

The domestic stock market began the new year by establishing a new recovery high; for instance, the S&P 500 Index reached approximately 1,150 during mid-January, which is about 73% above the market low reached during March 2009. However, optimism among investors eroded following concerns that the global economic recovery would be tempered by monetary tightening (higher interest rates and lower money supply) in developing countries such as China. Investor fears were also heightened by the spectre of sovereign debt default, particularly among certain European countries with large budget deficits. Although negative catalysts weighed on the stock market, corporations continued to report better than expected profits and the unemployment rate unexpectedly declined. For the month of January, the Dow Jones Industrial Average ended down 3.32%, the S&P 500 ended down 3.60%, and the Russell 2000 Index ended down 3.68%.

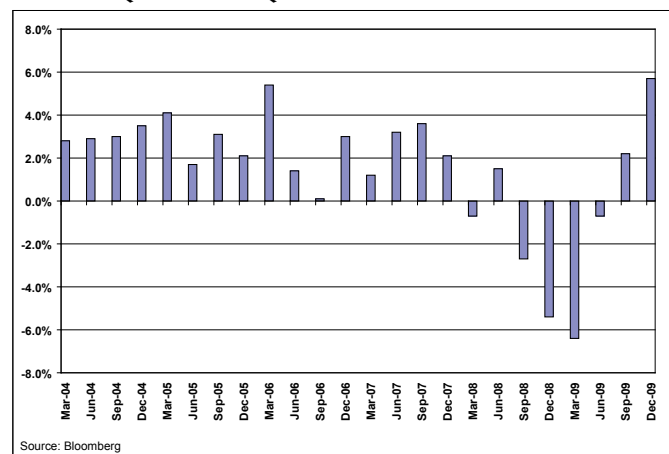
As previously mentioned, various negative catalysts have weighed on the stock market recently. While the reaction to monetary tightening in some developing nations has initially been negative, it is actually a positive sign that stimulus programs are leading to better than expected economic growth. However, the concerns regarding sovereign debt default are likely to linger. Recall that the initial episode began in November when Dubai World, which is a Dubai government owned company, spooked investors by announcing a debt standstill. As a result, investors began scouring the globe for nations in poor financial health that may encounter difficulty in making debt payments as well. The events highlight the issue of ongoing default risk among nations that borrowed heavily during the credit bubble and are now experiencing large fiscal budget deficits.

The bond markets appeared to have regressed in January. After spreads of almost all debt sectors compressed at extreme haste for most of 2009, spread levels widened in January. Implications surrounding policy changes suggested by the Obama administration and Congress sent ripples throughout the markets. Suggestions of

financial reform aimed at the United States banking system also contributed to volatility. A realization that consumers and businesses may have higher taxes in the future coupled with less than impressive economic data contributed to uneasiness. The bond market began to heed all the signs of uncertainty and investors moved into U.S. Treasury securities. Despite many analysts predicting this sector would perform the worst in 2010, it has actually performed the best of all bond sectors for the year thus far. Despite the impressive start, we do believe U.S. Treasury securities will face significant head winds if the recovery of the economy remains on track. Most economists expect the Federal Reserve will implement actions to methodically remove liquidity from the U.S. financial system, which in turn will place upward pressure on interest rates.

In a sign that the recovery is gaining traction, the advance report on fourth quarter gross domestic product (GDP) revealed that GDP increased by an annual pace of 5.7%, which was much better than expected (see Chart 1). However, a substantial portion of the overall increase in GDP was driven by inventory investment as businesses restocked empty shelves. Additionally, various stimulative actions and programs being implemented by the government are partially responsible for the pick up in economic activity. In order for a sustained recovery to gain traction, many economists believe an increase

Chart 1: Quarter over Quarter GDP



in consumer spending is necessary, especially since it comprises approximately two-thirds of total GDP. The personal consumption expenditure component of GDP increased by 2.0% during the fourth quarter.

Corporate earnings reports provide additional insight into the current and prospective economic environment. As of the time of this writing, approximately 70% of the companies comprising the S&P 500 Index have reported earnings for the calendar fourth quarter time period. The results continue to be encouraging, with approximately 75% of companies reporting positive earnings surprises. As discussed in previous commentaries, these results have been driven by significant cost-cutting measures on the part of corporations, such as inventory and workforce reductions. However, sales results have been mixed, leading to concerns that corporate profits could remain depressed if sales do not rebound in subsequent quarters. As a result, we believe investors will continue to pay close attention to the strength of sales during subsequent earnings seasons.

The challenges facing the job market are ubiquitous; however, government actions to stimulate the economy appear to be stabilizing the rate of job losses. In the most recent report, payrolls were reduced by only 20,000 in January compared to a loss of 150,000 jobs in December (see Chart 2). Despite the improving trend, the economy has lost jobs during each month since January 2008 with the exception of November 2009, resulting in total losses of over 7 million jobs. Additionally, while the unemployment rate remains elevated, a surprise drop was realized during January to 9.7% from the previously reported unemployment rate of 10.0% in December. For

comparison purposes, the unemployment rate stood at 7.7% during January of 2009. Weekly initial jobless claims have also experienced significant improvements compared to prior months, and have remained in the mid 400,000 range during January.

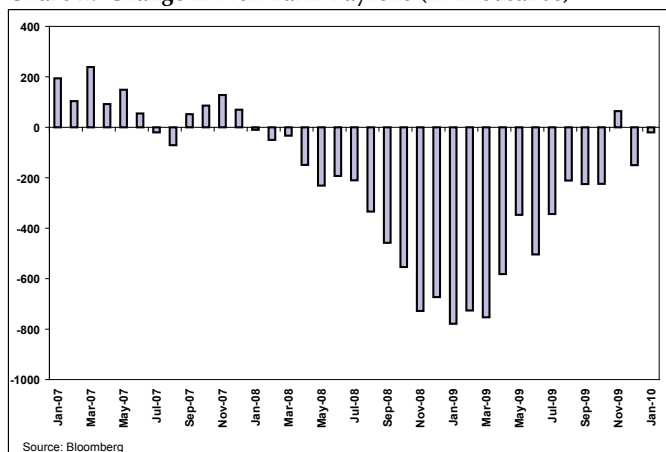
Maintaining Defensive Position

While lingering uncertainties present challenges to the global economy, we believe opportunities in the equity markets will persist over the near-term future, but that volatility will continue as well. As a result, we stand ready to adjust our defensive position in order to manage risk for our clients. Due to readings from our investment models, we are maintaining a small defensive position in the applicable funds and portfolios.

Our investment models have also remained relatively consistent since we transitioned into 2010 across the dynamic of large-, mid-, and small-cap companies. We have maintained a position in small-cap stocks, and we have also maintained an overweight in mid-cap stocks. Additionally, our models have continued to indicate a preference for value investments, and we have responded by maintaining an overweight allocation toward value investments across all capitalization ranges. In terms of sector exposure, we have maintained an overweight to the industrial materials and energy sector due to model indications. We are also overweight the consumer staples and healthcare sectors, while being underweight the technology sector. 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.

We will continue to position our fixed-income portfolios to accommodate a rising interest rate environment. The duration of our fixed-income portfolios remain slightly below that of our benchmarks, which should provide a benefit in a rising rate environment. In accordance with our models, we also continue to favor the investment grade sector over government agency and U.S. Treasury securities.

Chart 2: Change in Non-Farm Payrolls (in Thousands)



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.