THE MARKETS

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The Last Quarter In Review

Continued concern in the state of our economy did not stop the markets from producing positive bond and equity returns for the third quarter. Signs that the economy is slowly improving, growth in corporate profits, and anticipation of an easier U.S. monetary policy all contributed to this encouraging performance.

US Real GDP	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
	1.60%	5.00%	3.70%	1.70%	2.00%

GDP = consumer spending + business investment + government + exports – imports.
Source: www.bea.gov

After a revised 1.7% growth in the GDP for the second quarter, the economy produced a 2.0% increase (advanced estimates) for the third. While the economy continues to grow it is at a significantly slower pace than previous recoveries.

Consumers increased their spending as they contributed 2.6% to growth which was above the 2.2% increase in the prior quarter. Corporations contributed to our growth by adding to their inventories (1.44%) and investments (9.7%). Disposable personal income also increased (1.5%), but at a smaller pace than in the prior quarter (4.1%). Real residential investment dropped by 29% and state and local governments by .2% which detracted from the growth.

Consumer Price Index	1 Year	3 Year	5 Year	10 Year
	1.20%	1.65%	2.15%	2.36%

Consumer Price Index numbers are annualized through 9/30/2010.
Source: www.morningstar.com

The producer price index (PPI) moved up .8% for the quarter which was an increase from the (revised) .1% advance of the prior quarter. While prices are not increasing rapidly, these prices are important to watch. If the production prices continue to rise, the increases will eventually be passed on to the consumer.

Looking Forward

We anticipate a moderate recovery with continued volatility in the markets. In the first week of November, three events occurred that may have a significant impact going forward—the midterm election, the Federal Reserve's announcement of further easing of the monetary policy, and a better than expected employment report. While the markets have generally responded positively to the above events, there remains another potential obstacle for the economy. The Bush tax cuts are set to expire at the end of the year. If they are not extended, this could subtract approximately 1% from GDP for 2011.

> An economy hampered by restrictive tax rates will never produce enough revenue to balance our budget, just as it will never produce enough jobs or enough profits."
>
> John F. Kennedy

Housing, like other economic indicators, continues to give mixed signals. The impact of the foreclosure moratorium on future home sales is unclear. From the corporate sector, CEO's continue to see a slightly improving economy but remain cautious about adding many new jobs. Prolonged economic uncertainty, the lack of clarity on the expiring Bush tax breaks and the impact of the health and financial bills all appear to be the discouraging factors going forward.

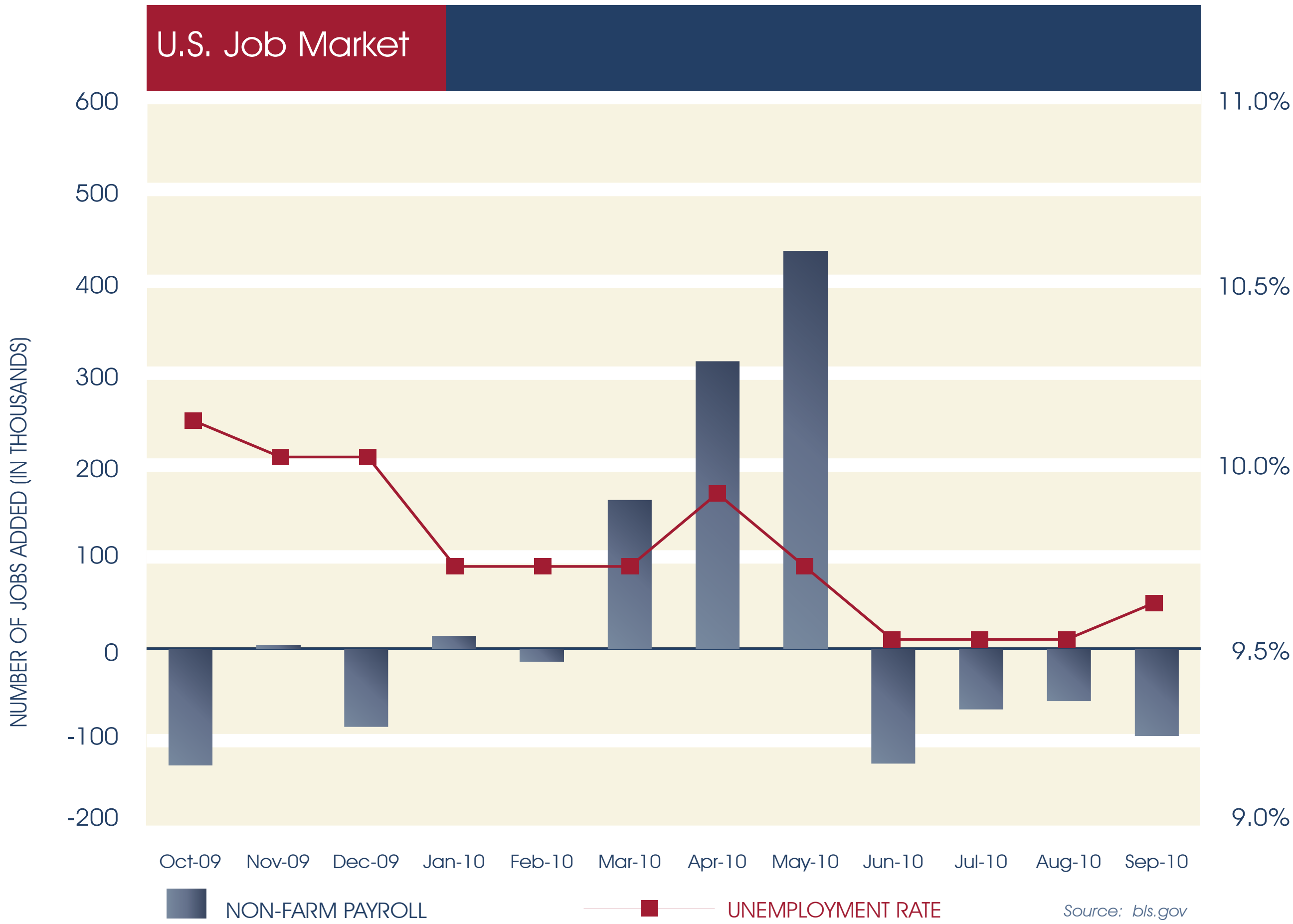
Equity Markets

The equity markets responded well to any good news and seemed to discount the bad throughout most of the quarter. Again, corporate profits improved as many companies continued to cut costs and benefited from some rising revenues which added to their bottom lines. Concern over the European sovereign debt issues have continued but seemed to wane over the quarter. Their markets healed considerably. The EAFE (Europe Australia and Far East Index) produced a 16.8% return. While we still remain cautious in this area, in some accounts we have increased our allocations toward the emerging markets for the quarter. We believe this area is still appealing given that the emerging economies are set to grow by 6.8 percent in 2010, more than double the 2.6 percent pace for the developed world. (per the International Monetary Fund)

Telecommunication stocks produced the highest sector return at 19.5% and software produced the second highest return at 16.05% (source Morningstar.com). Companies in these sectors tend to have higher cash flows and better balance sheets than those considered average. It is these higher quality companies we attempt to emphasize in our client's portfolios as we believe they are poised to excel when the economy moves forward. The lagging sector for the quarter was financial services though it still produced a 9.3% return. This area has been under-weighted for most of the year, but our allocations have increased over the prior quarter. Write downs in mortgages have been substantial but large banks may benefit from the improving economy and have continued to increase their profits through it all. We remain over-weighted in the health sector though it has yet to perform well this year. The continued overhang of the health reform bill and large patent expirations tend to keep these valuations low.

Major Indices	Returns †						Risk †			
	Qtr 3 2010	2009	1 Year	3 Year	5 Year	10 Year	1 Year	3 Year	5 Year	10 Year
Barclays Cap Aggr Bond Index	2.48%	5.93%	8.16%	7.42%	6.20%	6.41%	3.08%	4.14%	3.60%	3.80%
Barclays Cap Muni Bond Index	3.40%	12.91%	5.81%	6.04%	5.13%	5.73%	3.71%	6.02%	4.88%	4.56%
Dow Jones Industrial Average	11.13%	22.68%	14.12%	-5.38%	3.13%	2.51%	17.46%	19.89%	16.26%	15.75%
S&P 500 Index	11.29%	26.46%	10.16%	-7.16%	0.64%	-0.43%	19.09%	21.81%	17.61%	16.41%
Russell 2000 Small Cap Index	11.29%	27.17%	13.35%	-4.29%	1.60%	4.00%	25.74%	27.95%	22.92%	21.45%
MSCI EAFE (Foreign) Index	16.80%	31.98%	3.27%	-9.51%	1.97%	2.56%	20.80%	26.10%	21.24%	18.46%
MSCI EM (Emrg. Mrkts) Index	18.03%	78.51%	20.22%	-1.48%	12.74%	13.77%	20.14%	33.61%	28.41%	24.92%
NASDAQ Composite Index	12.54%	54.67%	12.61%	-3.43%	2.89%	-3.54%	23.42%	25.62%	20.72%	25.00%
DJ Wilshire REIT Index	13.22%	28.46%	30.14%	-6.98%	1.36%	10.12%	22.01%	41.88%	33.91%	26.11%
DJ / UBS Commodity Index	11.61%	2.78%	10.01%	-6.84%	-2.35%	5.19%	16.27%	24.13%	20.57%	17.53%
Goldman Sachs Commodity Index	8.27%	13.48%	4.22%	-13.30%	-10.22%	1.20%	22.09%	32.12%	27.75%	25.08%

† 1, 3, 5 and 10 year return & risk numbers are as of 9/30/2010. Risk, the standard deviation, is a statistical measure of volatility of a portfolio's returns around its mean. Past performance is no guarantee of future results. source: Morningstar Advisor Workstation



Interest Rates & Fixed Income

The Barclays Bond Aggregate Index moved up 2.4% in response to another big quarter for bond fund inflows. These inflows have helped to keep rates low, offering corporations continued advantage. Microsoft made headlines with their ability to borrow at less than 1% for 3 years. Looking forward, the Fed's desire to keep interest rates low may continue to increase prices on these bonds for the short term. However, over the long term we still believe these lower yielding bonds will be challenged to perform well given their low coupon payments and significant interest rate risk.

Throughout the year we have increased our investments in emerging market bonds favoring their higher yields and better price appreciation potential. These bonds offer higher yields due to both the emerging markets economies having higher inflation expectations and their perceived lower creditworthiness. While the emerging country economies do have higher inflation than the developed countries, some have already begun to tighten their monetary policies to limit continued inflation growth. Many of these countries also have much healthier balance sheets than governments in developed economies. While we still like the dynamics of these investments, the substantial new inflows have us monitoring this area closely.

Key Rates

	Prime Rate	3.25%	10 YR Treasury Yield	2.63%
	1 YR CD Rate	0.97%	30 YR Fixed Mortgage Rate	4.23%

as of November 3, 2010 *source: Bloomberg.com*

Commodities, Real Estate & Alternative Strategies

The Dow Jones UBS Commodity Index moved up 11.61% for the quarter. The biggest contributor to this performance was from the agriculture area where some supply issues arose due to poor crop performance while demand continued to increase. Hard metals also increased as gold moved up 4.8% and continues to set new highs. Gold's popularity reflects the view of it as a currency alternative since the balance sheets for governments of developed countries reflect a higher credit risk. Our strategy has been to keep a small percentage of gold in most portfolios throughout the year. Given the Fed's focus on maintaining low interest rates, we should continue to see pressure on the U.S. dollar which will tend toward higher commodity and energy prices. We have added to these areas throughout the year and will continue to do so as we see good entry points.

The FTSE NAREIT REIT Index produced a total return of 12.8% for the quarter. Like other equities, these real estate investments responded to the slowly improving economy and the presumed intervention of the Federal Reserve. The higher quality companies strengthened their positions by taking advantage of lower interest rates. For example, Simon Property Group retired $1.3 billion of debt in the quarter and re-issued new bonds with superior terms. While we have been under-weighted in this area, we will gradually increase our allocation as we believe these investments will continue to appeal to yield starved investors.

We continue to explore the use of alternatives within client portfolios to help with short term volatility. Some alternatives are not currently traded on the stock exchanges. These have a longer time frame between pricing, such as annually, which limits the effect of the minute to minute price swings felt by most equity and bond positions in the open exchange. One type of alternative, a non-traded real-estates investment trusts (REIT) for example is not immediately traded on the open exchange. While this creates a situation of limited liquidity, it also reduces the effect of short term market swings as the pricing is typically reset on a longer term than minute by minute. Some are even re-priced on an annual basis. Eventually though, an investment with this structure will either be sold on the open exchange or liquidated. Typically this type of investment is held for at least ten years which will allow investors to hold commercial real estate in such a way to limit the direct affect of daily market conditions during that period. Of course long-term trends and normal economic risks will continue to factor into the performance as with any investment. There are other concerns and factors alternatives can bring to a portfolio and we will continue to explore and research these options as they arise.

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