

Commentary

Despite some angst, stocks ended the second quarter having gone nowhere fast, with the S&P 500 ending just about where it started three months ago. The second round of quantitative easing (QE2) has now come and gone, and while stocks performed quite well while the program was in place, its long-term impact on the economy remains to be seen.

There are plenty of things we are keeping an eye on, including: the U.S. budget deficit, the August 2 deadline for raising the debt ceiling (the odds of a U.S. default are being pegged as remote, but delays in getting the issue resolved are causing market anxiety); default issues in Greece and the rest of the Eurozone (Greece appears to have at least momentarily averted a disorderly default process); Chinese overheating and the fear of a hard landing (policy tightening there and the recent decline in commodity prices have helped bring headline inflation down from peak levels); anemic U.S./global economic growth; stubbornly high unemployment; and a double dip in the real estate market.

Most expect the recent soft patch in the economy to be temporary, though its impact on corporate earnings will be closely evaluated in the upcoming weeks. The risk of recession appears to be contained and the prevailing view is that economic growth will rebound somewhat in the second half of the year with no need for QE3 on the horizon. With respect to stocks, we feel continued supportive Fed policy (ultra low short-term interest rates), strong corporate balance sheets, and reasonable valuations support a positive view of the markets over the intermediate term. While the trajectory of equity returns may not be as steep over the remainder of the year as compared to the past two years, we do not currently find a compelling enough reason to reduce exposure to stocks.

CONVERGENT TACTICAL POSITIONING

- We are underweight our strategic core fixed income target, given an intermediate-term risk in the ability of bonds 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 the real assets bucket, 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

OVERVIEW OF THE EQUITY AND FIXED INCOME MARKETS

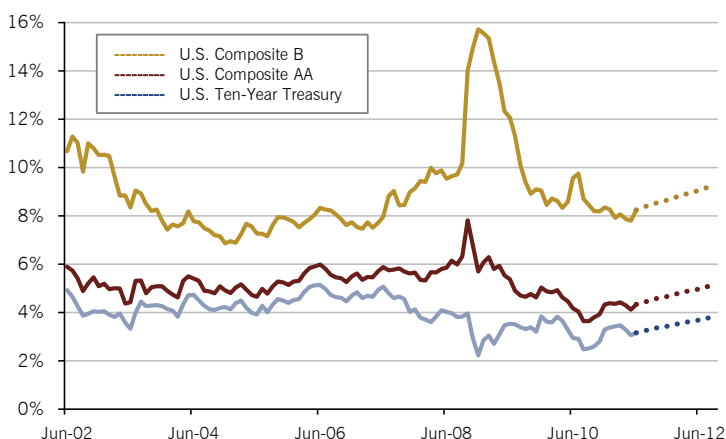
S&P 500 PRICE

The S&P 500 posted its second consecutive monthly decline in June, though a strong rebound in the final week limited the losses to less than 2% and brought the index to flat for the quarter. At the 2011 midpoint, the S&P 500 is up approximately 6% year-to-date, with nearly all of those gains coming in the first three months of the year.



CREDIT YIELDS

Despite spending much of June below 3.0%, the yield on the ten-year Treasury note rose to near 3.2% by month's end as QE2 ended. With the Fed out of the picture, some wonder who will pick up the slack in buying Treasuries. The Greek parliament's agreement on an austerity package also contributed to higher yields, reversing the prior weeks' flight to safety.



SUMMARY OF CURRENT EQUITY MARKET LEANINGS

- Our overall equity allocation is at a neutral weighting
- Several key factors (monetary policy, valuations, and corporate balance sheets) are supportive of stock markets, and we believe the risk of a recession is contained and economic growth will continue (though slow and choppy).
- Within the equity bucket, we are overweight U.S. and emerging market equity while underweight long/short equity.

BULLS

Strong corporate balance sheets/reasonable valuations

Monetary policy remains accommodative

Cash (dry powder) on sideline

BEARS

Stagnant economic growth in U.S. / hard landing in China

U.S. budget deficit/debt ceiling issues/European debt crisis

Commercial/residential real estate double dip




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SUMMARY

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

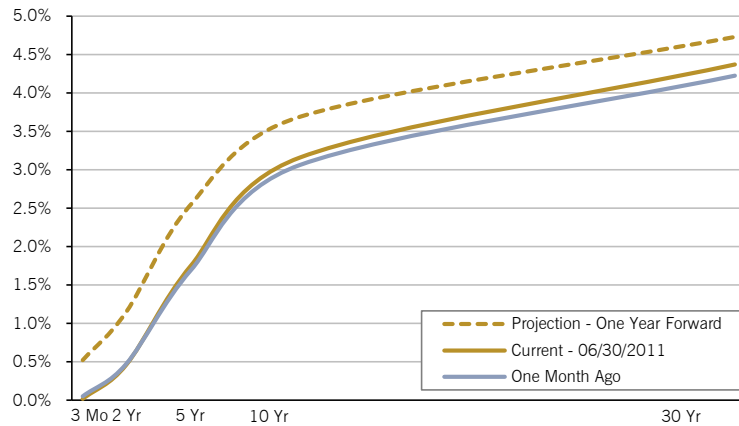
<p>CREDIT MARKETS U.S. Treasury Yield Curve T-Bills, Federal Funds, and Inflation LIBOR/T-Bill Rates and TED Spread</p>	<p>Bullish Neutral to Bullish Neutral to Bullish Bullish</p>	<p>Notes curve remains steep indicating recession is not anticipated supportive Fed despite end of QE2; inflation looks contained low spread = little anxiety</p>
<p>THE ECONOMY AND THE CONSUMER Consumer Confidence and Unemployment U.S. Consumer Income and Spending LEI and ECRI</p>	<p>Mixed Neutral to Bearish Neutral Neutral to Bullish</p>	<p>employment has stalled; confidence has faltered high unemployment and gas prices have hindered spending leading indicators resume upward trend</p>
<p>THE ECONOMY AND SUPPLIERS ISM Manufacturing Index Baltic Dry Index and Commodities Retail Sales</p>	<p> Neutral to Bullish Bullish Neutral Neutral</p>	<p>bounce back in June as supply disruptions waned oil declined as IEA released reserves; BDI remains stagnant consumers cautious but could shop more as gas prices ease</p>
<p>U.S. CORPORATIONS Corporate Earnings Stock Market Valuations Stock Market Technicals</p>	<p>Bullish Neutral to Bullish Neutral to Bullish Bullish</p>	<p>S&P 500 earnings expected to reach record levels trailing 12-month P/E near historic norms S&P 500 50-day average > 200-day average</p>
<p>INVESTOR FLOWS AND LIQUIDITY Money Market Funds Assets Mutual Fund Liquidity Ratio Mutual Fund Cash Flows</p>	<p>Mixed Neutral to Bullish Bearish Neutral</p>	<p>investor dry powder down to pre-crisis levels mutual fund managers holding low levels of cash positive cash inflows in May for bonds; outflows for stocks</p>
<p>FEAR MEASURES Stock Market Volatility U.S. Short Interest CMBS Spreads</p>	<p>Neutral to Bullish Neutral to Bullish Neutral Neutral</p>	<p>VIX at 16.5 -- low levels indicate little investor stress has been in a narrow band for some time in a stable, though elevated, range since last year</p>
<p>REAL ESTATE Mortgage Applications and Pending Sales Residential Delinquencies and Defaults Residential/Commercial Property Price Indicators</p>	<p>Bearish Bearish Bearish Bearish</p>	<p>hindered by high unemployment and large inventory have hit a plateau at high levels at 2003 levels; foreclosures providing downward pressure</p>
<p>CURRENCY U.S. Dollar Foreign Purchases of U.S. Securities U.S. M1 Money Supply and Velocity</p>	<p>Neutral Neutral Neutral Neutral</p>	<p>budget deficit is weighing on the U.S. dollar purchases of U.S. securities waned in April, but so did sales M1 at unprecedented levels but velocity is low</p>
<p>BORROWING U.S. Household Debt U.S. Savings and Debt Service Ratio U.S. Consumer Loan Charge-Off Rates</p>	<p>Neutral to Bearish Neutral to Bearish Neutral to Bearish Neutral to Bearish</p>	<p>deleveraging cycle will likely be a headwind for several years an increase in rates could raise debt servicing costs remain at very high historical levels</p>

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).

U.S. TREASURY YIELD CURVE

The long end of the Treasury yield curve shifted higher in June as QE2 ended, Greece saw some resolution, and the debt ceiling drama continued to play out. As short-term rates remain extremely low, the curve is at an extremely steep slope. For many, expectations of a recession are remote even though growth may be slow.

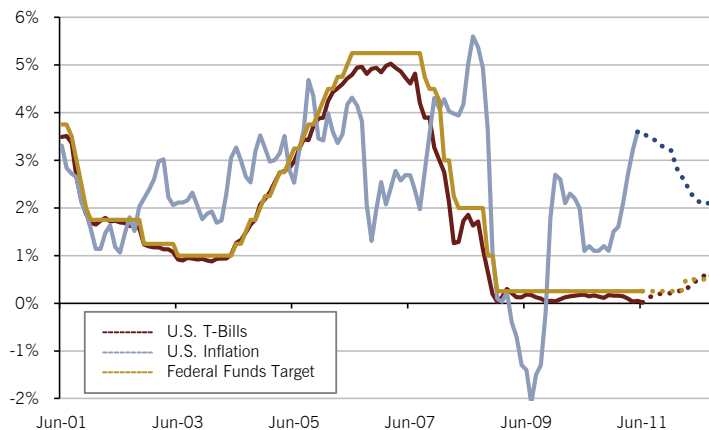
Advantage: Neutral to Bullish



T-BILLS, FEDERAL FUNDS, AND INFLATION

Consumer prices are up 3.6% on an annual basis, the largest amount since late 2008. However, the Fed believes the recent surge will subside and that longer-term expectations are still in check due to high unemployment, a soft real estate market, and low capacity utilization. Most do not see the Fed raising short-term rates until later in 2012.

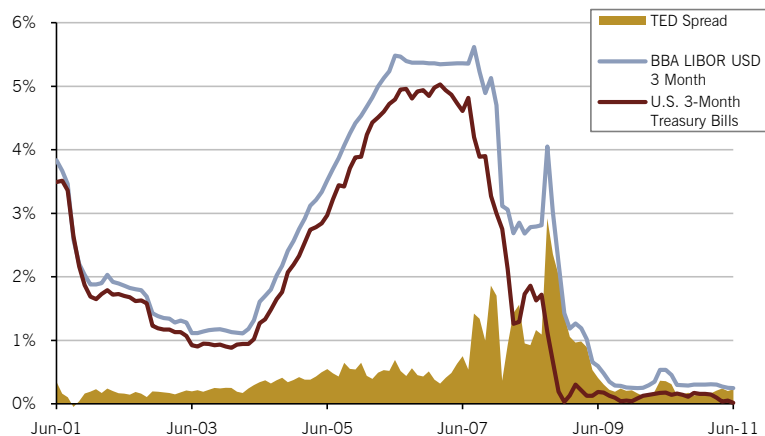
Advantage: Neutral to Bullish



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 uncertainty with the situation in Greece, spreads remain low and illustrate credit markets are not worried about any near-term liquidity challenges.

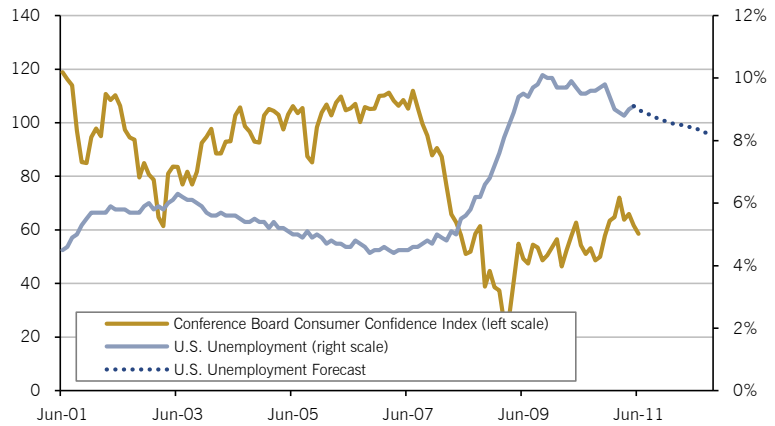
Advantage: Bullish



CONSUMER CONFIDENCE AND UNEMPLOYMENT

Despite a pullback in gasoline prices, consumer confidence fell again in June and is now at its lowest reading since last November. The drop reflects a less than favorable outlook for the jobs market.

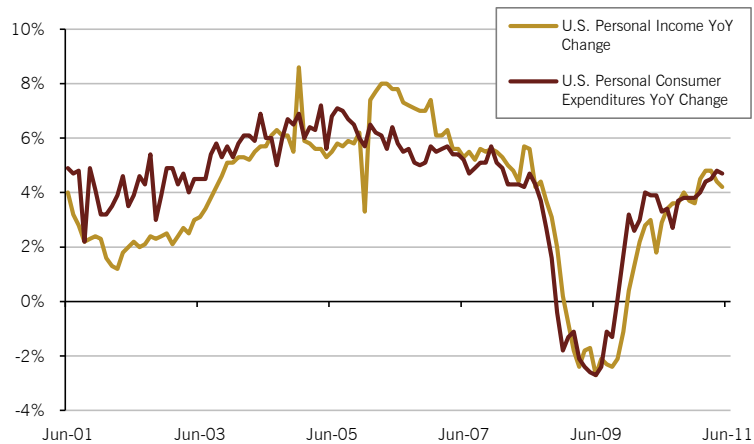
Advantage: Neutral to Bearish



U.S. CONSUMER INCOME AND SPENDING

Consumers put spending on hold in May amid worries about unemployment and higher gasoline and food prices. Lower spending levels provide additional evidence that the recovery slowed in the second quarter.

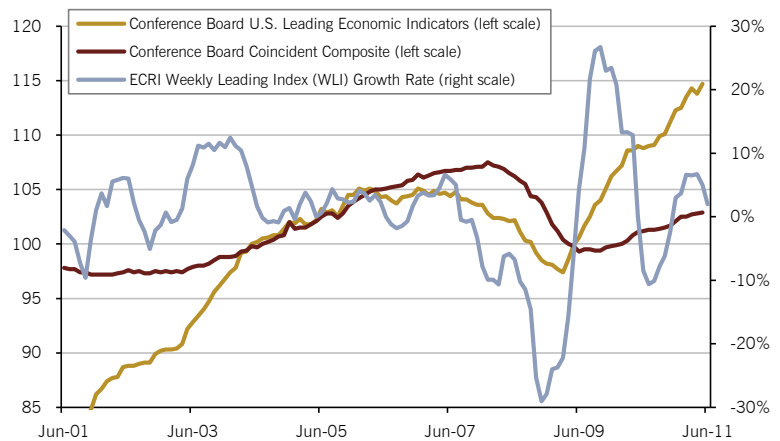
Advantage: Neutral



LEI AND ECRI

The U.S. index of leading economic indicators (LEI) resumed its upward trend in May, thanks in part to declining fuel costs and an easing of supply disruptions due to the earthquake in Japan. While the uptrend points to continued growth in coming months, most expect the path to be slow and choppy.

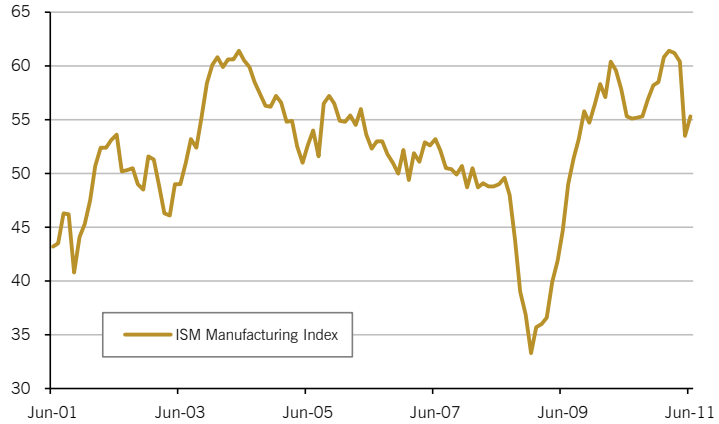
Advantage: Neutral to Bullish



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. As costs declined and disruptions associated with the earthquake in Japan subsided, activity accelerated in June for the 23rd consecutive month of expansion.

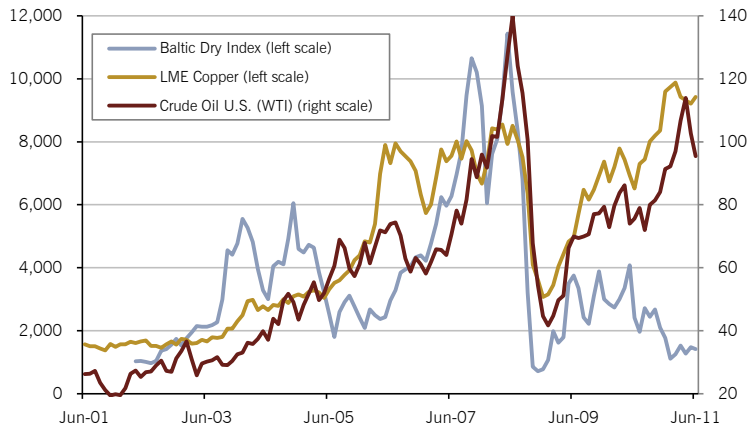
Advantage: Bullish



BALTIC DRY INDEX & COMMODITIES

Oil prices have retreated thanks in part (and perhaps only temporarily) to the International Energy Agency's unexpected announcement of the release of oil reserves intended to make up for lost production due to the Libya crisis. Meanwhile, the Baltic Dry Index, a measure of shipping costs used to gauge world trade, remains stagnant.

Advantage: Neutral



RETAIL SALES

Retail sales figures are an indicator of economic recovery. Consumers remained cautious through much of June, especially with regard to motor vehicles and parts, though the month ended on an encouraging note prior to the holiday weekend.

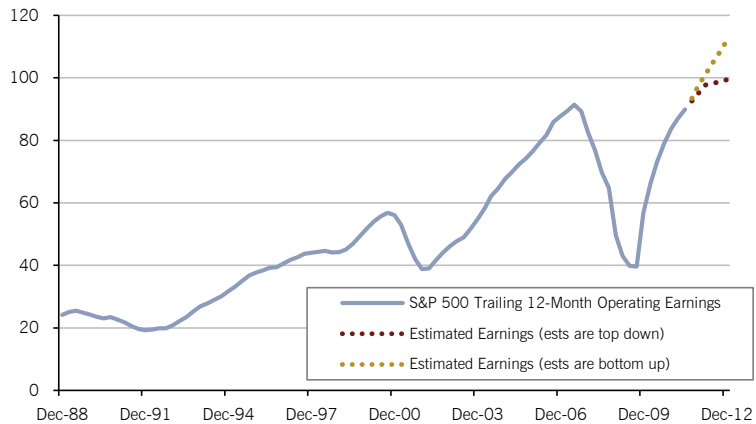
Advantage: Neutral



CORPORATE EARNINGS

All eyes are looking to Q2 earnings announcements to see how corporations have handled the recent economic softness. Earnings are expected to reach record highs in the second half of 2011. However, the rate of growth may taper off as year-over-year comparisons to 2010 become more difficult.

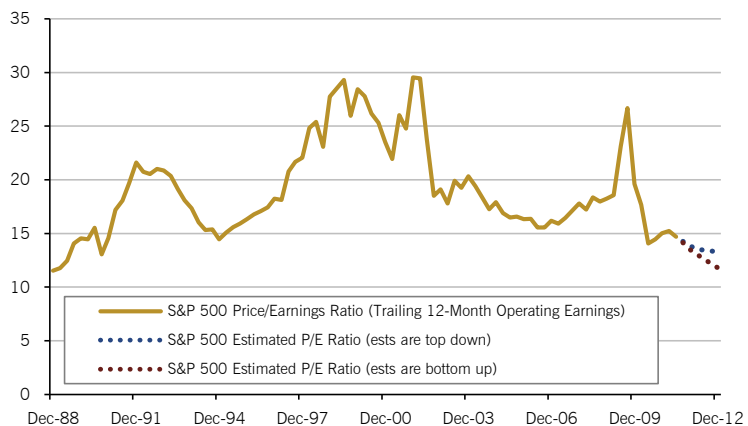
Advantage: Neutral to Bullish



STOCK MARKET VALUATIONS

Strong earnings growth has helped trailing 12-month P/E valuations look reasonable (slightly below historical norms). 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 22).

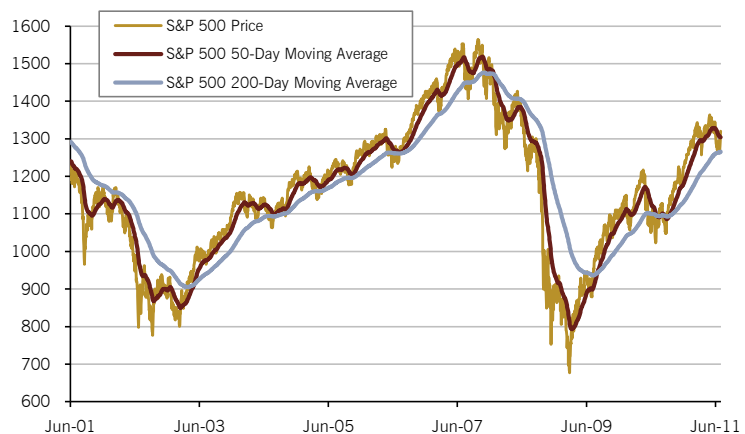
Advantage: Neutral to Bullish



STOCK MARKET TECHNICALS

The S&P 500 50-Day moving average is higher than the 200-Day moving average, which is interpreted by many as a bullish signal.

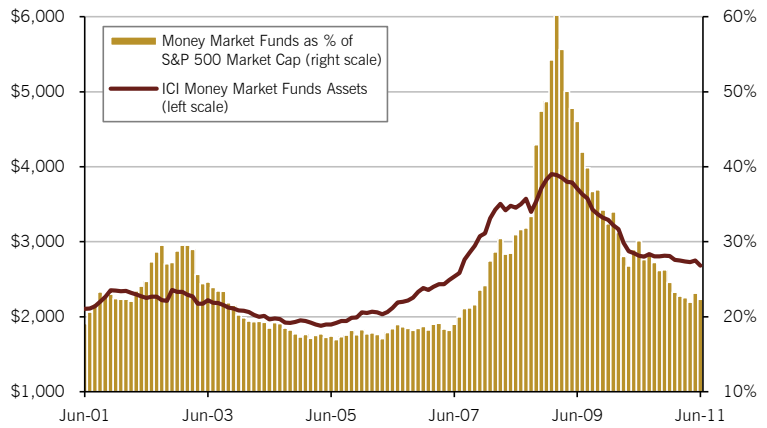
Advantage: Bullish



MONEY MARKET FUNDS ASSETS

Money market fund assets continued their decline in June and are now at their lowest level since before the credit crisis began. However, investors still have plenty of dry powder on the sidelines.

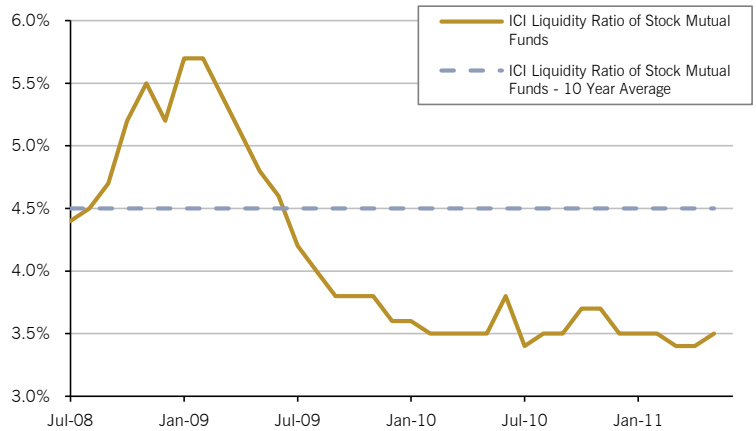
Advantage: Neutral to Bullish



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).

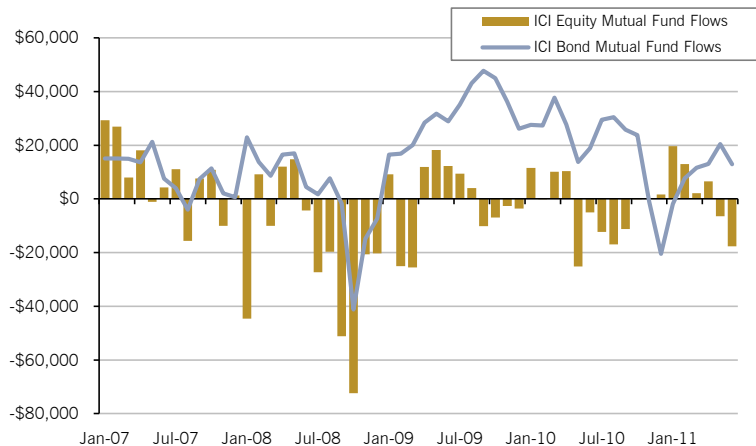
Advantage: Bearish



MUTUAL FUND CASH FLOWS

After expressing interest in stocks at the beginning of the year, investors have been turning away from equities in favor of bonds. Bond funds saw positive inflows in June for the fifth consecutive month, while stock funds experienced net outflows for the second month in a row.

Advantage: Neutral

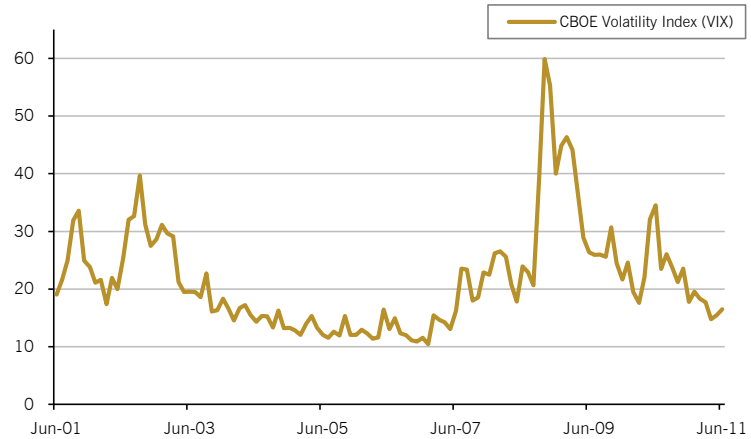


FEAR MEASURES

STOCK MARKET VOLATILITY

Volatility as measured by the Chicago Board Options Exchange Volatility Index (VIX) ended June only slightly higher than May at 16.5, remaining surprisingly low as investors continue to have faith in the market despite macro concerns. 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 in the markets.

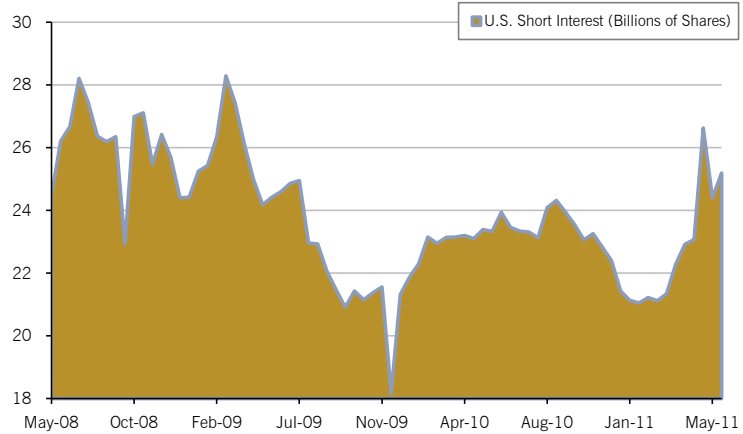
Advantage: Neutral to Bullish



U.S. SHORT INTEREST

Short interest can be a measure 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 rose in early June, but some suspect short covering contributed to the late month rally.

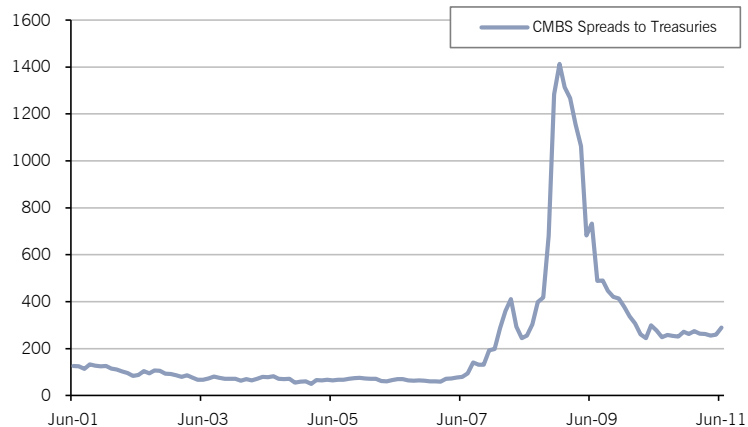
Advantage: Neutral



CMBS SPREADS

Even as the delinquency rate for commercial mortgage-backed securities remains at high levels, CMBS spreads over swap rates and Treasuries have been in a stable range since last year.

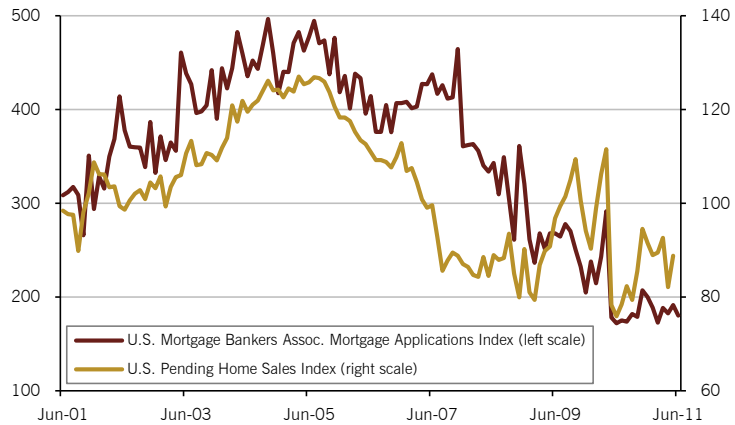
Advantage: Neutral



MORTGAGE APPLICATIONS AND PENDING HOME SALES

Pending home sales surged in May, perhaps pointing to increased housing activity in the second half of the year as falling prices have made properties more affordable. Still, the housing market recovery remains on shaky ground and is expected to progress unevenly thanks to continued high unemployment, tight lending standards, and a glut of inventory.

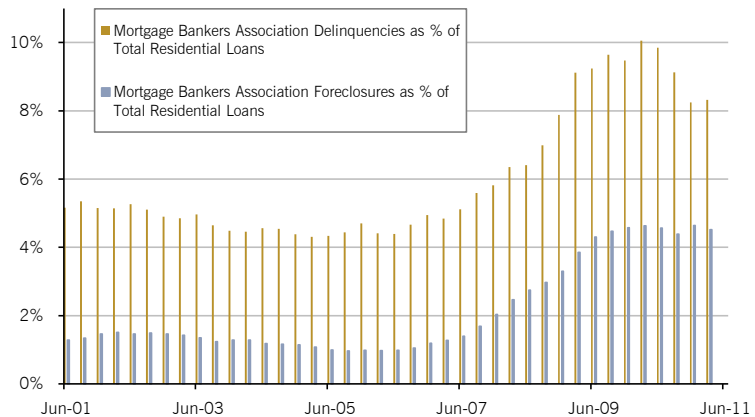
Advantage: Bearish



RESIDENTIAL DELINQUENCIES AND DEFAULTS

Mortgage delinquencies and foreclosures appear to have reached a plateau at relatively high levels, though some improvement has been seen in loans 90 days or more past due. Interestingly, half of all the loans in foreclosure are located in just five states: California, Florida, Arizona, Illinois, and Michigan.

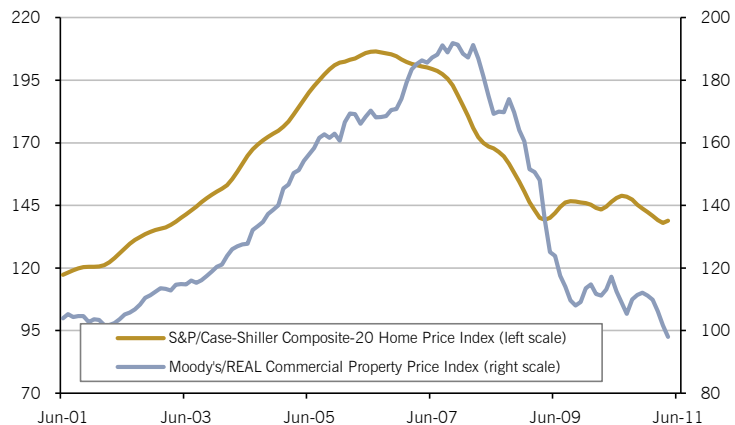
Advantage: Bearish



RESIDENTIAL/COMMERCIAL PROPERTY PRICE INDICES

U.S. residential home values rose in April as the spring home buying season was underway. The rise was the first increase in eight months. However, tight lending conditions, high unemployment, and a backlog of foreclosures continue to provide downward pressure on prices.

Advantage: Bearish

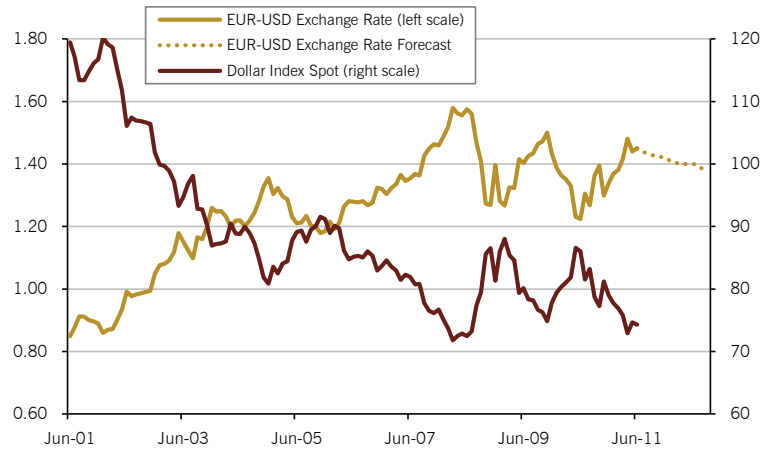


CURRENCY

U.S. DOLLAR

The U.S. dollar fell in June versus most major currencies. Though the dollar is not expected to soon lose its reserve currency status, worries about fundamental factors such as slower U.S. economic growth and the country's heavy debt burden are likely to hinder the greenback going forward.

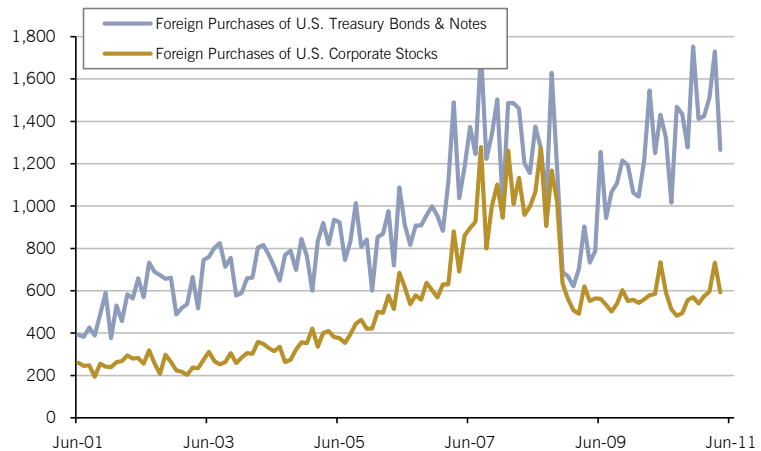
Advantage: Neutral



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

Worries about the U.S. government debt ceiling may have hindered global purchases of U.S. securities in April, though sales of such securities were also light. A longer-term worry is that high government debt levels could cause foreign buyers, such as China, to either demand higher U.S. interest rates or stop buying Treasuries altogether.

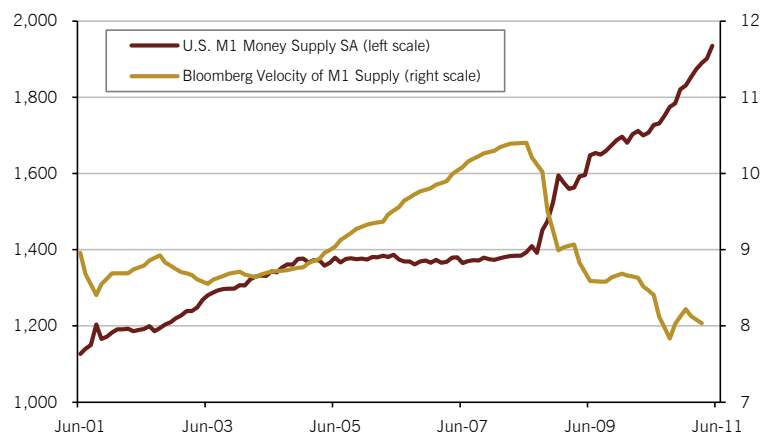
Advantage: Neutral



U.S. M1 MONEY SUPPLY AND VELOCITY

M1 consists of the most liquid forms of money, namely currency and checkable deposits. With the recent stimulus, M1 has spiked to unprecedented levels, causing fears of inflation and U.S. dollar weakness. Velocity of money (the rate at which money changes hands), 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

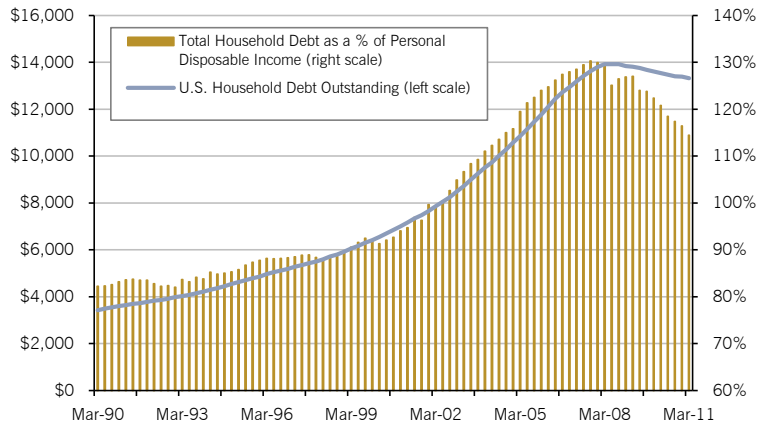


BORROWING

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

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

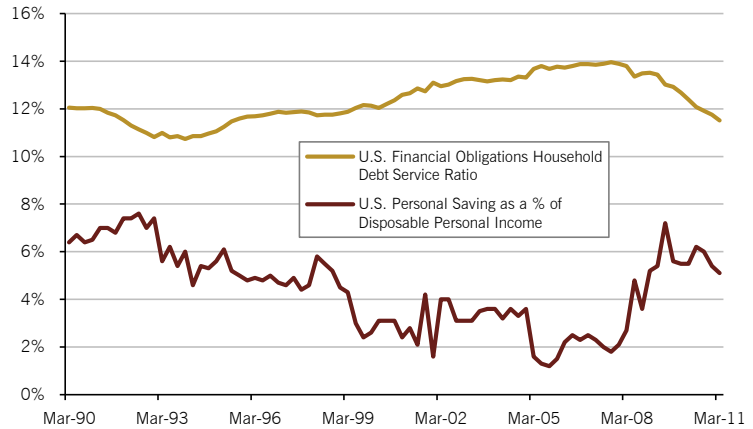
Advantage: Neutral to Bearish



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 and freeing cash flow for other spending. However, if rates spike, so too would debt payments not locked in with fixed rates.

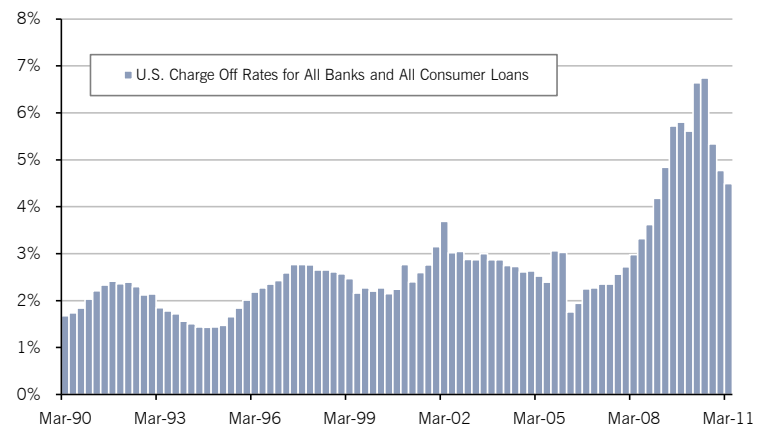
Advantage: Neutral to Bearish



U.S. CONSUMER LOAN CHARGE-OFF RATES

Given improvements in the labor market, banks are optimistic that they will not have to write off as many bad loans this year. Still, consumer bank loans (including credit cards but excluding real estate) written off as unrecoverable remain at very high levels on a historical basis.

Advantage: Neutral to Bearish



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