

Invest well. Manage well. Live well.™

NOVEMBER 2010

Commentary

Stock markets meandered a bit last month following U.S. mid-term elections and the Federal Reserve's widely anticipated announcement of quantitative easing details. Even as a smattering of economic data releases showed gradual improvement, tension in the Korean peninsula and a renewal of European debt concerns weighed on investors. Non-U.S.-denominated investments (whether debt or equity) and fixed income instruments did not fare as well, with the former hurt by a sharp rally in the dollar and the latter held back as investors reflected on the longer-term inflation and interest rate implications of QE2.

As the year comes to an end, many investors are turning their eyes towards whether there will be a Santa Claus rally or perhaps a boost to markets from the January effect (due to a combination of tax-driven behavior and the injection of additional funds into the market). As longer-term focused investors, we are more interested in items with farther reaching implications, such as whether there will be any compromise before year-end on extending Bush-era tax cuts. If there is any significant change in tax legislation, we will evaluate the potential impacts and, if necessary, revisit our taxable clients' strategic allocations and investment policy statements. In fact, considering we may potentially be in for a period of compressed asset class returns for certain asset classes (e.g., core fixed income), revisiting strategic allocations might be warranted for many clients to ensure that portfolios are on track towards meeting investment objectives.

CONVERGENT TACTICAL POSITIONING

While we continue to transition back to our strategic equity targets at a measured pace, we remain underweight to *developed* equity markets (though not emerging) in order to accommodate shifts to: (i) certain opportunistic credit segments (multi-sector, emerging market debt/currencies, and international bonds) to collect a current yield while addressing themes such as mitigating equity, deflation/inflation, and currency risks; and (ii) gold as a paper currency hedge and safe-haven asset. We have recently made a modest reduction to core fixed income allocations given low total return prospects in the space, shifting to a blend of cash and growth assets (equities and opportunistic credit) to approximate the risk of bonds with greater upside.

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

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

THE EQUITY AND FIXED INCOME MARKETS

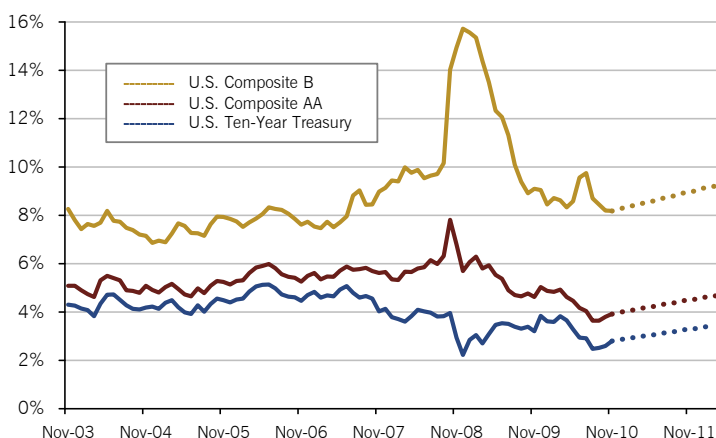
S&P 500 PRICE

Domestic large cap equities were mostly flat for the month of November, while small cap indices posted gains. International equities, however, registered meaningful losses in part because of U.S. dollar strength. Most equity benchmarks are poised to wrap up 2010 in the black. Year-to-date, the S&P 500 is up nearly 8%, including dividends.



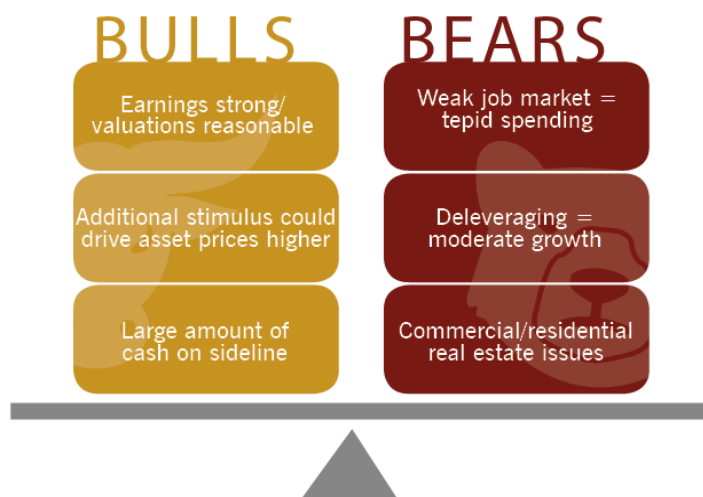
CREDIT YIELDS

Yields of U.S. Treasuries rose in November amid signs the U.S. economy is improving. If the recent quantitative easing is successful in spurring further economic growth, some fear inflation may come with it. Recent lackluster GDP data, however, has few worried about pricing pressures for now.



SUMMARY OF CURRENT EQUITY MARKET LEANINGS

While we are modestly below our target equity allocations, it is not due to an overly pessimistic outlook regarding stocks. Rather, our equity underweight accommodates our desired shifts to gold, emerging market currencies/debt, and other opportunistic credit segments that play into global themes we want to address. In fact, we are not below target with regard to what we categorize as "growth assets" within the portfolio.

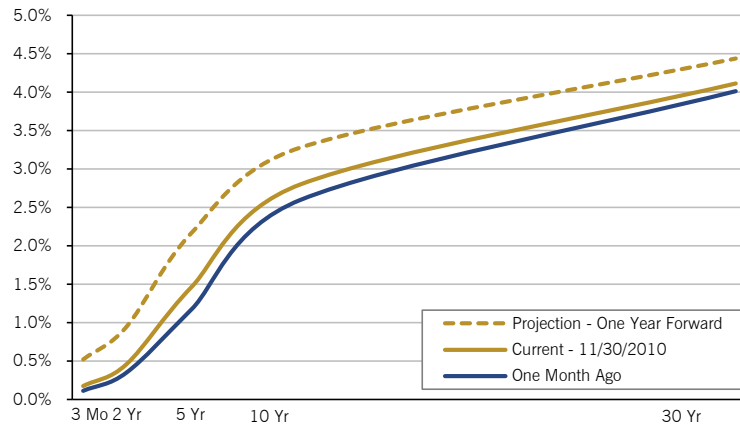


THE EQUITY AND FIXED INCOME MARKETS

U.S. TREASURY YIELD CURVE

The Treasury yield curve shifted higher in November even as the Federal Reserve announced it would buy \$600 billion of U.S. government bonds over the next few quarters to drive down interest rates and encourage borrowing. As a result of the Fed's actions, expectations for long-term economic growth and potential inflation have picked up.

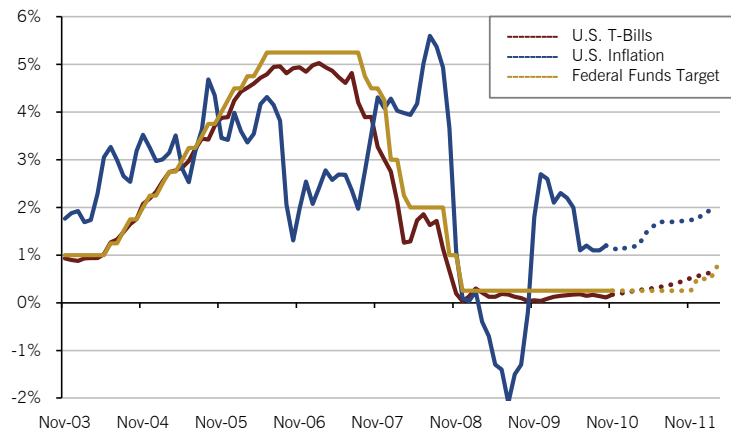
Advantage: Neutral



T-BILLS, FEDERAL FUNDS, AND INFLATION

Federal Reserve officials, who are pessimistic in their economic growth outlook for next year, plan to keep short-term interest rates near zero for an extended period. Longer-term, many fear aggressive moves by the Fed may lead to some form of inflation (perhaps caused by currency devaluation).

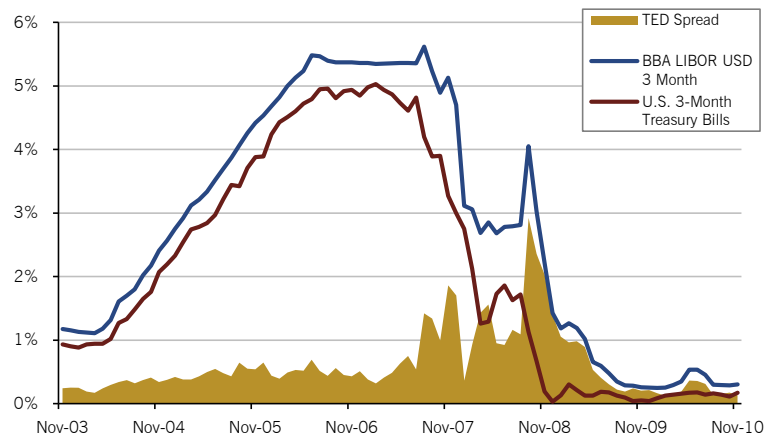
Advantage: Neutral



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.

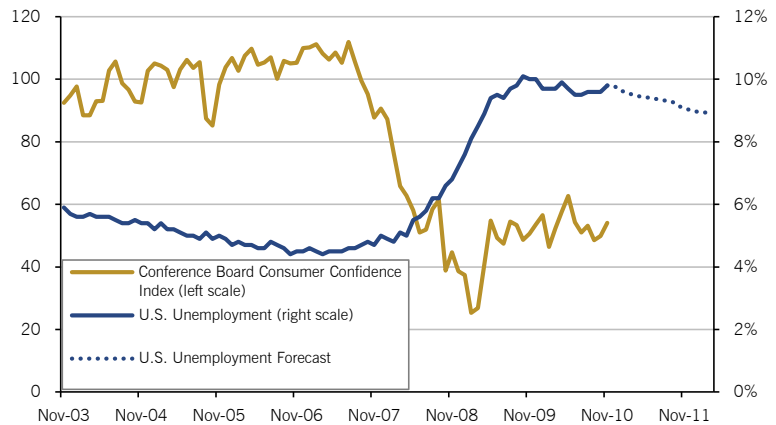
Advantage: Bullish



CONSUMER CONFIDENCE AND UNEMPLOYMENT

Consumer confidence rose to a five-month high as Americans kicked off the holiday season. Still, confidence remains well below levels that signal a healthy economy as consumers continue to wrestle with high unemployment.

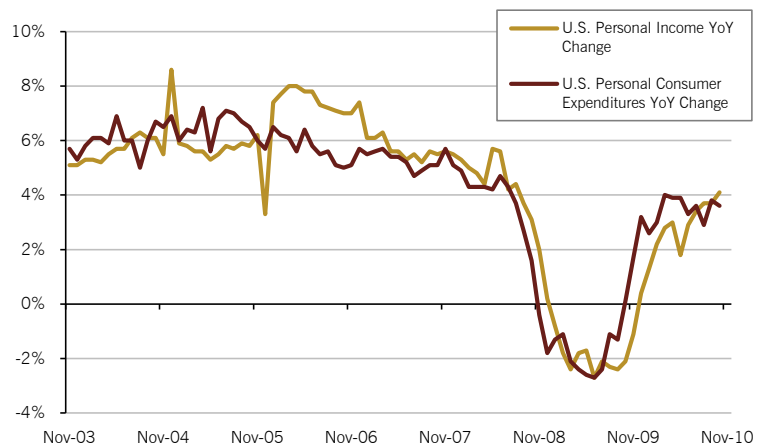
Advantage: Bears



U.S. CONSUMER INCOME AND SPENDING

The primary concern with high, lingering unemployment and low confidence is that consumers will increase savings and not spend enough to rejuvenate the economy. The upcoming expiration of unemployment benefits for many (barring an extension) could be a further detriment.

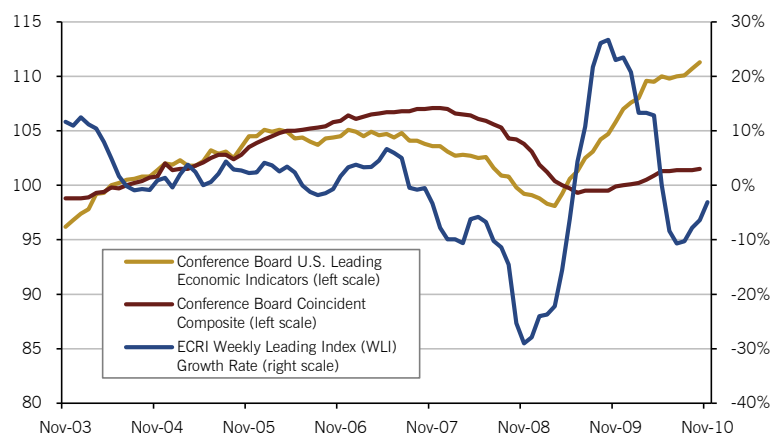
Advantage: Neutral to Bearish



LEI AND ECRI

The U.S. leading economic index (LEI) continues to trend upward, suggesting the modest economic expansion will carry on in the near term. The Economic Cycle Research Institute (ECRI) weekly leading index, meanwhile, is rebounding off levels that historically have signified a slowdown in economic growth.

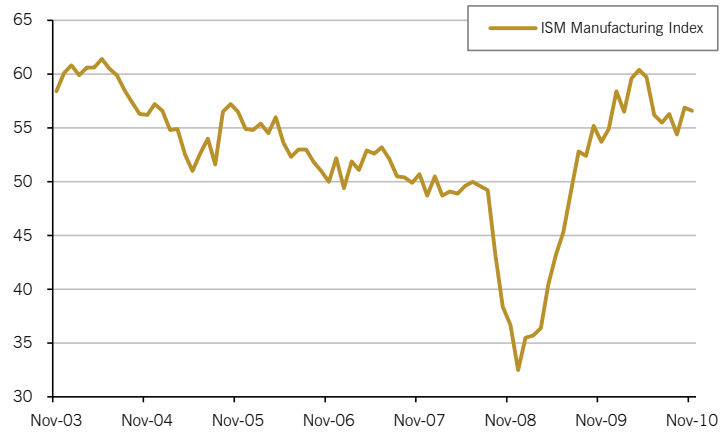
Advantage: Neutral



ISM MANUFACTURING INDEX

The ISM report is a national survey of purchasing managers covering such indicators as new orders, production, employment, inventories, prices, export orders, and import orders. A reading over 50% indicates expansion relative to the prior month, while a reading under 50% indicates contraction. The latest reading was the 16th consecutive month of expansion.

Advantage: Bulls



BALTIC DRY INDEX

The Baltic Dry Index (BDI), a measure of world trade, provides a barometer of the shipping costs for commodities. Copper, as a plentiful and heavily-relied upon metal in construction and manufacturing, can reflect trends in global economic growth. Interestingly, there has recently been quite a divergence between the BDI and the price of copper, reflecting perhaps a lack of vitality in global trade yet rising commodity prices.

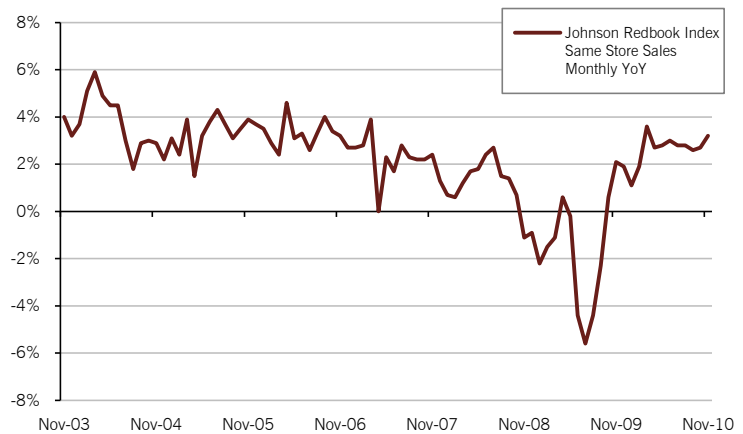
Advantage: Neutral



RETAIL SALES

Retail sales figures, which track the dollar value of merchandise sold to consumers, could be an indicator of economic recovery. Post-Thanksgiving and holiday sales appear to have gotten off to a strong start.

Advantage: Neutral

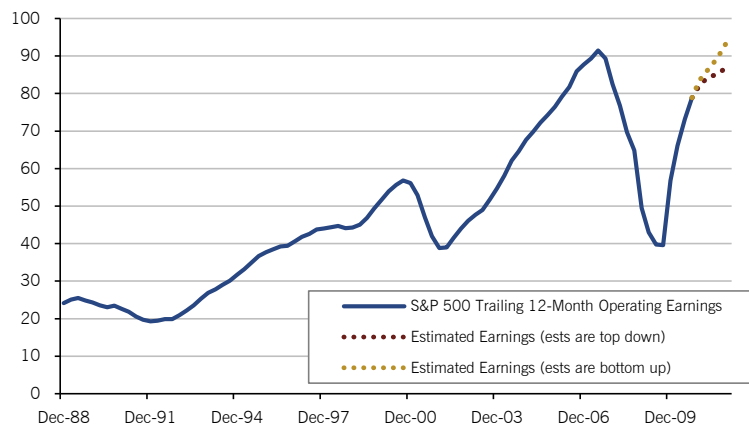


U.S. CORPORATIONS

CORPORATE EARNINGS

More than 70% of companies have beaten earnings estimates in the recent quarter. Nevertheless, there are expectations that the pace of growth will slow somewhat going forward. On another note, next year attention may turn towards getting companies to put their large cash hoards to work domestically.

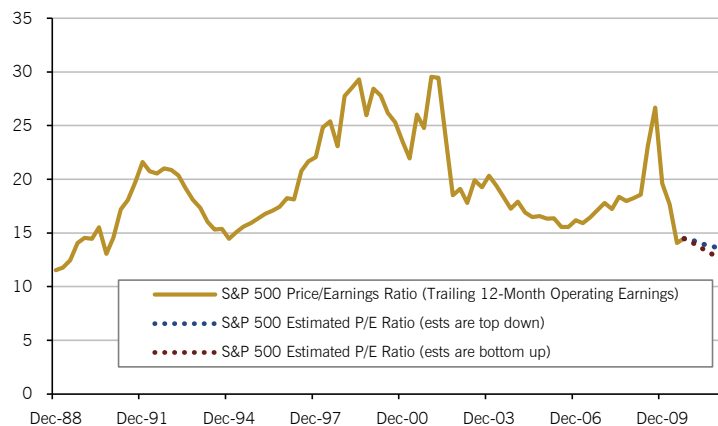
Advantage: Neutral to Bullish



STOCK MARKET VALUATIONS

Sustained earnings growth over the past year has helped trailing 12-month P/E valuations look reasonable (slightly below historical norms). Longer-term methods of measuring valuations, however, such as the ten-year real P/E pioneered by Yale economist Robert Shiller, remain a bit elevated (just over 20).

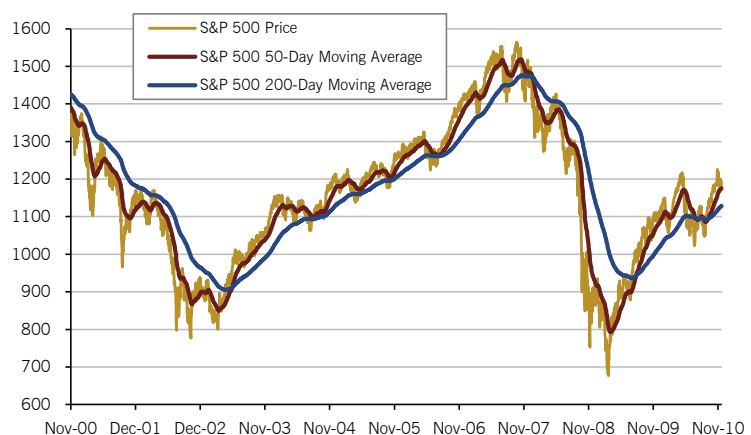
Advantage: Neutral to Bullish



STOCK MARKET TECHNICALS

After falling below the 200-day moving average for a brief period this summer, the S&P 500 50-day moving average crossed back into and remains in higher territory since September (the so-called "Golden Cross"). This is interpreted by many as a bullish signal.

Advantage: Bullish

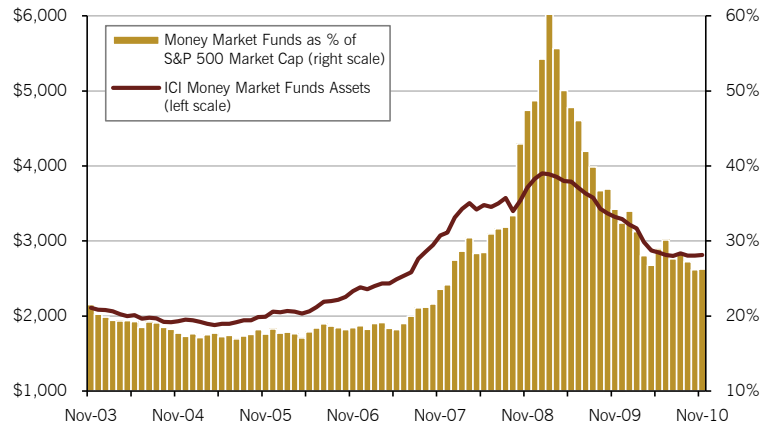


INVESTOR FLOWS AND LIQUIDITY

MONEY MARKET FUNDS ASSETS (\$ BILLIONS)

While much of the cash balance built up over the past few years has been put to work, there still remains a large amount on the sidelines in money market funds (approximately \$2.8 trillion), despite extremely low interest rates. Barring a secular shift towards increased cash and bond allocations, there remains plenty of dry powder available for stocks.

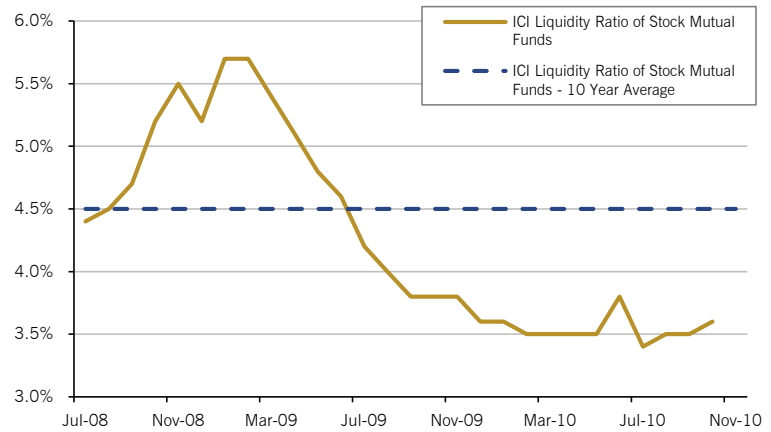
Advantage: Bulls



MUTUAL FUND LIQUIDITY RATIO

The liquidity ratio compares the amount of cash relative to total assets held by stock mutual funds. As stocks 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 throughout 2010 have been holding unusually low levels of cash.

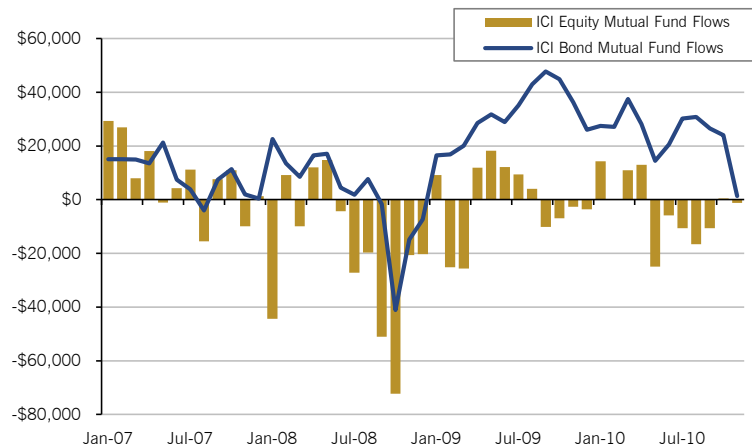
Advantage: Bears



MUTUAL FUND CASH FLOWS (\$ MILLIONS)

Despite the anticipated impact of QE2, net cash flows for stock funds were once again negative (though less so than in prior months). Shifting demographics and attitudes may be resulting in a secular shift towards income generating investments. Until this trend reverses, one leg of support for the stock market is wobbly at best.

Advantage: Neutral to Bearish

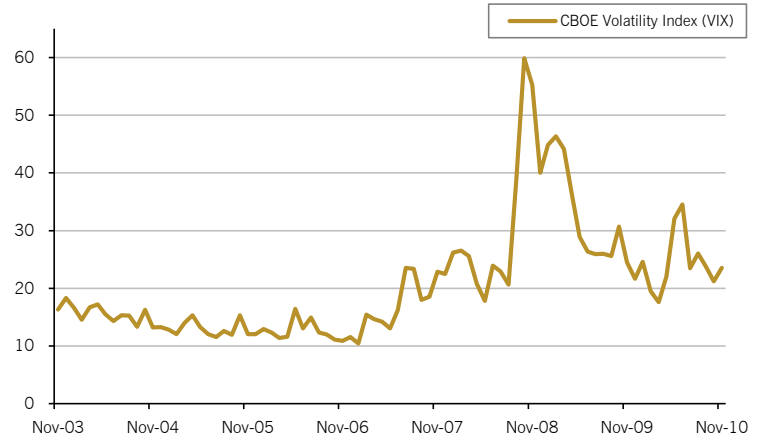


FEAR MEASURES

STOCK MARKET VOLATILITY

Volatility, as measured by the Chicago Board Options Exchange Volatility Index, ended November at 23.5. 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.

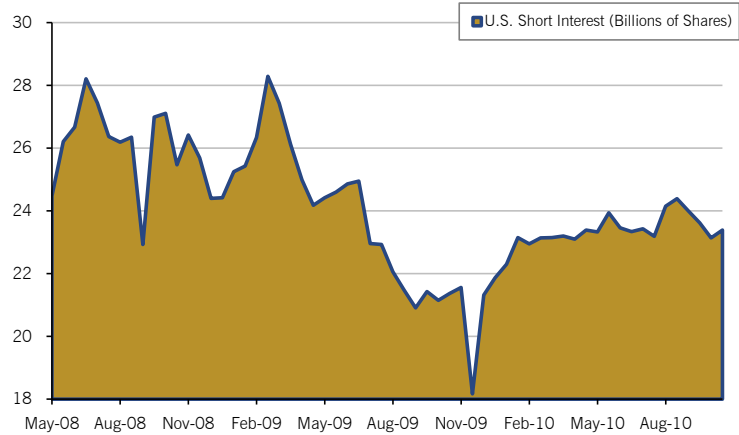
Advantage: Neutral



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.

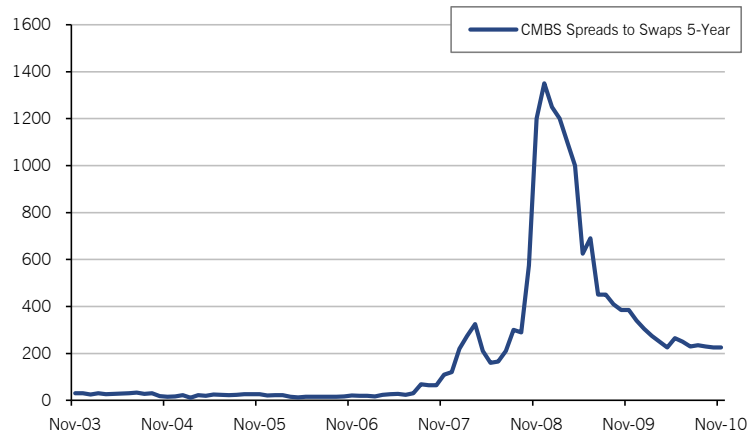
Advantage: Neutral



CMBS SPREADS

Problems in the commercial real estate market have been methodically working themselves out as banks move some troubled loan assets through their books. Commercial mortgage-backed securities (CMBS) spreads have been in a narrow, though historically elevated, range for months.

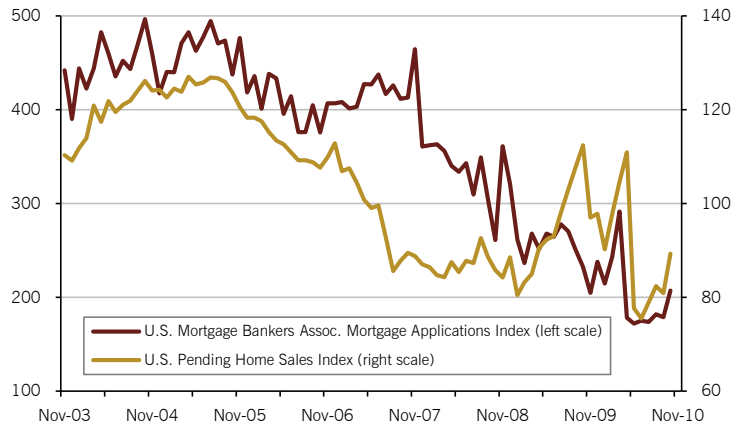
Advantage: Neutral



MORTGAGE APPLICATIONS AND PENDING HOME SALES

Though still at very depressed levels, U.S. mortgage applications for home purchases rose to a six-month high as mortgage rates are near all-time lows and housing affordability near record highs. Pending home sales have also recently improved, though recovery is expected to be uneven as banks deal with foreclosure issues.

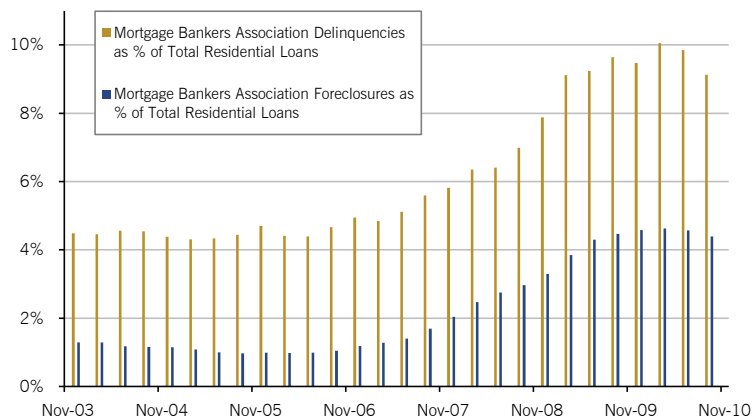
Advantage: Bears



RESIDENTIAL DELINQUENCIES AND DEFAULTS

Mortgage delinquencies and foreclosures remain near record levels. With unemployment and unsold inventories remaining high, foreclosure rates are expected to remain elevated and a headwind to the housing market and economy for some time.

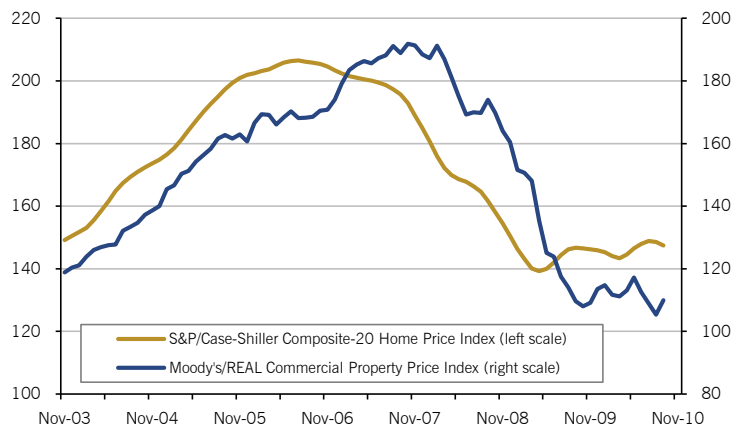
Advantage: Bears



RESIDENTIAL/COMMERCIAL PROPERTY PRICE INDICES

Home prices continue to fall in the nation's largest cities, and many feel they could be pushed down even further thanks to the end of tax incentives and record numbers of foreclosures.

Advantage: Neutral to Bearish

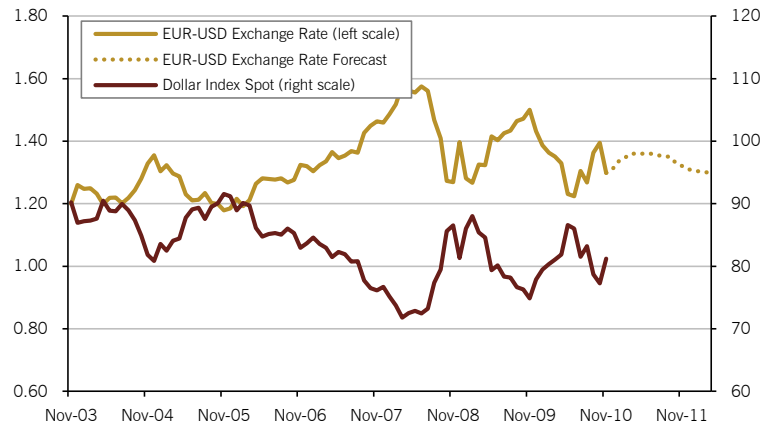


CURRENCY

U.S. DOLLAR

The dollar strengthened throughout November (the U.S. Dollar Index was up over 5% for the month) amid escalating concerns about Europe's debt crisis and tensions in Korea. Given longer-term issues, however, such as the size of the U.S. budget deficit, most expect the dollar to struggle against many currencies for some time. Many continue to see gold as a reasonable currency hedge.

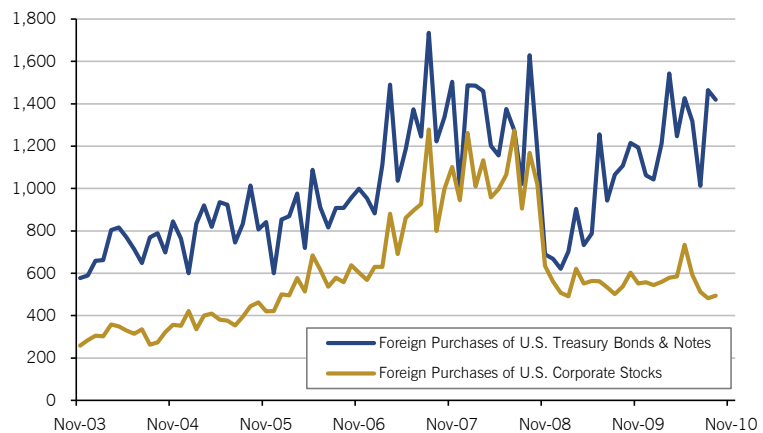
Advantage: Neutral



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

Global demand for U.S. stocks and bonds from foreign investors fell a bit in September. However, China, which remains the largest foreign holder of U.S. Treasuries, increased its holdings. Any significant drop in foreign demand could lead to higher U.S. interest rates.

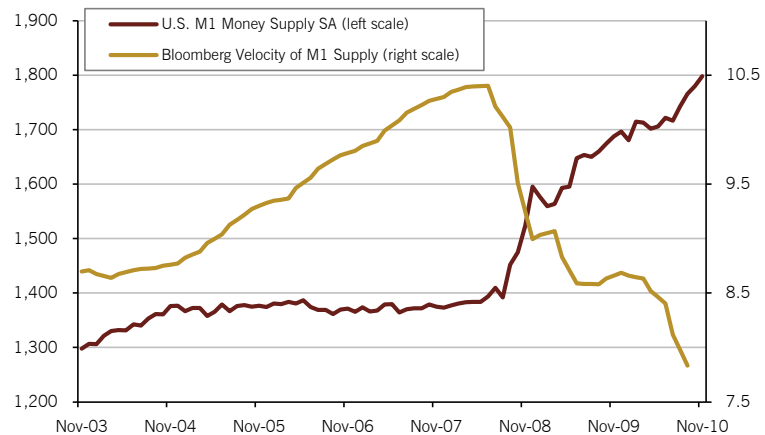
Advantage: Neutral



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, has actually been dropping as consumers and businesses are not spending or borrowing.

Advantage: Neutral to Bearish

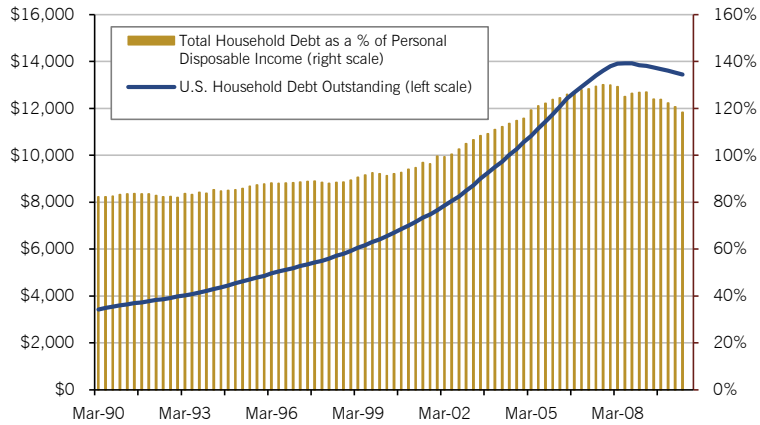


BORROWING

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

Fueled in part by declining interest rates, U.S. household debt (including mortgages and consumer credit debt), and its percentage of disposable personal income, have increased dramatically since the early 1990s. Despite talk of a deleveraging cycle, so far consumers have been decreasing debt slowly.

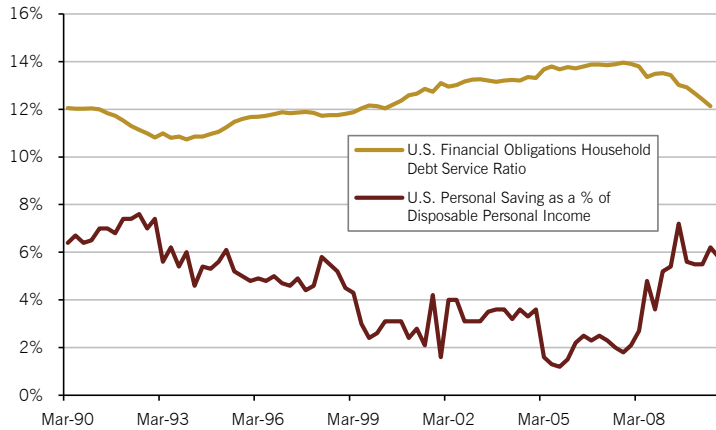
Advantage: Neutral to Bearish



U.S. SAVINGS AND HOUSEHOLD DEBT SERVICE RATIO

The debt service ratio measures how much of their earnings 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 muted due to the decline in interest rates. If rates spike, however, so too could debt payments.

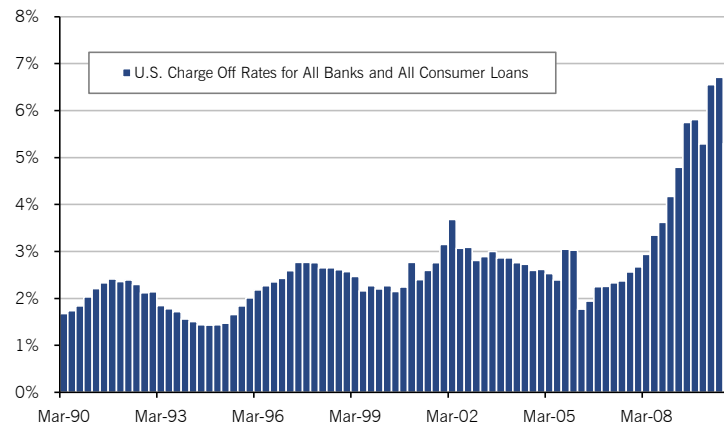
Advantage: Neutral



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.

Advantage: Neutral to Bearish



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