

Financial markets around the world staged a rebound during July, further contributing to the volatility that has been present throughout 2010. Investor concerns regarding the sovereign debt crisis in Europe appear to have been alleviated following the creation of a rescue fund and 'stress test' results that provided transparency to potential bank losses. Second quarter corporate profit reports also provided ongoing evidence that the recovery in earnings is being accompanied by sales growth. However, the strength of the economic recovery remains uncertain following a weak employment report and indications of moderating growth rates. While various categories of risky assets participated in the rally, U.S. Treasury securities also maintained recent gains due to the benign inflation environment and sluggish economic recovery. For the month of July, the Dow Jones Industrial Average ended up 7.23%, the S&P 500 ended up 7.01%, and the Russell 2000 Index of small-cap stocks ended up 6.87%. For the year-to-date period through July, the Dow Jones Industrial Average ended up 1.87%, the S&P 500 ended down 0.11%, and the Russell 2000 Index of small-cap stocks ended up 4.79%.

In fixed-income markets, investors maintained their ongoing pursuit of fixed-income securities, which has been a consistent theme throughout the year. As a result, the asset class generally moved higher in price and lower in yield. Bonds were buoyed throughout the month as investors searched for yield, corporate balance sheets improved, and favorable valuations remained intact. Historically low interest rates continued to plague investment returns, which sent investors scouring for yield. In order to meet their goals, investors have been accepting additional risk through longer maturities or lower credit ratings, and have been comfortable with this strategy as corporate balance sheets illustrated improved liquidity and less default risk. During the previous month corporate yield spreads widened versus U.S. Treasury securities, which provided investors additional incentive to accept credit risk when coupled with improved corporate fundamentals. Most fixed-income sectors produced positive returns for the month, with risk based corporate debt holdings reporting the highest returns.

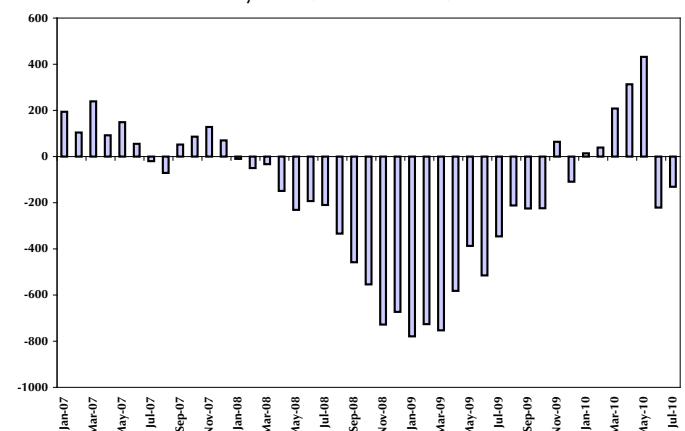
Within the corporate bond sector, high yield corporate bonds performed the best. Regarding maturity, investors continued to show more interest in bonds issued between three years and ten years relative to shorter and longer portions of the fixed-income curve. Fixed-income products also gained support later in the month as "stress tests" on European financial institutions were administered with minimal adverse results. Most institutions were presented

with passing grades despite controversy over measurement criteria. Consequently, the "safe haven" trade into U.S. Treasury securities eased somewhat throughout July. However, most bonds issued through the U.S. Government and its agencies still posted positive results for the month as some investors remained cautious on the direction of the economy.

The sovereign debt crisis in Europe has served as a key catalyst for financial market volatility throughout 2010. Following heightened fears, investor concerns regarding the sovereign debt crisis in Europe appear to have been alleviated following the creation of a \$1 trillion rescue fund organized by eurozone members and the International Monetary Fund. Additionally, eurozone members coordinated 'stress tests' on many of Europe's largest banks in order to ascertain their ability to withstand a deterioration in economic conditions and potential loan losses. Several gauges of financial market stress suggest that these measures are helping to ease investor concerns, and the euro currency has staged a rebound as well. Nonetheless, investors will continue to closely monitor countries with high debt levels and large fiscal deficits, and will search for indications that austerity measures are effective in resolving the crisis.

Job growth in the U.S. continued at a sluggish pace during July, with the employment report illustrating a significant loss of jobs. However, temporary workers hired to conduct the 2010 census led to volatility in the employment report in recent months. For instance, while a total of 131,000 jobs were reported lost in July (see chart 1), the private sector actually added 71,000 jobs. Since the year began, the U.S. economy has added a total of 630,000 private sector jobs, illustrating that the job market is improving. Despite the progress,

**Chart 1: Non-Farm Payrolls (in Thousands)**

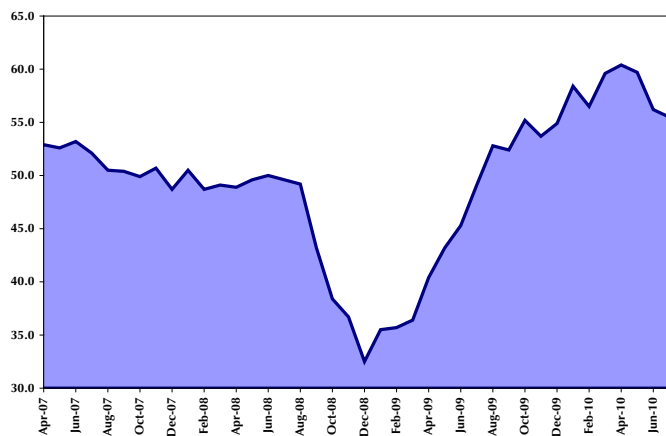


Source: Bloomberg

further improvement in the economy and labor market will be necessary to replace the approximately 8.5 million jobs lost during the recession. Additionally, the unemployment rate remains elevated at 9.5% during July, which is unchanged from June and compares to 9.4% during July 2009. Even with job growth, many economists anticipate that the unemployment rate will remain elevated as unemployed workers re-enter the labor force.

Mixed signals from various economic indicators during July suggest that the economic recovery is persisting, but at a slower pace. The Institute for Supply Management (ISM) Manufacturing (see chart 2) and Non-manufacturing Index declined to more moderate levels during July, although both indicators remain above the expansionary level of 50. In the most recent report, industrial production increased by 0.1% in July compared to the previous month, and is up 8.2% year-over-year. Retail sales excluding autos increased by 4.4% during June compared to last year, which is also a more moderate increase compared to prior months. Finally, second quarter GDP increased by a quarter-over-quarter annualized rate of 2.4%, which is a slower rate of growth compared to the 3.7% increase during the first quarter.

**Chart 2: ISM Index**



Source: Bloomberg

The recovery in corporate profits has persisted during 2010, and encouraging evidence has emerged that sales growth is taking hold. The initial recovery in corporate profits was driven primarily by cost-cutting measures, while sales growth was largely absent. Since cost-cutting measures are limited in scale, investors sought indications that sales growth would return and provide an ongoing catalyst for growth of corporate earnings. As of the time of this writing, approximately 85% of companies in the S&P 500 Index have reported earnings for the second quarter of 2010, and approximately 62% of companies reported positive surprises in sales growth, with an average year-over-year sales growth rate of 9%. Additionally, around 77% of companies

reported positive earnings surprises, with an average year-over-year earnings growth rate of 50%. Investors will continue to view sales and profit growth as further evidence of the economic recovery.

**Maintaining Defensive Position Amid Volatile Market Environment**

During the second quarter, we increased our defensive position in the applicable funds and portfolios due to readings from our investment models that indicated deterioration in the risk/reward relationship in the stock market. Given the lingering uncertainties and challenges facing the global economy, we believe volatility will continue to be present in the stock market. However, we also believe that opportunities in the equity markets will persist over the near-term future as well. As a result, we stand ready to adjust our defensive position in order to manage risk for our clients.

While our investment models have continued to maintain preference for small-cap and mid-cap investments, a more neutral positioning among value and growth investments is now being indicated. Previously, we had maintained an overweight to value investments relative to growth. In terms of sector exposure, we have maintained an overweight to the energy sector due to model indications. We are also overweight the consumer staples and healthcare sector, while being underweight the technology sector. We have also noted a shift in model preference toward international markets compared to domestic securities, and are prepared to adjust our allocations accordingly. We will continue to closely monitor market conditions and our internal investment models, making select tactical shifts as necessary to take advantage of opportunities and protect against downside risk.

As of the end of July our fixed-income models maintained a positive bias toward investment grade bonds. We still gravitated toward higher quality investments in this sector to guard against adverse credit quality changes. With yield spreads to U.S. Treasury securities still above historical averages, we anticipate that investment grade bonds may still offer attractive returns in the near-term and our fixed-income portfolios remained positioned to benefit from any appreciation in this sector. The duration of our fixed-income portfolios remained slightly below that of our benchmark. While we anticipate interest rates will not move from their historically low position, we want to guard against the potential for a reversal of sentiment. We will continue to monitor the fixed-income markets closely and position our portfolio in a manner to benefit investors without undue risk.

*Thank you for your interest in our investment management services. For more information on our portfolios or investment strategies, including fact sheets and prospectus, please contact us at Toll Free 866-633-3371.*