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Update on Recent Market Events –August 9, 2011

The equity markets have had a dramatic decline in recent days with the S&P 500 index declining over 6% Monday. This market decline is being driven mostly by fear and uncertainty. The downgrade of U.S. Treasury debt to AA+ from AAA by Standard & Poor's late Friday certainly had an impact on investor sentiment. However, many market observers point to two other key reasons for the stock market decline. First, market participants are reacting to the uncertainty about the extent of the European debt crisis and what steps policymakers will take to deal with that crisis. Second, investors are reacting to new data pointing to a slowing in the rate of economic growth in the U.S. which began with the downward revision to the estimate of first quarter Gross Domestic Product to only 0.4%. This fear is leading investors out of stocks and commodities driving down prices and causing a flight to safety trade into gold and Treasury bonds despite the credit downgrade.

Stock prices are a reflection of investor's expectations for future corporate earnings. The downgrade of U.S. Treasury debt has the potential to impact corporate earnings - if borrowing rates are pushed higher and fiscal policies are enacted that reduce government spending or raise taxes, which lead to reduced consumer and business spending. The European debt crisis poses a threat to credit markets globally because many banks have large exposures to European sovereign debt. A default on the debt of any of the Euro zone countries could have a major impact on bank capital. Therefore, it is likely that European leaders will take the necessary steps to avert a debt default.

In the past few days certain economic data have shown a slowing rate of growth. For example, the Institute of Supply Management's Manufacturing Index declined to 50.9 from 55.3, and the non-manufacturing index declined to 52.7 from 53.3, though both indexes remain above 50 which is the level that indicates expansion. However, not all the data has been negative. For example, July chain store sales were up 4.6% over last year and corporate profits have been strong with the average operating earnings for companies in the S&P 500 index reaching an all time high in the second quarter. While much of the new data appears to point to a tepid rate of growth, the real danger is that consumers and businesses pull back spending in reaction to the recent market events. That could lead to a self-fulfilling prophecy and actually tip the economy into a recession.

We are monitoring the developments and have been in contact with a number of managers. The heightened volatility is likely to continue as recent events unfold. This is a difficult time to correctly anticipate the direction and severity of movements in specific sectors of financial markets given the numerous factors impacting investor sentiment. Therefore, it is best to avoid emotional reactions during times of extreme volatility but rather to focus on fundamentals and long-term investment objectives. The managers we have spoken to have the same thought process. At this time we are maintaining our tactical asset allocation recommendations. Your asset allocation is intended to reduce downside risk of the portfolio. You are invested in a broad set of asset classes which should help us in this time of uncertainty. We will notify you promptly if our recommendations change. Please call us with questions or to discuss the positioning of your portfolio.



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The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. This world-renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market. An investor cannot invest directly in an index. Indexes are unmanaged.

International investing involves a greater degree of risk and increased volatility. Changes in currency exchange rates and differences in accounting and taxation policies outside the U.S. can raise or lower returns. Also, some overseas markets may not be as politically and economically stable as the United States and other nations. Investments in emerging markets can be more volatile.