

S&P 500 PRICE



Since hitting a closing low of 676 on March 9th, the S&P 500 has rallied 36% through the end of May, one of the largest three-month rallies on record, and is up 3% on a 2009 year-to-date basis. Nevertheless, the index remains some 41% off of its October 2007 high of 1565 (on a price basis).

NOTES/COMMENTARY

Over the past three months stock markets have staged an extremely sharp rebound as investors have been encouraged by signs that the global economy has regained its footing. While many of the dire scenarios (including a collapse of the global financial markets) have been avoided, caution remains warranted as the rally seems somewhat low in quality.... high beta stocks with poor earnings/fundamentals or stocks that were heavily shorted have rebounded the most, and there is still a lack of foreign/institutional buyers. And while some of the immediate economic uncertainty has been alleviated, the road to sustained economic recovery will likely be a long and volatile one given the balance sheet issues to be worked through.

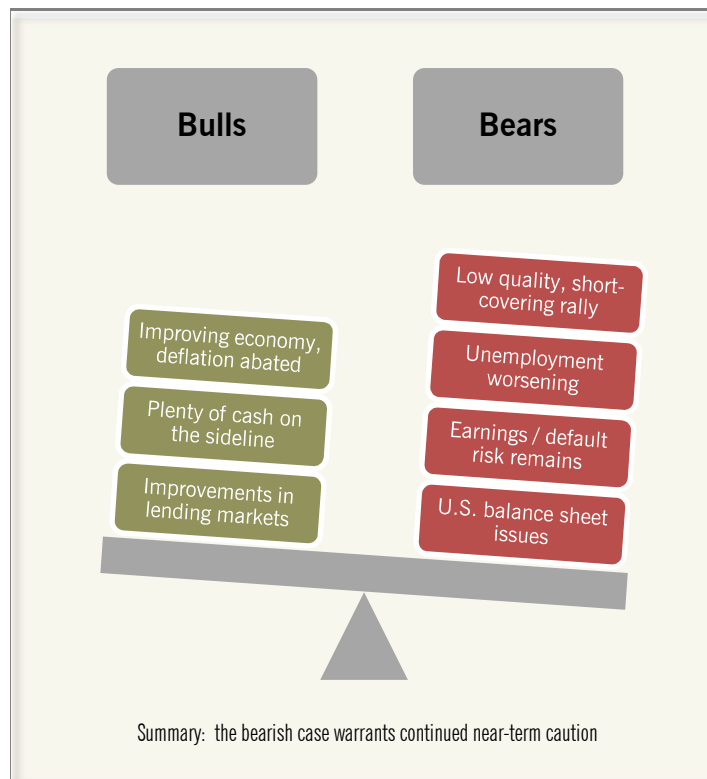
The Bullish Case

- signs of improving health in the global economy and avoidance of utter catastrophe
- liquidity in the lending markets is markedly improved
- there still remains plenty of cash on the sidelines

The Bearish Case

- recent rally has been low quality. Corporate earnings uncertainty remains, and valuations (as far as we can tell) are not necessarily cheap
- employment is expected to deteriorate further, sapping confidence and hindering residential housing market recovery
- credit spreads remain at wide levels (bond investors still foresee increased defaults)
- longer-term, the U.S. faces balance sheet issues

SUMMARY OF CURRENT EQUITY MARKET LEANINGS

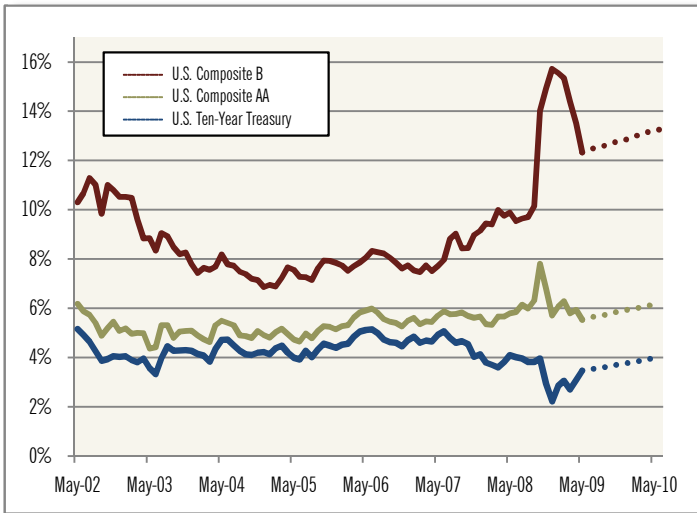


CONVERGENT TACTICAL POSITIONING

Equity		
US Large Cap Equity	underweight	
US Small/Mid Cap Eq.	neutral	
Developed Non-U.S. Eq.	underweight	
Emerging Markets Eq.	neutral	
Private Equity	neutral	
Directional Hedge Funds	underweight	
Real Assets		
Real Estate	neutral to slight underweight	
Commodities	slight overweight	
Arbitrage/Credit		
Multi-Strategy Hedge	neutral	
Opportunistic Credit	significant overweight	
Fixed Income		
Core Fixed Income	neutral	
Cash Equivalents	neutral	

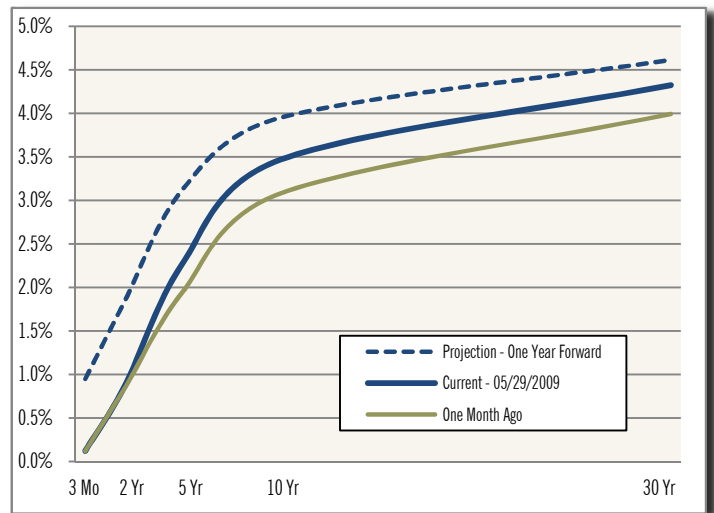
As of May 2009, our tactical positioning remains unchanged. We continue to recommend a somewhat defensive stance to protect portfolios against disruptions. Credit opportunities still offer attractive risk-adjusted prospects, and we continue to recommended reduced equity allocations in favor of such positioning (though we have shifted away from the high yield and bank loan sectors). Commodities (particularly gold) are recommended for weak dollar and inflation positioning.

CREDIT YIELD SPREADS



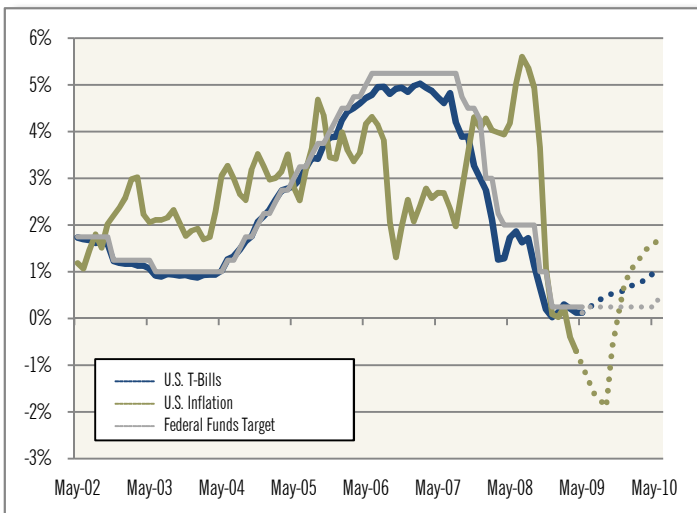
Yield spreads have narrowed significantly since peaking last November (thanks in part to rising Treasury yields) but remain wide as investors see defaults yet to come. The corporate credit opportunity has not gone away, and being higher in the capital stack still looks like a better risk-adjusted play than equities. Nevertheless, much of the near-term beta may have been captured in the high yield and bank loan segments and we have shifted allocations accordingly. **Advantage: Bears**

U.S. TREASURY YIELD CURVE



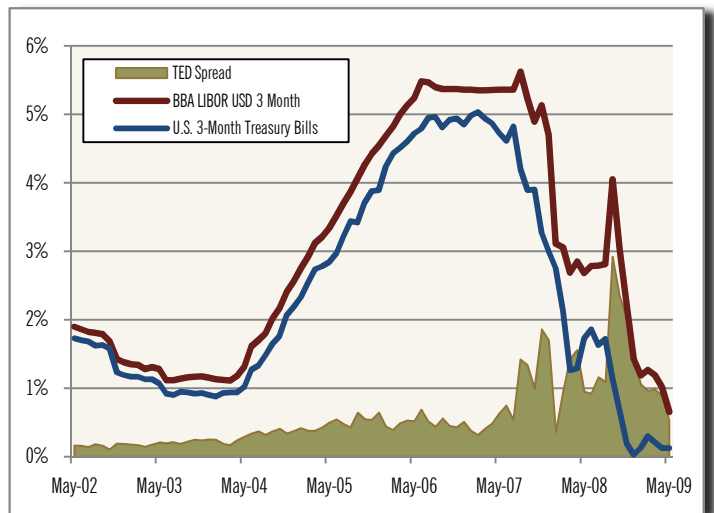
As the U.S. Treasury market has sold off, yields on ten-year notes have been pushed to their highest levels for the year. The steepness of the yield curve (the gap between two- and ten-year notes) is at record levels, as short-term maturities remain in high demand for safety purposes while longer maturities fight off concerns about heavy new issuance. While higher yields may be a potential threat to the recovery if they drive up the cost of borrowing too high, any further increases may be muted by concerns about the economy. **Advantage: Neutral**

T-BILLS, FEDERAL FUNDS AND INFLATION



Inflation is expected to start accelerating around the end of the year thanks to the huge monetary stimulus (after being held in check for a while due to high unemployment and weak consumer spending). The Fed keeping the economy out of a deflationary spiral is a positive for asset prices in the short term, but could cause longer-term issues. **Advantage: Bulls**

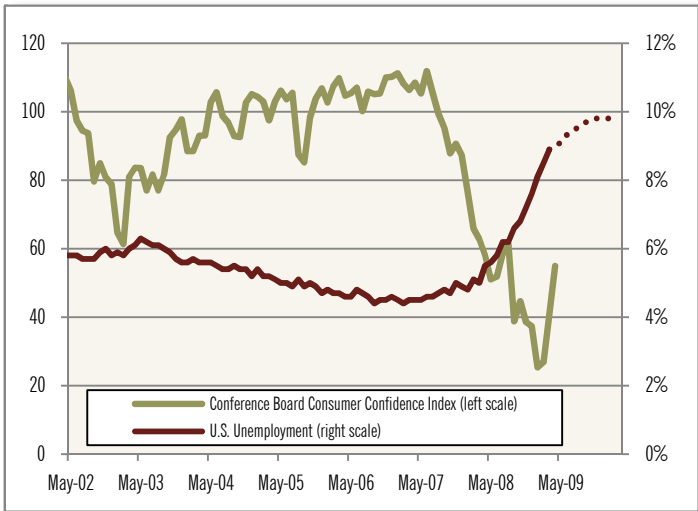
LIBOR/T-BILL RATES AND TED SPREAD



The TED spread is a measure of how tight the credit markets are as illustrated by the difference between T-Bill yields (a risk-free loan) and LIBOR yields (the rate at which banks lend to one another). Last Fall's wide TED spreads indicated a high degree of anxiety and riskiness in the bank lending market as liquidity was being withdrawn. The recent decline (to the high end of typically observed levels) illustrates the risk of bank defaults is considered to be dramatically decreased. **Advantage: Bulls**

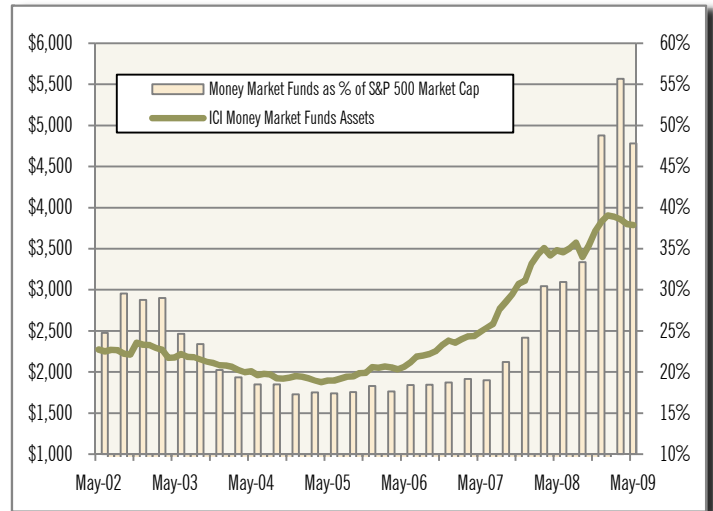
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

CONSUMER CONFIDENCE & UNEMPLOYMENT



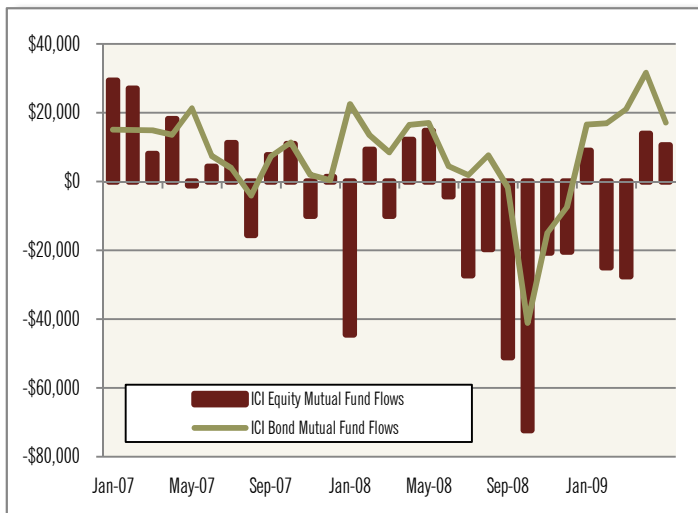
As stocks have rallied and some economic data has improved, consumer confidence has surged off record lows and is at the highest level since before the credit crisis began in full last September. Employment figures, however, are not expected to show reprieve until perhaps early 2010, remaining a headwind that may crimp consumer spending (which makes up more than 2/3 of U.S. economic activity) and impede recovery in the housing market. **Advantage: Bears**

MONEY MARKET FUNDS ASSETS (\$ BILLIONS)



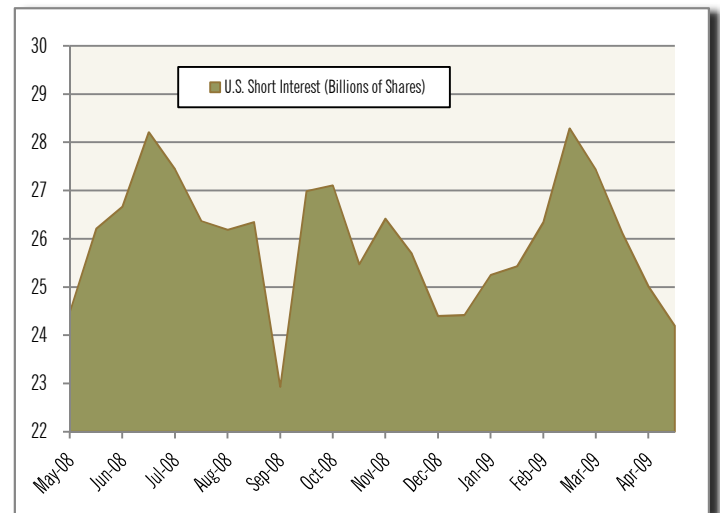
Despite the equity market rally, there remains a huge amount of cash on the sidelines, especially as a percentage of stock market capitalization. It will be a positive for stocks when it re-enters the market in full force. On an anecdotal basis, as the rally has progressed, many of our equity managers have started to selectively increase their exposure (both gross and net) and reduce their cash balances, focusing on high quality companies trading at low valuations. **Advantage: Bulls**

MUTUAL FUND CASH FLOWS (\$ MILLIONS)



Estimates for May indicate a continued positive turnaround for flows into equity mutual funds as investors jumped back on the bandwagon. A positive development, at least for now, though equity inflows lagged those into bond funds and were not as strong as might be expected given the extent of the rally. **Advantage: Neutral**

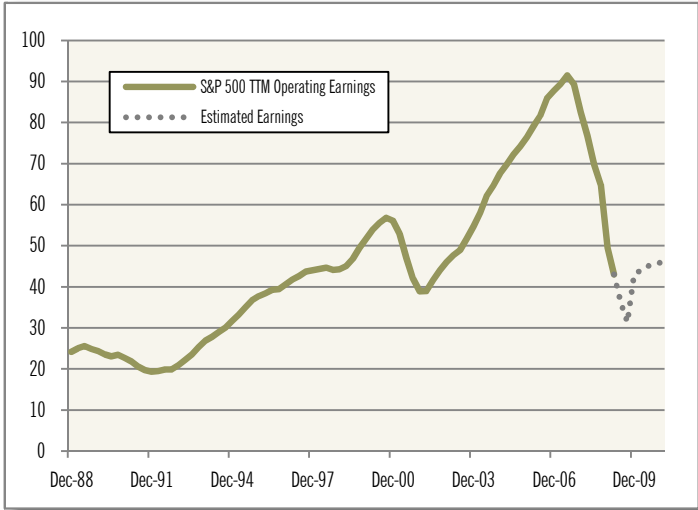
U.S. SHORT INTEREST



Short interest (the number of shares sold short but not yet covered) can be a telling indicator of investor sentiment, though it is often viewed as a contrary indicator since high levels of short positions are eventually covered, providing upward pressure on stock prices. Short interest dropped significantly in recent weeks, indicating the latter part of the rally benefited to some degree from short covering. **Advantage: Bears**

Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

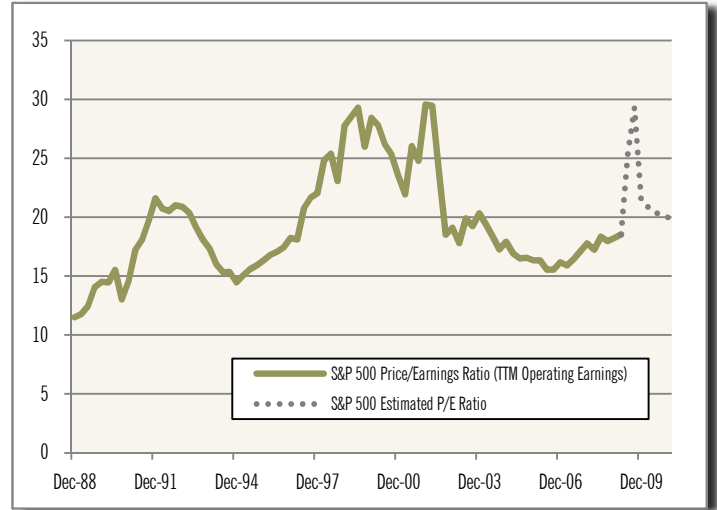
CORPORATE EARNINGS



Earnings continue to plummet, with operating earnings down some 44% from last year. The first quarter of 2009 was not as bad as Q4 of last year, however, as FAS 157 limited additional charges. After bottoming out this summer (on a year-over-year basis), a stabilization at \$40-50 is projected by Standard and Poor's. Further improvements will be needed for sustained stock growth, though.

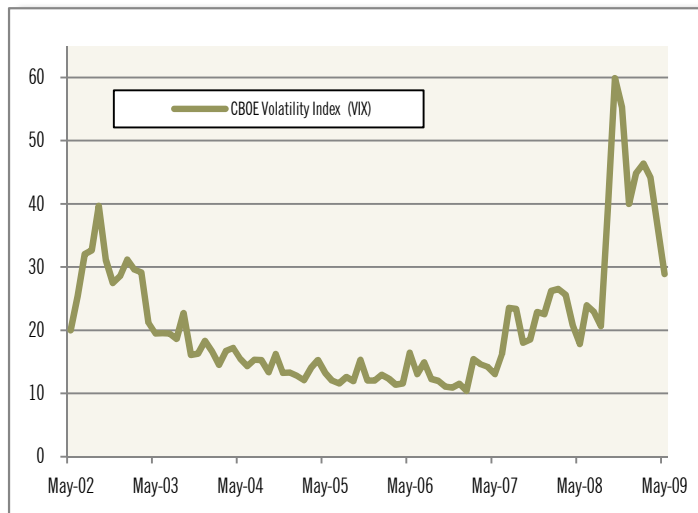
Advantage: Neutral

STOCK MARKET VALUATIONS



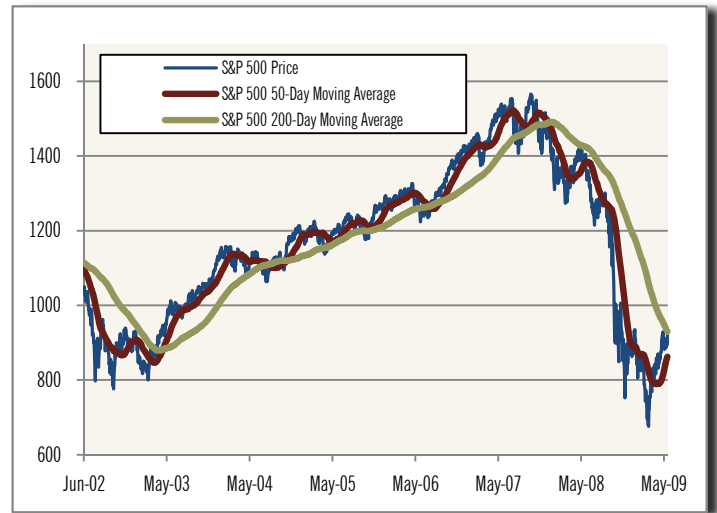
Valuations are not necessarily cheap on a historical basis, though one could argue that slightly higher P/E's are acceptable in a low interest rate environment. Evaluating valuations is no easy task, however, as earnings volatility has led to a lack in confidence about the accuracy of P/E readings. Nevertheless, until an earnings rebound occurs, the only way for valuations to become more attractive in the short term is for stocks to fall. **Advantage: Bears**

STOCK MARKET VOLATILITY



Stock market volatility remains at elevated levels though well below peak observations. Generally speaking, high readings accompany negative shocks. Declines in volatility, however, should reflect a more confident market. **Advantage: Neutral**

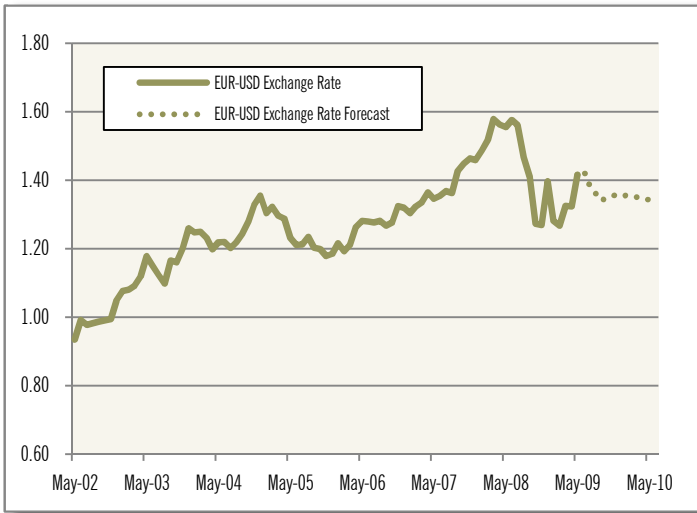
STOCK MARKET TECHNICALS



Some technicals are improving, but others remain bearish. The 50-day moving average of the S&P 500 is still below the 200-day moving average, interpreted by many as a "sell" signal. **Advantage: Bears**

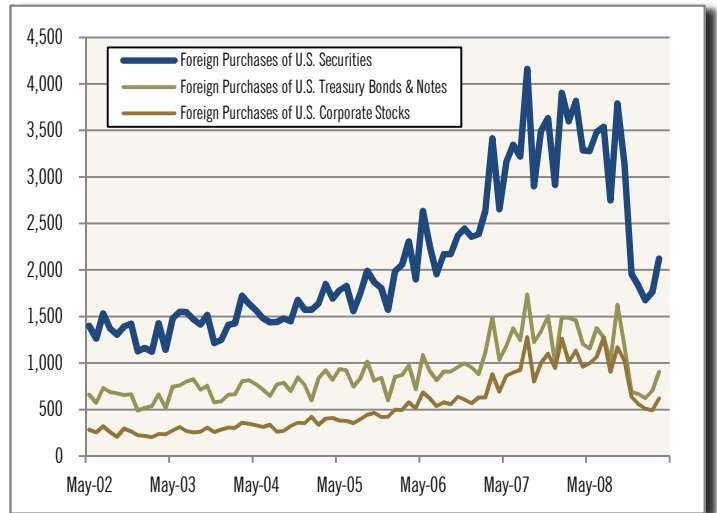
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

EURO / U.S. DOLLAR EXCHANGE RATE



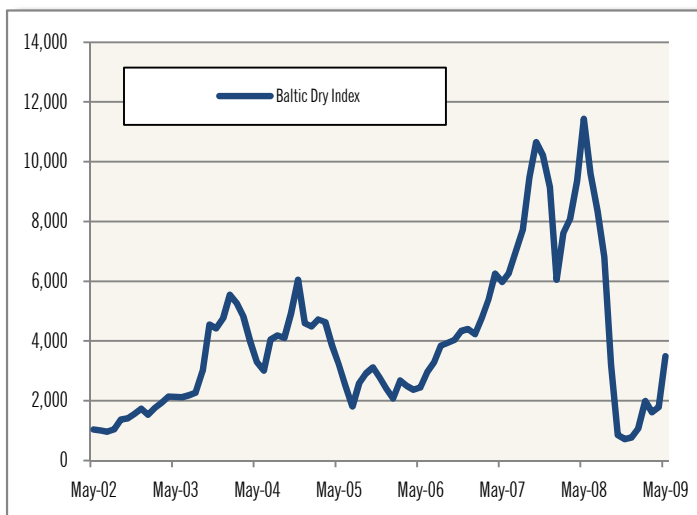
The U.S. dollar remained under pressure as its recent safe-haven attraction has been undermined by the ongoing stock market recovery and concerns over the size of the U.S. budget deficit. Dollar weakness and rising inflation expectations have also contributed to surging interest in commodities. There are fundamental reasons for continued secular dollar weakness (though the Euro may also be weak on a global basis), and exposure to commodities as well as international equities and bonds could provide a hedge for U.S. investors. **Advantage: Neutral**

FOREIGN PURCHASES OF U.S. SECURITIES (\$ BILLIONS)



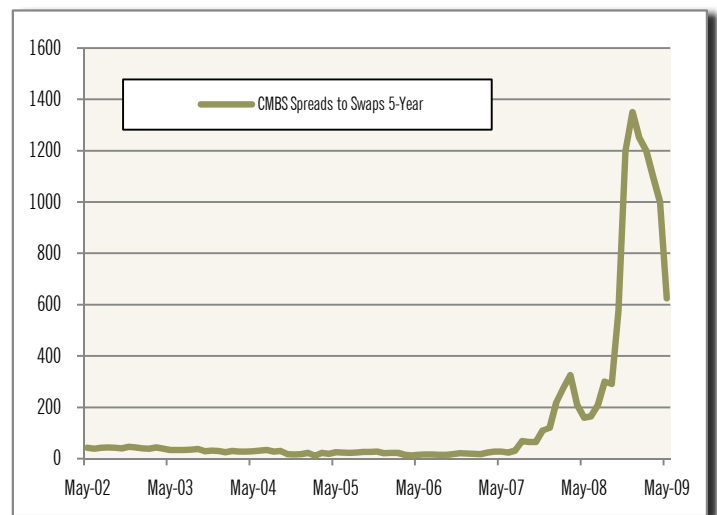
Foreign purchases of U.S. securities has declined dramatically since the crisis began as investors have pulled their capital back home. Though modest improvements are being seen recently, dollar concerns may keep some foreign investors away. A lack of demand for American investments is bad news for U.S. markets. **Advantage: Bears**

BALTIC DRY INDEX



The Baltic Dry Index (BDI), a measure of world trade, provides a barometer of the price of moving major raw materials by sea, taking into consideration the demand for shipping capacity versus the inelastic supply of dry bulk carriers. The BDI, in a sign of improving health in the global economy, continues to rapidly recover ground lost since plummeting last fall, rising to a eight-month high thanks to Chinese demand for iron ore and other goods. **Advantage: Bulls**

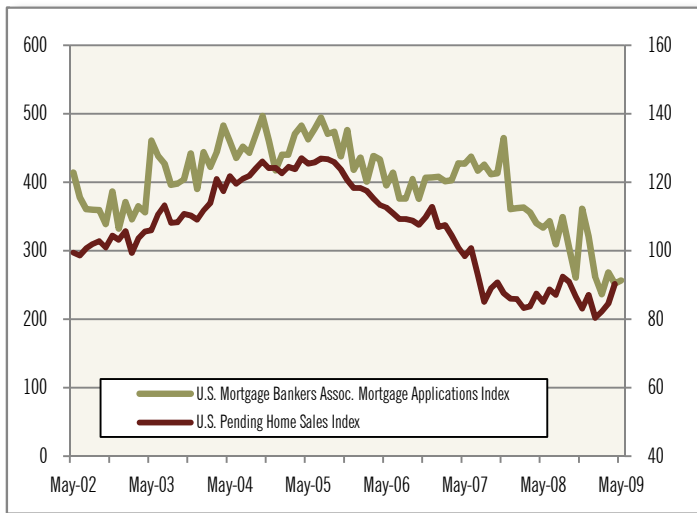
CMBS SPREADS



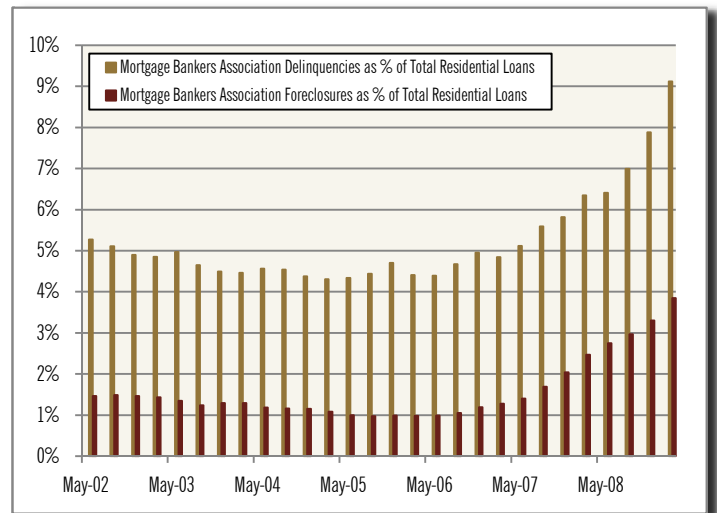
Despite a significant pullback in CMBS spreads, commercial real estate loss expectations remain high in a historical context, thanks in part to a large amount of loans that need to be refinanced in the next two years. Furthermore, as vacancies rise (U.S. office vacancies are expected to exceed 18% next year, the highest level since 1992), some commercial real-estate owners are struggling to pay their mortgages. **Advantage: Bears**

Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

MORTGAGE APPLICATIONS & PENDING HOME SALES



RESIDENTIAL DELINQUENCIES & DEFAULTS



The residential real estate market is still under pressure, though there are some positive indications that the bottoming process is forming. After hitting a record low in January, the decline in pending home sales (used to predict actual home sales activity) has reversed, thanks in part to tax credits for first-time homebuyers included in the recent stimulus package. Mortgage applications have not shown much increase, however. Neither have home prices, which have yet to stabilize. As such, the housing market recovery is likely going to be a slow and gradual process. **Advantage: Bears**

Home owners, saddled with debt, remain under pressure as mortgage delinquencies and foreclosures are spiking. Huge amounts of outstanding consumer credit and rising unemployment will likely be a headwind to the housing market for some time, and could be the next shoe to drop as the wave of foreclosures is spreading to borrowers with good credit and is not expected to crest until next year.

Advantage: Bears

Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

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