CONVERGENT | WEALTH ADVISORS

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MARKET PULSE REPORT

AUGUST 2011

Commentary

Government bonds have done particularly well in the recent market turmoil. The dramatic decline in yields can be partially explained by a reassessment of economic and inflation prospects, as economic growth has been unacceptably weak and a global recession is a possibility. The Federal Reserve's pledge to keep low short-term rates in place until mid-2013 has also contributed to yields shifting lower. Perhaps most important has been the global flight to Treasuries as a safe-haven in a period of extreme uncertainty, which is a bit ironic coming on the heels of their downgrade.

But what of bonds' prospects going forward? It appears bonds are now richly priced compared to some other assets, especially if economic growth muddles along and inflation drifts lower but does not spiral into deflation. In that scenario, which is the base case for many economists, Treasuries will likely contribute little return to portfolios for some time, particularly in inflation-adjusted terms. From the standpoint of generating returns to help portfolios achieve their objectives, they might even be considered more risky than the more volatile growth-oriented assets they are meant to offset. As such, we are considering a further reduction to our core fixed income allocation and are exploring lower volatility areas in the credit opportunities space as well as real assets that can provide a systematic portfolio hedge or futher diversification.

While equities other risk assets have gotten cheaper, there is still near-term uncertainty with regard to the economic outlook. The economic and market indicators we track are giving mixed signals. For the time being we are maintaining a neutral stance, though we are considering shifts within our stock allocation such as increasing emerging market equity exposure.

CONVERGENT TACTICAL POSITIONING

- We are underweight our strategic core fixed income target because of the intermediate-term risk of bonds' ability to preserve purchasing power.
- This underweight accommodates a shift to opportunistic credit segments (e.g., multi-sector, emerging market currencies/debt, and mortgages) where we can collect a current yield while addressing inflation, currency, and U.S. interest rate risks.
- Within real assets, we remain underweight REITs in favor of gold, which serves as a paper currency hedge and safe-haven asset.
- Our overall equity allocation is neutral.

EQUITY	**neutral**
U.S. Equity	overweight
Developed Non-U.S.	underweight
Emerging Markets	overweight
Private Equity	neutral
Directional Hedge	underweight
REAL ASSETS	**neutral**
Real Estate	underweight
Commodities	overweight
ARBITRAGE/CREDIT	**overweight**
Multi-Strategy Hedge	neutral
Opportunistic Credit	overweight
CORE FIXED INCOME	**underweight**
Core Fixed Income	underweight
Cash Equivalents	neutral

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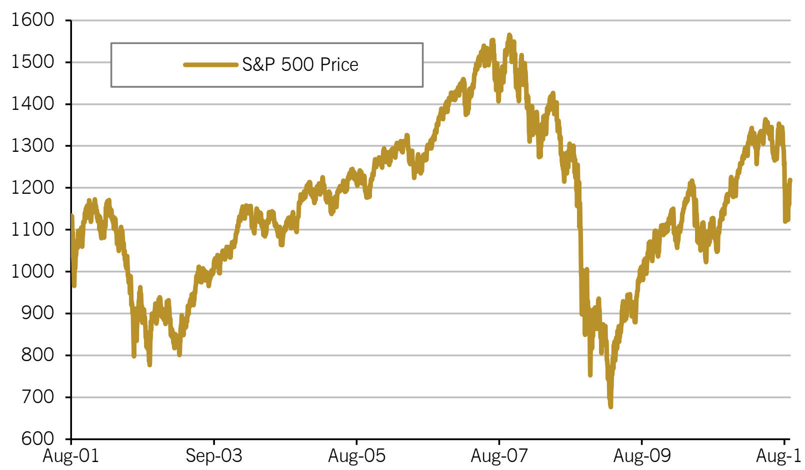
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

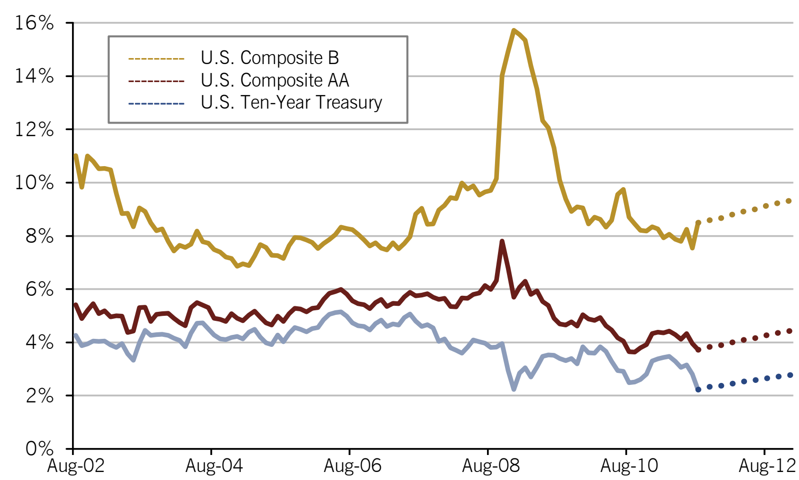
S&P 500 PRICE

Stocks fell in August for the fourth month in a row, and the S&P 500 is now flirting with bear-market territory (commonly defined as a decline of 20% from a recent peak). Stocks were hammered early in the month by the debt downgrade and never fully recovered, as weak economic data has some investors pricing in a recession. Sovereign debt problems in Europe also continue to weigh on the markets.



CREDIT YIELDS

The downgrade of U.S. debt from AAA to AA+ did little to dampen the appetite of global investors for U.S. Treasuries. In August, a flight from risk assets led the yield on the ten-year note to drop below 2%. High yield corporate bonds did not fare as well. Though their yields are still low on an absolute basis, spreads to Treasuries are widening significantly.

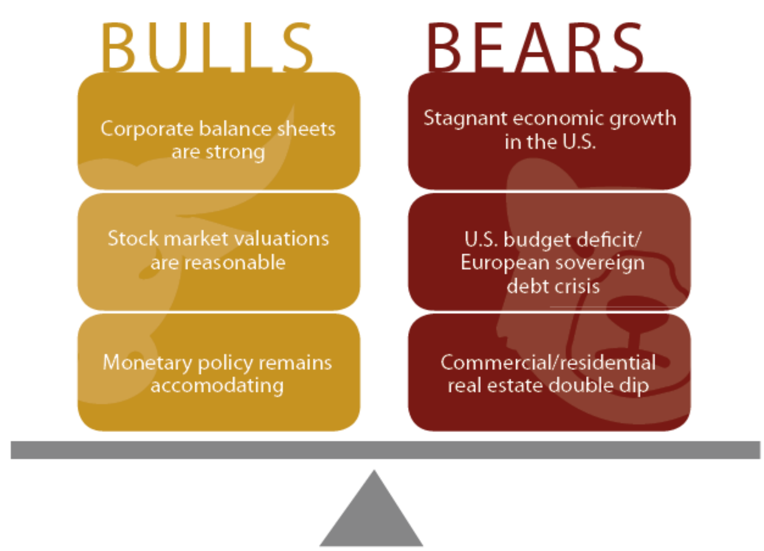


SUMMARY OF CURRENT EQUITY MARKET LEANINGS

• Our overall equity allocation is neutral.

• Several key factors (monetary policy, valuations, and corporate balance sheets) remain supportive of stocks even if economic growth is sluggish.

• Within the equity category, we are overweight U.S. and emerging market equity while underweight long/short equity.



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

APPENDIX

SUMMARY

Below is a summary of the key statistics contained in this Appendix.

CREDIT MARKETS		**Bullish**	**Notes**
U.S. Treasury Yield Curve		Neutral to Bullish	curve is steep - typically indicates recession not anticipated
T-Bills, Federal Funds, and Inflation		Neutral to Bullish	supportive Fed low interest rate policy for the next two years
LIBOR/T-Bill Rates and TED Spread		Bullish	despite turmoil, low TED spread = little liquidity anxiety
THE ECONOMY AND THE CONSUMER		**Mixed**	
Consumer Confidence and Unemployment		Bearish	employment has stalled; confidence has tumbled
U.S. Consumer Income and Spending		Neutral	consumers still spending, but for how long?
LEI and ECRI		Neutral to Bullish	leading indicators march higher as ECRI trends down
THE ECONOMY AND SUPPLIERS		**Neutral**	
ISM Manufacturing Index		Neutral	barely expanded in August (at 50.6); lowest level in 2 years
Baltic Dry Index and Commodities		Neutral	copper has hit a plateau; BDI remains stagnant
Retail Sales		Neutral	will Hurricane Irene impact September figures?
U.S. CORPORATIONS	↓	**Mixed**	
Corporate Earnings		Neutral to Bullish	corporations are healthy thanks in part to overseas sales
Stock Market Valuations		Neutral to Bullish	valuations reasonable - trailing 12-month P/E near average
Stock Market Technicals	↓	Bearish	S&P 500 50-day average < 200-day average
INVESTOR FLOWS AND LIQUIDITY	↓	**Neutral to Bearish**	
Money Market Funds Assets	↓	Neutral	investor dry powder down to pre-crisis levels
Mutual Fund Liquidity Ratio		Bearish	mutual fund managers holding low levels of cash
Mutual Fund Cash Flows		Neutral	highest level of stock outflows since 2008 selloff
FEAR MEASURES	↓	**Neutral to Bearish**	
Stock Market Volatility	↓	Neutral to Bearish	VIX jumps to over 30 - investors feeling some stress
Correlations		Neutral	have spiked higher in risk-off market shift
CMBS Spreads		Neutral	starting to widen from the past year's stable range
REAL ESTATE		**Bearish**	
Mortgage Applications and Pending Sales		Bearish	mortgage applications at 15-year lows
Residential Delinquencies and Defaults		Bearish	below peak levels, but likely to remain high for some time
Residential/Commercial Property Price Indices		Bearish	finding a bottom as prices inch off recent lows?
CURRENCY		**Neutral**	
U.S. Dollar		Neutral	budget deficit is weighing on the U.S. dollar
Foreign Purchases of U.S. Securities		Neutral	foreign purchases of U.S. bonds at high levels
U.S. M1 Money Supply and Velocity		Neutral	M1 at unprecedented levels but velocity is low
BORROWING		**Neutral to Bearish**	
U.S. Household Debt		Neutral to Bearish	deleveraging cycle likely a headwind for several years
U.S. Savings and Debt Service Ratio		Neutral to Bearish	any increase in rates could raise debt servicing costs
U.S. Consumer Loan Charge-Off Rates		Neutral to Bearish	below peak but remain at high historical levels

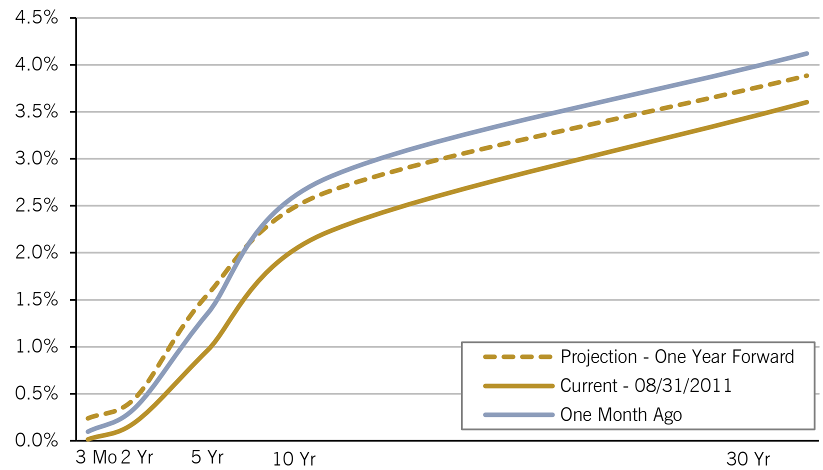
Note: The arrows indicate the directional change from the prior month's reading (i.e., a shift from "Bullish" to "Neutral to Bullish" is viewed as a negative change).

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

U.S. TREASURY YIELD CURVE

The Treasury yield curve shifted dramatically lower in August as fears of a double-dip recession took hold and government bonds benefited from a flight to quality. Nevertheless, the yield curve remains extremely steep, indicating for many that the odds of a full-blown recession are low.

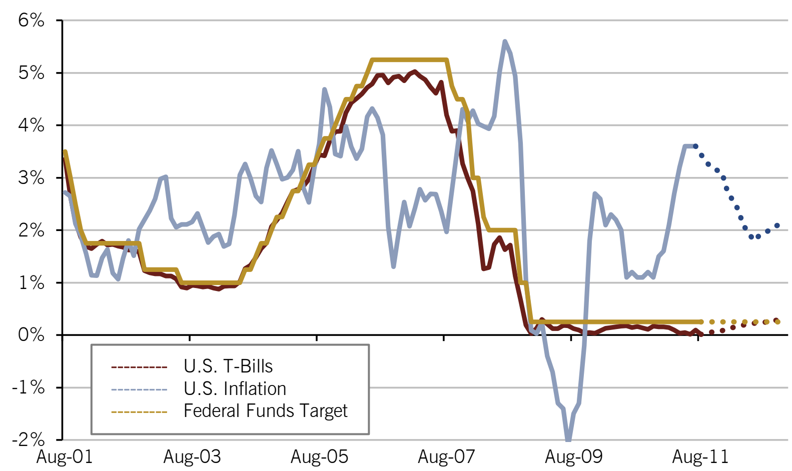
Advantage: Neutral to Bullish



T-BILLS, FEDERAL FUNDS, AND INFLATION

The Fed announced it will keep short-term interest rates near zero through mid-2013 despite consumer prices being up 3.6% on an annual basis, the highest level since late 2008. Many expect costs to remain contained given high unemployment and a general slowdown in economic activity.

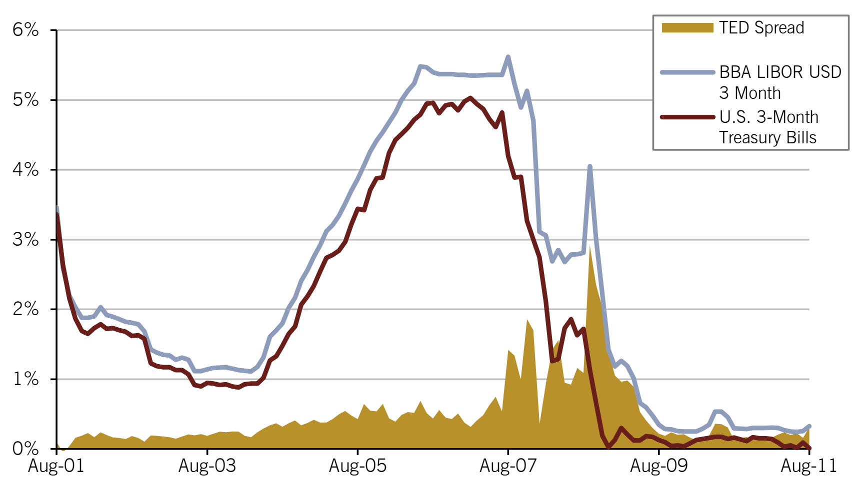
Advantage: Neutral to Bullish



LIBOR/T-BILL RATES AND TED SPREAD

The TED spread is a measure of the tightness of the credit markets, 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). Despite recent market turmoil, spreads remain relatively low and indicate credit markets are not overly worried about near-term liquidity challenges.

Advantage: Bullish

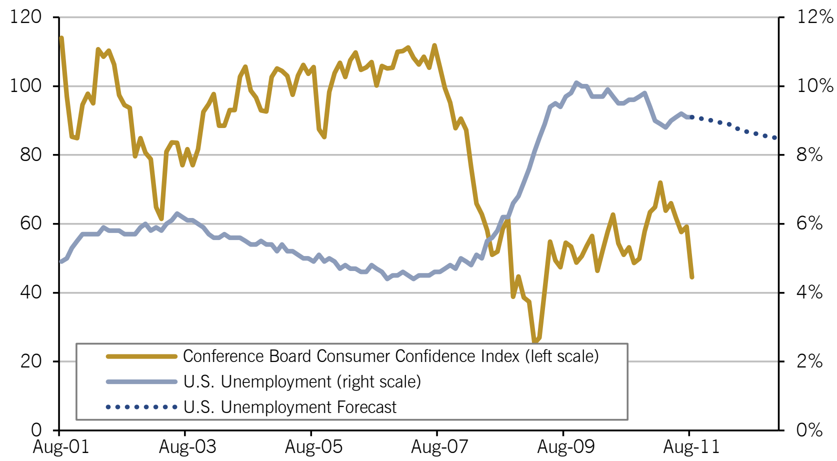


Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

CONSUMER CONFIDENCE AND UNEMPLOYMENT

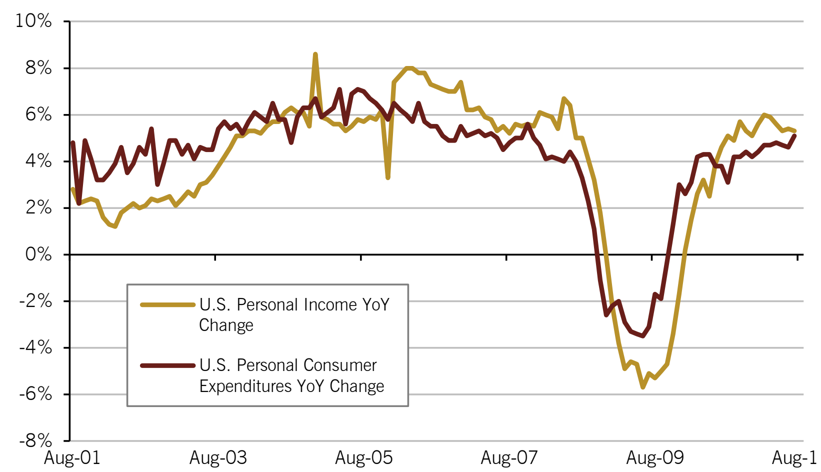
Consumer confidence plunged in August to its lowest level in over two years. The debt downgrade, stock market turmoil, weak job market (no new jobs were created last month), high food and energy prices, and uncertain economy have U.S. consumers increasingly worried about the short-term outlook.

Advantage: Bearish



U.S. CONSUMER INCOME AND SPENDING

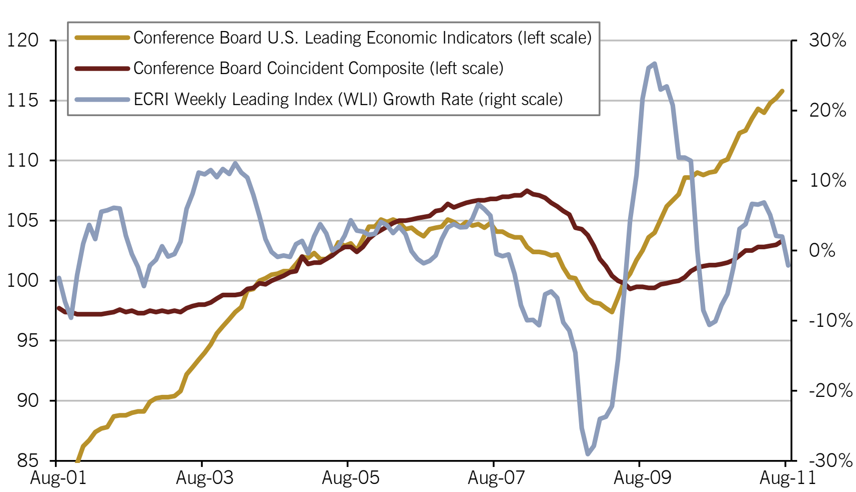
Consumer spending has been holding up better than expected given low confidence and high unemployment, though the full impact of the stock market declines may have yet to filter through. Because consumer spending accounts for about 70% of domestic economic activity, a sustained decline could push the country into recession.



LEI AND ECRI

The U.S. index of leading economic indicators (LEI) continues to trend upward, helped by the Federal Reserve's low interest rate policy. However, a leading index from the Economic Cycle Research Institute has shown some recent weakness.

Advantage: Neutral to Bullish

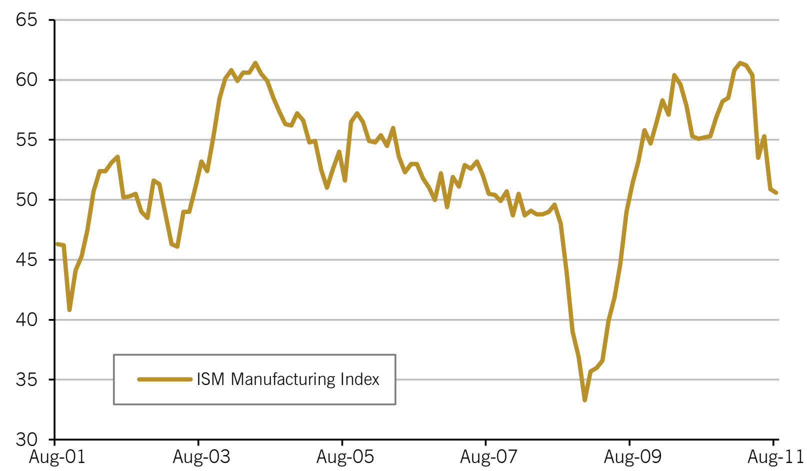


Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

ISM MANUFACTURING INDEX

The ISM report is a national survey of purchasing managers covering numerous metrics. A reading over 50 indicates expansion relative to the prior month, while a reading under 50 indicates contraction. Manufacturing activity remains expansionary, albeit barely (at 50.6), and is at the lowest levels in two years.

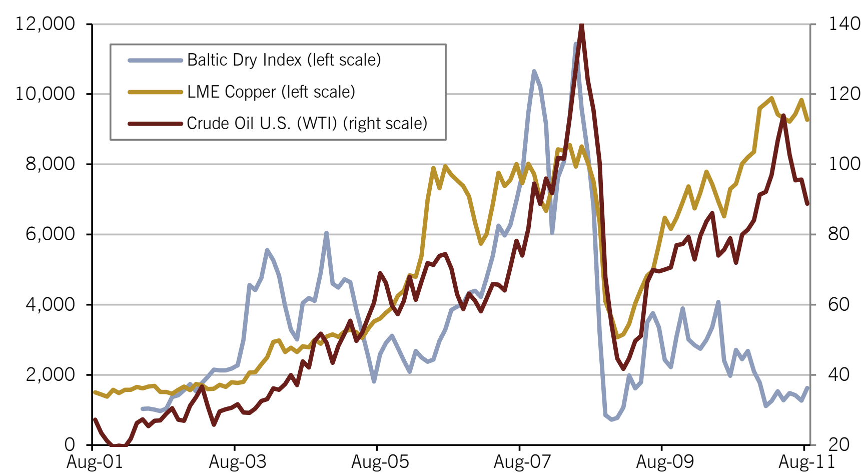
Advantage: Neutral



BALTIC DRY INDEX & COMMODITIES

The Baltic Dry Index, a measure of shipping costs used to gauge world trade, remains stagnant. Meanwhile, demand for copper, which is used heavily in construction and manufacturing, has hit a plateau.

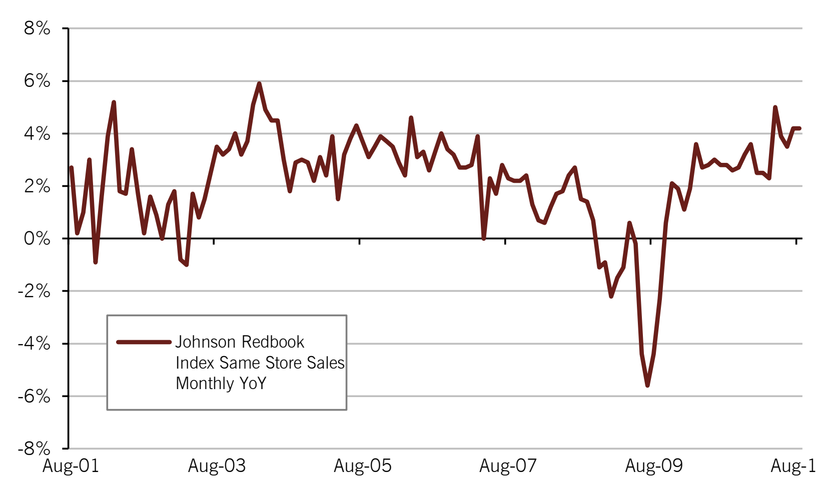
Advantage: Neutral



RETAIL SALES

Retail sales figures can be an indicator of economic recovery. Figures were mixed in August, but the impact of Hurricane Irene's disruption on back-to-school sales won't be known until September's report.

Advantage: Neutral

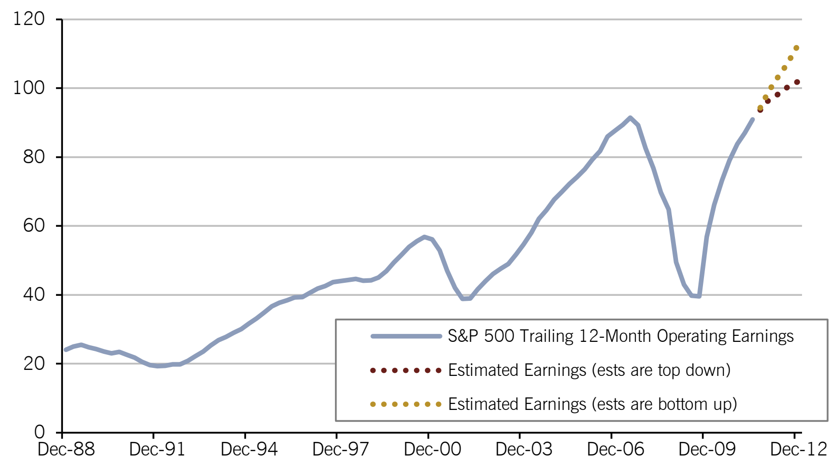


Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

CORPORATE EARNINGS

Despite a slowdown in the domestic economy, corporate earnings are still showing plenty of resilience, largely due to overseas sales. However, the rate of growth may decelerate in upcoming quarters as the economic weakness filters through to profits and year-over-year comparisons become more difficult.

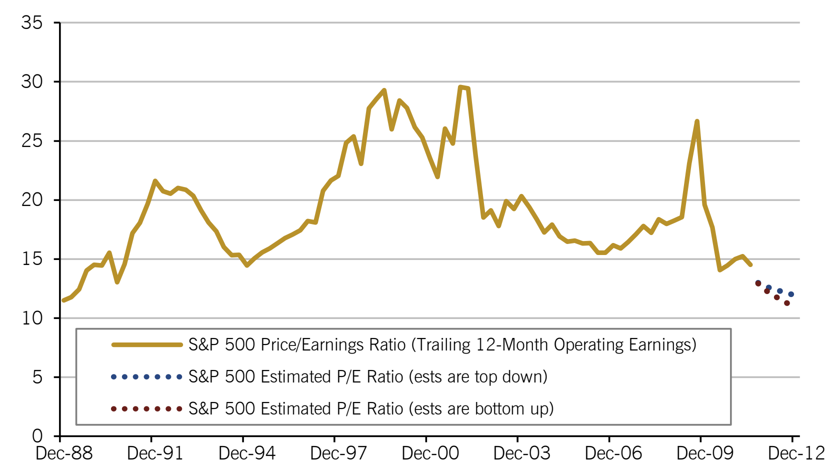
Advantage: Neutral to Bullish



STOCK MARKET VALUATIONS

Trailing 12-month P/E valuations for the S&P 500 look reasonable (slightly below historical norms), helping investors somewhat offset macro worries. However, longer-term methods of measuring valuations, such as the normalized P/E ratio developed by Yale economist Robert Shiller, remain a bit elevated (over 20).

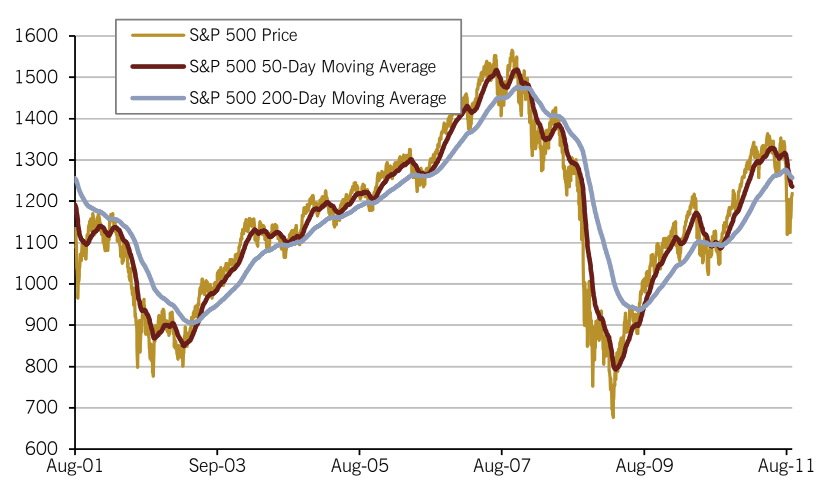
Advantage: Neutral to Bullish



STOCK MARKET TECHNICALS

The level of the S&P 500 50-day moving average has fallen below the 200-day moving average (the so-called "Death Cross"), which is interpreted by many as a bearish signal.

Advantage: Bearish

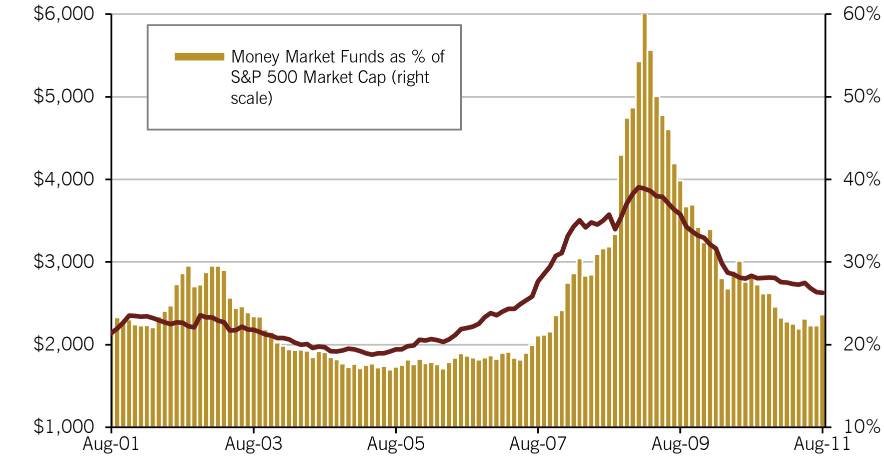


Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

MONEY MARKET FUNDS ASSETS

Despite the recent fall in stocks, assets in money market funds yielding next to nothing continue to decline and are at their lowest level since before the credit crisis began.

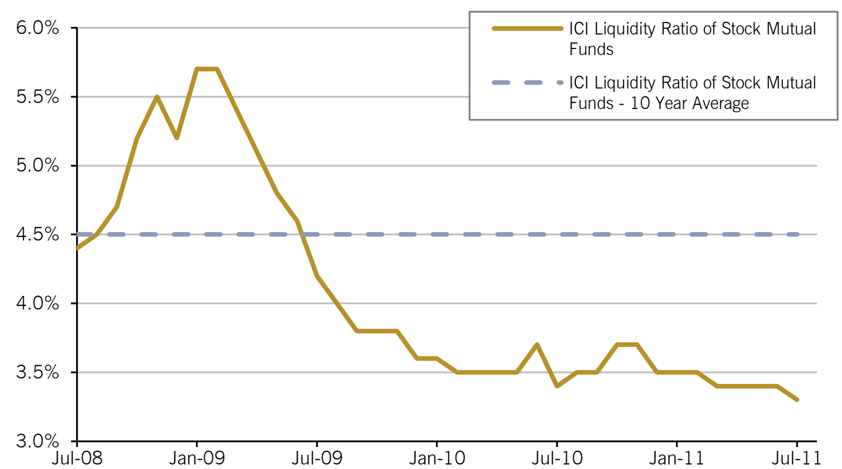
Advantage: Neutral



MUTUAL FUND LIQUIDITY RATIO

The liquidity ratio compares the amount of cash relative to total assets held by stock mutual funds. As stocks tumbled in 2009, mutual funds were bearish and sitting on significant cash. Since then, most of that cash has been put to work (meaning little in additional cash to invest) and managers are holding an unusually low level of dry powder.

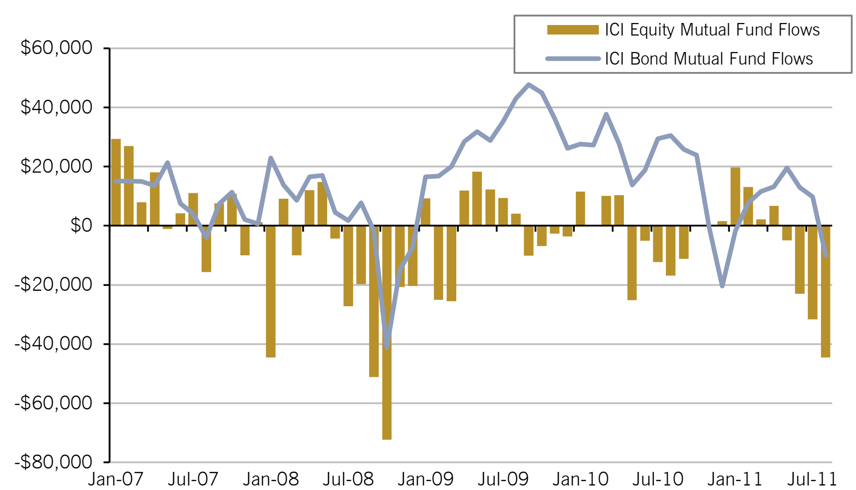
Advantage: Bearish



MUTUAL FUND CASH FLOWS

Over the past month, stock mutual funds experienced the largest level of redemptions since 2008, as investors clearly do not want to sit through another 2008/2009 type of meltdown. According to ICI, over the past four months some $104 billion has flowed out of equity funds.

Advantage: Neutral

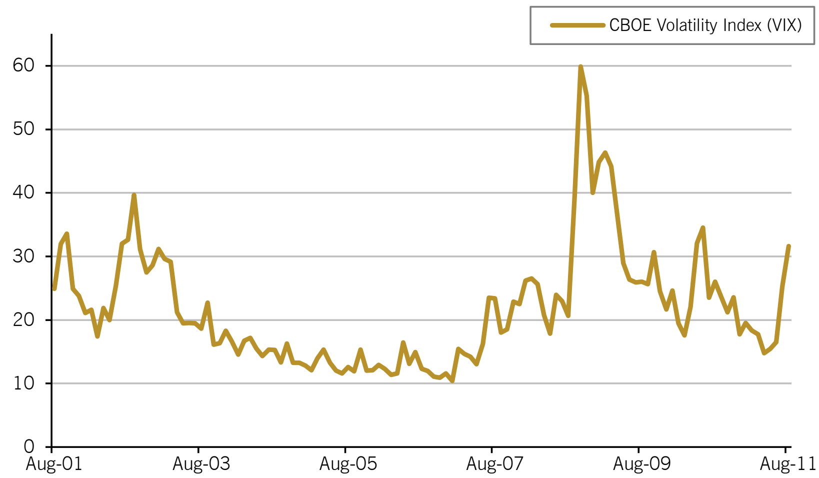


Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

STOCK MARKET VOLATILITY

Volatility, as measured by the Chicago Board Options Exchange Volatility Index (VIX), spiked in August to levels not sustained since the credit crisis in 2008/2009. Readings in excess of 30 generally correspond with times of investor fear or uncertainty, while values below 20 are typically associated with less stressful times.

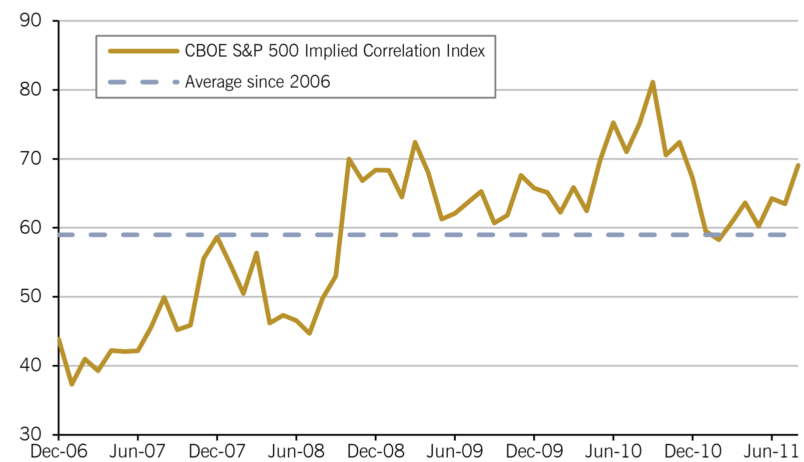
Advantage: Neutral to Bearish



CORRELATIONS

Correlations between stocks that comprise the S&P 500 have spiked in the recent correction as selling has been indiscriminate. The high correlations indicate a difficult environment for active management as stock pickers have seen limited opportunities to outperform.

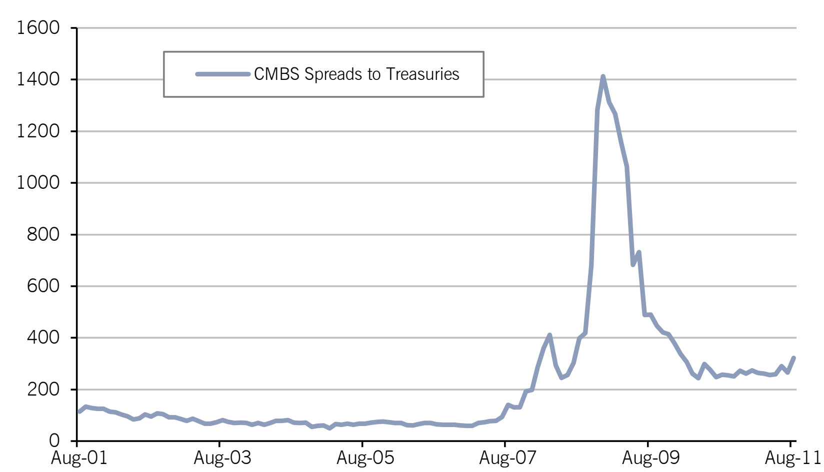
Advantage: Neutral



CMBS SPREADS

Spreads on the yields of commercial mortgage-backed securities over swap rates and Treasuries jumped a bit in the recent month as macroeconomic issues (U.S. unemployment and European sovereign debt) roiled the market.

Advantage: Neutral

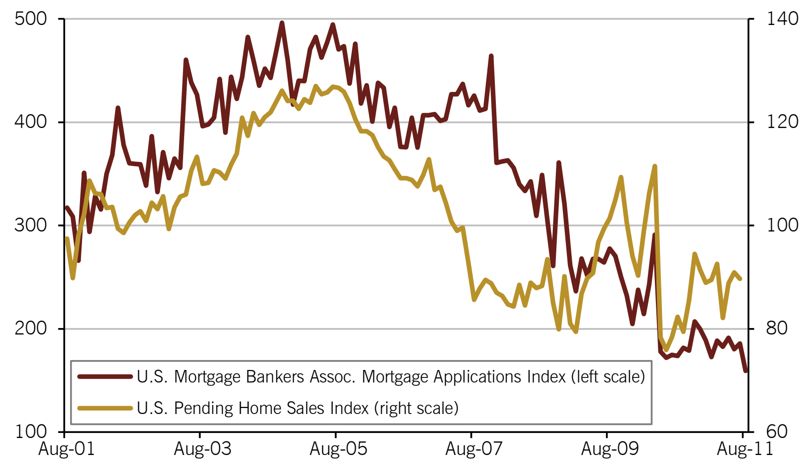


Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

MORTGAGE APPLICATIONS AND PENDING HOME SALES

Mortgage applications have plunged to a 15-year low as homebuyers hold off purchasing in the face of high unemployment. Even with record low mortgage rates and affordability, some fear that without further job growth there might not be significant improvement to sales.

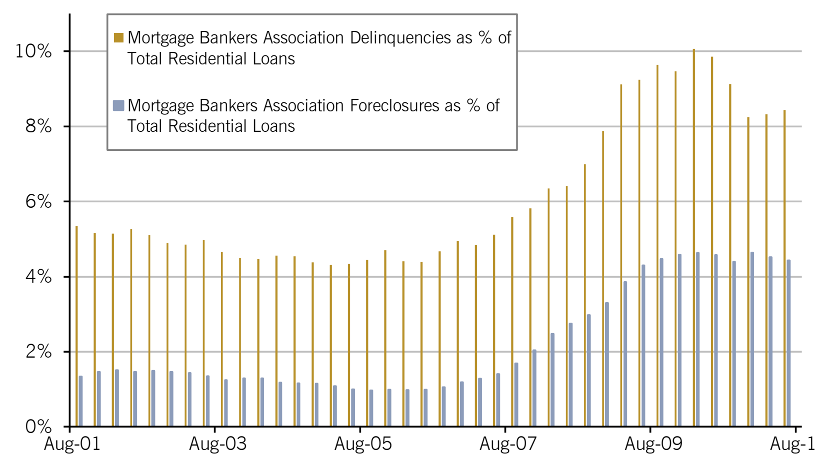
Advantage: Bearish



RESIDENTIAL DELINQUENCIES AND DEFAULTS

Mortgage delinquencies and foreclosures remain elevated but below 2010 peaks. Many expect the overall rate to slowly trend lower but remain above typical averages for some time.

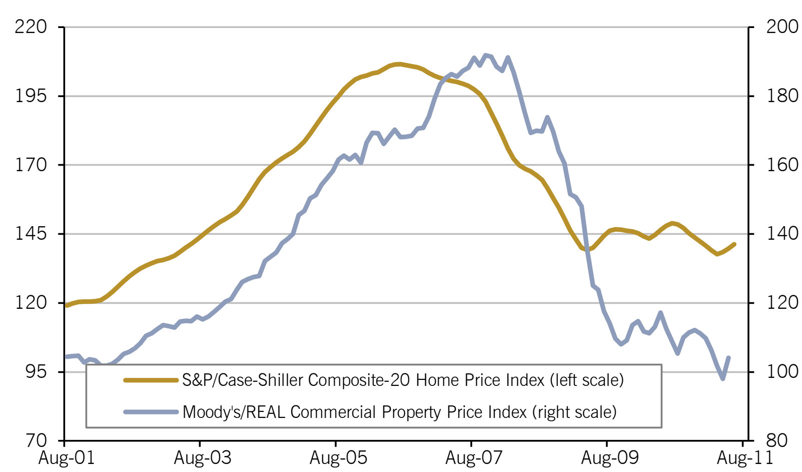
Advantage: Bearish



RESIDENTIAL/COMMERCIAL PROPERTY PRICE INDICES

Home prices rose for the third straight month, but remain below year-ago levels due to mixed signals regarding whether a housing recovery is taking shape. Meanwhile, commercial property prices have inched off record lows, but remain down about 45% from peak levels.

Advantage: Bearish

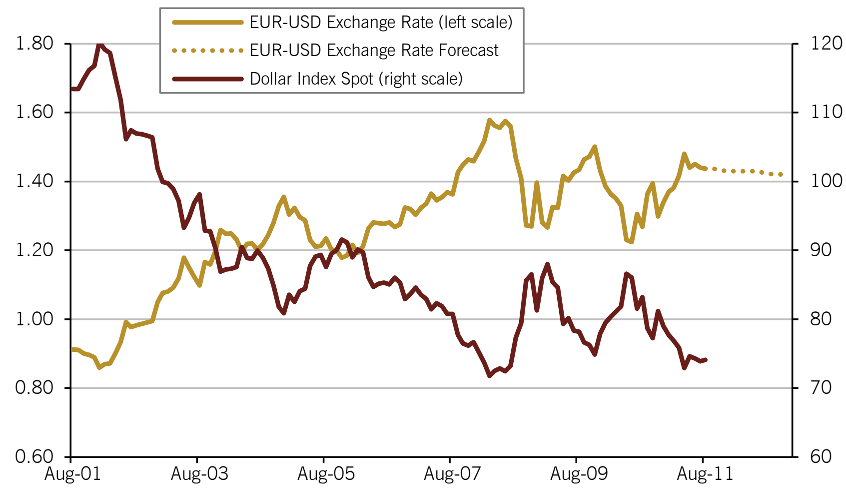


Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

U.S. DOLLAR

The U.S. dollar has been stable during the recent market turmoil, but remains near its 2008 low. Though the dollar is not expected to lose its reserve currency status anytime soon, worries about slow U.S. economic growth and the country's heavy debt burden are likely to hinder the greenback going forward.

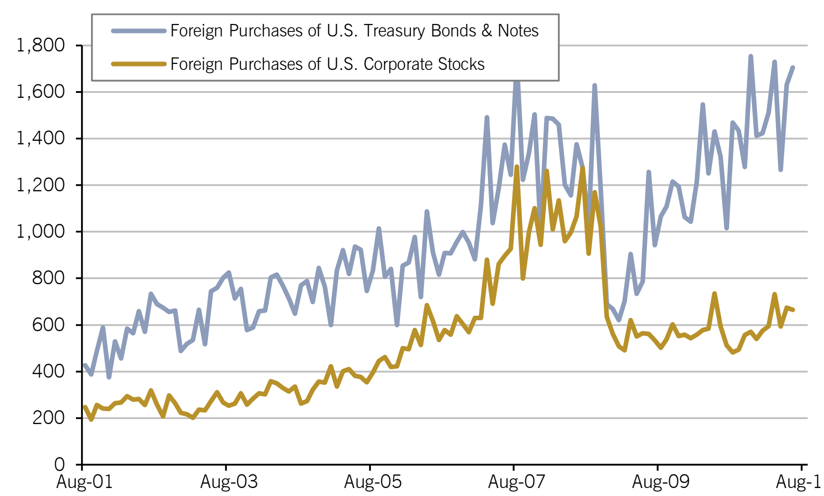
Advantage: Neutral



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

Despite worries about the U.S. government debt downgrade, foreign purchases of U.S. bonds (though not stocks) remain heavy. A longer-term worry is that high government debt levels could cause major foreign buyers, such as China, to either demand higher U.S. interest rates or stop buying Treasuries altogether.

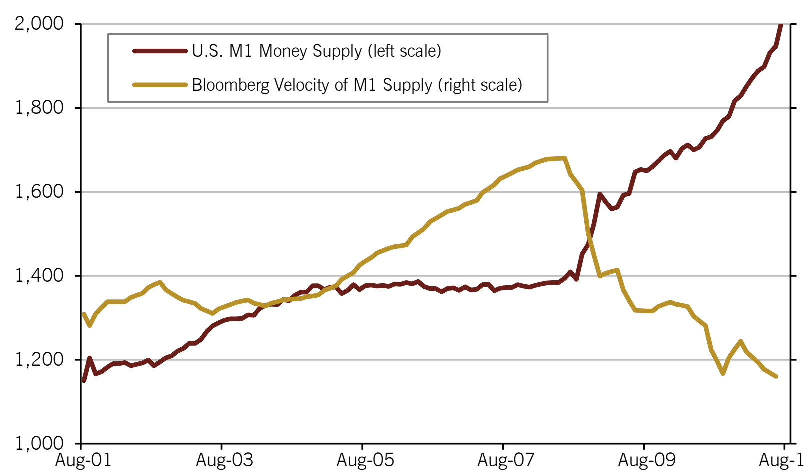
Advantage: Neutral



U.S. M1 MONEY SUPPLY AND VELOCITY

With the recent stimulus, M1 has spiked to unprecedented levels, causing fears of inflation and U.S. dollar weakness. The velocity of money, however, remains low as consumers and businesses are not spending or borrowing at high levels. Any increase in velocity could provide insight into future inflation.

Advantage: Neutral

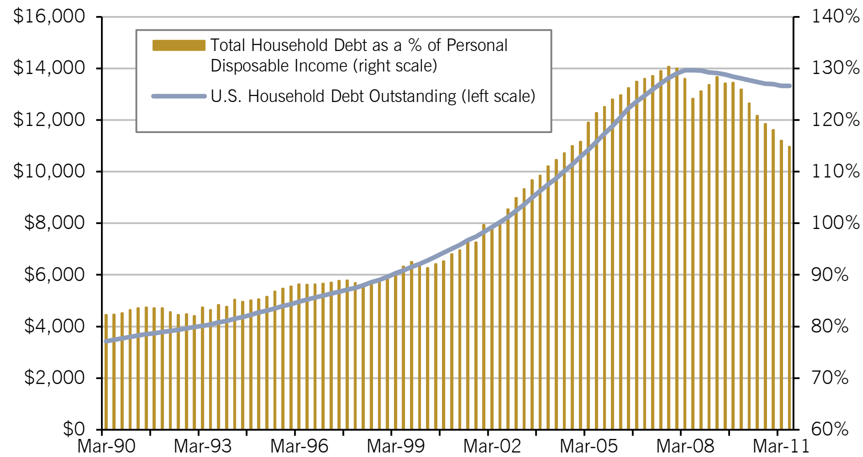


Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

U.S. HOUSEHOLD DEBT AS A PERCENTAGE OF DISPOSABLE INCOME

U.S. household debt (including mortgages and consumer credit) and, in particular, the percentage of disposable personal income it represents, continue to decline. However, the ongoing deleveraging cycle and the thrift that accompanies it will likely be a headwind to the economic recovery for several years.

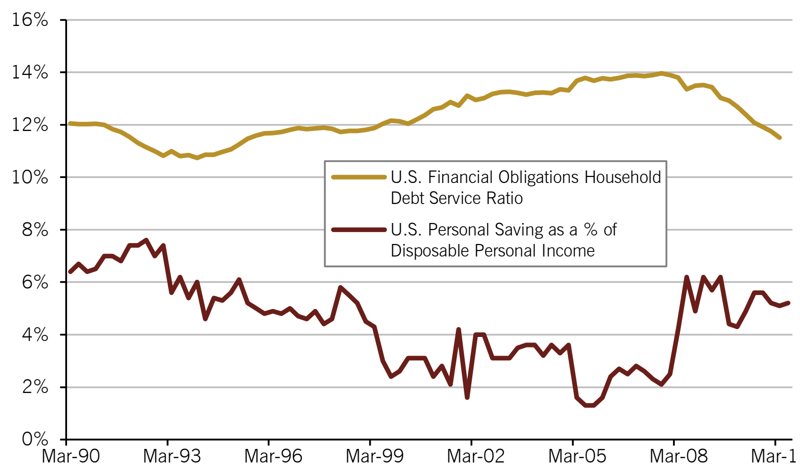
Advantage: Neutral to Bearish



U.S. SAVINGS AND HOUSEHOLD DEBT SERVICE RATIO

The debt service ratio measures the amount households spend on debt payments as a percentage of their earnings. Despite the increase in total debt over the past 20 years, lower borrowing costs have eased the burden of servicing this debt, freeing cash flow for other spending. However, if rates spike, so too would debt payments not locked in with fixed rates.

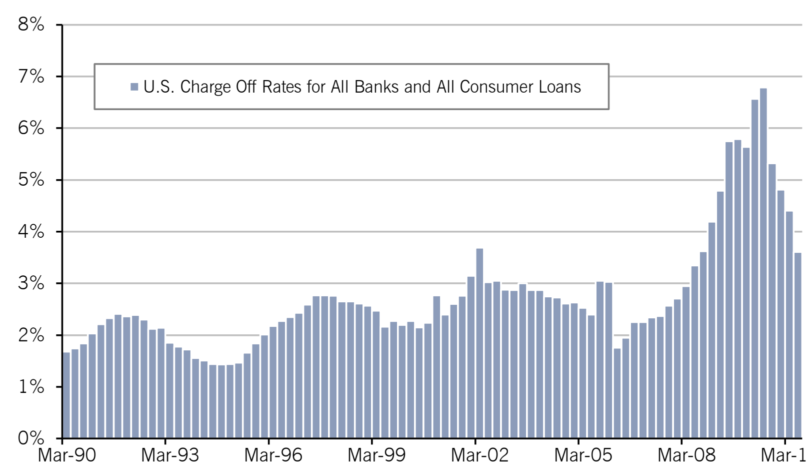
Advantage: Neutral to Bearish



U.S. CONSUMER LOAN CHARGE-OFF RATES

Default rates on consumer bank loans (excluding real estate) have declined significantly, particularly for credit card users. Still, there is not much increase in the willingness of banks to lend or for consumers to borrow.

Advantage: Neutral to Bearish



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

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