

ECONOMIC TRENDS

Economy	The myriad of government stimulus programs continue to support economic growth and the recovery is enduring. In fact, consumer spending has been rising and it may be stronger than expected this year. However, the rate of economic growth will continue to be lower than normal due to the soft labor markets and the deflationary impact of debt repayment. As a result, the housing markets will remain hampered by high inventory, foreclosures and underwater mortgages.
Inflation	Capacity utilization and industrial production are not close to peak levels so inflation may remain muted in the near term. However, we are concerned about rising price levels on a longer term basis. As the recovery matures, higher production costs rather than excess aggregate demand may generate upward pressure on prices. In addition, a distinct inflationary risk comes from the massive amount of liquidity in the financial system, in no small part from the Fed's quantitative easing program.
U.S. Dollar	Given the poor financial situation in numerous European countries, an improving economy in the U.S. and the Fed's quantitative easing program, the relationship between the euro and the U.S. dollar is likely to remain volatile. Relative to other currencies, the dollar has recently benefited from an improving economic outlook. However, on a longer term basis, our currency will likely trend lower due to rising government debt levels and the monetization of our debt.

ASSET CLASS

Cash/Money Market Instruments	<ul style="list-style-type: none"> • Against a backdrop of slow growth and low inflation, the Federal Reserve is expected to remain accommodative for an extended period. • With the Federal Funds rate near zero, we expect interest rates on cash instruments will remain near zero as well.
Intermediate Govt/Corporate Bonds	<ul style="list-style-type: none"> • Bond yields will likely rise during 2011 as signs of a stronger economy begin to emerge. However, a steady Fed Funds rate and low inflation should limit the magnitude of the increase in interest rates. • Low yields and fiscal deficits reduce the relative value of government bonds. • Investment grade corporate bonds remain attractive due to supportive technicals and strong credit metrics.
Tax-Exempt Municipal Bonds	<ul style="list-style-type: none"> • State and local governments will continue to face a very challenging fiscal environment in 2011. • Most issuers will successfully work through their budgets, and problems will be limited to select borrowers and sectors. • Though headline risk may increase volatility, municipal bonds remain resilient in a rising interest rate environment.
U.S. Equity	We expect the stock market to move higher, supported by massive government stimulus and a continuation of the economic recovery. Recent increases in real consumer spending and leading manufacturing indicators, coupled with our expectations for strong earnings growth, high profit margins and healthy corporate balance sheets, should 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.
International Equity	International equities will likely outperform their domestic counterparts as faster economic growth rates drive stock prices higher. In the near term, the U.S. dollar may continue to appreciate given the widespread economic issues in Europe. This will serve as a headwind for a period of time, but longer term we expect the U.S. dollar to trend lower.
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 some restrictive monetary policies in leading emerging markets such as Brazil and China.

POTENTIAL THREATS

Risks and Notable Items to Watch	<ul style="list-style-type: none"> • Geopolitical Risks — Issues between Israel and Iran, North and South Korea, and U.S. military actions in Afghanistan/Iraq. • Foreign Demand for U.S. Debt — Our stimulus programs are financed with debt, and a reduction in foreign demand could lead to higher interest rates. • Legislative Risks — Gridlock and/or the development of poor regulations in the aftermath of the healthcare and financial reform legislation. • 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. • China — A tighter monetary policy is being used to cool the real estate markets. Poor execution could lead to significant declines in the valuation of risky assets worldwide.
---	---