of higher prices. In addition, persistent concerns about sovereign debt levels will sustain the abnormally high investor demand for precious metals. However, gains may be limited by economic growth that is lower than normal in the developed countries and by restrictive economic policies in leading emerging markets such as Brazil and China.

POTENTIAL THREATS

Opportunities, Risks and Notable Items to Watch	<ul style="list-style-type: none"> • Geopolitical Risks — Social unrest in oil producing countries. Instability in the Middle East and U.S. military actions in Afghanistan, Iraq and now Libya. • Governmental Policy Risks — The inability of our government to address the federal budget deficit and long-term debt accumulation. The potential for unintended consequences from the Federal Reserve's zero interest rate policy. • U.S. Economic Risks — A longer than expected string of weak jobs reports and the potential impact that rising energy / commodity prices have on consumer consumption. • Sovereign Debt Concerns — The issues surrounding Europe have cast a shadow on the finances of a number of countries, particularly those in the developed world (Portugal, Ireland, Greece, Italy, and Spain). • China — A tighter monetary policy is being used to cool the real estate markets. Poor execution of the policy could lead to significant declines in Chinese real estate prices.
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