



Highlights

Overall, economic news flow was positive in May and early June. First quarter GDP growth was +3.0%, led by business spending and personal consumption. Retail sales growth has been positive each month in 2010. In residential real estate, housing starts increased month on month in May, with pending home sales also experiencing growth. The major negative in the U.S. economy continues to be the weak labor market. In May, business payroll rose by 41,000 according to the Department of Labor, which trailed the consensus forecasts by economists. This creates concerns about the sustainability of the recovery, as the consumer is an integral part of the U.S. economy. Another positive is the low level of inflation with both the consumer price index (CPI) and producer price index (PPI) reporting month on month declines last month. In terms of asset class performance, stocks reacted negatively to the sovereign debt crisis in Europe and subsequent austerity measures and relief aid in several countries. Exports are likely to be negatively impacted by slower European growth and the strength of the U.S. dollar relative to the Euro. There is concern that European financial institutions with financial viability concerns may ultimately impact the health of U.S. financial institutions and our economy. ❖

Source: Bloomberg

Asset Class	Index	5/31/10	Total Return 1 Month	Total Return 3 Month	Total Return YTD	Total Return 1 Year
Domestic Equities	Dow Jones Industrial Average	10,137	-7.56%	-1.16%	-1.63%	22.66%
	S&P 500	1,089	-7.98%	-0.89%	-1.50%	20.99%
	S&P 400 Mid-Cap	763	-7.20%	3.66%	5.56%	34.52%
	Russell 2000	662	-7.58%	5.61%	6.31%	33.69%
International Equities	EAFE Index	1,364	-11.34%	-7.37%	-12.02%	6.99%
Fixed Income	Barclays Capital Intermediate Gov/Cr	-	0.71%	1.30%	3.15%	7.33%
	Barclays Capital 7 Yr Muni	-	1.00%	1.15%	3.25%	6.89%

Sources: Bloomberg, Barclays Capital Indices

Market Update

Equities. Global stock markets turned negative in late April. From April 23rd (recent high) through May 26th, the S&P 500 Index total return was -12.1%. This represents the first 10% stock market correction since the rally began in March 2009. To put the market correction in perspective, the S&P 500 Index total return is +65.3% from 3/9/09 to 5/31/10. In terms of market capitalization, the sell-off was broad-based with large, mid and small caps all reporting negative returns of 7 or 8% in May. International markets continued to underperform the U.S. market, in both Europe and Asia. On a sector basis, all 10 major economic sectors in the S&P 500 reported declines in May. Defensive sectors, such as telecommunication services (-3.9%), consumer staples (-4.7%) and utilities (-6.1%) held up slightly better than the market. With increased concerns of a global economic slowdown, economically sensitive sectors such as energy (-11.8%), industrials (-9.8%) and basic materials (-9.6%) lagged the market. ❖

Sources: Bloomberg; Bank of America Merrill Lynch

Fixed Income. U.S. government bonds benefited once again from a flight to safety and avoidance of risk. In May, U.S. government bond prices rallied and yields fell significantly, especially on longer bonds. According to Barclays, U.S. Treasuries were up 1.7% last month and are now up 3.6% so far in 2010. Credit did not fare as well in May as spreads relative to Treasuries widened in the month. Corporate bonds were down -0.5% in May and are also up 3.6% in 2010. Municipal bond returns were also positive with the Barclays Capital 7 Year Municipal Bond Index earning a 1.0% return. In a reversal of the first four months of the year, higher rated bonds outperformed lower rated bonds. From a maturity perspective, longer-term bonds continued to outperform shorter-term bonds. ❖

Source: Barclays Capital Indices

Bottom Line

The global economic recovery is fragile, especially with the ongoing problems in Europe. The increased volatility in the stock market is due to the possibility of a domino effect in Europe spilling over into the U.S. The high level of unemployment is also a major risk for consumption going forward. Short-term, the economic news flow is expected to be positive with solid company earnings expected in the 2nd quarter. As we progress into the later part of this year and early in 2011, the market is sensitive to economic data and the increased risk of a double dip recession. We continue to monitor leading economic indicators and other factors that influence expected economic growth.

As a result of increased risk in the macroeconomic environment, we have reduced our allocation to equities. Our asset allocation is currently neutral between equities and fixed income. Effectively, the return potential favors equities as the stock market is cheaper than the bond market but the heightened risk favors a higher allocation to bonds. ❖