THE MARKETS

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THE LAST QUARTER IN REVIEW

For the quarter, the equity markets experienced an overhang from the issues that occurred during the first quarter; the Japanese earthquake, continued unrest in oil producing countries and economic news that indicated the economy may be slowing. These factors acted as headwinds to equity markets, but most fixed income markets produced solid gains.

US Real GDP	Q 2 2010	Q 3 2010	Q 4 2010	Q 1 2011	Q 2 2011
	3.8%	2.5%	2.3%	.4%	1.3%

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

The contributors to the increase of GDP were exports, nonresidential fixed investment, private inventory investment, and federal government spending which were partly offset by a negative contribution from state and local government spending.

Revisions to the U.S. gross domestic product (GDP) data of previous periods confirmed the recession in 2008-09 was deeper than initially believed and the recovery was slower and patchier. The net effect is that while it was previously reported the economy had recovered from the recession and we were in recovery, actually due to the revisions we now find that the economy has yet to fully recover from the recession.

Consumer Price Index	1 Year	3 Year	5 Year	10 Year
	3.43%	1.07%	2.14%	2.36%

Consumer Price Index numbers are annualized through 06/30/2011
Source: www.morningstar.com

The Bureau of Economic Analysis released that the price index for gross domestic purchases increased 3.2% in the second quarter. Recent price increases are significantly higher than last year about this time, when chairman Bernanke announced QE2. Given the dual mandate of the Fed to keep inflation in check and unemployment low, this could make it difficult to establish any new 'easing'.

LOOKING FORWARD

We anticipate the 'seesawing' effect in the markets to continue. News of a macro-economic event may disturb the market on one day but then the effect is reversed when good earnings information is announced. We believe the biggest macro news that could put pressure on markets is on how the Euro area will respond to ongoing concerns of budget shortfalls and potential debt defaults of the Southern European countries.

Two of the major headwinds for the prior quarter appear to have less of an impact over the near term. The supply chain disruption caused by the Japanese earthquake has begun to recover and the unrest in the Middle East and North Africa continues but oil prices have stabilized.

> *"The unemployment rate remains elevated; however, the Committee expects the pace of recovery to pick up over coming quarters and the unemployment rate to resume its gradual decline …"*
> *Federal Open Markets Committee in their June 2011 notes.*

The Fed's recent easing (QE2) came to an end in June but they continue to watch carefully the employment numbers for signs that the economy is stable. Over the next couple of quarters, the question remains how long will companies continue to surprise us with great performance while the economy muddles along? In addition, there is strong concern over how Washington D.C. will deal with the budget deficit.

Equity Markets

Equity markets responded to all the mixed economic news by providing divergent results. Overall, the higher quality companies did the best for the quarter. The S&P 500 index (large companies) produced a slight (.10) gain, while Russell 2000 (small companies) fell 1.61%. Overseas also produced inconsistent results with the EAFE (predominately large companies in Europe, Australia and the Far East) increasing 1.56%, but the EEM (predominately large companies in the emerging markets) dropped 1.15%. The health care sector was the biggest winner for the quarter with a 7.22% rise. Consumer defensive also fared well with a 5.34% gain followed by utilities with a 5.22% increase. The biggest detractor of the quarter was the financials sector which dropped 5.58%. We believe that equity markets will continue to experience volatility until we see a clearer picture of economic growth. The economic picture will probably stay cloudy until the housing and labor market turn decidedly up. In order for this to occur, more money needs to flow into the system. We need to see the financial institutions increase their lending and corporations increase their investment spending. The financial institutions are still cautious given the considerable overall sovereign debt situation, increased regulatory requirements and the amount of foreclosures on their books. In addition, corporations have remained cautious due to the slow domestic economy as well as uncertainty around our government's actions and budget.

Generally, equities still look attractive as some stocks are paying higher dividends than their bonds and many investors are still underexposed to equities. Corporate America is generally overcapitalized with money on its books that will either need to be paid out in dividends, or used for expansion or to acquire other businesses. Even though the most recent GDP report was disappointing which could pressure equities in the short term, corporate profits still appear to be increasing.

Many investors have shied away from equities due to their 10 year track record. The graph on Page 3 illustrates historically how equities have fared after reaching low 10 year returns.

Major Indices	Returns †						Risk †			
	2Q 2011	2010	1 Year	3 Year	5 Year	10 Year	1 Year	3 Year	5 Year	10 Year
Barclays Agg Bond Index	2.29%	6.54%	3.90%	6.46%	6.52%	5.74%	2.70%	4.16%	3.62%	3.81%
Barclays Muni Bond Index	3.89%	2.38%	3.48%	5.58%	4.93%	4.99%	5.01%	5.55%	5.19%	4.68%
Dow Jones Industrial Average	1.42%	14.06%	30.37%	6.09%	4.97%	4.20%	12.57%	19.02%	16.51%	15.36%
S&P 500 Index	0.10%	15.06%	30.69%	3.34%	2.94%	2.72%	13.76%	21.21%	17.88%	15.82%
Russell 2000 Small Cap Index	-1.61%	26.85%	37.41%	7.77%	4.08%	6.27%	18.30%	27.29%	22.76%	20.85%
MSCI EAFE (Foreign) Index	1.56%	7.75%	30.36%	-1.77%	1.48%	5.66%	18.04%	25.85%	21.47%	18.27%
MSCI Emerging Mrkts Index	-1.15%	18.88%	27.80%	4.22%	11.42%	16.20%	17.10%	31.12%	27.37%	24.11%
NASDAQ Composite Index	-0.04%	18.02%	32.72%	7.56%	6.04%	3.39%	16.91%	23.80%	20.67%	21.51%
DJ Wilshire REIT Index	3.97%	28.07%	34.95%	4.71%	1.67%	10.53%	13.63%	40.83%	33.78%	26.11%
DJ/UBS Commodity Index	-6.73%	16.83%	25.91%	-11.87%	-0.05%	6.62%	16.97%	22.93%	20.86%	17.62%
Goldman Sachs Commodity Index	-7.94%	9.03%	26.11%	-21.66%	-6.16%	3.69%	18.56%	30.25%	27.50%	25.05%

† 1, 3, 5 and 10 year return &risk numbers are as of 06/30/2011. Risk, the standard deviation, is a statistical measure of volatility of a portfolio's return around its mean.

Past performance is no guarantee of future results. Source Morningstar Advisor Workstation

Investing at any point five years after the bottom was established	Average Annual Returns			
	One year after	Three years after	Five years after	Ten years after
August 1939 (8/39–8/44)	+11.78%	+15.46%	+13.82%	+14.32%
September 1974 (9/74–9/79)	+12.53%	+10.72%	+12.61%	+15.34%
February 2009 (2/09–12/10)	+23.01%	?	?	?

Source: Morningstar, Inc. as of 3/31/11. **Performance is historical and does not guarantee future results.** Investment period for the February 2009 bottom is 2/09 through 12/10 since five years of data is not available. This information is for illustrative purposes only. Equity index returns assume reinvestment of all distributions. Index returns do not reflect fees or expenses, and it is not possible to invest directly in an index.

Interest Rates & Fixed Income

Concern of Greece sovereign debt default and potential contagion caused fixed income investors to move toward safer areas. The Morningstar U. S. Treasury Index gained 2.36% for the quarter and the Morningstar Euro-zone Government index gained .69%. The difference in credit risk was apparent though, as the majority of the countries of the Euro-zone index gained more than 1% for the quarter. In contrast, Greece, Portugal, and Ireland dropped 14.9%, 10.8% and 6.3% respectively.

Since many investors have preferred the safety of bonds over equities, it is more difficult to find attractive investments in the debt area of the market. However, one place that we are finding value is in the high yield area of the Municipal bond market. While the majority of dollar amounts in this area are issued by investment grade municipalities there are many issues which carry a somewhat higher credit risk which are overlooked by most investors. This area still carries a lower historical default rate than in the corporate high yield sector and in some cases pays higher yields. Our belief is that the economy will continue to improve, this should provide additional means for these governments to satisfy their obligations. It should be noted that these securities should be selected after researching thoroughly. We have done considerable due diligence and have selected a few portfolio managers who have considerable experience in this area.

Key Rates				
	Prime Rate	3.25%	10 YR Treasury Yield	3.125%
	1 YR CD Rate	0.87%	30 YR Fixed Mortgage Rate	4.33%

As of August 8, 2011 *Source: Bloomberg.com*

COMMODITIES, REAL ESTATE & ALTERNATIVE STRATEGIES

What a difference a quarter makes as after posting a 18.7% gain for the first quarter, the Morningstar long-only commodity index dropped 7.62% in the 2nd quarter. The Morningstar Agriculture index dropped 8.55%, and the Morningstar Energy Index suffered a 7.36% loss.

Real Estate Equities for the quarter, were decidedly mixed as the U.S. market finished up 3.97% while the non-U.S. market finished down 1.99%. This put further distance between the two areas as the U.S. market has outperformed the foreign by approximately 15%. The Asia-Pacific area provided the most challenges as they faced the headwinds of governmental and central bank tightening. We typically include a global allocation to allow participation in both of these markets.

Due to the recession, the commercial real estate market continues to face diminished demand. However, there is very little new construction occurring which provides some support for existing property prices. When the economy recovers, this may be an area that benefits from a limited supply. The costs associated with constructing new properties could be substantially higher than they are today as some of the input costs to these properties will probably rise as the emerging markets like China have continued their demand for the materials needed to build these type of properties.

REITs offer good diversification from stocks and bonds, but combine some elements of both. Generally, they provide more income than the average equity, and higher price appreciation potential than bonds. As with any alternative investment, one of the benefits they offer are their lower correlation to the equity and fixed income markets. Over the last twenty years, REIT's moved in step with the equity markets around 50% of the time and only 20% of the time with fixed income prices.

In addition to overall diversification benefits, they may also provide good performance as interest rates rise. They have generally performed well in rising interest rate environments. In February of 1994, with interest rates at 3%, the Fed began raising interest rates and didn't stop until they reached 6% in February of 1995. During this period, REITS outperformed both equities and fixed income.

We continue to believe alternatives can help mitigate risk especially in light of a volatile economy and market. For questions and advice specific to your portfolio, please contact your Relationship Manager.

""Do not forsake wisdom, and she will protect you; love her, and she will watch over you. Wisdom is supreme; therefore get wisdom. Though it cost all you have, get understanding." Proverbs 4:6-7

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