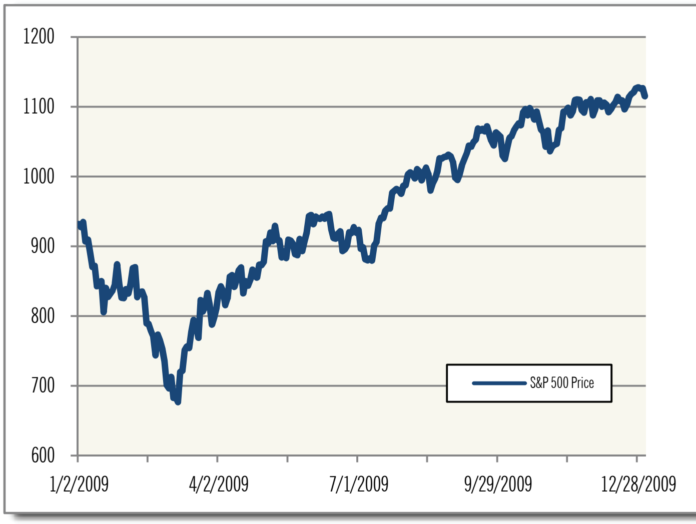
CONVERGENT | WEALTH ADVISORS

MARKET PULSE REPORT

DECEMBER 2009

S&P 500 PRICE



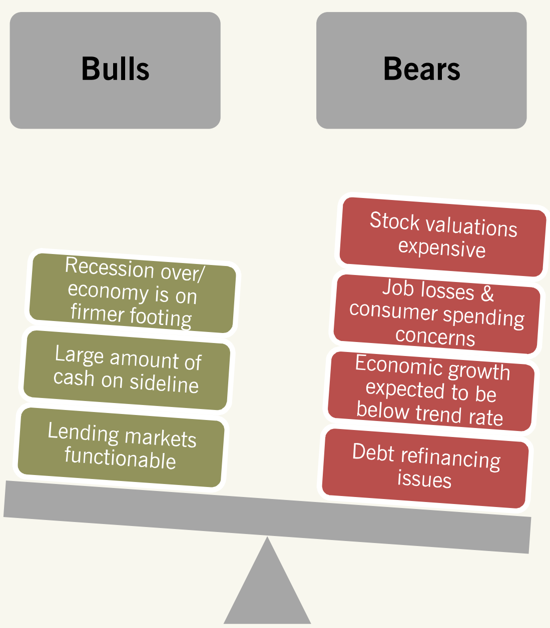
Stocks finished 2009 on a high note, with the S&P 500 wrapping up the year with a 2% December gain. Despite turbulence early in the year, the index rose in nine of the past ten months on the way to a 26% advance for the year. Since the March 9th closing low of 676, the S&P 500 is up a stunning 65%, though still 29% below its 2007 peak of 1565.

NOTES/COMMENTARY

With 2009 in the rear-view mirror, we go into the New Year feeling that there is a high level of risk embedded in many asset classes, stocks in particular. The heightened risk in equities has led us to reduce pure long-only equity exposure, to seek out portfolio growth in less market oriented strategies (hedged strategies) and to having a healthy diversification component in credit and real assets. The massive deleveraging cycle needs to continue, yet the stimulus support that has clearly bolstered markets (cash-for-clunkers, Treasury buying programs, first-time home buyer tax credits, near-zero interest rate policies) will eventually be removed. Economic statistics and earnings clarity are generally improving, but valuation measures such as Professor Robert Schiller's widely-tracked 10-year price-earnings ratio are not at levels conducive to generating attractive long-term returns.

While low quality stocks and bonds led the charge in 2009 in a liquidity-driven surge, we feel that fundamentals may begin to matter again in 2010. Quality oriented long-only credit and equity managers, long/short strategies, and other non-market determined manners of obtaining growth rather than directly via stocks might be more favorable going forward than the high beta strategies that led last year. Given the wide potential range of economic outcomes and above average valuations an overweight to core fixed income and cash is ok too, particularly given that inflationary pressures still seem rather distant.

SUMMARY OF CURRENT EQUITY MARKET LEANINGS



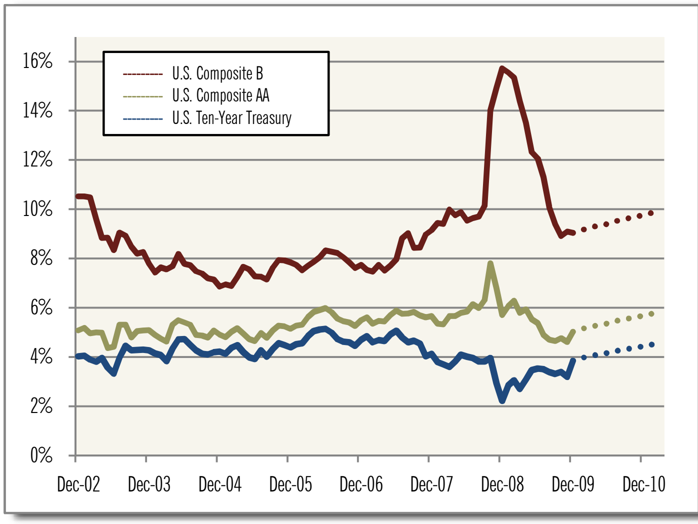
Summary: plenty to worry about and we are maintaining a defensive tilt

CONVERGENT TACTICAL POSITIONING

Equity	
US Large Cap Equity	underweight
US Small/Mid Cap Eq.	slight underweight
Developed Non-U.S. Eq.	underweight
Emerging Markets Eq.	slight underweight
Private Equity	neutral
Directional Hedge Funds	underweight
Real Assets	
Real Estate	neutral
Commodities	overweight
Arbitrage/Credit	
Multi-Strategy Hedge	neutral
Opportunistic Credit	overweight
Fixed Income	
Core Fixed Income	slight overweight
Cash Equivalents	overweight

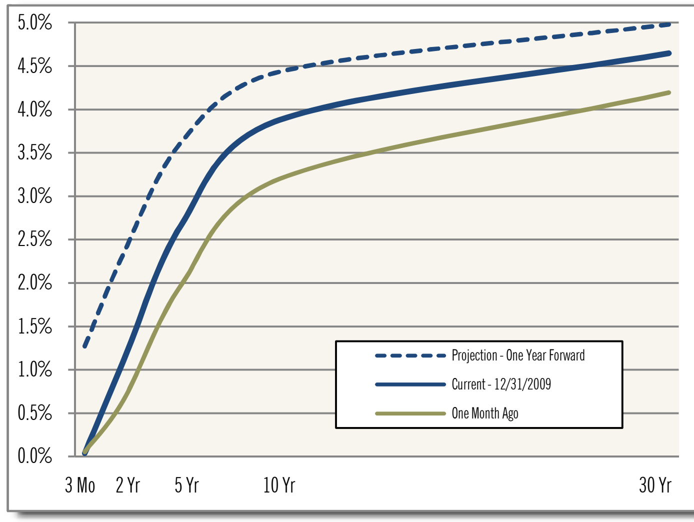
To manage portfolio risk, we are keeping in place shifts to overweight certain segments of the opportunistic credit market, commodities (gold in particular), and core fixed income/cash, while underweighting equities which we feel may be a bit overextended. There is the sense that 2010 might be a compressed return and heightened risk environment for many asset classes, and as such we are treading thoughtfully and carefully with regards to exposures.

CREDIT YIELD SPREADS



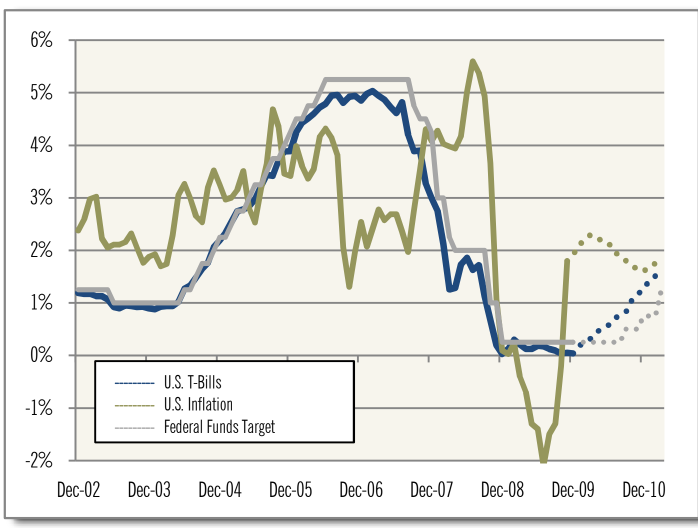
High yield corporate credit yields and spreads, which in hindsight reached "crazy high" levels, have contracted significantly and are now near average historical levels. Returns in the high yield space going forward are expected to be much more moderate than the record 2009 gains, and could suffer if spreads widen. The consensus, however, calls for a continued modest rise in yields of Treasuries/investment grade corporate debt in conjunction with those of junk bonds. **Advantage: Neutral**

U.S. TREASURY YIELD CURVE



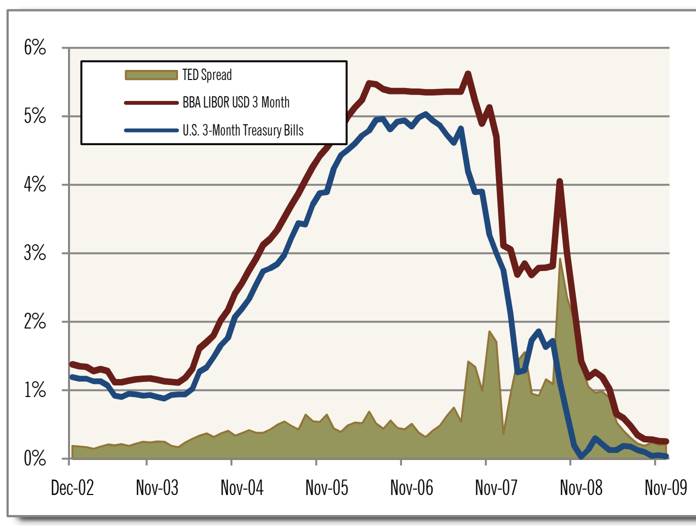
Thanks in part to record issuance, yields on Treasuries spiked in December as government bonds concluded 2009 with one of their worst annual performances on record. With the Fed committed to keeping interest rates "exceptionally low" for some time, however, rates are expected to remain mostly rangebound, despite supply issues. We are currently exploring increasing exposure to investment grade international bonds, due in part to concerns of a secularly weak U.S. dollar but also as we desire to add further diversification to our credit exposure. **Advantage: Neutral**

T-BILLS, FEDERAL FUNDS AND INFLATION



Is headline inflation finally rearing its head, as many have expected? Doubtful, as sluggish job creation and low resource utilization are expected to act as a brake. It is likely that recent numbers are simply higher due in part to low year-over-year comparison points. Disinflation is expected to continue in the short-term; longer-term, there is the fear that inflation could rapidly and unexpectedly spike much higher. **Advantage: Neutral**

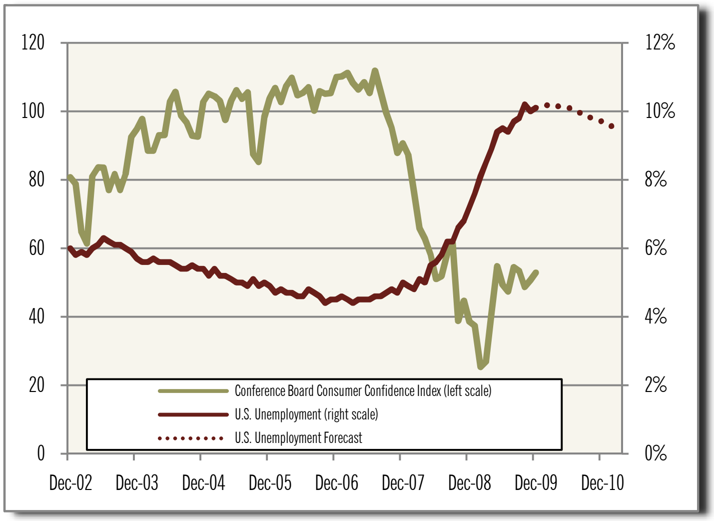
LIBOR/T-BILL RATES AND TED SPREAD



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). During last year's credit crisis, extremely wide TED spreads indicated a high degree of anxiety and riskiness in the bank lending market as liquidity was being withdrawn. The recent decline (to lower levels than before the crisis began) illustrates that the risk of bank defaults is considered to be dramatically decreased. **Advantage: Bulls**

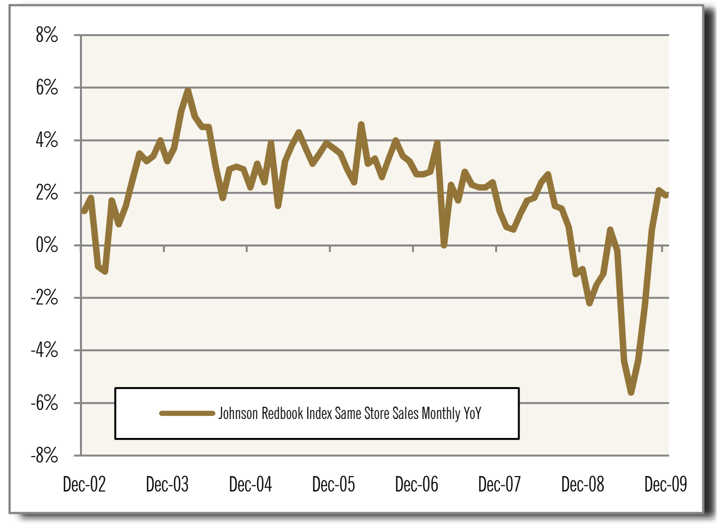
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

CONSUMER CONFIDENCE & UNEMPLOYMENT



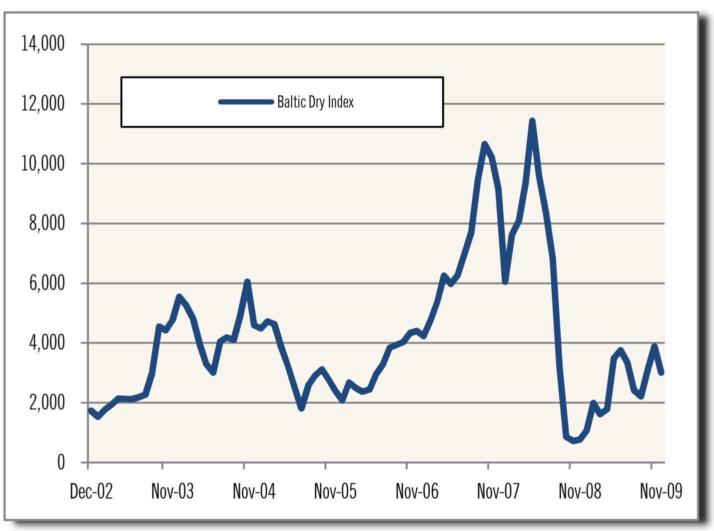
Many feel that the unemployment rate, which has broken the 10% barrier and hit its highest level since 1983, might be close to peaking. Unfortunately, just because companies are doing less downsizing does not necessarily mean that new hiring is going to pick back up. Worries about job losses have kept consumer confidence very weak, and far below levels that signify a solid economy. As consumer spending accounts for about 2/3 of economic activity, fears are that restrained spending could derail the recovery. **Advantage: Bears**

RETAIL SALES



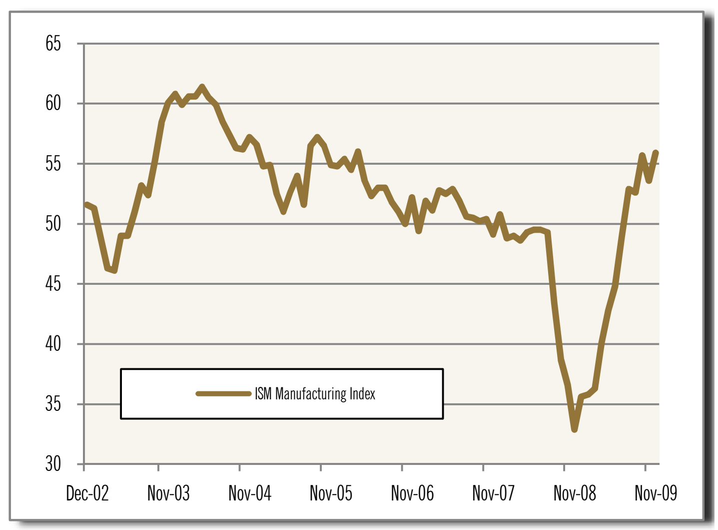
Rising retail sales figures, which track the dollar value of merchandise sold to consumers, could be an indicator of continued recovery and ultimately inflationary pressures. Recent data has been mixed, however; December sales were up 1.9% over the same month of the previous year, though down -4.6% from the previous month (month to month changes are not illustrated in the graph above). Still, consumers seem to be in a more generous mood than mid-2009, and spent more in recent months than many had expected. **Advantage: Neutral**

BALTIC DRY INDEX



The Baltic Dry Index (BDI), a measure of world trade, provides a barometer of the price of moving major raw materials by sea, taking into consideration the demand for shipping capacity versus the inelastic supply of dry bulk carriers. The BDI has been rising off of late 2008 levels, recently thanks in part to strong steel and iron-ore markets. **Advantage: Neutral**

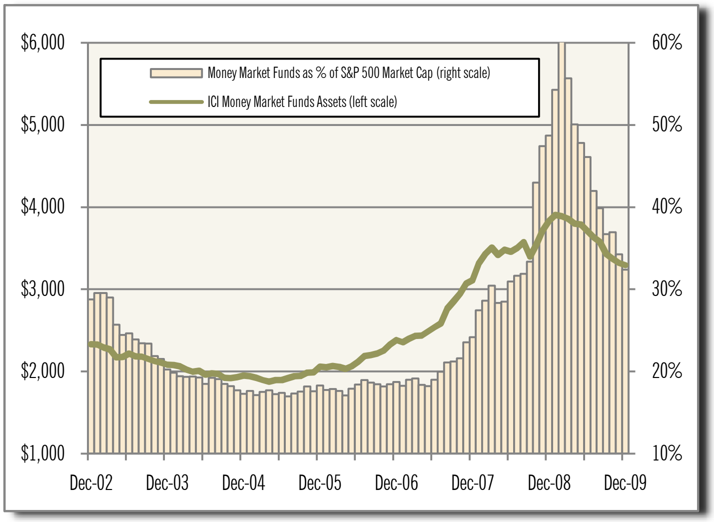
ISM MANUFACTURING INDEX



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. The index has been one of the better predictors of the business cycle over the years. A reading over 50% indicates expansion relative to the prior month, while a sub-50% reading indicates contraction. **Advantage: Bulls**

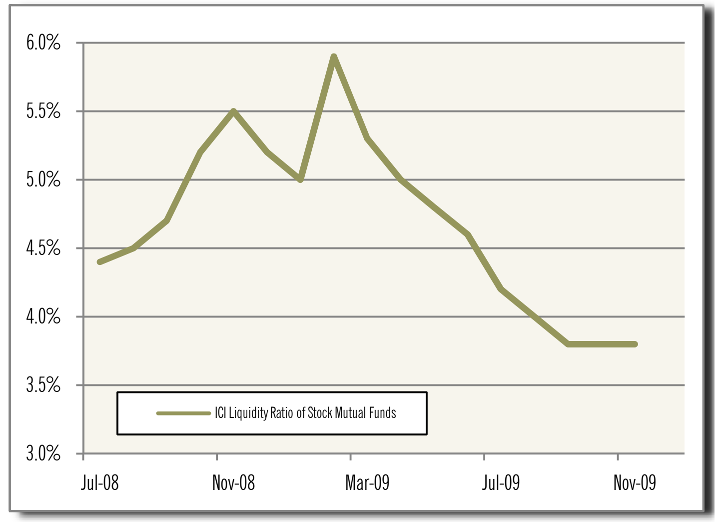
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

MONEY MARKET FUNDS ASSETS ($ BILLIONS)



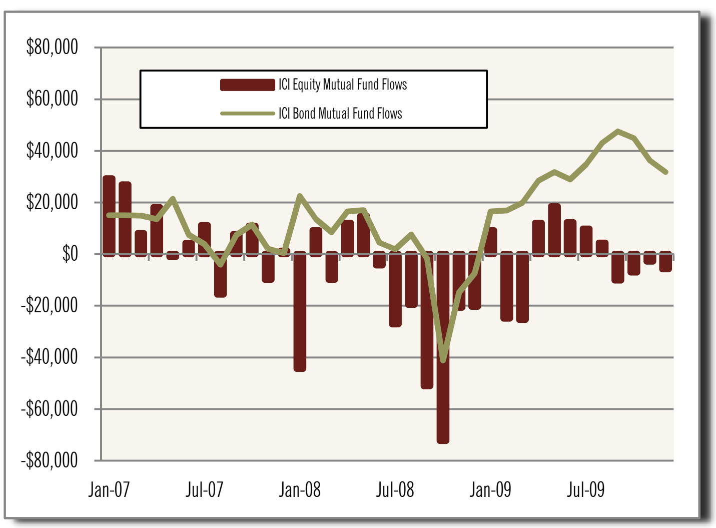
Some of the cash balance built up over the past few years has been put to work, but there still remains a large amount on the sidelines. Unless investors have decided to dramatically increase their savings rate (and there is possibility of that we are experiencing a secular shift towards increased savings and higher bond allocations) there remains plenty of powder available for stocks, at least from retail investors. Many managers, however, have already reduced their cash balances in an attempt to keep up with the market. **Advantage: Bulls**

MUTUAL FUND LIQUIDITY RATIO



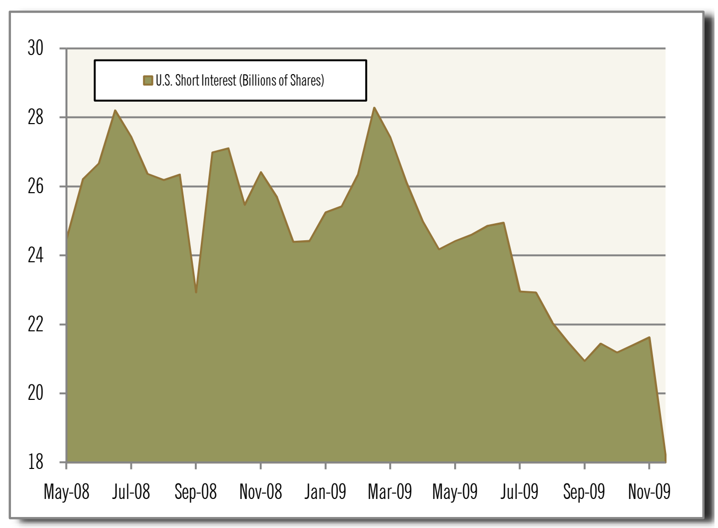
The liquidity ratio compares the amount of cash relative to total assets held by stock mutual funds. As the stock market tanked in early 2009, mutual fund managers were bearish and sitting on an increasingly large amount of cash. In the ensuing rally, however, managers have put most of that to work and are now holding historically low levels of dry powder. If retail investors continue to shy away from equities, insiders continue to sell and portfolio managers are now fully invested, where will the next leg of buying power come from? **Advantage: Bears**

MUTUAL FUND CASH FLOWS ($ MILLIONS)



Dollars continue to flow into bond funds while equity mutual funds record outflows. Is this evidence of a secular shift in investor behavior? Perhaps, or maybe retail investor activities are simply a good contrary indicator. Whether (and when) retail investors jump back into equities remains to be seen, but it certainly has not held up the recovery so far. **Advantage: Neutral**

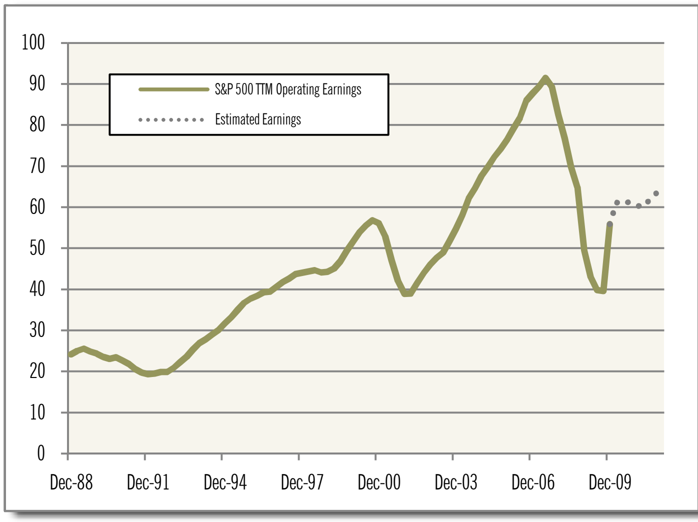
U.S. SHORT INTEREST



Short interest (the number of shares sold short but not yet covered) can be a telling indicator 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 covering has been heavy since the market lows, and perhaps a significant contributer to stock gains. As short interest has declined, the benefits from any short squeeze are probably behind us. **Advantage: Bears**

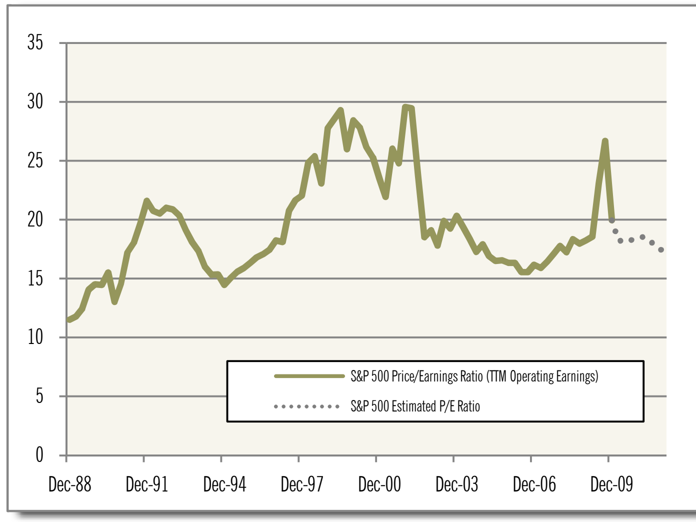
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

CORPORATE EARNINGS



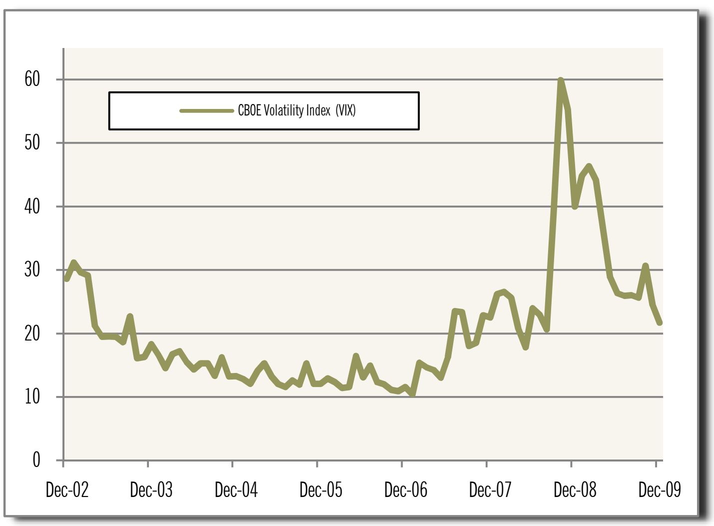
After falling for a record nine straight quarters, annual earnings are back in the black on a year-over-year basis. For all of 2009, operating earnings are expected to come in at about $56. Top down estimates for 2010 are not much higher, though bottom-up estimates are running at about $75. This wide range in projections illustrates a lack of clarity as to whether economic recovery continues or stalls. Nevertheless, it is apparent the mood towards corporate earnings has improved dramatically. **Advantage: Neutral**

STOCK MARKET VALUATIONS



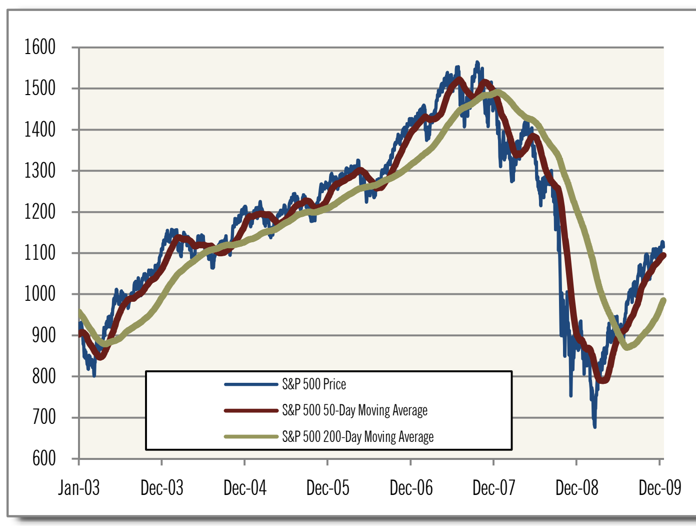
Despite an improvement as Q4 earnings have been recorded, valuations are still relatively expensive by almost any measure, whether based on forward, trailing, operating, as reported or smoothed earnings. The S&P 500 currently trades at about 20x operating earnings, a level that simply is not conducive to attractive longer-term returns. In order for valuations to become more attractive, revenue growth needs to continue to show improvement and catch up with high expectations or prices need to fall (or a combination thereof). **Advantage: Bears**

STOCK MARKET VOLATILITY



Volatility (as measured by the VIX) continues to fall. Bears argue that the VIX returning to levels last seen before the credit crisis could be a sign of complacency, while bulls point out that it allows investors to remain more confident and fully invested as the cost of hedging has become cheaper. **Advantage: Neutral**

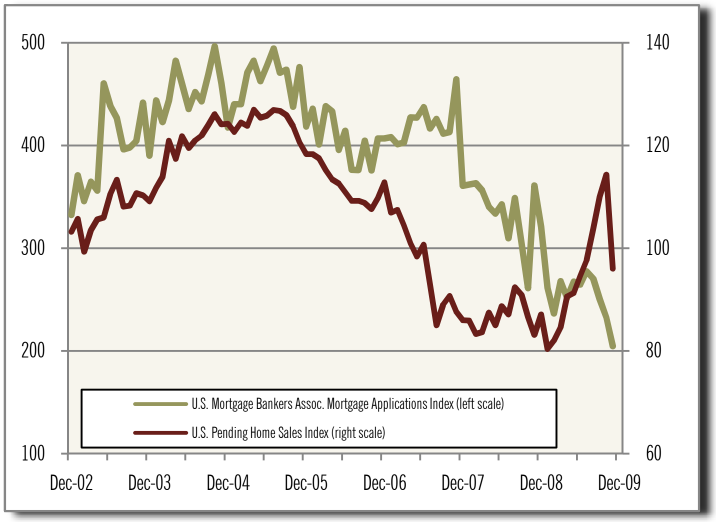
STOCK MARKET TECHNICALS



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

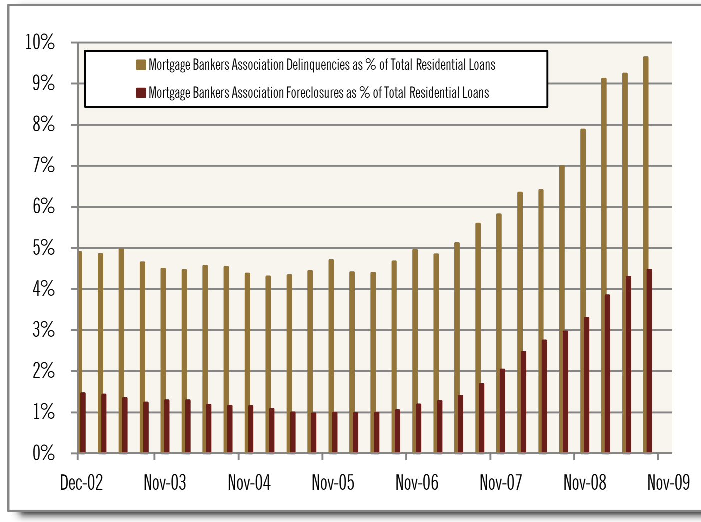
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

MORTGAGE APPLICATIONS & PENDING HOME SALES



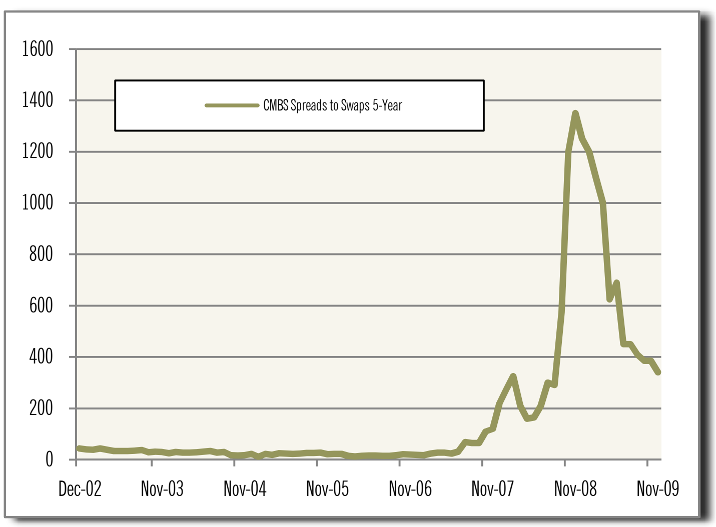
Many feel that recent home sales figures have been driven by the first-time homebuyer tax credit program as well as speculators snapping up houses in distressed sales. Interestingly, even as pending home sales had been rising, mortgage applications have been declining, perhaps indicative of waning stimulus or constrained credit markets. While any improvements in the housing markets are welcome, double digit unemployment and a large amount of supply is likely to keep a lid on any gains. **Advantage: Bears**

RESIDENTIAL DELINQUENCIES & DEFAULTS



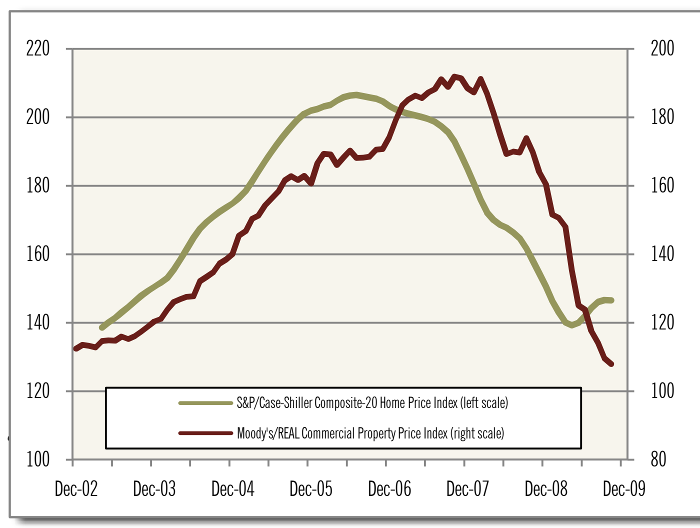
Mortgage delinquencies and foreclosures continue to surge. With high unemployment, the wave of foreclosures is not expected to crest until sometime later this year, and will be a headwind to the housing market and economy for some time. **Advantage: Bears**

CMBS SPREADS



Despite a significant pullback in CMBS spreads since last fall, levels are still high in a historical context and concerns remain about commercial real estate loans. Loss expectations are high thanks in part to a large amount of loans that need to be refinanced in the next couple of years at the same time that vacancies are rising, rental rates are falling, and many commercial real estate owners are struggling to pay their mortgages. **Advantage: Bears**

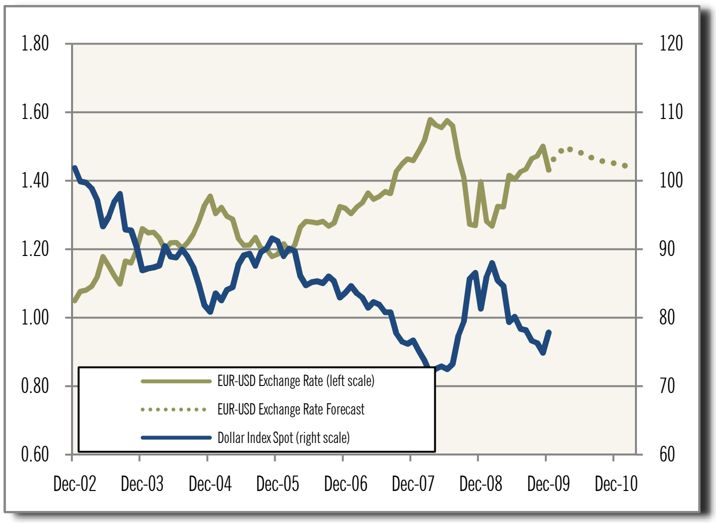
RESIDENTIAL/COMMERCIAL PROPERTY PRICE INDICES



Both residential and commercial real estate prices have experienced a dramatic pullback from levels seen a few years ago and are now hovering at or below values last seen back in 2003. While residential prices may be stabilizing (at least for the time being), the descent in commercial price index levels has not yet been stemmed. **Advantage: Neutral**

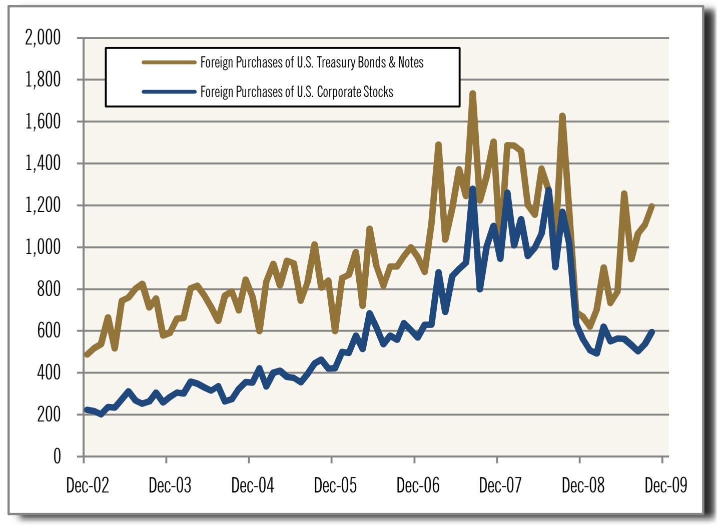
Sources: Bloomberg, Standard & Poor's, Ibbotson, Investment Company Institute

U.S. DOLLAR



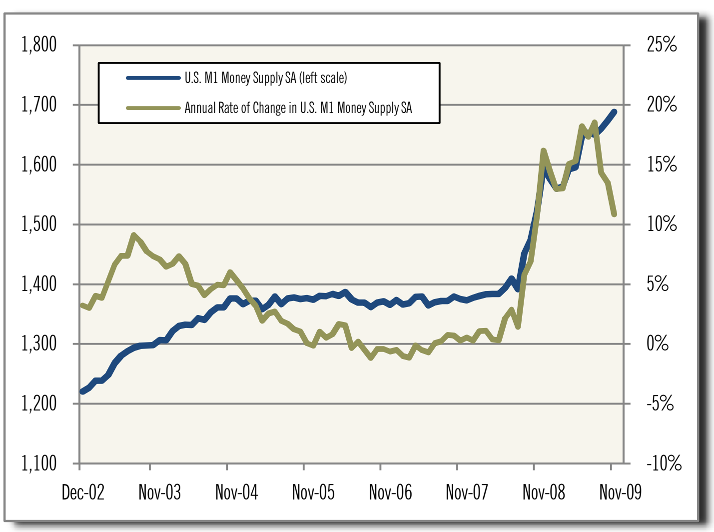
The U.S. dollar bounced a bit in December, but most still consider it to be in a secular decline in the face of concerns over the size of the U.S. budget deficit and mounting questions over its reserve currency status. The dollar has been further hampered by expectations of continued low domestic interest rate policies while other countries are starting to raise rates. **Advantage: Neutral**

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



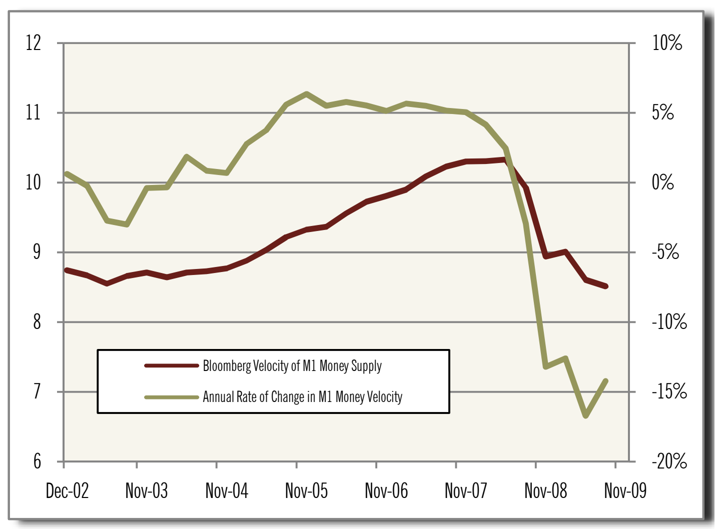
Foreign purchases of U.S. stocks remains constrained, though Treasury securities are still in demand. Going forward, a concern is that dollar worries may keep some foreign investors away. In the long-run, a lack of demand for American investments is not helpful to U.S. market returns. For now, at least, things appear to have stabilized. **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 Fed-initiated programs of fiscal and monetary stimulus to unlock credit and revive the economy, M1 has exploded to unprecedented levels, causing fears of 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 dramatically as consumers and businesses are unwilling to spend money in a difficult environment or are not able to take advantage of lending programs. **Advantage: Neutral**

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

ECONOMIC/MACRO THEMES

Listed below are several economic/macro themes that we are currently considering as we evaluate our tactical portfolio positioning. Several of these themes, and the manner of addressing them, overlap. When evaluating these risks/opportunities, we consider both if there are practical manners of addressing them that are accretive to the total portfolio (on a relative and risk-adjusted basis) as well as potential outcomes if these themes do not come to fruition (i.e. what if we are wrong).

RISKS

- **Low reward/high risk environment** -- more specifically, the concern that the recent equity market advance has been a cyclical bull rally within a secular bear market, and that a variety of asset classes have unsound fundamentals and rich valuations. Either renewed economic weakness, or a continuation of global economic recovery which leads to a retraction of the massive fiscal/monetary stimulus, could be a trigger to a reversal in investor purchases.

  Risk Horizon: *Near-term* *Probability: High* *Portfolio Threat: High*

  Portfolio Impact: *Losses in growth assets, including equities, real estate, commodities, high yield*
  To Mitigate: *Decrease exposure to long-only assets that are potentially overvalued in favor of cash or other investments that are less sensitive to market beta; for risk assets, increase usage of long/short managers; increase usage of fundamentally-driven and high quality equity strategies (though not necessarily fully removing our preference for low fee, tax efficient large cap exposure)*
  Cost of Being Wrong: *Not necessarily high, as we are only recommending a decrease in exposure to growth assets and not a full elimination. A portion of any further rally might be missed, but the bulk of any upside can still be captured*

- **Deflation** – if economic growth stagnates and a double dip recession is experienced, there is the possibility of falling into a deflationary spiral as the Fed is potentially limited in additional options to stimulate pricing levels. Disinflation (the current environment) is not the concern, but rather an extended period of deep decline in prices of all assets.

  Risk Horizon: *Near-term* *Probability: Moderate* *Portfolio Threat: High*

  Portfolio Impact: *Losses and/or underperformance in equities and growth assets*
  To Mitigate: *Maintain core fixed income (including Treasuries) and cash positions; increase allocation to gold*
  Cost of Being Wrong: *If inflation and yields spike, Treasury losses could be significant, so diversify bond exposure and do not go out too far in maturity*

- **Inflation** – while deflation is a portfolio concern in the near-term, looking out longer-term there are risks that inflation could spike due to the huge monetary stimulus or in response to a debasement of the dollar. This could occur with or without strong economic growth (i.e. stagflation). Regardless, interest rates will likely rise if inflation fears materialize.

  Risk Horizon: *Intermediate to long-term* *Probability: Moderate to High* *Portfolio Threat: Moderate*

  Portfolio Impact: *Losses in core bonds; underperformance in equities*
  To Mitigate: *Increase exposure to real assets (including commodities/gold) and commodity currencies; shorten core fixed income duration; consider reducing fixed income allocations (but not yet given near-term deflation concerns)*
  Cost of Being Wrong: *Real assets have various drivers of return and belong in a portfolio beyond being viewed as simply an inflation hedge, but commodities can be very volatile so do not warrant huge overweights. Given low yields, shortening bond portfolio duration should come at a modest opportunity cost*

- **Rising interest rates** – interest rates, which are currently near historical lows, could rise significantly for a number of reasons including strong economic growth, inflation fears, U.S. dollar weakness, supply issues or reduced foreign demand. The Fed is committed to keeping a policy of low rates for the time being, however, so no immediate action may be necessary.

  Risk Horizon: *Intermediate to long-term* *Probability: High* *Portfolio Threat: Moderate*

  Portfolio Impact: *Losses in core bonds (especially longer duration Treasuries)*
  To Mitigate: *Reduce bond portfolio duration; diversify core fixed income exposure; consider reducing allocation to core fixed income; shift to cash*
  Cost of Being Wrong: *Even with a steep yield curve, given low absolute yield levels the opportunity cost of overweighting cash/ultra-short credit is minimal. Given that yields are near zero for money market instruments, however, this is not a viable long-term strategy. If reducing bond allocations, the question is where to go? Shifting into riskier assets does not make sense currently*

Other areas of portfolio risk that we are evaluating include (i) a secular shift towards savings and increased fixed income allocations (driven in part by evolving demographics); (ii) slower economic growth in the developed economies of U.S./Europe driven in part due to structural reductions in consumer consumption/spending (in conjunction with faster growth in developing economies), (iii) the ongoing debt overhang (and concommitant soverign risk and U.S. bank risk); (iv) geopolitical shocks (war, terrorism); and (v) changes in U.S. tax legislation.

ECONOMIC/MACRO THEMES

OPPORTUNITIES

- **U.S. dollar weakness** -- there are fundamental reasons (such as U.S. budget deficits) for the dollar, which has lost some appeal as a safe haven, to continue its long-term secular downtrend. Short-term rallies as carry trades are unwound could be expected, however, and forecasting currencies is treacherous. Of course, a significant and rapid drop in the dollar could lead to inflation and rising interest rates, both of which pose risks to a portfolio (as illustrated above).

  Horizon: *Near to long-term* *Probability: Moderate* *Opportunity Level: Moderate*

  To take Advantage: *For U.S.-based investors: increase allocation to commodities (including gold); increase exposure to emerging market debt/currencies; increase exposure to international equities and bonds*

  Cost of Being Wrong: *Underperformance of international versus U.S. securities. There are other reasons (expected growth rates, market cap/GDP), however, that warrant increased foreign exposure. With regards to commodities, long-term real assets returns are not dependent upon currency movements. Emerging market currencies could be volatile, so warrant only modest portfolio allocations.*

- **Shortage of Natural Resources** – the emergence of the middle class in economies such as China, India, and Latin/South America (demographic groups that currently do not have much in the way of debt) could put a strain on natural resources, leading to a continued secular uptrend in commodity prices.

  Horizon: *Long-term* *Probability: High* *Opportunity Level: Moderate*

  To take Advantage: *Increase allocation to diversified commodities, emerging market equities and commodity currencies*

  Cost of Being Wrong: *Underperformance versus developed equities/bonds. Commodities and emerging market currencies are also volatile and most suitable for investors with a long investment horizon not impacted by current spending needs.*

Other opportunities we are exploring include: (i) the longer-term distressed cycle; (ii) repricing of illiquidity (i.e. private real estate/equities being potentially more attractively priced than public equities); (iii) long-term - more rapid economic growth in developing economies (in contrast with slower growth in developed nations).

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 Equity	underweight	Low reward/high risk environment. Positioning: underweight equities, particularly long-only, while overweighting long/short and focusing on fundamentals	- given economic and forward earnings uncertainty, along with expensive valuations, there is a high level of downside risk associated with stocks and an underweight allocation (but not elimination) is recommended - 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 Equity	slight underweight		- our already low levels of small cap exposure make further reductions not meaningful - we generally have an overweight tilt to small (and value) relative to large - all cap managers, with their increased allocation flexiblity, may be able to better position portfolios
Developed Intl Equity	underweight		- a recommended reduction but generally less so than domestic - resulting overweight to international relative to U.S. provides some protection against secular dollar decline - valuations in many international regions are more attractive than that of the U.S.
Emerging Market Equity	slight underweight		- strong long-term economic growth prospects, potentially much greater so than in the developed regions - current valuations are difficult to decipher (i.e. China) and a high level of volatility is expected - as we deem it is appropriate to shift back into risk (growth) assets, we anticipate overweighting developing mkts
Private Equity	neutral		- good opportunity set (with better pricing than public markets), but managers have existing portfolio distractions
Directional Hedge Funds	underweight		- though reduced, L/S allocations are significantly overweight relative to long-only equity allocations - better anticipated protection against equity downturn but may lag in rallies (barring superior stock selection) - managers are seeing correlations among stocks decrease (and dispersions in returns increase)... superior selection matters
Real Assets	**overweight**		**- increased allocation as currency/inflation hedge and longer-term play on natural resource shortage**
Real Estate	neutral	Inflation; U.S. dollar weakness; shortage of natural resources. Positioning: overweight (gold in particular)	- commercial real estate refinancing issues remain, but values abound for those private managers with capital - REITs are not necessarily cheap, but becoming clearly divided between thrivers and merely-survivors
Commodities	overweight		- recommend gold exposure for safe haven, weak dollar and inflation posturing - 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**		**- low hanging fruit (beta) is probably played out, but pockets of opportunities remain**
Multi-Strategy Hedge Funds	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 opportunities - redemption, liquidity and restructuring issues are much less of a distraction
Opportunistic Credit	overweight		- as spreads have narrowed, high yield corporate debt/bank debt beta opportunity has waned - emerging market debt could provide a currency/inflation hedge - exploring increasing investment grade global bond exposure
Fixed Income	**overweight**		**- increased allocation while waiting to deploy back into overpriced growth assets**
Core Fixed Income	slight overweight	Low reward/high risk environment; deflation Positioning: Overweight for risk management purposes.	- in the near-term, Treasury/munis may be beneficial as deflation plays out - despite supply issues, demand remains strong from both retail and foreign investors - given low yields, long-term prospects are muted... inflation and rising rates may end the bull market in credit
Cash Equivalents	overweight		- low bond yields relative to cash makes holding dry powder in cash or short-term instruments sensible