

Good news, bad news. That seemed to be the story of this quarter. As it began, we saw signs of economic recovery with increased corporate earnings and manufacturing growth. The European debt crisis then intensified, oil spilled into the Gulf and home sales dropped significantly after government incentives expired. Fear, uncertainty and volatility pervaded the market once again.

From early February through late April, the Dow Jones Industrial Average (DJIA) gained 1,300 points and then dropped 1,500 points from late April through the end of the quarter. During the first eight trading days of July, it added back 680 of those points before ending last week with a triple digit decline. The VIX, an index of market volatility, rose above 45 for the first time since the first quarter of 2009. To put this in context, the benchmark's historical average is around 20 and the index reached nearly 60 during the peak of the financial crisis near the end of 2008.

What is going on? There is no clear trend emerging just yet. The economy is showing signs of recovery but the growth is slower than many had hoped. Job growth is slow and there is ongoing weakness in the housing market, despite the fact that mortgage rates remain low. While the deleveraging process has begun, debt levels remain elevated. Inflation is almost nonexistent yet the timing of monetary policy changes is still unclear.

So what does all this mean for the markets? Current opinions differ widely as to whether the market is overvalued (if the doom scenario plays out and we still have a few years left of the secular bear market) or undervalued (if current earnings estimates pan out and most of the negativity is already priced in.) The most likely scenario is that we are in for a period of up and down cycles in a trading range as the market struggles to determine which is the dominant trend. This uncertainty will ultimately resolve itself, and we will begin to see an upward trend but patience will be required until we get to that point. Remember that investing is not a short sprint around the track; it is more like a long marathon with high and low points along the way. Patience, discipline and keeping your eye on your ultimate goals are critical to achieving success. It is important to know why you are investing, to understand your own risk tolerance and to be invested in a diversified portfolio composed of a variety of asset classes so that you can weather the storms that will invariably occur along the journey.

As discussed earlier in the year, we are continuing to allocate a portion of the equities to the diversifying strategies and real assets funds we introduced recently. For the six months ended June 30, 2010, these funds collectively (weighted in the percentages they represent in the portfolios) beat the S & P 500 by five percentage points. Only one of the eleven funds underperformed the index over this time period. For the twelve months ended this quarter, these funds collectively returned 11.6% versus 14.4% for the S & P 500. These funds are performing the way they were intended to, providing additional downside protection during down markets while participating nicely in market upswings. Our commitment to increasing diversification and reducing volatility in the portfolios by investing in asset classes with lower correlations to each other continues.

As always, please feel free to call me if you have any questions or concerns. Enjoy the rest of your summer.

