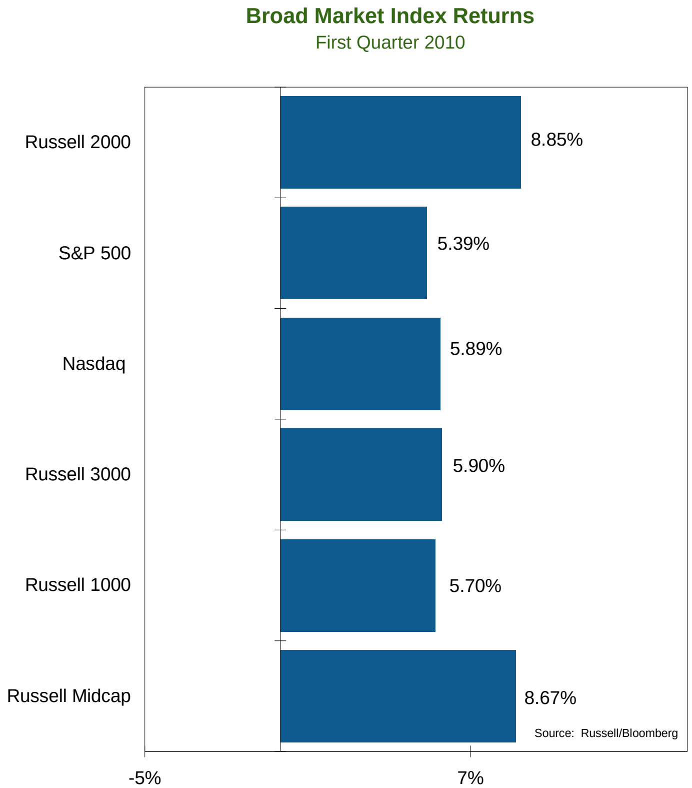
First Quarter 2010 Market Summary

The Economy

Positive economic momentum has continued throughout the first quarter of 2010 on the heels of an unprecedented 2009 in which the government bailed out struggling companies and pumped in record amounts of fiscal stimulus. As a result, the country's outstanding debt rose to more than $12 trillion. Going forward, the economy is expected to expand gradually with the help of continued government stimulus and a low interest rate environment.



The main question on investors' mind is the sustainability of the economic recovery. There have been indications that we are in the early stages of a sustained, but moderate, economic recovery. There are a variety of cyclical forces that may give investors hope, such as unused fiscal stimulus, increasing demand for capital expenditures, and an accommodative monetary policy. Challenges to U.S. economic growth remain in the growing budget deficit, the state of global sovereign debt, and doubts over the ability of governments worldwide to effectively manage the economic circumstances.

The consensus is for a slow, prolonged recovery, and the prospects for either a V-shaped recovery or double-dip recession have proved less likely. The recovery will likely still warrant accommodative government policy and a low interest rate environment. It will also be important to monitor whether the floors in housing and consumer confidence hold through 2010.

Investors will look to see a continued uptick in economic activity headed into the second quarter. Companies' renewed access to the capital markets should allow them to retire debt, issue equity capital, reduce leverage, and repair their balance sheets. The U.S. should continue to benefit from fiscal stimulus and inventory rebuilding going forward.

Highlights

GDP

The economy grew at a rate of 2.2% in the third quarter, and the revised number for fourth quarter GDP was 5.6%, beating expectations for growth of 4.5%. Increases in inventories and final sales were likely the two biggest contributors for a bigger GDP number, which would signal that the economic recovery is gaining strength.

LABOR MARKETS

According to the numbers, labor market conditions remain weak. January's non-farm payrolls report showed the economy lost 20,000 jobs. Nevertheless, the unemployment rate actually fell from 10.0% to 9.7%. This was followed by February's employment report indicating a loss of another 36,000 jobs, versus a forecast for a loss of 68,000. The unemployment rate held steady at 9.7%.

According to the March non-farm payrolls report, the U.S. economy added 162,000 jobs in March, signaling the largest job gain in three years. On top of temporary hiring, there was additional strength in the private sector with gains in private services (82,000 jobs), manufacturing (17,000 jobs), and construction (15,000 jobs). Despite these job gains, the unemployment rate remained elevated at 9.7%. Nevertheless, the employment report marks a cyclical turning point, as there is have been significant private sector job gains.

There are indications that the worst of the employment downturn is behind us. Yet, structural changes in the labor market - such as permanent layoffs and weaker-than-expected economic growth - will be catalysts for a slow employment recovery.

The quarter concluded with hints of a cyclical turn in the labor market and U.S. economy. In the last week of March, initial jobless claims declined by 6,000 to 439,000, and layoff announcements (-55% year-over-year) confirmed a continuation of an improving trend.

Despite weak labor market data, there are suggestions that the recovery is gaining traction and sustainability as the earlier policy stimulus and beginning of a private demand recovery have started to create more private sector jobs in the first quarter.

MANUFACTURING

The Institute for Supply Management (ISM) indices are expected to show improvement throughout 2010. December's ISM index showed growth in the manufacturing sector was accelerating. The index beat expectations for a reading of 54.8, rising from 53.6 in the previous month to 55.9. The pickup in activity was driven by a large gain in new orders. The non-manufacturing ISM index also rose back into expansionary territory with a reading of 50.1 for December. February's number was down slightly (56.5) from 58.4 in January. However, the manufacturing ISM saw a nice improvement in March, rising from 56.5 to 59.6, and placed the index at its highest level since 2004.

The non-manufacturing ISM index also rose further to 55.4 in March, up from 53.0 in February. For both the manufacturing and non-manufacturing indices, these readings have been above the break-even level of 50 throughout the first quarter. A reading above 50 indicates that businesses experienced month-over-month gains and that the economy is expanding. Both indices indicate a continuing and broadening uptrend in activity.

HOUSING

Housing data remained volatile throughout the quarter. The National Association of Home Builders (NAHB) index, an overall gauge of the housing market, beat expectations in February, though it still remains very depressed. The index rose from 15 to 17 (out of 100) for January. However, the index fell from 17 in February back to 15 in March, signaling that tough times remain ahead for the housing sector. The index has now regressed back to levels last seen in May of 2009.

January new home sales came in much weaker than expected, having decreased 11.2% versus expectations for an increase of 3.5%. The existing home sales report was similar, registering -7.2% for January.

February's existing home sales reported a 7.0% increase year-over-year, though the supply of existing homes is still at a very high 8.6 months. Sales had plunged after the initial expiration of the first-time homebuyer tax credit last November; now they appear to be gaining support from an extended homebuyer tax credit as well as from low prices, low mortgage rates, and the strengthening economic recovery.

The housing market will continue to suffer from excess supply and record mortgage delinquencies; however, there is hope that the worst of the crisis is behind us. As we move into the next quarter, there continues to be several headwinds to the housing sector, including the removal of home-buying tax credits and rising mortgage rates.

CONSUMER SPENDING

Though consumption has stabilized somewhat, the consumer continues to face strong headwinds due to high unemployment, tight lending conditions (banks have been buying securities rather than expanding lending), high levels of debt, and reduced wealth effects. Given these circumstances, one would expect to see trends of increased saving and moderated consumption. Nevertheless, despite sluggish personal income growth throughout the quarter, consumer spending has been moderate. Real consumer spending rose +0.3% month-over-month in February and with the rise in vehicle sales to an 11.8 million SAAR (season adjusted annual rate) for March, spending appears to be continuing to improve.

TRADE DEFICIT

It was announced in January that the U.S. trade deficit jumped from $32.9 billion in October to $36.4 billion in November, primarily driven by higher petroleum imports.

The monthly budget statement for February indicated that the U.S. deficit grew from -$42.6 billion in January to -$220.9 billion in February. The primary drivers of the growing deficit were stimulus expenses related to tax credits and small-business subsidies.

FED

The Federal Open Market Committee (FOMC) voted to keep the fed funds rate in a range between 0.0% and 0.25% throughout the quarter. In its statement accompanying its decision, the FOMC retained language stating that the rate would likely remain "exceptionally low for an extended period of time."

After the markets closed on February 18th, the Fed increased the discount rate by 50 basis points from 0.25% to 0.75%. This increased the spread over the fed funds rate (the rate banks charge each other for overnight loans) to 50 basis points. The central bank said the move was made in response to improving financial market conditions. "The modifications are not expected to lead to tighter financial conditions for households and businesses and do not signal any change in the outlook for the economy or for monetary policy," the Fed said in a statement following the announcement. The move is largely symbolic, because banks do little borrowing at the discount window.

The Fed also shortened the term of some discount window loans and raised the minimum bid in the term auction facilities it uses to supply overnight funds to banks. Those facilities were among the numerous innovations Fed Chairman Ben Bernanke introduced since the onset of the credit crunch in mid-2007 to ensure there was a supply of funding for U.S. banks.

As the recession deepened, the Fed moved to support the housing market by buying more than $1 trillion of mortgage-related securities. When buying those securities, the Fed credited the selling banks with reserves at the Fed. This large amount of what is known as “excess reserves” has caused some to worry that an improvement in the economy could be met with an inflationary lending upturn from banks.

Investors expect the Fed will continue to support growth in the near term, with the fed funds rate remaining the key monetary policy tool. Monetary stimulus such as record low central bank rates, quantitative easing, and liquidity-based programs aimed at stabilizing the financial system have been unprecedented, and the market will continue to closely scrutinize the Fed’s exit strategy during the remainder of 2010.

Healthcare Bill

President Obama’s landmark healthcare bill was signed into law on March 23rd after a very contentious process to approve the legislation in Congress. The bill is designed to overhaul the nation’s healthcare system and guarantee access to medical insurance for tens of millions who are currently uninsured. The effort to pass the legislation was dramatic and long. Every Republican – and some Democrats - voted against it initially, ensuring that the issue will remain pivotal in the upcoming mid-term elections. Some Republicans are even vowing to attempt to repeal the law.

Logistically, about 32 million of the country’s 49 million uninsured (the majority of those left out are undocumented immigrants) would, starting in 2014, be required to purchase insurance. The Congressional Budget Office (CBO), a non-partisan agency, estimates that the new health reforms will cost the country approximately $940 billion over the next decade. Many of the reforms do not come into place until 2013 or 2014.

While the president and the Democrats who voted for the bill lauded the fact that millions who previously could not afford medical insurance would now be guaranteed coverage, Republicans voiced concerns about the costs of the bill, including the huge expansion of Medicaid, a burden cost of which the states will eventually need to absorb. Even though the legislation has passed, it will continue to be a prominent and divisive issue for some time to come, and the long-term effects on the economy remain to be seen.

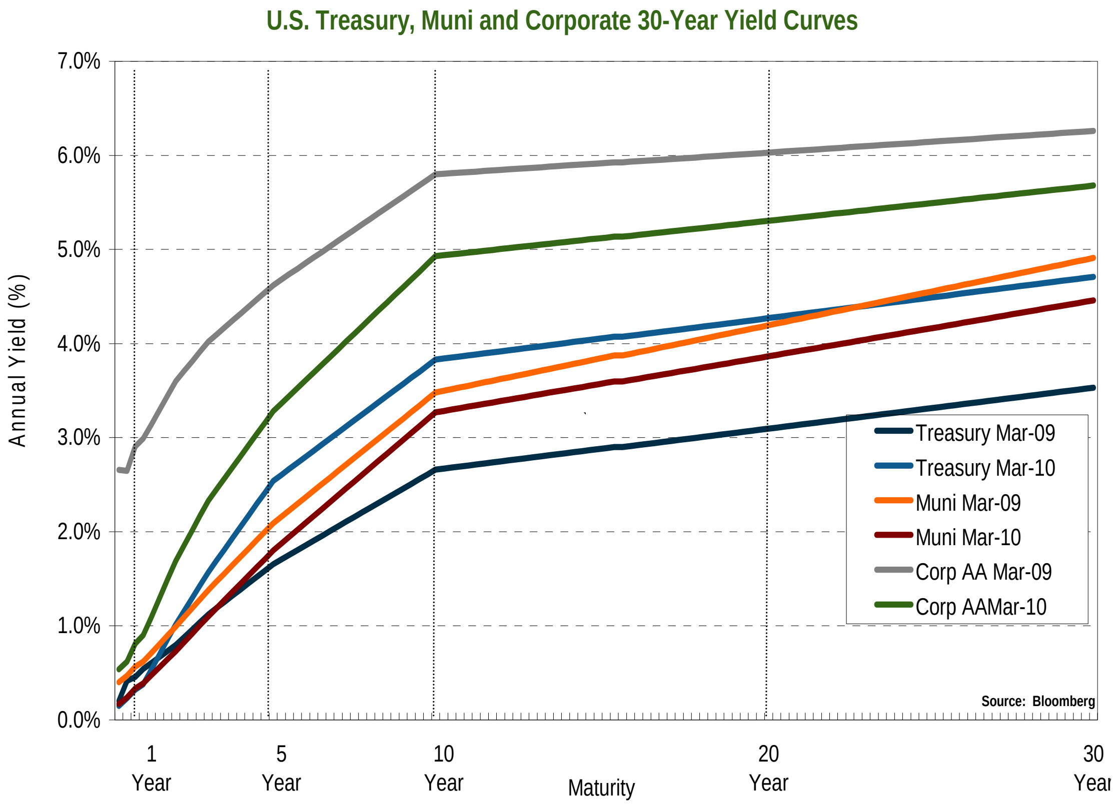
Interest Rates

Within the fixed income markets, the first quarter of 2010 remained relatively uneventful, as the market seemed to be treading water waiting for economic data to provide an indication of what the next secular trend in rates will be. After strong price gains - and attendant yield declines - in January, the bond market generally saw flat movement over the subsequent two months of the quarter. The softening in prices during the quarter can be attributed to an increasingly positive flow of economic data, indicating that perhaps the recovery is sustainable.

On the government side of the ledger, the yield curve remained essentially flat during the quarter, with a slight steepening due to yields declining somewhat more at the short end of the spectrum. The yield on the 2-year U.S. Treasury declined from 1.14% at December 31, 2009 to 1.02% as of March 31, 2010, while the yield on the 10-year Treasury dropped only one basis point, from 3.84% to 3.83% for the quarter. The steepening of the yield curve was more pronounced during the latter part of the quarter, indicating that the market is concerned about the potential for inflation. Supporting this idea is the fact that the yield on the 30-year Treasury, which is most affected by inflation expectations, witnessed a rise in yield during the quarter, from 4.64% to 4.71%. Also weighing on the Treasury market during the quarter was the flood of new issuance, as well as a concern that there is much more supply to come in the years ahead.

The credit area of the fixed income market continued its recent trend of performing better than Treasurys. The yield on the Barclays Capital Corporate Bond index declined from 4.74% on December 31, 2009 to 4.49% on March 31, 2010, due primarily to continued improvements in the underlying economy. The economy's continuing recovery also benefited high yield issues once again: the Barclays Capital U.S. Corporate High Yield index gained 4.62% in the first quarter, and its yield dropped from 9.20% on December 31, 2009 to 8.66% on March 31, 2010. Many analysts believe that even though credits have enjoyed outstanding performance over the past 12 months, there are potentially some gains yet to be made relative to Treasury obligations.

The municipal bond segment performed in line with the government sector during the quarter. The Barclays Capital Municipal Bond index posted a return of +1.25% for the three months ended March 31, 2010, with an ending yield of 3.59%. The municipal market is still somewhat concerned about the prospects of various state governments, and their ability to service debt during uncertain economic times.



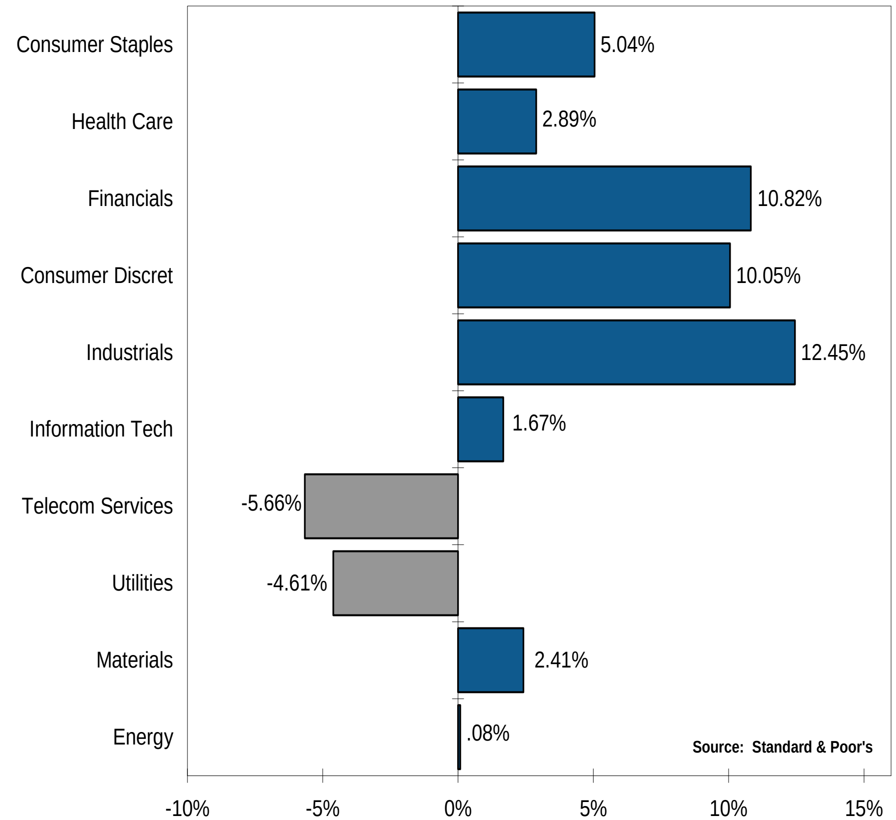
Equities

Equities extended their rally from 2009 into the first quarter of 2010 with positive quarterly gains for both the S&P 500 and the NASDAQ Composite. The S&P 500 finished the month of March with a 6.03% return, bringing the quarterly return to 5.39%. Similarly, the NASDAQ composite finished the quarter with a 5.89% return.

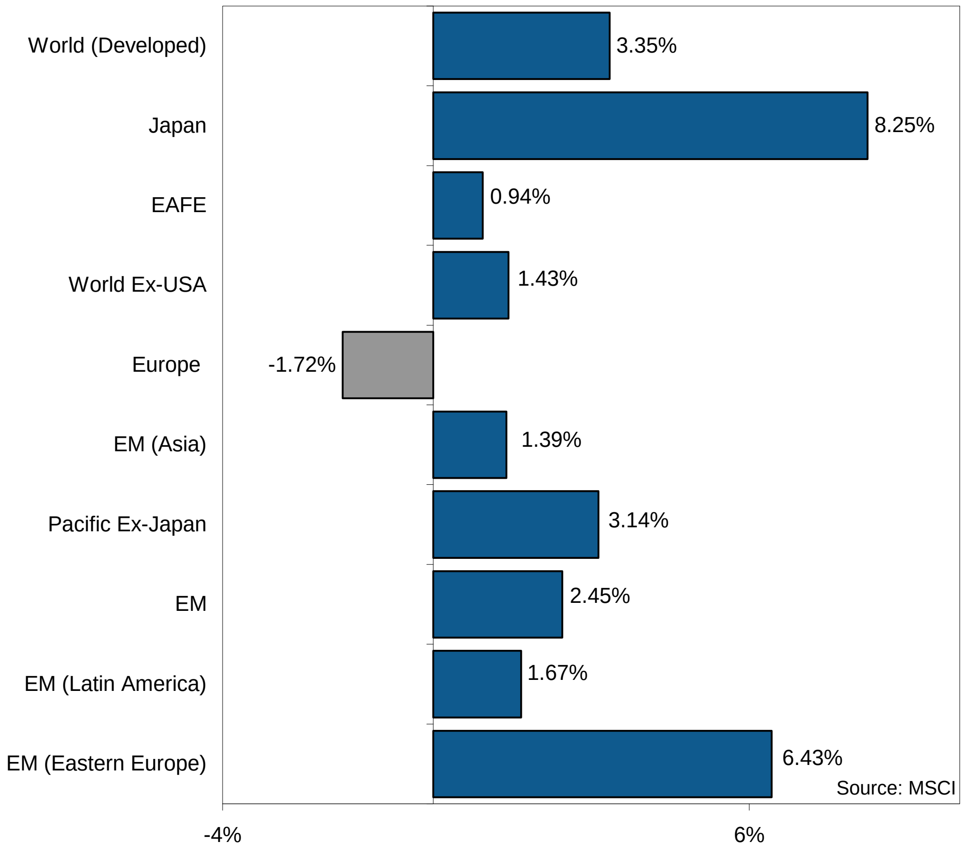
Emerging markets were up slightly as the MSCI Emerging Markets index posted a gain of 2.45% for the quarter. This index is up 81.55% within the last 12-month period. Emerging market indices for Asia, Eastern Europe and Latin America all posted positive returns, with Eastern Europe leading the way with a 6.43% quarterly return. The Emerging Markets Eastern Europe index is up 107.74% within the last year.

U.S. Equity Market Returns by Major Sector

(Securities in S&P 500, 1st Quarter 2010)



Non-U.S. Equity Market Returns
By Country (U.S.Dollars)
1st Quarter 2010



Developed markets also began the year slightly up as the MSCI EAFE, a major benchmark for international equity, returned 0.94% for the quarter and a 55.2% gain within the last 12 month period. The MSCI Europe index finished down slightly with a quarterly return of -1.72%. Japan finished the quarter with an 8.25% return. Large-cap, mid-cap, and small-cap equity indices all posted positive returns as the Russell 1000, Russell Mid-Cap, and Russell 2000 posted gains of 5.70%, 8.67%, and 8.85%, respectively.

Domestically within the S&P 500, Industrials and Financials led the way with quarterly gains of 12.45% and 10.82%. The only two sectors to post a negative return for the quarter were Telecom Services and Utilities, with returns of -5.66% and -4.61%, respectively.