CONVERGENT | WEALTH ADVISORS

MARKET PULSE REPORT

MAY 2010

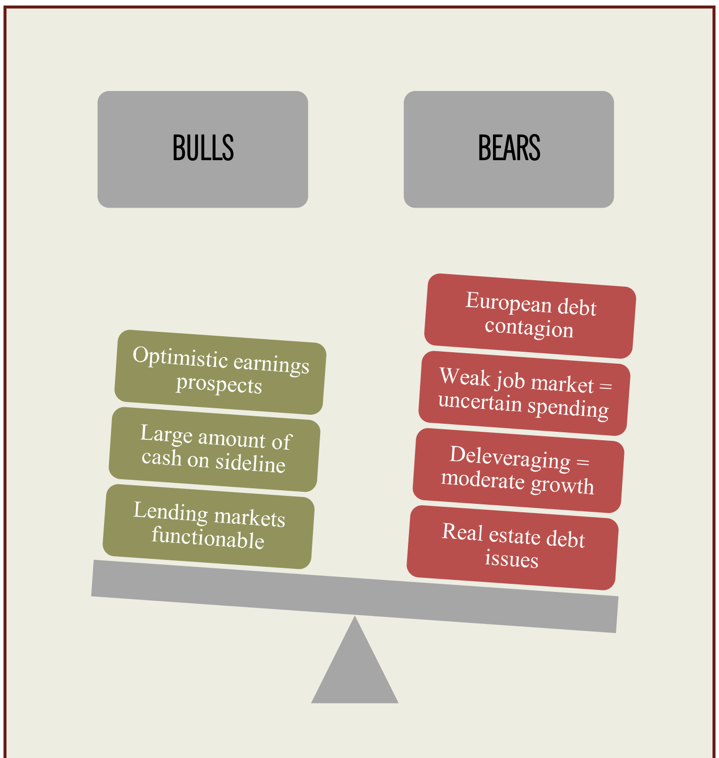
S&P 500 PRICE - PAST THREE YEARS

Stocks posted their worst month since the dark days of early 2009, as the S&P 500 fell about 8.0% in May. Technically speaking, the index also ended the month in correction territory, down about 10.5% from the peak hit April 23rd. Of course, the market is still more than 60% above the March 2009 lows.

NOTES/COMMENTARY

The crisis in European economies, which are plagued by high levels of debt, has taken a toll on asset prices worldwide and spurred a dramatic increase in volatility. The "flash crash" in early May, one of the most tumultuous stock market sessions in history, caused the VIX to jump to heightened levels not seen in more than a year. Whether this is simply a normal stock market correction (the first such correction since stock indices hit their lows in March of last year) or the start of a new bear market remains to be seen. Downward pressure on stocks has come primarily from concerns that Greece's debt struggles could morph into a chain of defaults and fuel a renewed global downturn. Indeed, Spain's debt rating was downgraded late in the month and it now appears that Hungary can be added to the list of countries at risk. Adding to worries about global growth is the fear that a slowdown in China could dampen global demand for commodities and other goods. Uncertainty regarding financial regulation here in the States is not helping investors feel comfortable, nor is the unrelenting BP oil spill or growing tensions in Korea and the Middle East.

SUMMARY OF CURRENT EQUITY MARKET LEANINGS

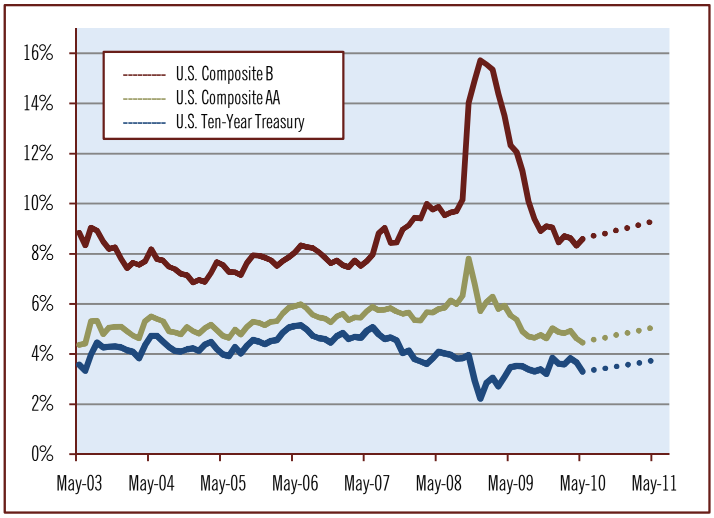


CONVERGENT TACTICAL POSITIONING

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

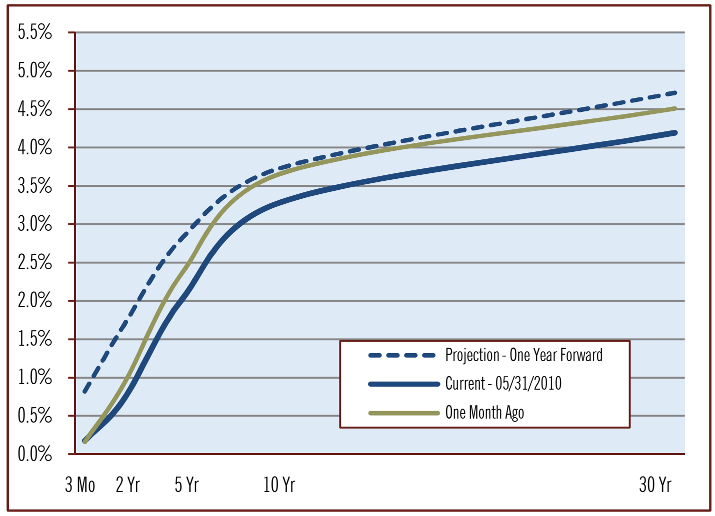
At the expense of a full equity allocation, we are maintaining modest overweight positions to gold (as a paper currency and inflation hedge) and certain segments of the opportunistic credit market (multi-sector, emerging currencies and international bonds to address themes such as mitigating equity, inflation and dollar risk).

CREDIT YIELDS



The yield of the ten-year Treasury note fell to 3.3% at the end of May as deflationary and safe-haven pressures drove investors into U.S. government debt. High yield corporate bonds did not fare as well, pushing spreads to around their widest levels this year. Low yields are helpful for the economy, but we will be watching spreads closely. **Advantage: Neutral to Bullish**

U.S. TREASURY YIELD CURVE



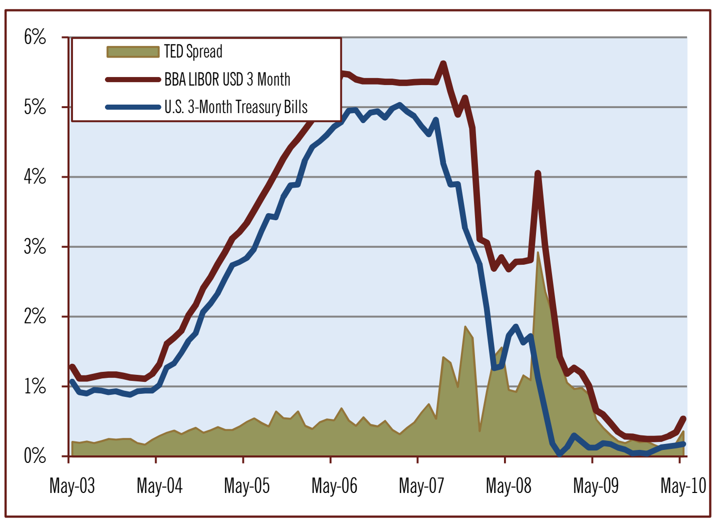
Even though yields fell sharply in May, the Treasury yield curve remains very steep with short term rates well below long term. For many, this indicates a low likelihood of another imminent recession. A further decline in yields and flattening of the curve, however, could be a prelude to economic difficulties. **Advantage: Neutral to Bullish**

T-BILLS, FEDERAL FUNDS AND INFLATION

The slow pace of employment growth and constrained inflation has the Fed keeping short-term interest rates at record lows, though a few hawkish Fed officials are speaking of a need at some point for tighter policy. Longer-term, many fear some form of inflation is inevitable and that rates will rise. **Advantage: Neutral**

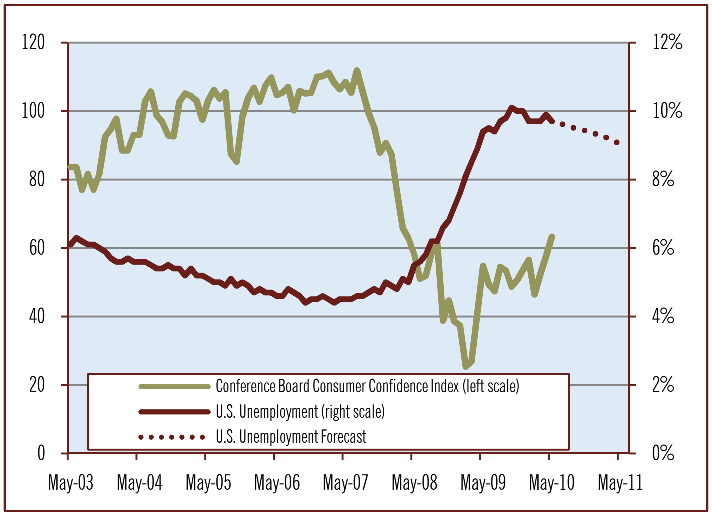
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

LIBOR/T-BILL RATES AND TED SPREAD



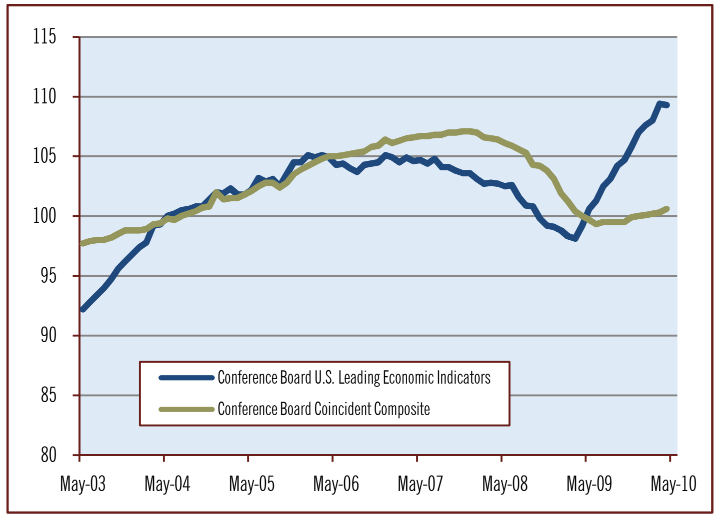
The TED spread is a measure of how tight the credit markets are as illustrated by the difference between T-Bill yields (a risk-free loan) and LIBOR yields (the rate at which banks lend to one another). Low levels illustrate that credit fears have subsided and that the functionality of credit markets has improved markedly. There was a blip higher in May, which could prove worrisome. **Advantage: Neutral**

CONSUMER CONFIDENCE & UNEMPLOYMENT



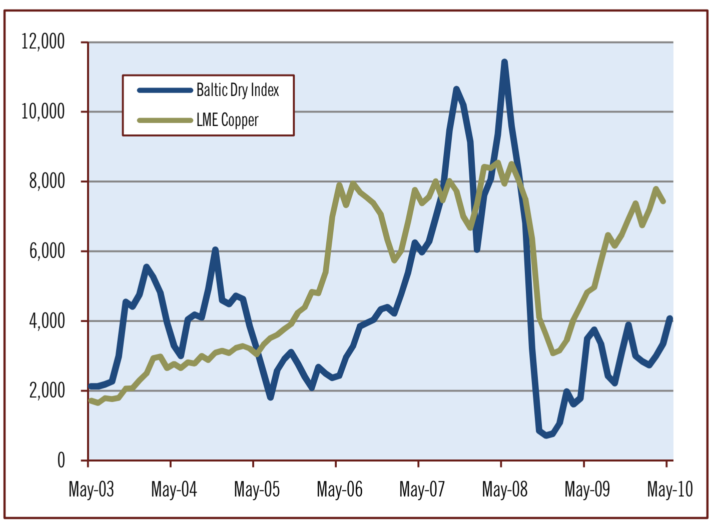
With the unemployment rate lingering near 10%, the job market continues to show the effects of the recession. Unless businesses increase hiring, consumers, while currently exhibiting some confidence, may not have the incomes to sustain recent gains in spending. **Advantage: Bears**

INDEX OF LEADING ECONOMIC INDICATORS



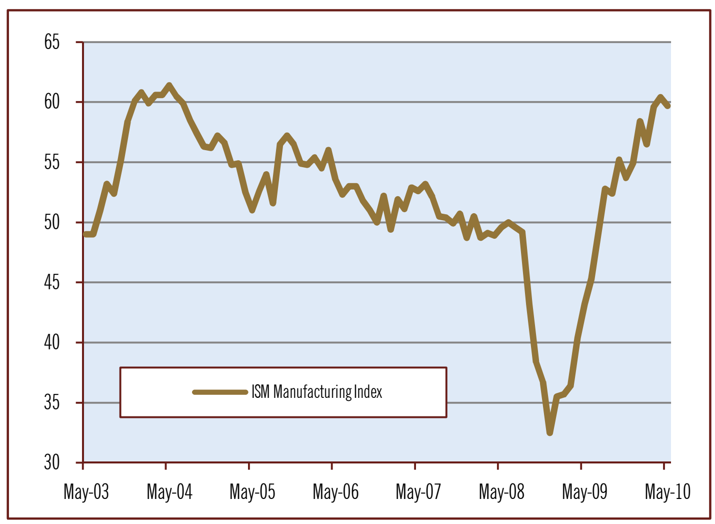
The leading economic index for the U.S. is near its highest levels, having risen steadily for a year. The index of coincident indicators has also been rising modestly. Taken together, the two composites suggest cointinued improving conditions. **Advantage: Bulls**

BALTIC DRY INDEX



The Baltic Dry Index (BDI), a measure of world trade, provides a barometer of the shipping costs for commodities. The BDI is well off the lows seen a year ago as the status of the global economy has improved, but has seen choppy trading for several months. **Advantage: Neutral**

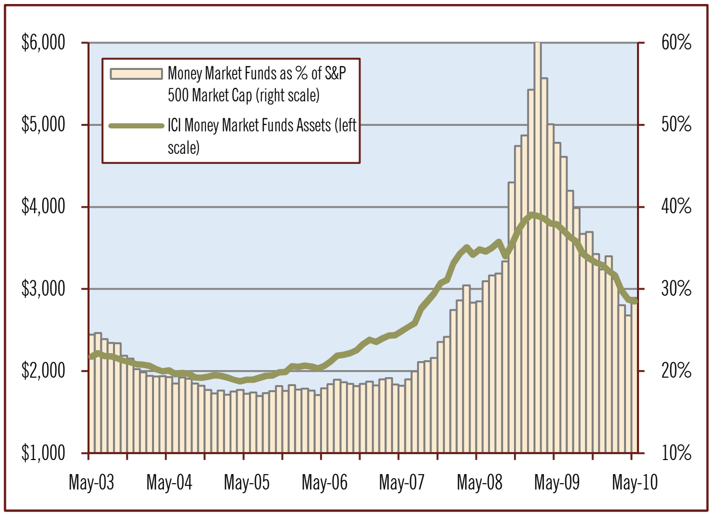
ISM MANUFACTURING INDEX



The ISM report is a national survey of purchasing managers covering such indicators as new orders, production, employment, inventories, delivery times, prices, export orders and import orders. A reading over 50% indicates expansion relative to the prior month, while a sub-50% reading indicates contraction. **Advantage: Bulls**

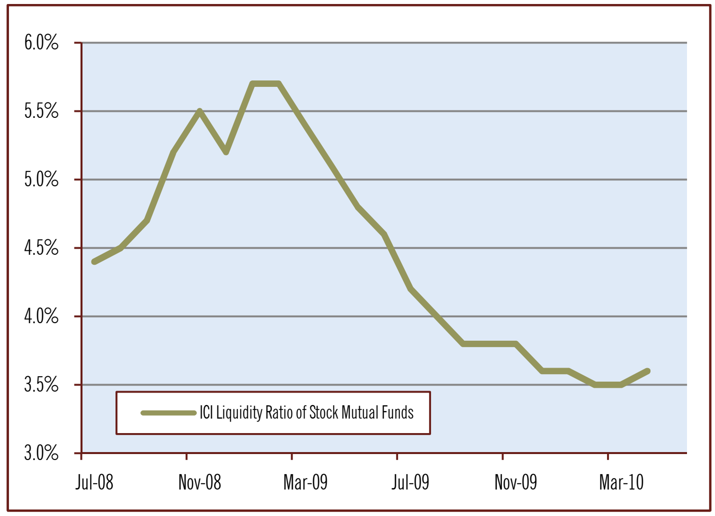
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

MONEY MARKET FUNDS ASSETS ($ BILLIONS)



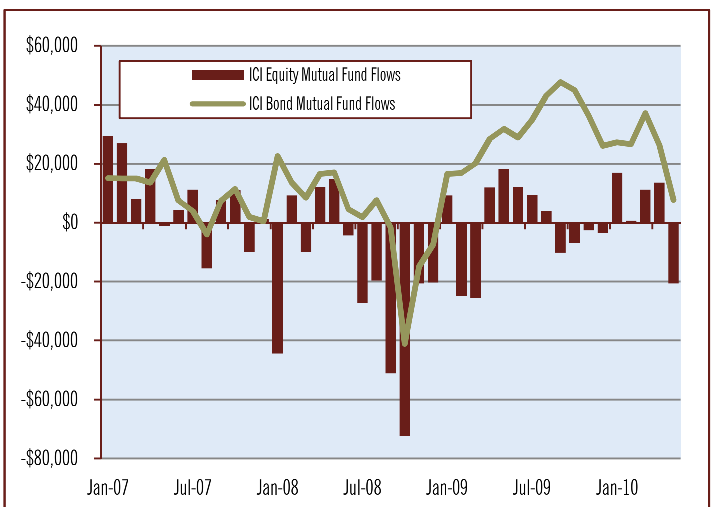
Much of the cash balance built up over the past few years has been put to work, but there still remains a large amount on the sidelines. Unless there has been a secular shift towards increased cash and bond allocations there remains plenty of powder available for stocks. **Advantage: Bulls**

MUTUAL FUND LIQUIDITY RATIO



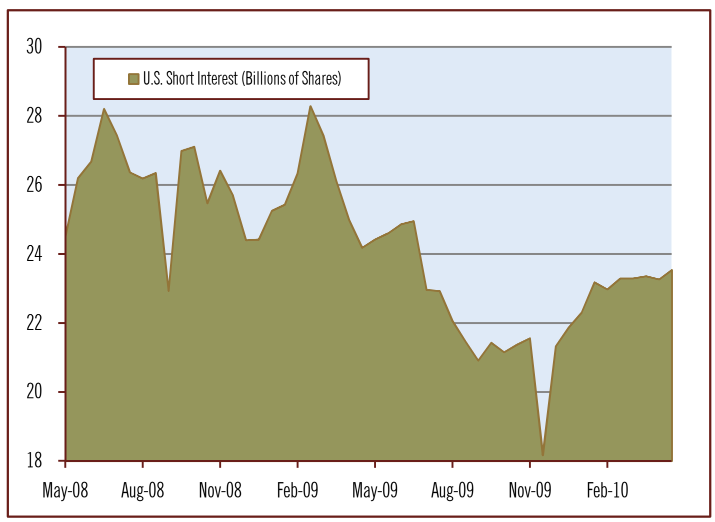
The liquidity ratio compares the amount of cash relative to total assets held by stock mutual funds. As stocks tanked in 2009, mutual fund managers were bearish and sitting on a large amount of cash. Since then, managers have put most of that to work and are now holding unusually low levels of dry powder. **Advantage: Bears**

MUTUAL FUND CASH FLOWS ($ MILLIONS)



Dollars continue to head into bond funds while equity mutual funds see outflows or at best limited inflows. Is this evidence of a secular shift in investor behavior towards income generating investments? Perhaps. **Advantage: Neutral**

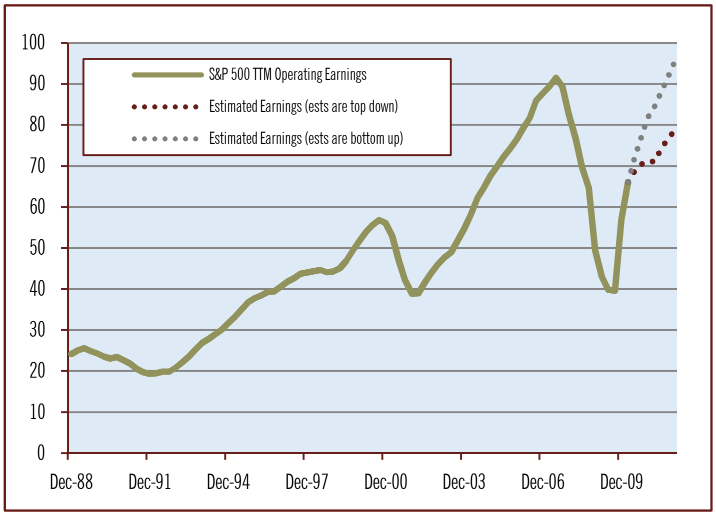
U.S. SHORT INTEREST



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. **Advantage: Neutral**

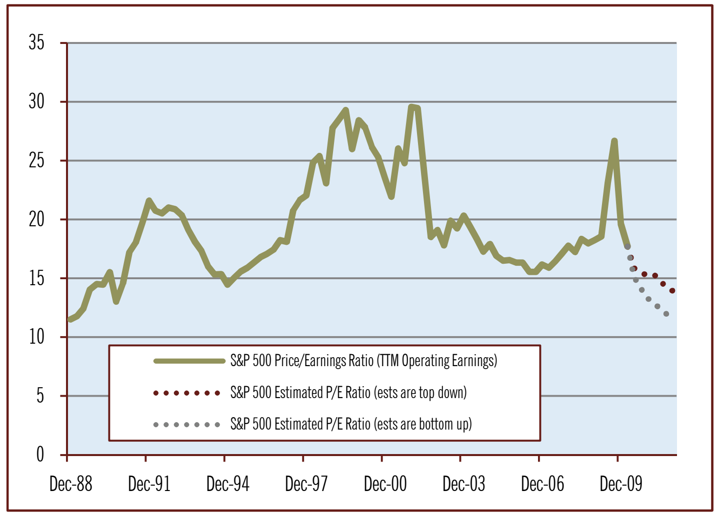
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

CORPORATE EARNINGS



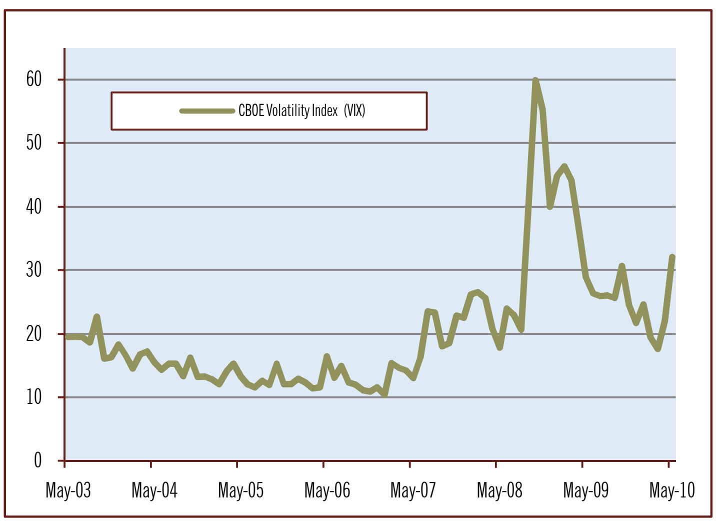
Though it has narrowed, the disparity between bottom up and top down earnings estimates from Standard and Poor's remains wide and illustrates a good deal of uncertainty in the forecasts. Some fear that gains this past year have been supported by unsustainable cost cuts and that the 2011 bottom up projection of $94.9, which would be an all-time high, is not realistic. **Advantage: Neutral to Bullish**

STOCK MARKET VALUATIONS



The recent price declines have helped trailing twelve month and forward P/E valuations look better (down to near historical average levels) as earnings projections remain robust. Longer-term methods of measuring valuations, such as the 10-year real P/E pioneered by Yale economist Robert Shiller, show stocks are still expensive, however. **Advantage: Neutral**

STOCK MARKET VOLATILITY



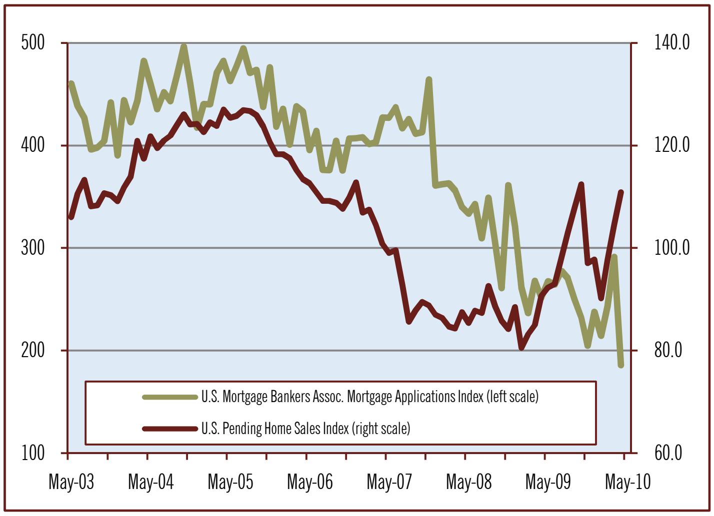
After hitting a multi-year low during April, volatility as measured by the Chicago Board Options Exchange Volatility Index, spiked to a high of 45.8 mid-month, the highest level in more than a year. The VIX retreated a bit to end May at a still relatively high 32.1. **Advantage: Neutral to Bearish**

STOCK MARKET TECHNICALS

Several technical indicators continue to be supportive of the equity market, but are showing signs of beginning to deteriorate. The 50-day moving average of the S&P 500 remains higher than the 200-day moving average, interpreted by many as a bullish signal. **Advantage: Bulls**

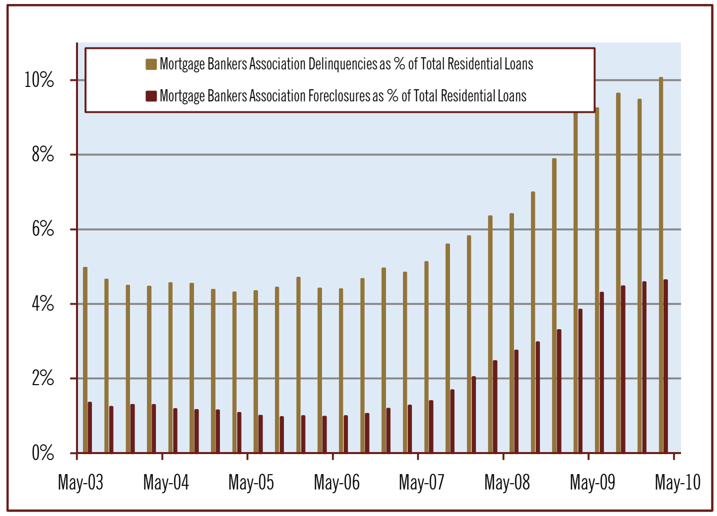
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

MORTGAGE APPLICATIONS & PENDING HOME SALES



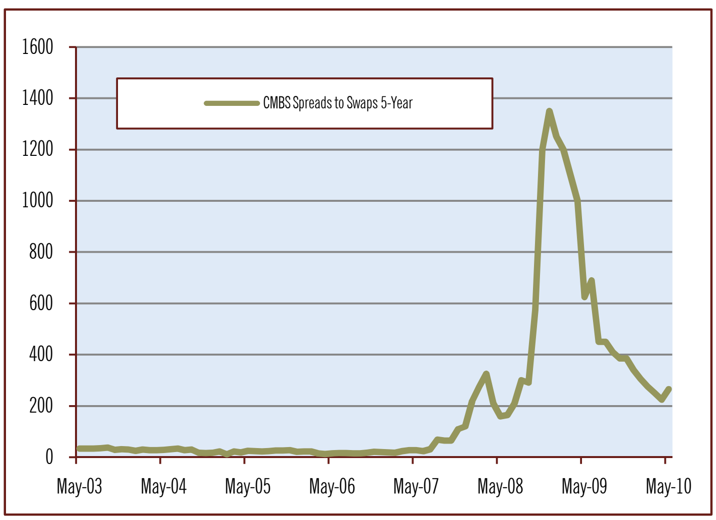
Pending home sales surged through the end of April as first-time home-buyers rushed to beat the deadline for a government tax credit. Low mortgage rates and improving confidence have also helped. Unfortunately, many analysts project sales will drop in the second half of the year if unemployment levels remain elevated. **Advantage: Bears**

RESIDENTIAL DELINQUENCIES & DEFAULTS



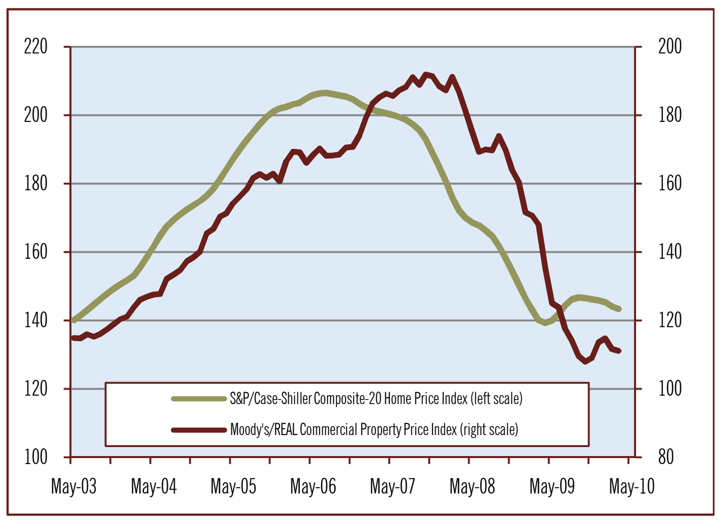
Mortgage delinquencies and foreclosures have surged to record levels. With unemployment remaining high, the wave of foreclosures is not expected to crest until sometime later in the year and will be a headwind to the housing market and economy for some time. **Advantage: Bears**

CMBS SPREADS



Problems in the commercial real estate market are starting to slowly work themselves out, as banks are systematically moving troubled loan assets through their books (or perhaps simply pushing distress into the future). The inflow of new nonperforming commercial real estate loans is also starting to drop. Still, charge-offs may not peak until 2011. **Advantage: Neutral to Bearish**

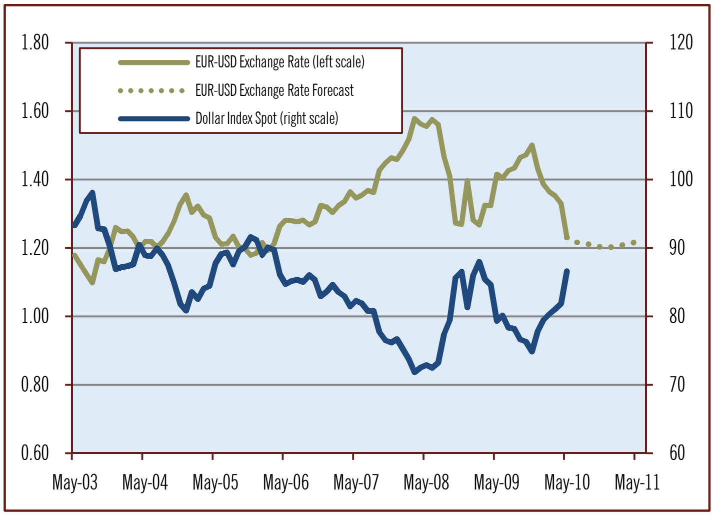
RESIDENTIAL/COMMERCIAL PROPERTY PRICE INDICES



Commercial real estate values dropped in March (the most recent available data). Landlords are struggling to fill empty spaces and raise rents. Office vacancies are near the highest levels in over 15 years. **Advantage: Neutral**

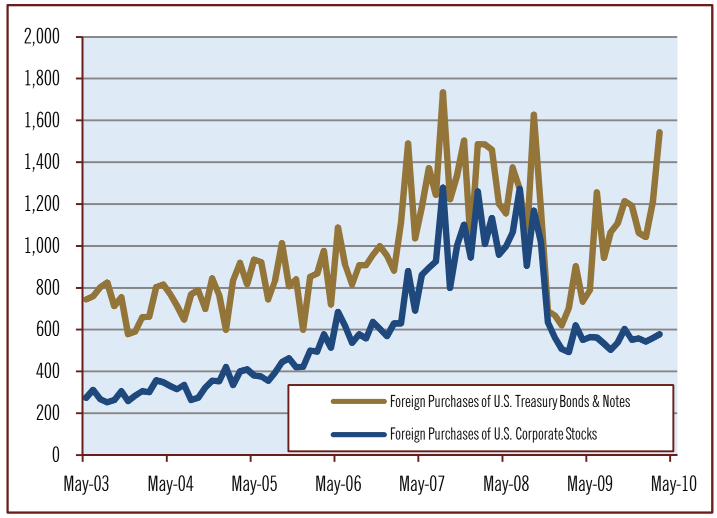
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

U.S. DOLLAR



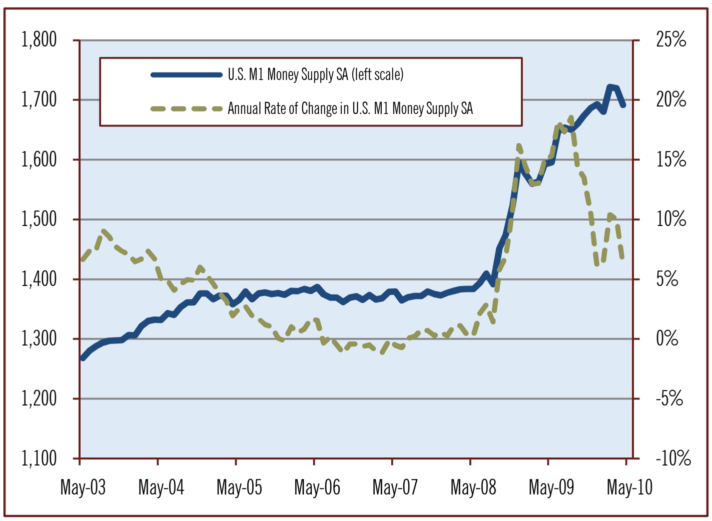
The U.S. dollar continues to surge while the euro is hitting multi-year lows on European debt concerns. Most still consider the dollar to face longer-term issues such as the size of the U.S. budget deficit, however, and expect that it may struggle against certain emerging market currencies. **Advantage: Neutral**

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



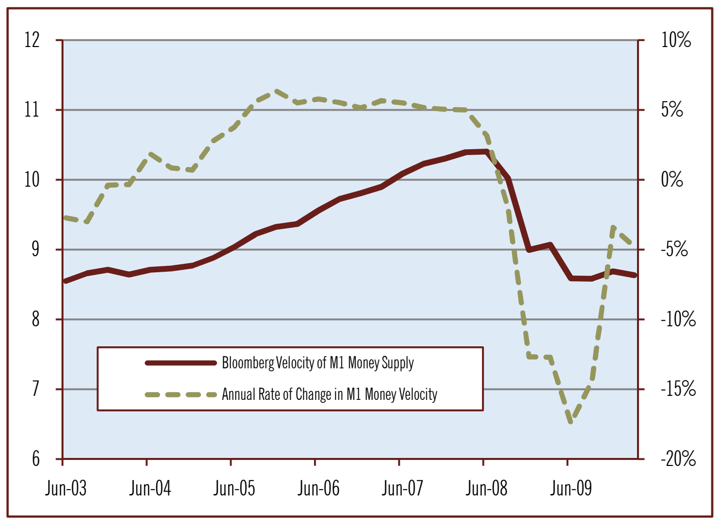
Treasury securities are still in demand from global investors, particularly as the European debt crisis plays out. Foreign purchases of U.S. stocks, meanwhile, remains constrained (as does domestic retail demand for U.S. equity funds). In the long-run, a concern is that U.S. fiscal worries may keep some investors away. **Advantage: Neutral**

U.S. M1 MONEY SUPPLY



M1, the most narrowly defined measure of how much money is in circulation, consists of the most liquid forms of money, namely currency and checkable deposits. With the recent Fed-initiated stimulus, M1 has spiked to unprecedented levels, causing fears of eventual inflation and dollar weakness. **Advantage: Neutral**

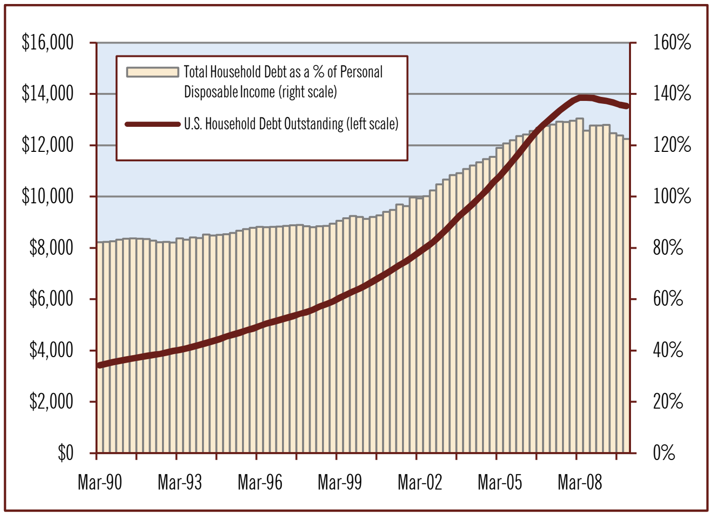
VELOCITY OF M1 MONEY SUPPLY



Velocity of money measures the rate at which money changes hands in order to purchase goods and services. While the money supply has surged, velocity has actually dropped as consumers and businesses are unwilling to spend money or are not able to take advantage of lending programs. **Advantage: Neutral to Bearish**

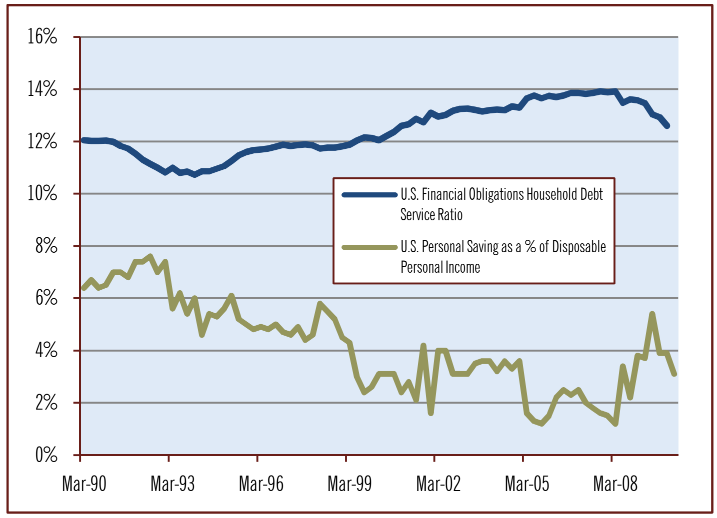
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

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



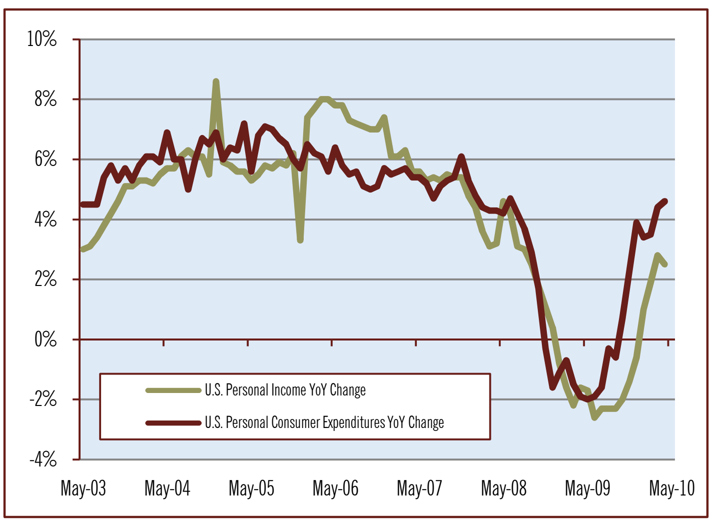
U.S. household debt (including mortgages and consumer credit debt) and its percentage of disposable personal income has increased dramatically since the early 1990's, fueled in part by declining interest rates. Despite all the talk of a deleveraging cycle, consumers so far have been decreasing debt at a slow pace. **Advantage: Neutral to Bearish**

U.S. SAVINGS & HOUSEHOLD DEBT SERVICE RATIO



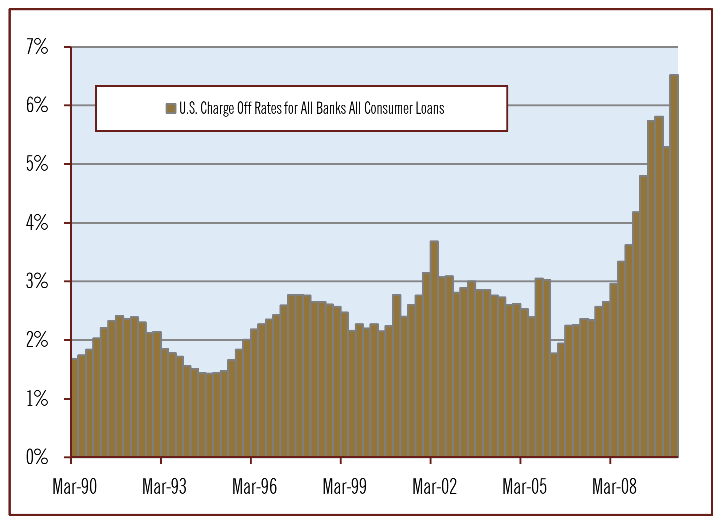
The debt service ratio measures how much of their earnings that households spend on debt payments. Despite the remarkable increase in total debt over the past few decades, the rise in service ratios has been more modest due to the decline in interest rates. If rates spike, however, so too could debt payments, and a low savings rate will not provide much of a buffer. **Advantage: Neutral**

U.S. CONSUMER INCOME AND SPENDING



Consumer spending continues to rebound. Unfortunately, spending is rising faster than incomes and is being financed by declining savings. **Advantage: Neutral**

U.S. CONSUMER LOAN CHARGE-OFF RATES



Even though interest rates remain low, U.S. consumer bank loans (including credit cards but excluding real estate) written off as unrecoverable remain near the highest levels on record. More recent delinquency data from credit card companies, however, indicates that charge-offs may be leveling. **Advantage: Neutral to Bearish**

Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute, Federal Reserve, Bureau of Economic Analysis

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ASSET CLASS COMMENTARY

ASSET CLASS	TACTICAL POSITIONING	THEME	ASSET CLASS NOTES/OBSERVATIONS
EQUITY	**underweight**		- a conservative allocation to equities in the current environment is warranted
US Large Cap	underweight	Low reward/high risk environment Positioning: underweight equities, particularly long-only, while overweighting long/short and focusing on fundamentals	- given economic uncertainty, there is risk associated with equities and an underweight allocation (but not elimination) is recommended - despite European and global debt worries, the likelihood of systematic failure is thought to be reduced - for most taxable clients a passive (low tax, low fee) approach is still recommended as the core - active mgmt focusing on fundamentals (high quality/high dividend) could provide some downside protection
US Small/Mid Cap	neutral to slight overweight		- by some metrics, small cap equities appear more fully priced than large cap. Their growth prospects, however, are more optimistic. - all cap managers, with their increased allocation flexiblity, may be able to better position portfolios
Developed Intl	underweight		- overweight to beaten-down international relative to U.S. - Eurozone fiscal concerns have not hindered managers' stock picking, and valuations are getting cheaper
Emerging Market	slight underweight		- strong long-term economic growth prospects, potentially much greater so than in the developed regions - current valuations are getting reasonable relative to developed markets - a high level of volatility is expected
Private Equity	neutral		- good opportunity set, but managers have existing portfolio distractions
Directional Hedge	slight underweight		- L/S allocations are near strategic targets; overweight relative to long-only equity allocations - better anticipated protection against equity downturns but may lag in rallies (barring superior stock selection) - managers are seeing correlations among stocks decrease (and dispersions in returns increase)... superior security selection could be a differentiator
REAL ASSETS	**overweight**		- increased allocation as currency/inflation hedge and longer-term play on natural resource shortage
Real Estate	neutral to slight underweight	Inflation; paper currency weakness; shortage of natural resources Positioning: overweight via increased gold exposure	- commercial real estate issues remain, but well-capitalized managers can find opportunities - REITs appear to be getting expensive, and yields relative to Treasuries are not at attractive levels
Commodities	overweight		- recommend 3-4% gold exposure for safe harbor, currency hedge and potential hedge against inflation spikes - central bank buying of gold, combined with stagnant production = bullish demand/supply attributes - diversified commodity exposure a non-equity manner of playing the emerging market economic growth story
ARBITRAGE/CREDIT	**overweight**		- pockets of opportunities with lower risk profile than equities
Multi-Strategy Hedge	neutral	Low reward/high risk environment; inflation; U.S. dollar weakness; rise in interest rates Positioning: overweight	- superior security selection (both long and particularly short) could be a significant value-add - corporate defaults expected to be an issue for several years, providing potential opportunities - redemption, liquidity and restructuring issues are much less of a distraction
Opportunistic Credit	overweight		- spreads are near historical levels... high yield corporate debt beta play is over - emerging market debt could provide a currency/inflation hedge - investment grade global bond exposure could provide credit and currency diversification
FIXED INCOME	**neutral**		- core fixed income at strategic targets
Core Fixed Income	neutral	Low reward/high risk environment; deflation Positioning: neutral	- given low yields, long-term prospects are muted... inflation and rising rates may end the bull market in credit - in the near-term, deflationary pressures are still being played out - demand and inflows to bond funds remain strong from retail and foreign investors
Cash Equivalents	neutral		- little to no yield being generated by cash assets