

Invest well. Manage well. Live well.™

MARCH 2011

CONVERGENT TACTICAL POSITIONING

Given an intermediate-term risk in the ability of bonds to preserve purchasing power, we are underweight our strategic core fixed income target. This risk comes if rates stay at historically low levels or prices are hurt by a further rise in yields. The underweight accommodates a shift to opportunistic credit segments (such as 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.

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Commentary

The surge in oil prices has been forefront on the minds of investors as of late -- and rightly so, as higher energy costs can have a meaningful impact on the economy. Crude oil prices surged nearly 20% during the first quarter, rising above \$100/barrel for the first time since 2008. Implications of higher prices are far reaching, including increased costs to producers and negative shifts in sentiment for consumers, each of which could cut into economic growth. But while most economists suggest higher oil prices are here to stay thanks to tight supply and increasing global demand, we do not believe they have reached levels yet that would produce a severe shock or recession. According to our research, prices would need to be sustained at around \$125/barrel through the summer in order to become an overt threat. And the impact of an oil shock might not be as painful as it once was, as the U.S. is striving to become less dependent upon oil. Nevertheless, if prices continue to rise, portfolios could benefit from exposure to broad commodities, energy equities, and emerging markets (stocks, bonds, and currencies).

Gold has been in the spotlight as well, with prices hitting record highs (in nominal terms). While some may suggest gold is reaching bubble-like levels (having risen in every calendar year over the past decade), we continue to believe a modest allocation is desirable as a portfolio hedge against global systemic shocks, paper currency aversion, and as protection in a spiking inflationary environment. In and of itself, gold is a very difficult asset to place a fair value on, and we recognize that increased investor ability to access the metal (via ETFs and futures) could lead to large price swings if sentiment shifts. Still, as the opportunity cost of holding this particular portfolio hedge remains relatively low (especially versus Treasuries or cash) and thematic reasons persist, we will continue to recommend a modest allocation.

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	

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

THE EQUITY AND FIXED INCOME MARKETS

S&P 500 PRICE

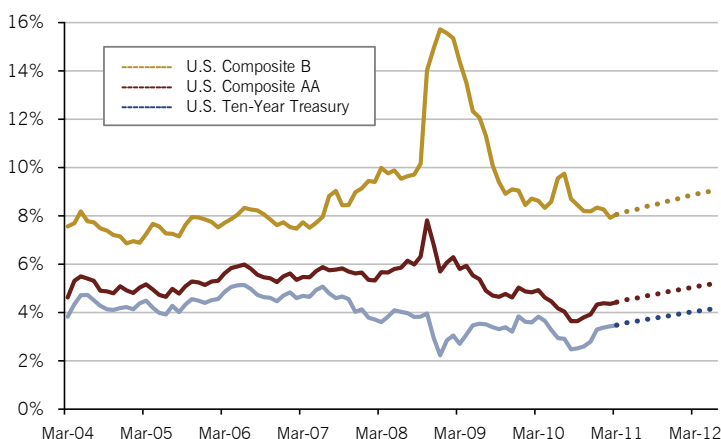
Neither Japan's nuclear crisis, continuing turmoil in the Middle East and North Africa, nor higher oil prices could prevent U.S. stocks from wrapping up a solid first quarter with a fourth straight month of gains (after including dividends).

Developed international stock benchmarks lagged, however, as Japan will take some time to fully recover.



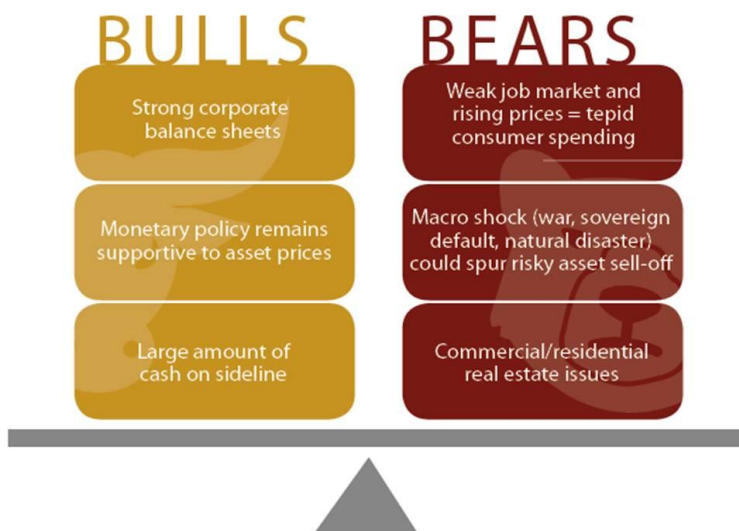
CREDIT YIELDS

Despite a mid-month flight to safety, yields of U.S. Treasuries ended March largely unchanged. The Federal Reserve, meanwhile, vows to continue its \$600 billion government bond-buying program and keep interest rates at low levels even as inflation and higher prices are gaining increased attention.



SUMMARY OF CURRENT EQUITY MARKET LEANINGS

Overall, we are at a neutral weighting (in line with strategic target) with regard to our equity allocation. While there are still some headwinds, we believe the global economy will continue its recovery and several factors (valuations, fundamentals, and technicals) are supportive of stock markets. Within the equity bucket, we are overweight U.S. and emerging market equity while underweight developed international and long/short equity.

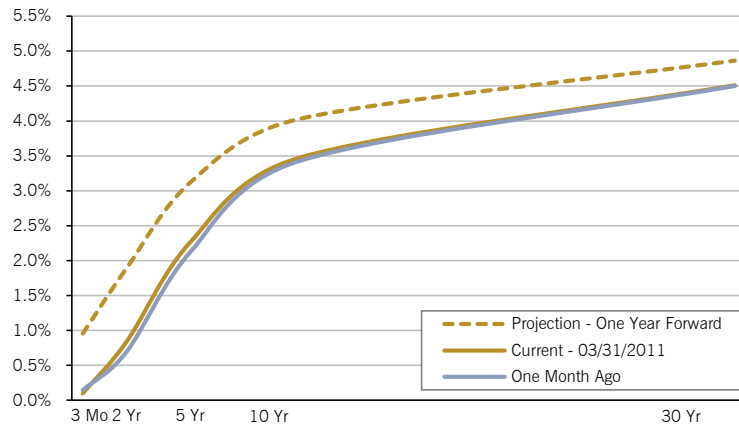


THE EQUITY AND FIXED INCOME MARKETS

U.S. TREASURY YIELD CURVE

The Treasury yield curve ended March largely unchanged. Still, as short-term rates remain exceptionally low, the curve is near the steepest level on record. For many, this indicates investor expectations of a continued improving economy.

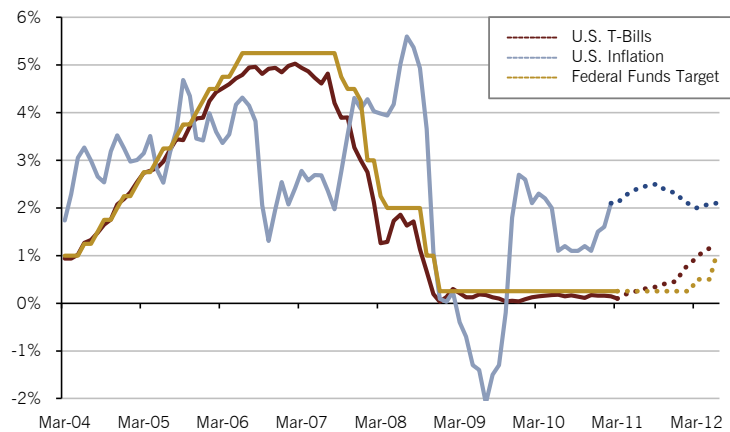
Advantage: Neutral to Bullish



T-BILLS, FEDERAL FUNDS, AND INFLATION

Higher energy prices combined with the steepest rise in food prices in decades contributed to a surge in producer prices. Still, the Federal Reserve believes the spike will be transitory and has stated that "long-term inflation expectations have remained stable." Most interpret this to mean the Fed will be in no hurry to raise interest rates.

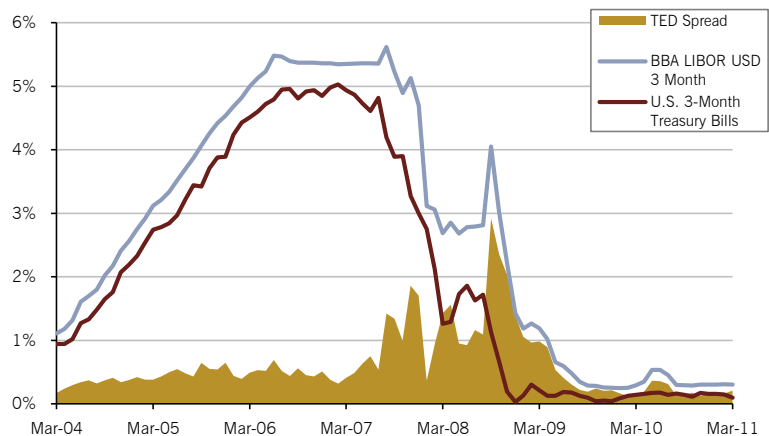
Advantage: Neutral to Bullish



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). Current low spreads illustrate credit markets are operating with little anxiety.

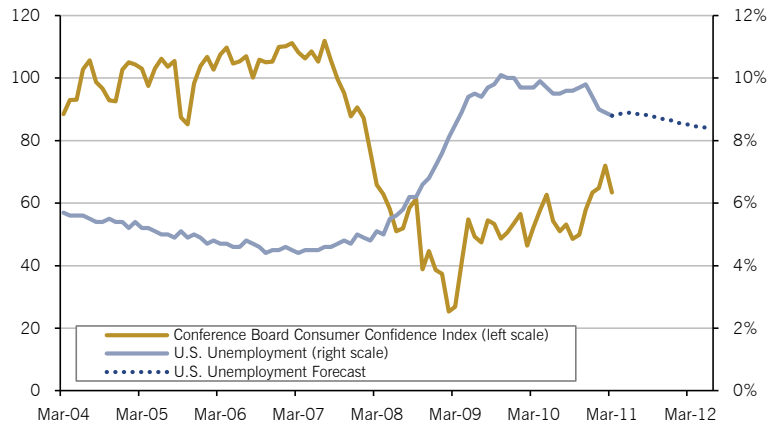
Advantage: Bulls



CONSUMER CONFIDENCE AND UNEMPLOYMENT

After rising for five straight months and hitting a three-year high in February, consumer confidence reversed course as shoppers started to worry about how rising gas and food prices will cut into household budgets. However, hiring has picked up and the unemployment rate fell to a two-year low of 8.8% in March.

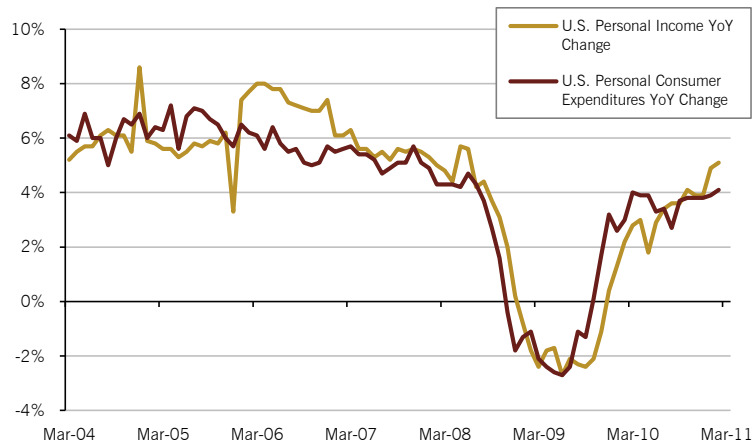
Advantage: Neutral to Bearish



U.S. CONSUMER INCOME AND SPENDING

Consumer income rose in February, but not enough to keep up with the rise in inflation (driven by higher fuel and food prices). Consumer spending also rose, but the increase in nominal terms was not so impressive once inflation was taken into consideration.

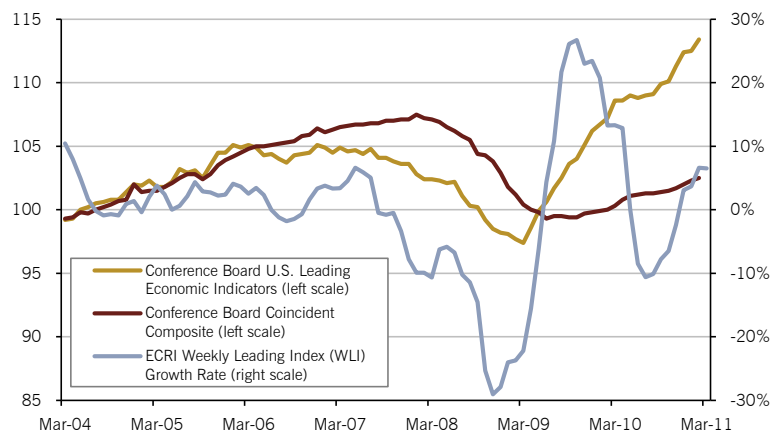
Advantage: Neutral



LEI AND ECRI

The U.S. leading economic index (LEI) continues to trend upward, notching its eighth consecutive gain in February and providing further evidence that the economic recovery has gained traction. Meanwhile, the index of coincident indicators has been rising at a more measured pace, illustrating the tepidness of the recovery thus far.

Advantage: Neutral to Bullish



ISM MANUFACTURING INDEX

The ISM report is a national survey of purchasing managers covering such indicators as new orders, production, employment, inventories, prices, and export/import orders. A reading over 50% indicates expansion relative to the prior month, while a reading under 50% indicates contraction. The latest reading was little changed from the previous month, representing the twentieth consecutive month of expansion.

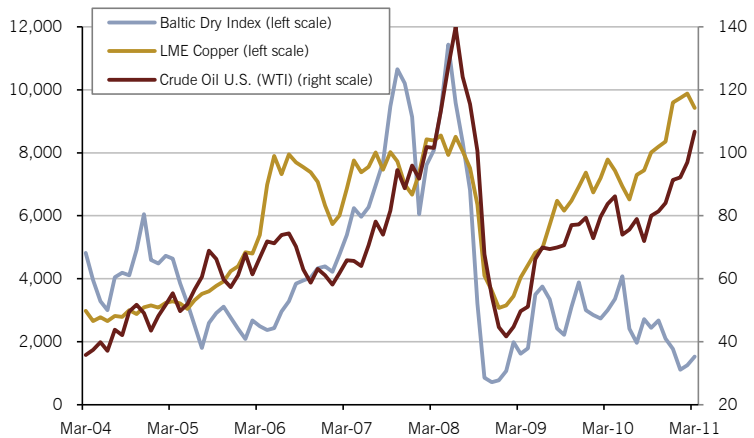
Advantage: Bulls



BALTIC DRY INDEX & COMMODITIES

The Baltic Dry Index (BDI) measures shipping costs for commodities and is used to evaluate world trade. Copper, a plentiful and heavily used metal in construction and manufacturing, can reflect trends in global economic growth. Recently there has been a huge divergence between the BDI and the price of commodities, and many feel the BDI says more about the oversupply of ships than the demand for cargo.

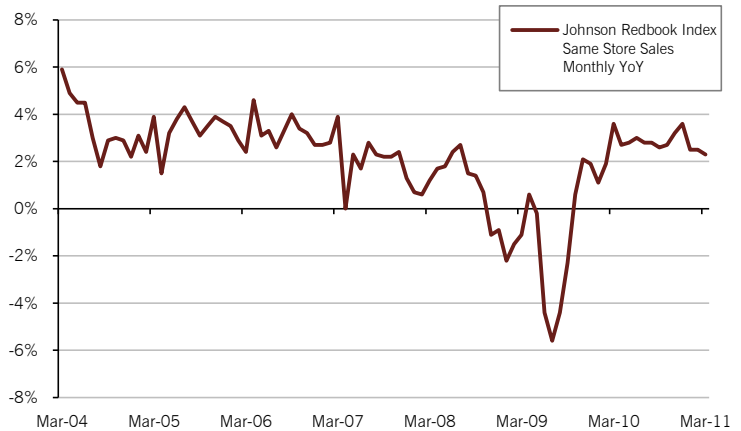
Advantage: Neutral



RETAIL SALES

Retail sales figures track the dollar value of merchandise sold to consumers and are an indicator of economic recovery. Higher gasoline prices and a late Easter contributed to modestly falling sales figures in March, even as employment has been improving.

Advantage: Neutral

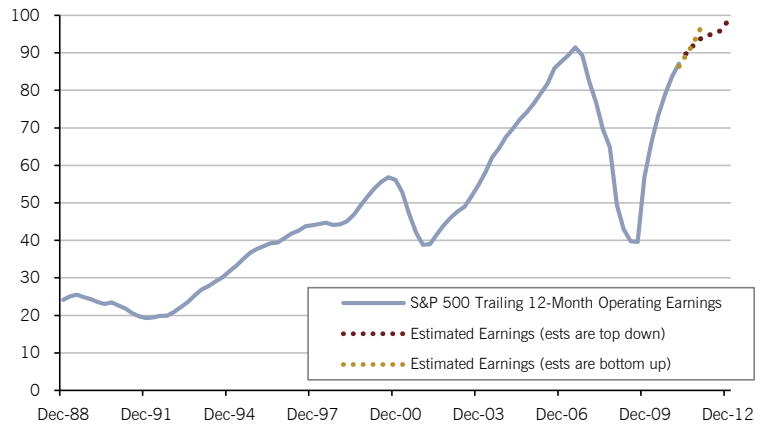


U.S. CORPORATIONS

CORPORATE EARNINGS

Earnings growth, which benefited in the past two years from significant cost cutting, might taper off in 2011 as year-over-year comparisons to 2010 will be difficult. Still, earnings on an absolute basis are expected to remain healthy and to approach record levels by the second half of this year.

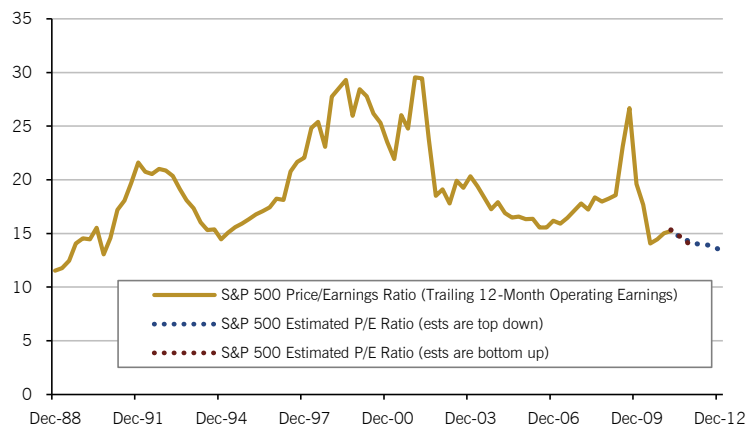
Advantage: Neutral to Bullish



STOCK MARKET VALUATIONS

Earnings growth over the past year has helped trailing 12-month P/E valuations look reasonable (slightly below historical norms) despite a run-up in stock prices. However, longer-term methods of measuring valuations, such as the normalized P/E ratio developed by Yale economist Robert Shiller, remain a bit elevated (near 24).

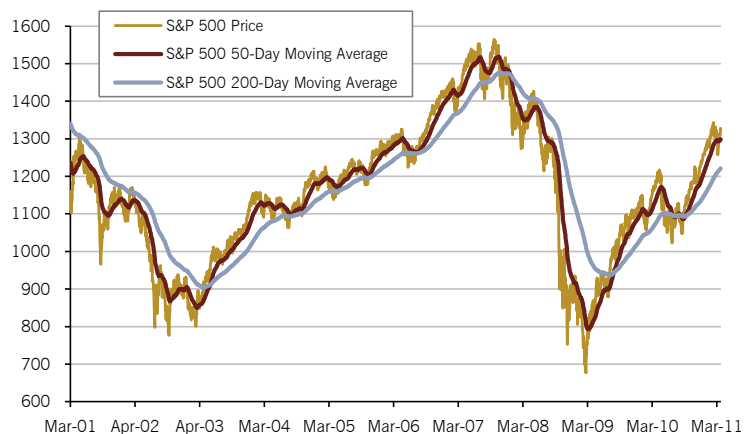
Advantage: Neutral to Bullish



STOCK MARKET TECHNICALS

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

Advantage: Bulls

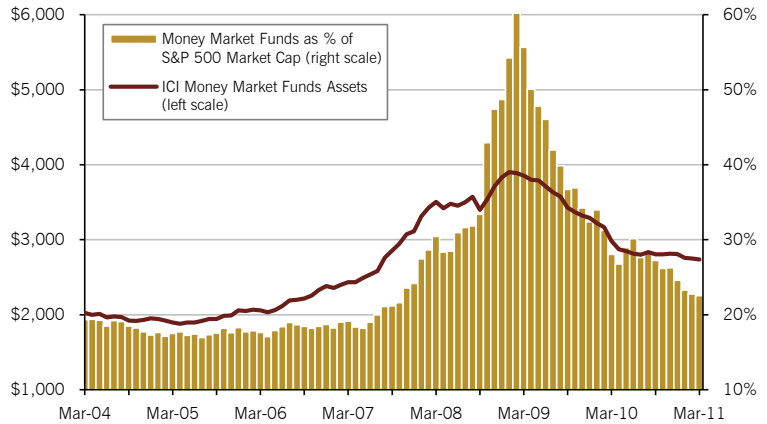


INVESTOR FLOWS AND LIQUIDITY

MONEY MARKET FUNDS ASSETS (\$ BILLIONS)

Money market fund assets continue to decline as dry powder on the sideline is slowly deployed, particularly as a percentage of rising stock market assets. Nevertheless, investors still have plenty of cash available to put to work.

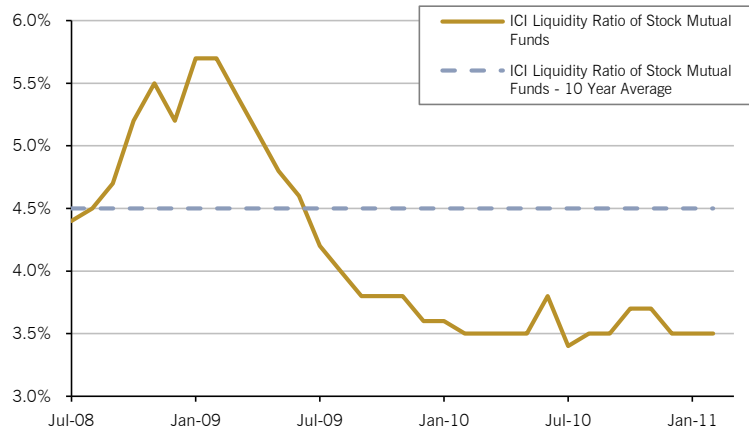
Advantage: Bulls



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 fund managers were bearish and sitting on a large amount of cash. Since then, managers have put most of that cash to work and, unlike retail investors, have been holding low levels of cash for some time (meaning little in additional cash to invest).

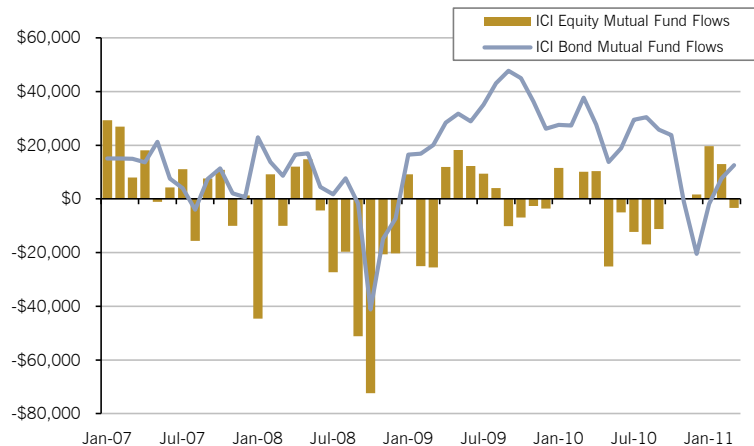
Advantage: Bears



MUTUAL FUND CASH FLOWS (\$ MILLIONS)

After several months of inflows, stock fund cash flows reversed course in the face of worrisome events in Japan and Libya. Meanwhile, bond funds had net inflows overall in March, but municipal bond funds did not participate, recording net outflows for the fifth consecutive month.

Advantage: Neutral

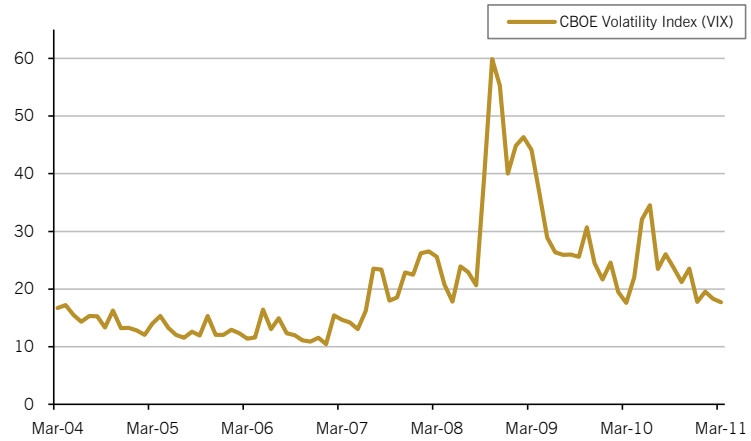


FEAR MEASURES

STOCK MARKET VOLATILITY

Japan's nuclear crisis, the war in Libya, and surging oil prices helped volatility spike mid-March to a level near 30 (as measured by the Chicago Board Options Exchange Volatility Index) before retreating to end the month at just below 18. Readings in excess of 30 generally correspond with times of investor fear or uncertainty, while values below 20 are typically associated with less stressful (or even complacent) times in the markets.

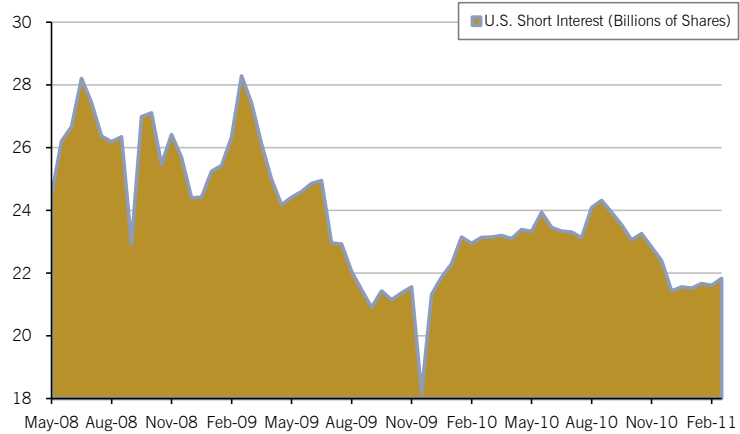
Advantage: Neutral



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 has been little changed in recent months, as short sellers have been wary about getting caught in a market bounce.

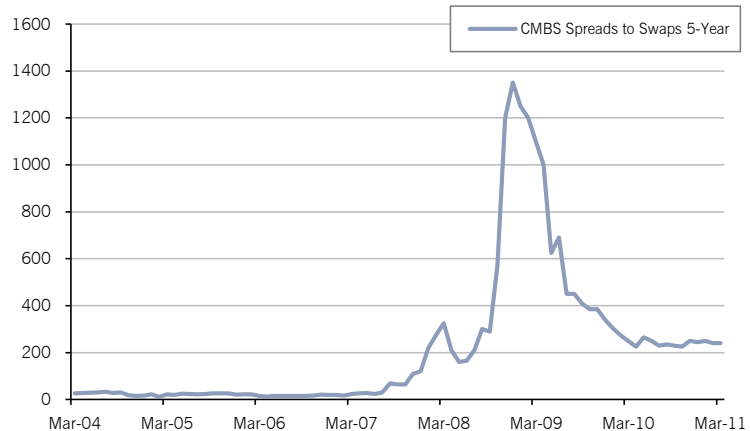
Advantage: Neutral



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 stable and in a narrow range since last summer.

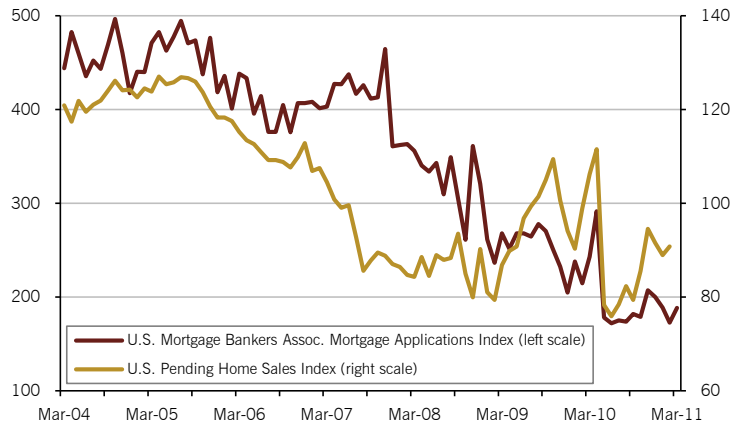
Advantage: Neutral



MORTGAGE APPLICATIONS AND PENDING HOME SALES

Despite a slight uptick in pending home sales and mortgage applications, the housing market remains weak. High unemployment, increased inventory due to foreclosures and uncertainty over prices have kept many potential buyers from making purchases.

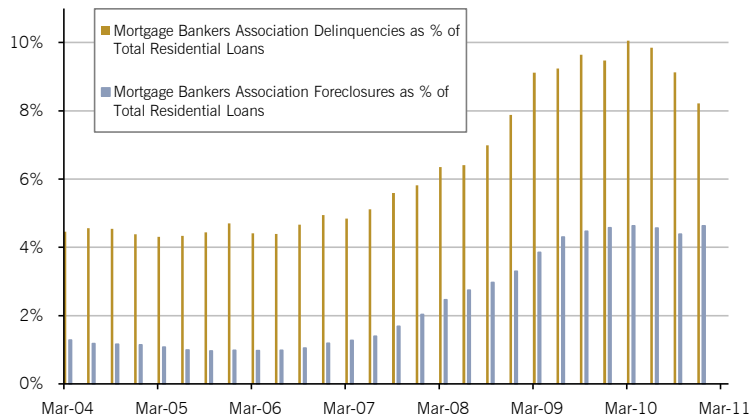
Advantage: Bears



RESIDENTIAL DELINQUENCIES AND DEFAULTS

Mortgage delinquencies and foreclosures appear to have reached a plateau as market conditions have improved. However, they could still get worse as a large amount of mortgages set to mature in the next few years might not get refinanced.

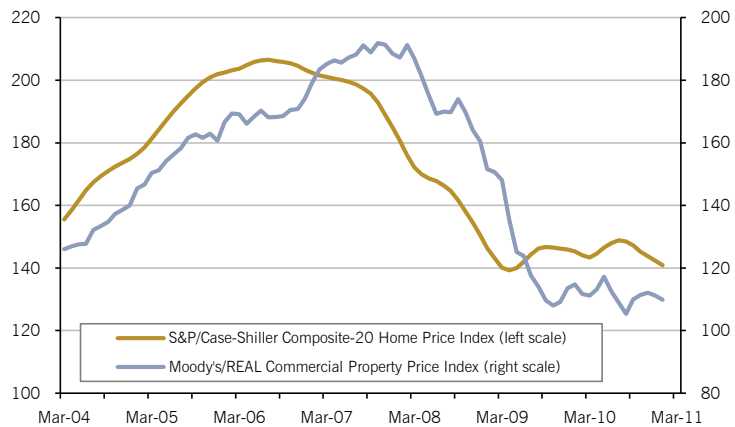
Advantage: Bears



RESIDENTIAL/COMMERCIAL PROPERTY PRICE INDICES

Many worry the housing market might be embarking on a second wave of falling prices, thanks to oversupply and weak demand. The Case-Shiller 20-city index or residential home prices fell for the sixth straight month, thanks to oversupply and weak demand. In four cities, average home prices are now at their lowest point in 11 years.

Advantage: Bears

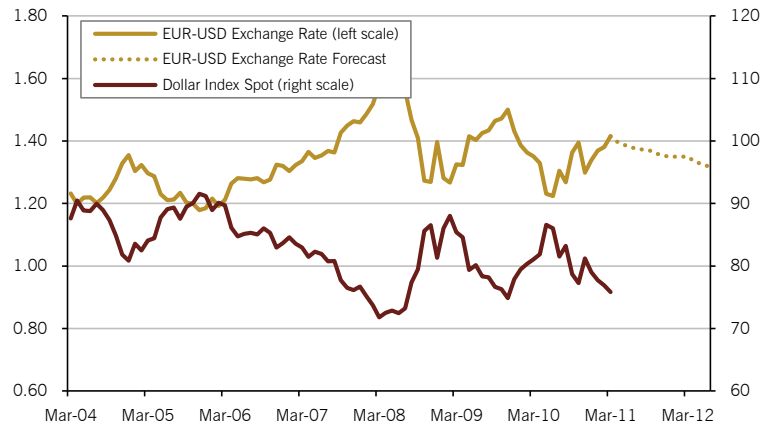


CURRENCY

U.S. DOLLAR

Weakness in the U.S. dollar continued in March, despite ongoing turmoil in the Middle East and the crisis in Japan -- factors that normally would be expected to give the greenback a boost from investors seeking a safe haven. Worries about the U.S. government debt burden and the Fed's low interest rate policy (especially as the European Central Bank is expected to soon raise rates) continue to hinder the dollar.

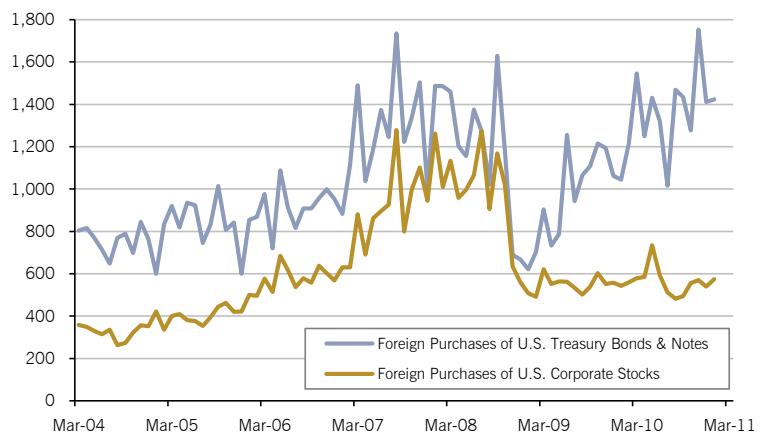
Advantage: Neutral



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

Global demand for U.S. securities (both bonds and equities) was little changed in January. While global uncertainty likely led to higher inflows since then, some worry that longer-term high government debt levels could cause foreign buyers to either demand higher U.S. interest rates or stop buying Treasuries altogether.

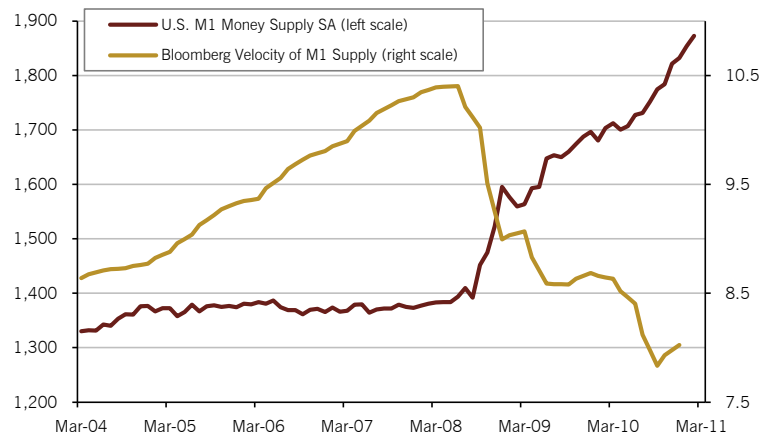
Advantage: Neutral



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 eventual inflation and 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

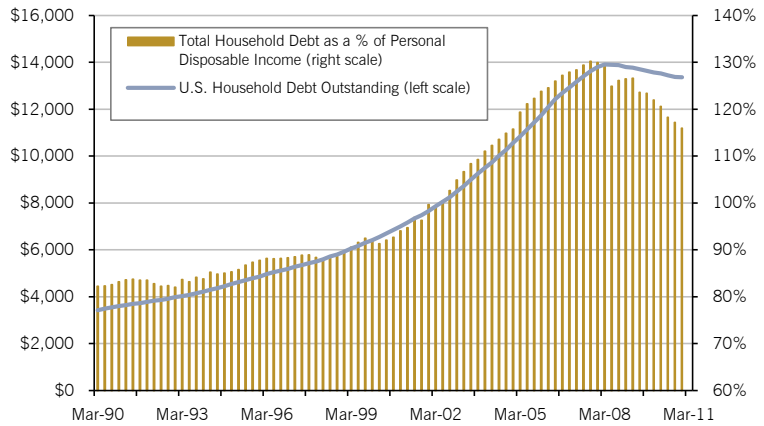


BORROWING

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

U.S. household debt (including mortgages and consumer credit), and the percentage it represents of disposable personal income, have increased dramatically since the early 1990s. Thus far in the current deleveraging cycle, consumers have been decreasing debt slowly and still have a way to go.

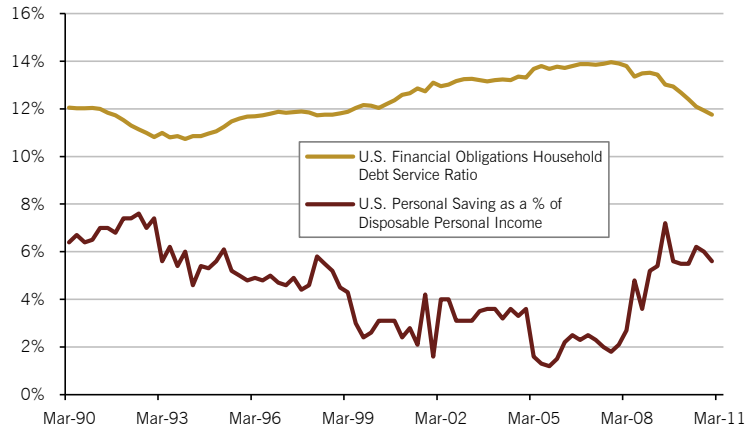
Advantage: Neutral to Bearish



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 remarkable increase in total debt over the past few decades, the rise in service ratios has been more muted due to the decline in interest rates. However, if rates spike, so too would debt payments, which would be problematic.

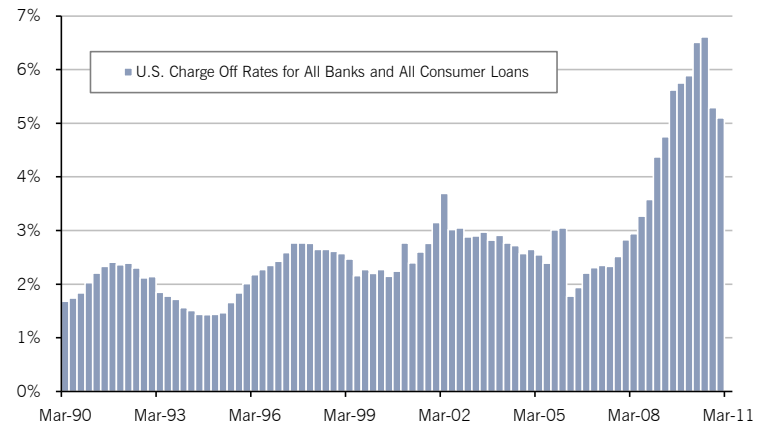
Advantage: Neutral to Bearish



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 near the highest levels on record.

Advantage: Neutral to Bearish



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