Altman Investment Management

Investment Strategy Highlights

JULY - AUGUST, 2010

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GENERAL OBSERVATIONS

In June and July, recent economic data was indeed unsettling with ramifications for the U.S. economy and financial markets during the recent quarter. Investor dismay was reflected in the recent quarters stock market performance and may persist for a while longer until the pace of the recovery improves. With government debt already at inflated levels, another round of government stimulus will most likely be met with some resistance.

On July 30th, the Department of Commerce announced the second quarter real GDP results. We anticipated that after growth of 2.7% in the first quarter, the economy will have slowed further to a rate of 2%-2.5% in the second quarter. Economic recovery began in the third quarter of 2009 with a growth rate of 2.2% followed by 5.6% in the fourth quarter. Compared to past recessions, the current expansion is slower with particular weakness in U.S. employment data. There is little doubt that the $862 billion stimulus package combined with monetary easing significantly bolstered the recovery. Nevertheless, the force of deleveraging in the private sector combined with state and local government retrenchment in order to balance budgets has had a powerful effect in reducing economic activity. Many economic statistics began slowing in April at a time when the stock market peaked after the major rally from March of 2009. At present, we believe that the economy will slow to a growth rate of 2.5% over the next eighteen months but will not return to recessionary conditions. The consensus view from a poll of economists conducted by *The Economist* magazine is growth of 3.1% in 2010 followed by 2.9% in 2011. We believe that strength will emanate from capital spending, federal spending, exports, and some further inventory restocking against a background of slower than normal consumer spending of about 2%. At present, consumers are increasing their savings, which currently stands at a rate of about 4%.

Employment will continue to grow at a slow rate until overall confidence recovers from what was the worst recession in the postwar period. Because of the high unemployment rate of 9.5% against the backdrop of enormous federal deficits, people feel uneasy about the future. The low consumer inflation rate of 1.1% should add to confidence but in the current environment there is also a worry about deflation and many economists are drawing correlations to the experience of Japan over the past two decades. A major positive in our opinion is the strong growth emanating from Asia and other developing regions with rising middle classes, which will add to economic growth in the future.

Some of the recent disappointing data includes a fall in the consumer confidence index to 52.9 in June from 62.7 in May. Auto sales fell to an adjusted annual rate of 11.1 million in June from 11.6 million in May. The Federal Reserve raised its forecast for unemployment in 2011 to a range of 8.3%-8.7%, up from its earlier forecast of 8.1% to 8.5%. Consumer debt fell by $25 billion in April and May as consumers elected to save more of their incomes. The ISM Manufacturing Index fell to 56.2 in June from 59.7 in May, while the ISM Non-Manufacturing (Service) Index fell to 53.8 in June from 55.4 in May. One should point out that business activity, new orders and employment continued to advance but at a slower rate. Almost all the housing statistics have been very weak as government stimulus ended despite very low mortgage interest rates. Inventory levels constitute 8.3 months of sales with a continuing high level of foreclosures in the background. However, despite the overall weakness in housing statistics, one exception was the median price of existing homes, which rose to $184,200 in June, up from $174,500 in May. Obviously, there is still an underlying demand for housing.

On a positive note, a strong productivity rate of 6.1% in the first quarter is expected to remain high. Personal income is up 1.6% year-over-year as of May. Real hourly earnings are up 0.9% year-over-year as of June. Inflation is falling with the producer price index up 2.8% twelve months through June and the aforementioned CPI up only 1.1%. Industrial production has increased 8.2% over the past year with the leading indicators up 9.2%. The inventory sales ratio has fallen to a more normal level of 1.24. Retail sales, which fell in May and June, are still up 4.8% from year-ago levels. Durable goods orders are up 15.4% over the past year through May. Overall, the mix of statistics suggest to us that business will continue to grow at a slower than normal pace for an economic recovery, but grow nevertheless.

At present, we remain positive on the U.S. economy with a growth rate forecast of 2.5% real GDP (down from 3%) in 2010 with 1.0% CPI inflation (down from 2%) and a gain in corporate profits of 20%. For 2011 we believe that the U.S. economy will grow 2.5% with inflation of 2% and a profits gain of 10%. The outlook for 2011 could be greatly affected by the results of the elections in November.

ECONOMIC OUTLOOK

Over the past month interest rates have fallen further against the backdrop of the slower-growing economy. 10-year Treasury bonds currently yield 2.9% versus 3.1% a month ago. Long-term high quality corporate bonds currently yield 5.7% versus 5.9% a month ago. Long-term municipal bonds yield 4.8% compared to 4.9% a month ago. The same pattern applies to 30-year mortgage bonds, which currently yield 4.7% compared to 4.9% a month earlier. With the Federal Reserve maintaining its 0%-25% basis point federal funds rate, the yield on 3-month Treasury bills is only 0.15%. With the economy slowing and unemployment remaining high at 9.5% it is unlikely that the Federal Reserve will change monetary policy until well into 2011, particularly if inflation remains quiescent. With the exception of municipal bonds and perhaps some corporate bonds, we do not find bonds attractive at current yields. Commodities have modestly risen over the past month with gold falling. The CRB index of commodities (428) has increased 0.7% with copper ($3.16 per lb.) up 5.7% and oil ($79 per barrel) up 2.6%. Gold at $1195 per ounce has fallen by 3.5%. During this period the dollar index (82.6) has declined from 86.1 or 4%. Usually gold rises when the dollar falls or when other commodities are rising, implying that inflation could increase. It is possible that the recent increase in the Euro's value explains gold's fall, or perhaps the fear of deflation, which reduces the value of all asset prices.

Another anomaly of recent vintage is the collapse of the Baltic Dry Index, a measure of the shipping cost of raw materials. From the end of May, when it was at 4200, it fell by 60% to 1700 by mid July. At present it is 1801 and has declined by 29% from its price a month ago. While its decline could be explained by the slowdown in Chinese trade of raw materials and the decline in prices during that period, the severity of the decline is more likely the result of an excess of ships coming on the market which were ordered during the boom period of 2007. Looking ahead, we expect modest improvement in commodity prices as the global recovery continues. The IMF recently raised its forecast of global growth from 4.2% to 4.6%.

The S&P 500 Stock Index (1093) has increased in July after a significant correction in May and June of about 15% from its April high. The price to earnings ratio is 14 and 12.7 times our earnings estimate of $78 per share and $86 per share for 2010 and 2011. These represent gains of 20% and 10%. About 40% of the S&P earnings emanate from foreign sources via some of the multinational companies that comprise the index. Sectors of the stock market that appear particularly attractive include cyclical companies (to benefit from the recovery), technology (growth and foreign exposure) and health care (demographics and benefits from the health care bill). At current valuations, equities appear quite attractive, especially when compared to the alternatives with yields at 50-year lows. Our recommended asset allocation is 65% equities (+5%), 25% municipal bonds, 3% gold (-2%), and 7% cash (-3%). We do not believe that there is a risk of near-term inflation from the federal government's fiscal expansion. We believe that the economy will continue to grow at a moderate pace against the background of financial reform and that the Federal Reserve will be successful in avoiding a possible deflation resulting from the financial deleveraging of individuals and corporations.

The Federal Reserve at its last meeting once again left rates unchanged at 0-.25, keeping the language "for an extended period". High unemployment, lack of inflation and a weak housing market were some of the reasons why the Federal Reserve reiterated its interest rate policy at the June meeting. At that meeting the Federal Reserve prematurely propped up its GDP forecast for 2010 to a range of 3.2 to 3.7 percent Q4/Q4, up from a range of 2.8 to 3.5 percent due primarily to strengthening private demand. We believe that growth rate in GDP will be modestly lower in the second half and have revised our forecast to 2.5% annualized rate. However, in anticipation of subdued inflation, the Fed lowered their inflation targets to 1.2 to 1.5 percent Q4/Q4, down from 1.4 to 1.7 percent and consistent with our own outlook.

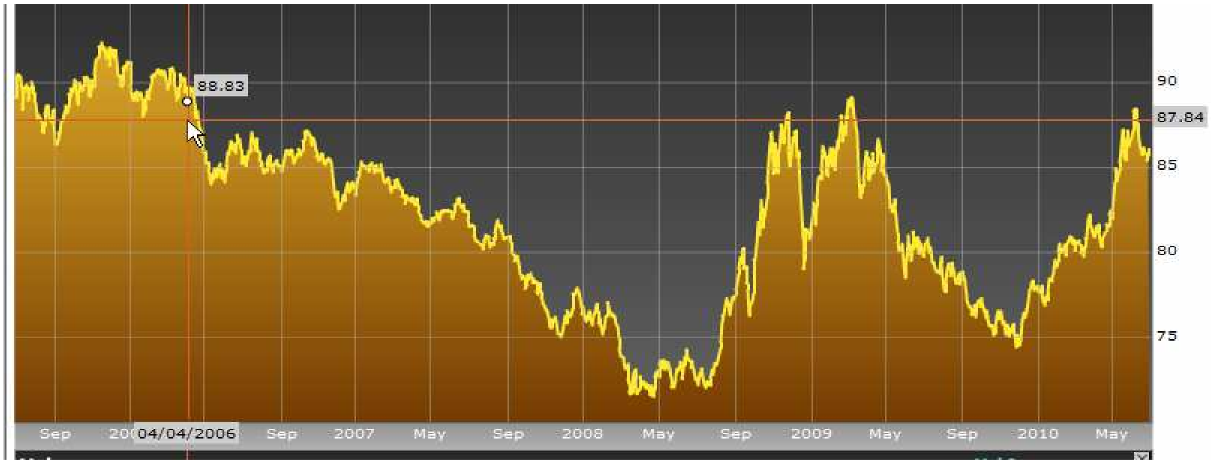
The CPI in May declined .2% after a .1% dip in April. The drop mostly attributed to falling gasoline prices which declined 5.2%. Deflationary fears are once again resurfacing as European policy makers narrowed their focus on deficit reductions. This reversal in sentiment was reflected in the yield on the 10 year treasury now at 2.93%, down over 1% in the past several months. It now has become evident that these rate cuts initiated by the Federal Reserve have not been enough to stimulate private sector demand growth against a backdrop of high unemployment. There is a large body of opinion that believes that the combination of high taxation and government regulation provides a disincentive for corporations to begin the post recession hiring process.

However, we believe the current concern over deflation will be short lived, in the midst of recovering corporate profits in the second quarter and continued strengthening global demand in China and other emerging economies. Since the financial crisis began in 2008, the Federal Reserve has made over $1 trillion dollars available to the U.S. banking system. Tightened lending policies coupled with high unemployment have kept inflation at bay. The Fed is now centered on the ballooning ratio of U.S. deficit to GDP, which now stands at close to 10-11%. Some economists fear this level of U.S. borrowing could cause foreign investors to lose their appetite for U.S. bonds and send our interest rates higher, sparking inflation.

The consumer sector appeared to be holding its own in May, with the data reporting an uptick in consumer purchasing power and modest upticks in wages/ salaries and consumer spending. The U.S. savings rate peaked in Q2 2009 demonstrating the resiliency of consumption that with time should take the reigns and steer the economy forward along its recovery path. The recent figures reflected in the Consumer confidence Index didn't confirm the coincident spending patterns when the index fell 3.9 points to 50.4 in July, the lowest reading since February. This drop is consistent with our expectations for slower economic growth in the second half.

EXHIBIT I

The Euro/US Dollar Index



Source: Altman Investment Management Research and Bloomberg

The U.S. dollar index has strengthened considerably since bottoming in 2008, as the U.S. economy slowly improves. More recent strength in the first half of this year has been a direct result of the weakening Euro amid the Greek sovereign debt crisis and worries over a possible contagion effect. Greece could choose or be forced to abandon the euro within the next several years, but the rest of the single currency zone should hold together.

On May 5th the European Commission released its forecast for a slow but continuing economic recovery. Global GDP is estimated at 1% and 1.5% for 2010 and 2011 respectively. Typically GDP growth in Europe is led by a pick-up in exports, followed by employment growth which in turn stimulates internal consumption by the private sector. A key element to watch will be the effect proposed austerity measures across European countries will have on future growth.

Despite the U.S. 10 and 30 year treasury rates trading at 2.98 and 3.93 respectively, the U.S. continues to be viewed as still one of the safest places to invest. The belief is apparent not only in domestic mutual fund and pension trading activity but also by foreign investors. Major foreign holders of treasury securities have increased by over 21% since the market bottomed in March of 2009. It is argued that a higher interest rate environment within the U.S. is necessary to continue to attract foreign investment in order to maintain dollar strength. However, the underlying fundamentals for most of the major currency zones look poor, but the U.S. is the best of the bunch. This suggests that the dollar will remain firm over the next year.

There is much debate over the natural U.S. unemployment rate which is defined as an unemployment rate that is neither deflationary nor inflationary. For over a decade the rate is estimated to have been 5%. But the concern that the Fed remains on the side lines too long with respect to interest rate policy, as the former FOMC did, will thwart any efforts to stave off inflation. There was talk in the April Fed Meeting by some participants that the real rate is now around 6%. Some economists argue that a range of 6-8% is more appropriate given today's environment.

The June unemployment rate came in at 9.5%. Like past recoveries, we expect job growth to be somewhat subdued rather than a persistent upward slope. We are encouraged by the moderate gains in private sector employment and the gradual renewal of non-farm payrolls growth from trough levels in early 2009. We would expect the path to be uneven despite recent evidence that consumer sentiment continues to improve. The basic premise that the weak initial jobless claims are the result of special factors rather than an indication of a deteriorating employment situation is yet to unfold. Concern over jobs and income growth are more evident in the latest consumer confidence figures which fell almost 10 points last month. Consumer confidence will most likely continue to fluctuate in reaction to economic releases. Recovering industrial production coupled with an ISM composite index level holding above 50 support future job creation and should help to bolster consumer confidence going forward.

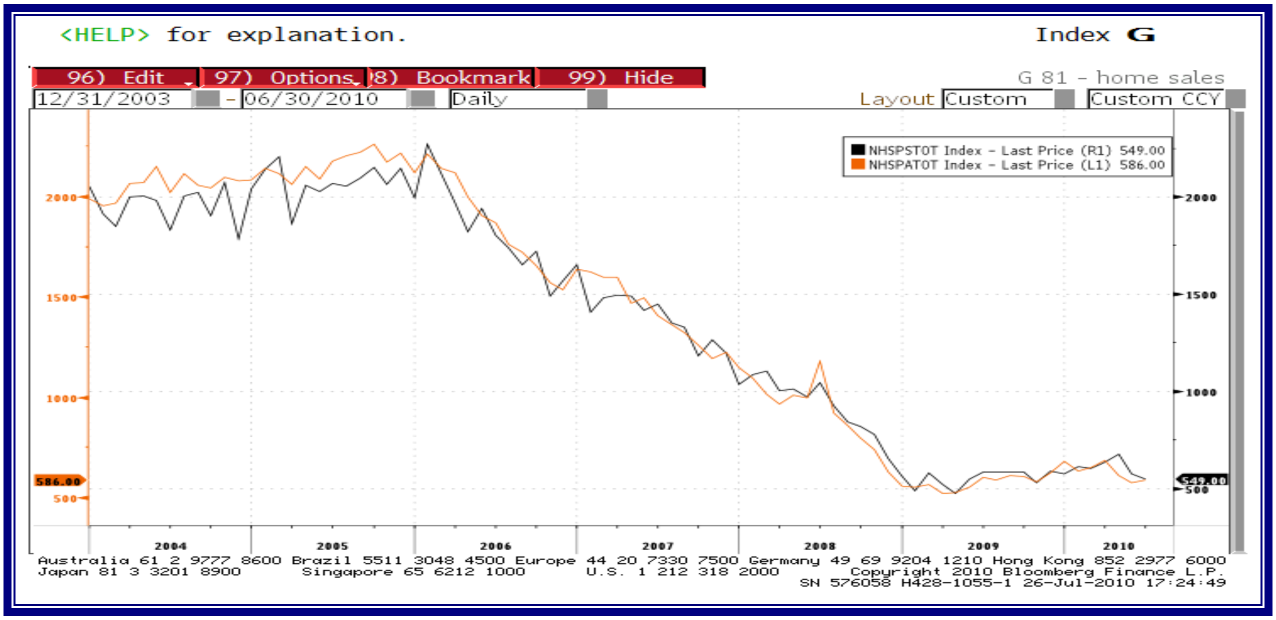
No shift in tone from Fed Chairman Bernanke. In a speech at the annual meeting of the Southern Legislative Conference of the Council of State Governments today, Federal Reserve Chairman Bernanke struck a cautious tone on the current economic recovery, in line with that of his recent semi-annual testimony. He said that rising demand from households and businesses should help sustain growth as the boost from the rebound in inventories fades, and that the economy should continue to expand at a "moderate pace." He also cited notable headwinds in the near term, including the housing market, given the large foreclosure pipeline, and the commercial real estate sector. Furthermore, he noted that the recovery in the labor market has been sluggish and that "significant time" will be needed to restore the 8.5mn jobs lost over the recession. He again highlighted the high level of long-term unemployed, and the possible lasting ramifications on employment and earnings prospects. There was no change in language around financial markets either - Bernanke noted that domestic financial conditions have improved substantially since the recession, although were "somewhat less supportive of growth in recent months." The bulk of the speech focused on state and local government; the bottom line being that "dealing with the fiscal challenges at all levels...will be essential to ensuring that our...economy delivers rising living standards."

RECENT ECONOMIC STATISTICS

- ***Existing House Prices have stabilized.***

Although prices have stabilized, the sustainability of the housing market recovery in the absence of any government stimulus remains to be seen. According to S&P/Case-Shiller, 10-City and 20-City Composite Indexes each advanced 0.5% in May, on a seasonally adjusted basis. These prices were at their highest since December 2008, as 14 of the 20 metro areas posted gains. There may be additional "residual impact" from the homebuyer tax credit, as the deadline to complete transactions has been extended to September 30. Since reaching a trough in May 2009, the 10-City Composite Index has recovered 5.4%, while the 20-City Composite Index is up 4.6%, but both remain about 29% below their cycle peaks in April 2006. On a y/y basis, both indexes have increased for the fourth straight month, each rising at the fastest pace since at least August 2006, as 13 metro areas have posted annual gains.

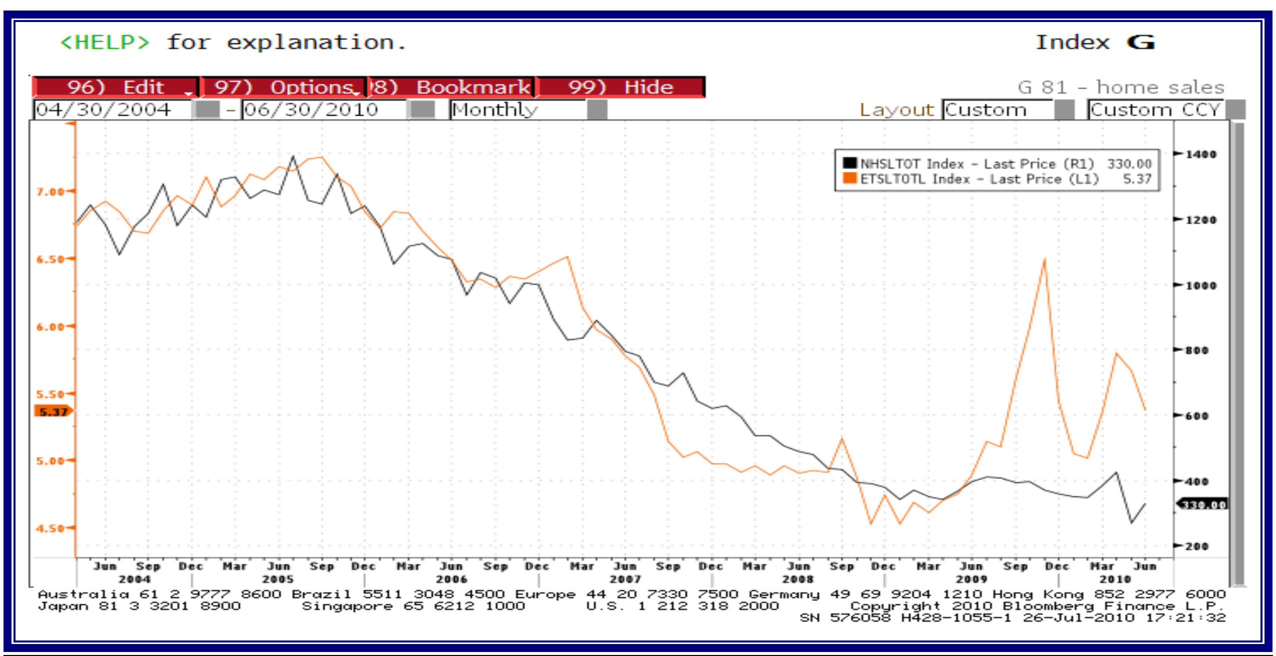
EXHIBIT II- Housing Starts and Permits



Source: Bloomberg and Altman Investment Management, LLC

The homeownership rate fell 0.2 points to 66.9% in Q2, the lowest level in over a decade. The homeowner vacancy rate slipped 0.1 point to 2.5%, matching the rate from a year ago. The rental vacancy rate held steady at 10.6%. Even so, both the homeowner and rental vacancy rates remain elevated by historical standards. As a result, we do not expect significant upward pressure on housing prices in the near future.

EXHIBIT III- Home Sales



Source: Bloomberg and Altman Investment Management, LLC

➢ ***Weekly Chain-Store Sales Mixed***

Weekly chain-store sales have been mixed this quarter, as many retailers are in transition between summer merchandise and back-to-school items. The ICSC/Goldman Sachs Retail Chain Store Sales Index rose 0.6%, up in four of the last five weeks, and reaching a new high. On a y/y basis, the index is up 3.8%. Redbook's sales index has declined 0.7% in the first three weeks of July, slightly worse than the monthly target of -0.6%. The index is up 2.8% from a year ago, below the targeted increase of 2.9%. Redbook noted "firm and steady" sales at discount stores, but "sluggish business" among other retailers.

➢ ***Richmond Activity Moderates***

The Richmond Fed Manufacturing Index slipped seven points to +16 in July, indicating growth for the sixth straight month, but at a more moderate pace. Among individual indicators, notably employment strengthened, while shipments and new orders decelerated. Manufacturers were slightly less optimistic about the six-month outlook. Capital expenditure plans grew at a slower pace, but hiring plans strengthened. Both current and future price growth remains muted.

The Service Sector Revenues Index rose three points to +8 in July, lifted by "solid gains" at non-retail services firms. Retail sales remained flat, as consumers shied away from big-ticket items and shopper traffic declined sharply. Both retail and non-retail service firms expect future demand to grow at a slightly slower pace. Price pressures in the overall service sector were minimal and are expected to remain low in the near term.

➢ ***Construction Spending***

June construction spending rose 0.1%, better than the consensus, 0.5%. But note the net revision to prior months was -0.8%, so net spending was marginally softer than expected. The quality of the data, though, means that differences of a few tenths are not remotely significant. The story here is the continued surge in public spending, up by 1.5% in June as the stimulus spending kicks in, while spending drops post-tax credit, and the decline in private non- res continues, though at a greatly reduced pace. Public construction rose at a 15.8% annualized rate in Q2, the biggest gain since Q4 2006, and there is plenty more in the pipeline as the long-lagging infrastructure components of the stimulus accelerate. We expect another big gain in this direct GDP component in Q3.

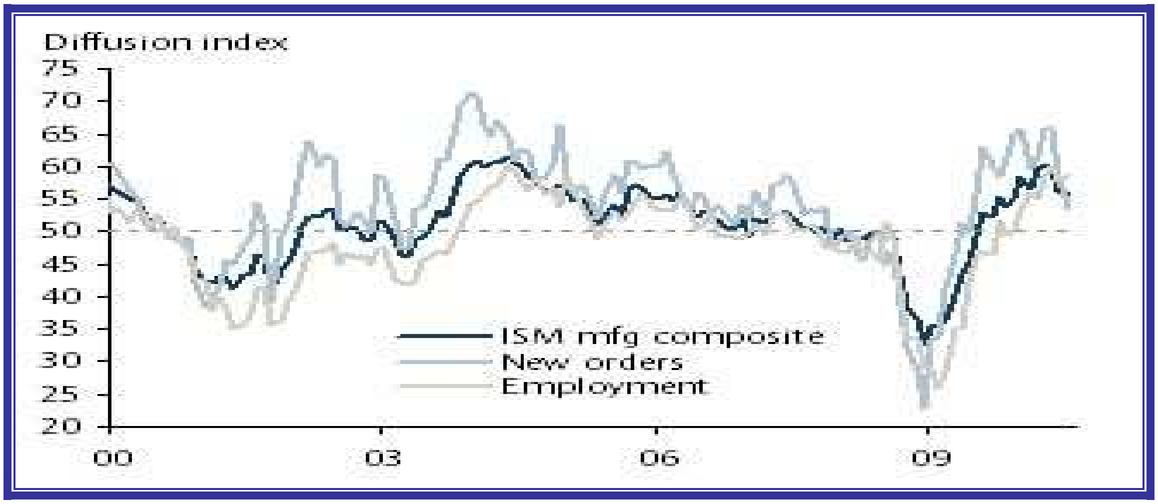
➢ ***ISM manufacturing index slips less than expected as inventories build***

The ISM manufacturing decreased to 55.5 in July, below June's 56.2 but above our and consensus forecast of 54.0. The new orders index dropped to 53.5 from 58.5 and production fell to 57.0 from 61.4, each the lowest print in a year. The supplier deliveries index moved higher to 58.3 from 57.3, and the inventories index jumped to 50.2 from 45.8, though this may reflect unwanted inventory buildup from poor sales. The employment index increased to 58.6 from 57.8, showing that while activity has moderated over the past couple months, payroll growth has continued. Outside the five components of the headline index, the new export orders index edged higher to 56.5 from 56.0 while imports sank to 52.5 from 56.5. The prices index increased to 57.5 from 57.0.

Overall, this is a mixed report. The drop in the new orders index indicates further slowing in demand growth, and the decrease in the production index shows that this has fed through to activity. The strength in the employment index is encouraging, however, as it suggests that the broad trend of labor market improvement has continued unscathed through the slowing in production.

EXHIBIT IV

Manufacturing orders growth slowed in July, but hiring continues



Source: ISM, Haver Analytics

Productivity in the second quarter fell at a 0.9% rate, below the consensus, 0.1%. Hours worked jumped 3.6%, more than we expected. But unit labor costs rose only 0.2%, below the consensus 1.5%, thanks to 0.7% dip in hourly comp. In y/y terms productivity growth slowed to 3.9% from 6.3%, coming off its early-cycle peak. This is inevitable; productivity always surges as output begins to rise then fades back to trend, about 2-1/4%. What was exceptional this time was the drop in unit labor costs, which reached 3.5% at the peak in Q4 09 and which were still down 2.8% y/y in Q2. Companies have squeezed comp costs, now up only 1.0% y/y, and the benefits have accrued to their bottom lines as margins have exploded. This can't last forever, which means earnings growth has to slow sharply over the next year, even if sales volumes accelerate.

The NFIB small business optimism index dipped again in July, but by only 0.9 points to 88.1. In June, it fell 3.2 points. We view this decline as a reaction to the drop in stock prices, which has also hit consumer confidence quite hard. Now that about half the drop in prices has been recovered, we expect no further significant decline in the NFIB index. It still remains at recession levels, but it is well off its spring 09 lows. The key sub indexes are mostly little changed from June, though the index of respondents expecting a "better economy" dropped to -15 from -6. Better news in the "credit harder to get" index, which remained at 13. That's high, but it has been steady for 3 months; bank deleveraging is not dependent on the stock market. Bank C&I lending has stopped contracting; if it expands, NFIB will rise.

Financial Conditions Ease as Payrolls Disappoint. Payrolls came in weaker than expected both on private and ex-census payrolls and the market reacted strongly to the numbers in July. The market's reaction to this news pushed the U.S. Financial Conditions Index to its lowest levels on record. This encouraged bond yields to continue to decline to new lows along the curve. In the process, the 2-year yield is hitting new cycle lows intraday below 50bp, the 5-year yield trading below 1.50% and the 10-year yield closing below 2.75%. The dollar trend is also impressive, with fresh local highs in EUR/$ and lows in $/JPY. The USD TWI has now reversed almost all of the appreciation it saw in the first few months of the year when upward revisions to the U.S. growth picture dominated.

The trade deficit has sharply widened more than expected to $49.9bn in June, from a slightly downward revised May level (revised from $42.3bn to $42bn). The sharp widening is driven by a decline in exports (down $2bn, or a nominal 1.3% decline) and an increase in imports (up $6bn, or a 3% nominal increase). The decline in exports is mainly due to a fall in goods exports (driven by declines in capital goods exports, in particular) while exports of services rose slightly (by 0.8%). The surge in imports is also mainly due to goods (and consumer goods in particular), although services imports rose too. As a result, the real trade deficit in goods widens by $ 8 billion of which only 0.5 Billion is due to petroleum.

This is a much larger deterioration in the trade balance than Commerce assumed in its preliminary estimate of second-quarter GDP, which showed 2.4% annualized growth. The report therefore adds to other indications (from previous data on construction outlays and inventories) of a downward revision to this figure. Absent significant upside surprises in upcoming reports on retail sales and inventories, we would put this revision somewhere in the 1% to 1½% range.

The potential downward revision to our U.S. forecast, something our U.S. economists had flagged as imminent for a while, suggests that several of these trends can ultimately run further. We continue to expect 2010H2 to show growth of around 1.5%. But with resistance to renewed fiscal stimulus, we now forecast a more gradual pick up in GDP growth through 2011 than before. The result is that the year-over-year growth rate in 2011Q4 has dropped to 2.25% (around 90bp lower than before) and our year-average forecast has fallen to 1.9% from 2.4%. We continue to see disinflation, though given recent upward revisions to core PCE data and signs that rent disinflation may be ending, at a slower pace than before.

With the unemployment rate rising, we now expect the FOMC to re-engage in unconventional easing through asset purchases (USTs) and/or a more ironclad commitment to lower short rates. And we now expect 5-year yields to trade around 1% and the 10-year yield to around 2.5% by year end. The market has been very focused on a potential shift in this direction. And tomorrow's FOMC meeting has become the most significant in some time for that reason. The FOMC announced on August 10th that they will reinvest the pay down of MBS in the bond market. This was packaged as 'preventing a tightening' but the market concluded that this was another step towards renewed easing. We view that any step towards a supportive Fed policy.

- ***Additional Comments-On the Macro Themes***

We continue to manage portfolios under three macro themes: a) U.S. growth is likely to disappoint; b) non-U.S. growth is likely to hold up better than expected at least relative to the U.S. and China to back off its tightening policy and Europe suffers less from the sovereign fall-out than feared; c) sovereign and systemic risks have been overpriced at least in the near-term. This has left us with a relatively positive view on equity markets recognizing that U.S. growth problems need to be balanced against better non-U.S. news and excessive risk premia). We continue to focus on equity valuations relative to a current slowdown in the U.S. (and a more positive relative view of China. We believe this does set the stage for the potential of further compression of risk premia as witnessed through the credit markets in the ensuing months. We remain cautious relative to the U.S. currency which should provide better visibility in non U.S. earnings of cyclicals in the next several quarters.

MARKET OVERVIEW

While U.S. economic statistics have been a net drag to the equity markets in June and July, this doesn't seem to be the case so far in August. The most surprising feature in the markets action in August is the resilience of equities holding firmly above their 200-day average. Our U.S. growth view remains the major headwind for the equity market. As we enter a potentially strong quarterly earnings season with undemanding valuations and better non-US performance there is remains much that is positive about the equity outlook and staying negative on US stocks on the growth slowdown I suspect is already reflected in stock market valuations.

The coincident price action makes it clear just how significant an obstacle the U.S. data has been, even in the face of other more positive forces. Through June and July, we re-examined the days on which a major U.S. data release occurred. On those days where major U.S. data was released, the Standard and Poor's 500 fell on average by 8.8 points. On those days without U.S. data, the SPX rose on average by 6.2 points.

The market on average performed much more strongly in July than June (up 70 points versus down 60 points). But the *difference* between U.S. data days and other days remained remarkably similar. Even in July, U.S. data days were on average 14 points worse than non-data days and the largest gain on a major US data day that month was barely more than 5 points. What changed in July is not that U.S. growth news did not affect the market – the net drag seems to have been large as in June. Instead, other forces overwhelmed that. In particular, better earnings news which kicked off that month, better data in the rest of the world and the sharp relaxation in sovereign fears overwhelmed U.S. growth news. It is on the basis of these forces that we have argued not to translate any negative U.S. growth views into a simple negative view on U.S. stocks.

It's still early in the month (August), but so far things look different than either June or July. We have had three major U.S. data days this past week with the average gain on those three days substantially positive, while the market pulled back a little on the other two days. And for the month as a whole, we are up considerably still. But while these are early days we have managed to pass through the period of the ISM and payrolls with equities moving significantly higher, something we did not manage in either June or July.

Why the shift? The simplest reason is that the surprises to the U.S. data have so far been a bit less brutal in August. The ISM releases were both positive surprises despite the underlining rise in inventories and drop in orders. Despite negative payrolls the report was arguably not as large a shock as in some prior releases. This suggests that the market may have adjusted its expectations enough that it has become a little less vulnerable to negative U.S. data news.

But part of the answer also likely comes from a growing anticipation that softer growth news will bring some policy response. Recall that the last major market decline (on 21st July) occurred in response to a more hawkish-than-expected statement from Chairman Bernanke. But since then, the market has shifted footing. Bonds have rallied sharply, the part of the yield curve that still captures views on the effectiveness of policy (5s-10s now or 5s-30s) has steepened and the dollar has weakened. Alongside rising equities and falling volatility and increased market speculation about potential shifts towards quantitative easing, this looks less like a simple disconnect between equities and bonds and more like a market pricing a policy easing ahead. The result has been that our U.S. Financial Conditions Index has already eased.

On both fronts, the critical question is whether the market is right. On growth, our own forecasts suggest that – at some point in the coming months at least – the market will face fresh disappointments. This is because we think that U.S. growth views are still too high. But we still think the implications of that for stocks may be offset by likely better global growth news, a shift away from tightening in China and still elevated risk premia.

On the second, we now do forecast a clearer return to unconventional policy easing. But we also think that this is likely to come in the face of more challenging economic outcomes. And our own view is that a significant move in this direction is most likely in the next quarter, especially if there is an even sharper deterioration in growth momentum in the September data releases.

The upcoming FOMC meeting is likely to be important to the near-term outlook since the market has started to rely on the notion of a Fed response and may be disappointed if it does not get a firm signal.

International Components' Directions Remain Equally Split. While five components have shown some improvement, this was outweighed by the significant drops in the other five, dragging down overall headline and momentum. Our Global PMI continued falling, although at a slower pace than in the last two months, supported by better signs of activity out of Europe. Our New Orders Less Inventories Aggregate showed another relatively sharp drop this month, mainly on the back of the lower orders and higher inventories in the U.S. The Belgian and Netherlands Manufacturing Survey Aggregate, the TWI Aggregate and the Baltic Dry Index were all lower over the course of the month, continuing the trend from the last month. Our Consumer Confidence Aggregate, however, improved slightly in July, driven by better confidence in Japan and Eurozone. GS Industrial Metals Index, U.S. Initial Claims and Korean Exports also made positive contributions this month.

Pace of Industrial Growth Decelerating. We highlighted in mid-July that the Advanced GLI pointed to slowing in industrial momentum, although from high levels. Today's GLI reading has indeed confirmed that momentum has turned negative, though only slightly. While our U.S. forecast is still firmly below consensus, our global forecast does not envision a very sharp slowdown in growth. With the GLI suggesting that the pace of deceleration has picked up lately, it will be critical to watch whether this negative trend in momentum continues.

Federal Reserve Bank Chairman Ben Bernanke signaled in July that the Federal Open Market Committee (FOMC) would consider further policy actions to support a faltering recovery—including a strengthening of the "extended period" language and the purchase of additional assets. Last week, James Bullard, president of the Federal Reserve Bank of St. Louis, argued that additional Fed stimulus should take the form of Treasury purchases, rather than a hardening of the FOMC's commitment language. We attempt to quantify the effects of the Fed's unconventional policies on the ten-year Treasury rate to date. While our results are subject to considerable uncertainty, we find that (1) the Fed's purchase programs has lowered long-term yields by around 50 basis points, and that the FOMC's "extended period" language has had an additional effect of similar magnitude. While our results thus suggest that both commitment language and the asset purchase program have been effective in supporting the recovery, purchases of Treasuries may well be preferable for providing additional stimulus. This is because the Fed has already picked the "low-hanging fruit" of the extended period language and would probably need to enter into a much more iron-clad commitment to keep rates low to achieve a further easing. The committee may well view such an iron-clad committee as more dangerous than another asset purchase program. A first step in this direction might be the reinvestment of maturing mortgage backed securities receipts.

- **<u>The FED's Proposal Analyzed</u>**

First of all, we considered the impact of the Fed's entire asset purchase program on long-term Treasury rates. Considering the effect of the whole $1.75tr purchase program rather than Treasuries alone is helpful because the announcements were spread over two dates: (1) the November 25, 2008 announcement to buy $600bn of assets ($500bn of mortgage-backed securities (MBS) and $100bn of agency debt), and (2) the March 18, 2010 announcement to buy an additional $750bn MBS and $100bn of agency debt and to start the purchase of $300bn in Treasury securities. The underlying idea of considering the entire program is that purchases of different asset classes have a high degree of substitutability as they all reduce the supply of long-duration government-guaranteed or quasi-government-guaranteed assets.

Secondly, we looked at past periods in which the Fed attempted to boost the economy through a commitment to low rates. We identified three periods in which the FOMC signaled its intention to leave its policy rate on hold: (1) between August 2003 and January 2004 the FOMC intended to keep rates low for a "considerable period", (2) in December 2008 it announced to keep the funds rate unchanged "for some time" and (3) in March 2009 it adopted the "extended period" language. We combine these three periods to denote that the FOMC is `on hold'. We compared the market response to periods when the Fed signaled a tightening policy in January 2004 to December 2005 during which the Fed signaled its intention of `gradual tightening' through a "patient" and then a "measured" withdrawal of policy accommodation.

We have concluded that the Fed's asset purchase program has lowered long-term yields by around 44 basis points. Goldman Sachs research performed some regression analysis that showed that the long-term interest rate has fallen by 0.025 basis points for every $1bn of announced purchases, totaling 44 basis point for the entire $1.75 trillion purchase program. This result is consistent with a New York Fed report which found that the Fed purchases have reduced the 10-year term premium by between 38 and 82 basis points. (See "Large-Scale Asset Purchases by the Federal Reserve: Did They Work?" *Federal Reserve Bank of New York Staff Reports* 441, March 2010.)

The commitment language has been equally effective. Our estimates further suggest that the FOMC's `on hold' commitment language has reduced the long-term rate by 44 basis points. As one would expect, we find that weaker degrees of commitment have smaller effects: the indication of 'gradual tightening' appears to have reduced long-term rates by only 29 basis points relative to what they would have been without that language.

Both the Fed's commitment language and its asset purchase program have been effective in reducing long-term rates and thus supporting the recovery. However, the Fed has already picked the "low-hanging fruit" of the extended period language. In order to achieve a further easing, the committee would probably need to adopt a much more iron-clad commitment to keep rates low, by tying rate hikes either to a particular date or an economic condition (presumably one that seems relatively distant at present). The committee may well regard such a commitment as more constraining—and hence more dangerous from a risk management perspective—than a renewed asset purchase program. Hence, another Treasury purchase program may well be the preferred avenue for providing additional monetary stimulus. A first step in this direction might be the reinvestment of maturing mortgage backed securities receipts—a step that was already discussed at the June FOMC meeting.

The Federal Open Market Committee in June decided to reinvest principal repayments of agency and mortgage-backed securities in Treasury securities. With this change in policy the Committee reacted to a downgrade in its assessment of the economic outlook, recognizing that "the pace of recovery … has slowed in recent months." The Federal Open Market Committee (FOMC) today took a "baby step" towards renewed quantitative easing by deciding to hold the size of its portfolio fixed by reinvesting principal repayments of agency debt and agency mortgage-backed securities (MBS) into longer-term Treasury securities. In an accompanying statement, the New York Fed's Open Market Desk indicated that purchases would be concentrated in the two- to ten-year sectors of nominal coupon securities, though other securities, including TIPS would also be bought. Meanwhile, the FOMC indicated that it will "continue to roll over the Federal Reserve's holdings of Treasury securities as they mature."

The reinvestment decision marks a step towards a more expansionary monetary stance in that it removes a slight bias toward tightening of the monetary policy position. In previous commentaries we have argued that it is the expected stock of asset holdings by the Fed which matters for long-term rates (see "Extended Period" vs. Asset Purchases: How Effective Are the Fed's Unconventional Polices?," *US Daily Comment*, August 3, 2010). By announcing to keep the balance sheet fixed—rather than letting it shrink over time—the Fed thus raised the expected future stock of asset holdings and thereby eased monetary conditions. In March, Brian Sack, Manager of the Open Market Desk, indicated that this shrinkage would be in the neighborhood of $200bn from that time through the end of 2011 (roughly a 21-month period, so just short of $10bn per month), though of course this figure may have risen as lower interest rates would have instigated more mortgage refinancing. To our knowledge, the Fed has not provided an updated estimate of this run-off. Our best attempt at identifying the effect of past Fed purchase announcements suggests that the ten-year Treasury rate fell by 2½ basis points for every $100bn of expected purchases. Today's market reaction—a 6-basis-point drop in ten-year Treasury rates after release of the statement—thus suggests that the market had been expecting the balance sheet of the Fed to shrink at least $250bn over the next few years ("at least" because the markets were not completely surprised by this decision, so rate levels prior to the announcement presumably reflected some probability of this move).

The decision was taken in response to a downgrade of the FOMC's economic outlook. The Committee demoted its previous assessment—that "the economic recovery is proceeding and that the labor market is improving gradually"—to "the pace of recovery in output and employment has slowed in recent months." Household spending is now seen to be increasing only "gradually" and the description of business spending on equipment and software was changed from "has risen significantly" to "is rising." The one upgrade was the Committee's removal of the observation that "financial conditions have become less supportive of economic growth." Overall, the statement concluded that the pace of economic recovery is likely to be "more modest in the near term than had been anticipated," instead of "moderate for a time."

Changes in the inflation paragraph were inconsequential, removing references to declines in prices of energy and other commodities but continuing to note that "measures of underlying inflation have trended lower." In our view, it is noteworthy that the Committee chose to keep this phrase in the statement despite upward revisions to the core PCE index. Those revisions preserve the sense of disinflation, but from a slightly higher position than had previously been reported.

Altogether, we view this statement as a "baby step" toward renewed quantitative easing policy later this year or early next, though this obviously depends on a view that the economy remains as sluggish as we forecast. As outlined by Chairman Bernanke in his Humphrey-Hawkins testimony at the end of July, the remaining options for additional easing are: (1) strengthening the commitment to keep short-term rates exceptionally low for an "extended period", (2) cutting the interest rate on excess reserves (IOER) from its current 25-basis-point level and (3) resuming asset purchases. We would conclude that meaningful additional easing—dubbed "QE2"—would require a stronger commitment to keep the federal funds rate near zero and/or another sizable asset purchase program. Either or both could occur. If asset purchases are part of QE2, they are apt to be in U.S. Treasuries and for size — at least $1 trillion — both to impress market participants and to have a meaningful effect on yields. We would expect an asset purchase would need to total at least $1tr to lower ten-year yields by 25 basis points.

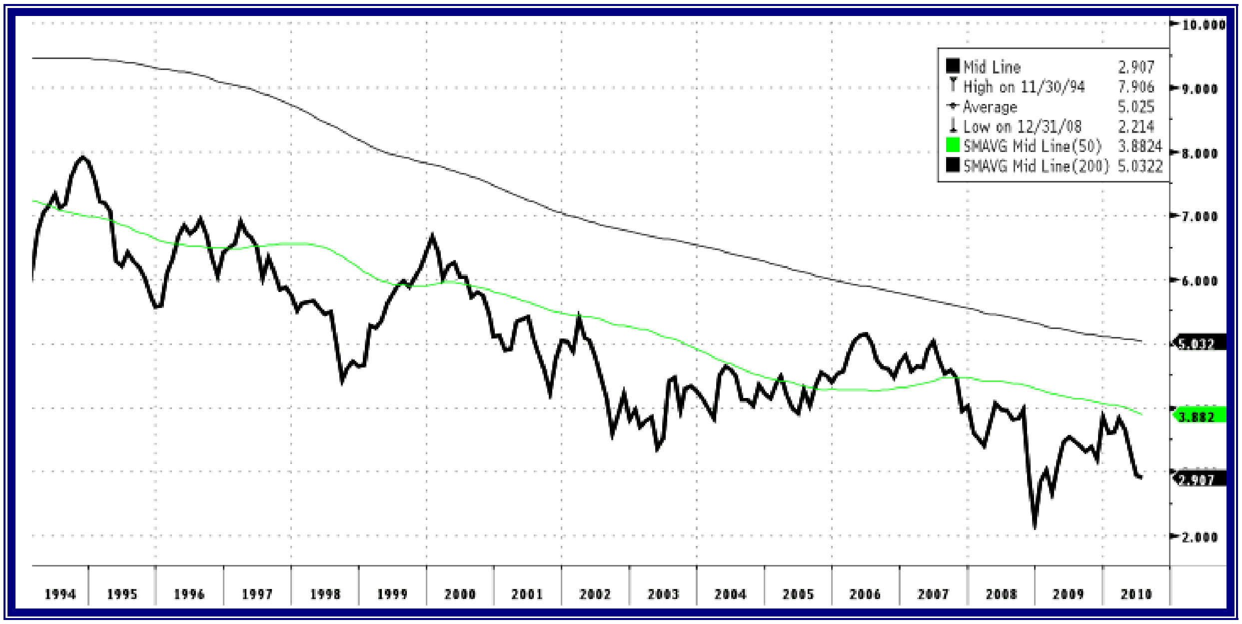
Further steps toward QE2 will be sensitive to any increase in unemployment that has been a reliable sign of imminent recessions since at least World War II. In this context, our economic outlook—which sees the unemployment rate drifting back up to 10%—suggests that the most likely timing for additional asset purchases would be late 2010 or early 2011.

THE U. S. FIXED INCOME MARKETS

In our view, heightened uncertainties are bound to persist, led by sovereign developments in Europe and U.S. financial regulatory reform. The extraordinary challenges associated with the former, and the highly politicized nature of the latter, suggest headline risk could potential surface over the ensuing quarters. Unfortunately government fiscal tightening and more constraints on U.S. financial institutions are hardly the most constructive backdrop to ensure a robust global recovery and renewed employment growth. Slower potential growth suggests that government bond yields – which typically rise at this stage of the cycle as risk appetites improve – are likely to remain anchored near current levels. That is, except for the periphery nations in Europe, where rates should stay elevated relative to core AAA issuers for some time.

EXHIBIT V

Ten Year Generic Treasury Yield



Source: Bloomberg and Altman Investment Management, LLC

Importantly, the substantial threat to financial market stability and renewed economic growth should keep major central banks on the sidelines until 2011. Benign inflation pressures provide policymakers with the additional latitude to delay normalizing overnight rates. Liquidity premiums have also risen across spread sectors and in inflation-linked debt (though these instruments are direct government obligations, they do not typically benefit from safe haven flows). The dearth of expedient solutions in Europe and the onset of the summer season will do little to boost liquidity prospects near term.

GOVERNMENT RELATED DEBT

Although spreads currently trade near long-term norms, even modest widening is likely to generate out performance compared to risk-free debt. U.S. government-sponsored enterprise (GSE) step-up coupon structures currently offer the best value. These structures diversify portfolios and are a defensive hedge against rising interest rates. Short callable GSE debt also is attractive relative to certificates of deposit. In non-callable (bullets), supranational debt (e.g., KFW, EIB) provide yield pick-up relative to U.S. agency debt.

Spreads on current coupon agency pass-through MBS are near historic lows. Although spreads should be well-supported in the near term, current valuations are not compelling, in our view. As opposed to pass-throughs, Ginnie Mae CMOs are attractive since investors can purchase this government-backed debt with higher yields and protection against extension risks, in some structures. In ABS, investors should focus on lower quality to identify relative value, particularly amongst the BBB-rated credit card and retail auto issues, which compare favorably to unsecured corporate debt.

EXHIBIT VI

10-year U.S. Government Agency Yield minus 10-year Treasury Yield

Source: Bloomberg and Altman Investment Management, LLC

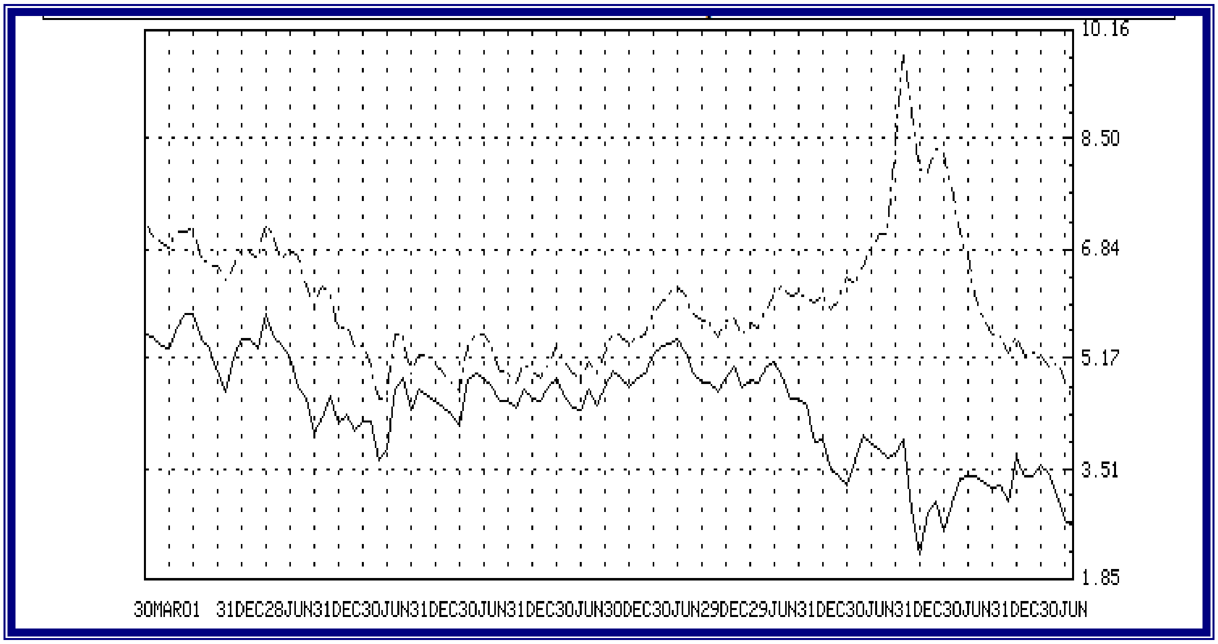
HIGH GRADE CORPORATES AND PREFERREDS

Thus, fragile market conditions and elevated volatility are more likely to prevail in coming months than market rallies. While credit spreads are likely to grind wider near term, we do not recommend reducing risk exposures. Indeed, current valuations are trading at recessionary levels even though fundamentals are still quite favorable. Investors with a longer view should leg into this pullback during the coming months by opportunistically adding solid high beta credits and quality issuers.

Although risk aversion triggered by the European crisis has overshadowed spread compression for now, the fundamental backdrop for U.S. corporate bonds remains positive. That said, we expect cash spreads to continue grinding wider in the near term (primarily in financials) until a resolution on the European situation becomes more apparent. Keep in mind that the same factors which led us to favor corporate bond performance compared to other fixed income sectors remain intact. At this time, we continue to emphasize improving credit quality as well as taking advantage of any recent spread widening to look for attractive opportunities in high quality U.S. corporate debt.

EXHIBIT VII

U.S. Corporate 7-10 year (dotted line) versus U.S. Treasuries 7-10 year (solid line)



Source: Bloomberg and Altman Investment Management Research, LLC Data: ML Global Bond Indices:

Value still exists in the capital trust preferred arena, consistent with our positive conviction on subordinated bank debt. We favor preferred issues with high liquidity amongst the largest bank/finance/insurance names. We recommend capital trust preferreds of U.S.-based issuers compared to their Euro financial counterparts. The best opportunities continue to be reflected in the primary market, which currently trades cheap compared to secondary issues.

EXHIBIT VIII

		12/31/2009	3/31/2010	06/31/2010
10 Year Muni *		3.96%	3.96%	3.71%
10 Year Treasury		3.83%	3.83%	2.95%
Ratio		103%	103%	125%

Source: Bloomberg and Altman Investment Management, LLC
** Merrill Lynch Global Index- Investment Grade*

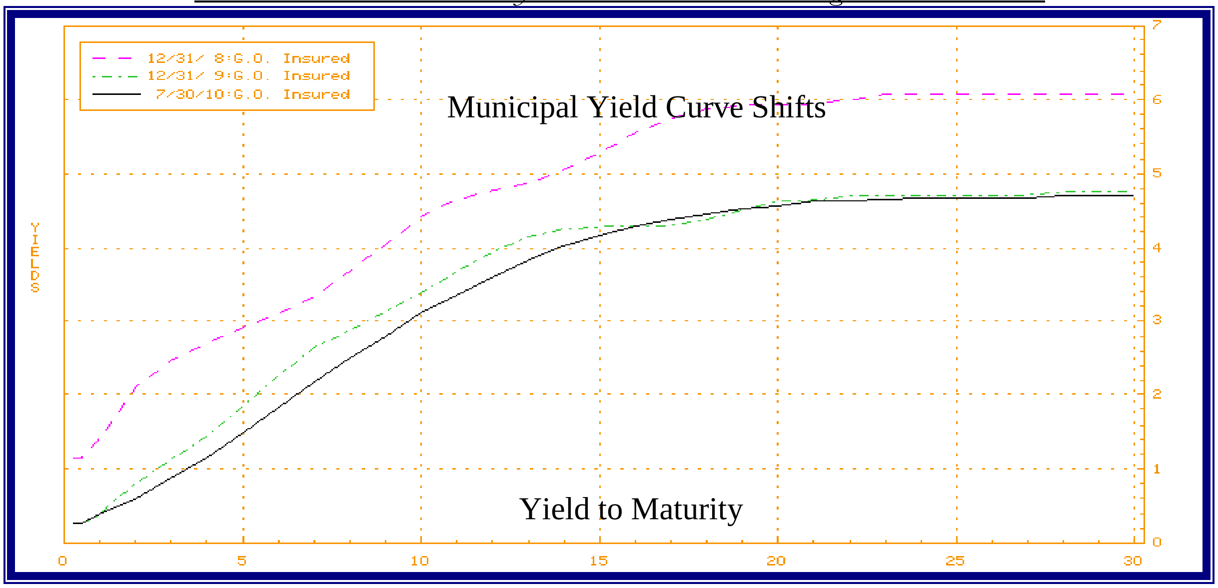
* The impact of an upward shift in the yield curve on long duration instruments suggests that positive performance will likely be led by return on the cost of borrowing, not the price of the issue.

MUNICIPAL BONDS

While municipal spreads relative to Treasuries have risen and ratios reflect improved valuations, absolute yields are anemic. Headlines related to municipal budget strains (e.g.; Central Falls, RI) and the European crises have been the root cause. We expect this trend to continue as geopolitical risks persist, budget gaps are addressed, federal funding diminishes and 2011 solvency issues resurface. Additionally, recent developments about IRS audits to ensure that BABs were sold at the initial offering price (where at least 10% of the bonds are sold to the public) may have negative credit implications, driving spreads wider. Investors should focus on high quality issuers. We recommend AA GO spreads with a focus on 5-10 years to maturity.

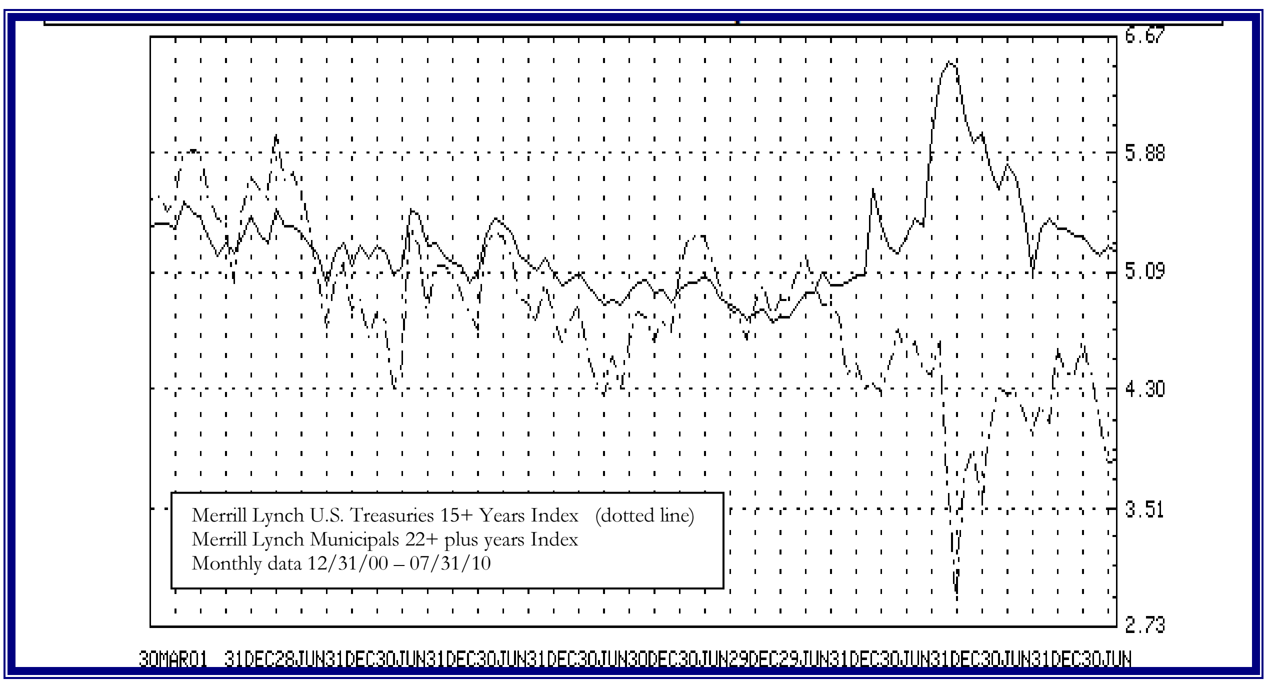
EXHIBIT IX

Fair Market Yield Curve History: Generic Muni - General Obligation Insured Curves



Source: Bloomberg and Altman Investment Management Research, LLC

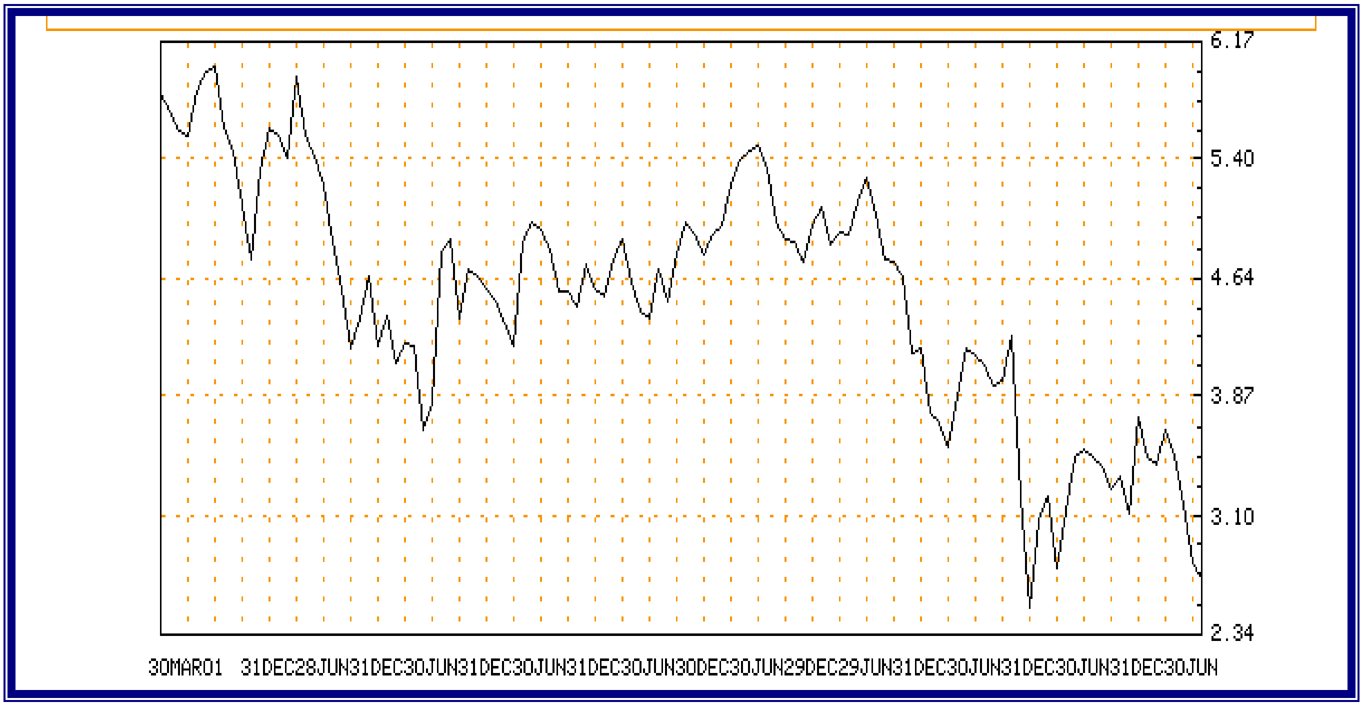
EXHIBIT X



Source: Bloomberg and Altman Investment Management Research, LLC

Long term Municipal to Treasury spreads widened significantly in the second half of 2008 illustrating the massive move into the safe haven of U.S. Treasuries. While municipals have rallied through 2009 with yields leveling out in 2010 closer to its mean, long term U.S. Treasuries remain well below mean levels.

EXHIBIT XI



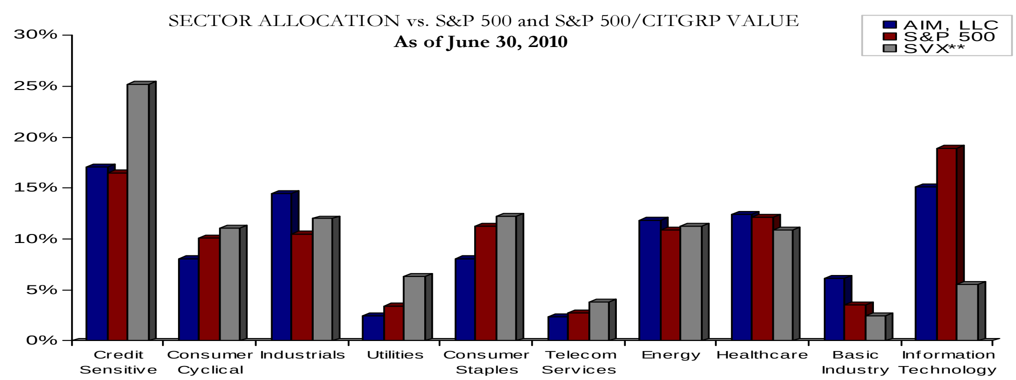
Source: ISM, Haver Analytics

EQUITY ALLOCATION STRATEGY

EXHIBIT XII

ALTMAN INVESTMENT MANAGEMENT

CORE VALUE EQUITY PORTFOLIO



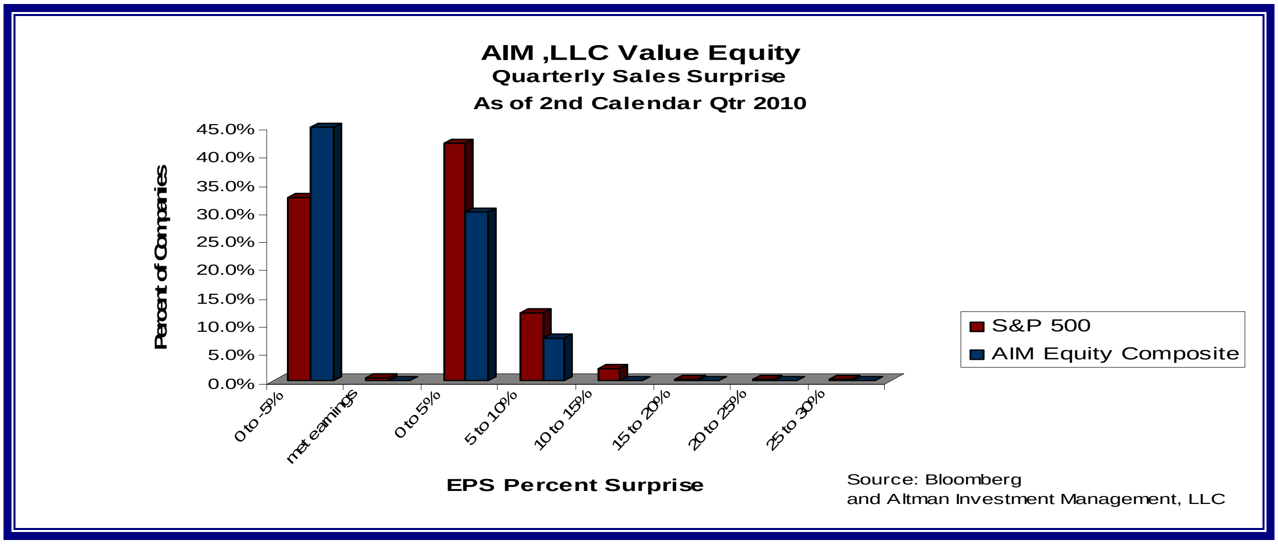
AIM,LLC	18.9%	6.1%	15.1%	2.9%	8.8%	2.4%	10.7%	12.8%	5.9%	14.3%
S&P 500	16.3%	10.1%	10.3%	3.7%	11.5%	3.0%	10.7%	12.1%	3.4%	18.8%
SVX **	25.0%	11.0%	11.5%	6.9%	12.4%	4.0%	10.3%	10.7%	2.4%	5.6%

Source: Bloomberg as of 6/30/10 consolidated into the GICS sectors. Numbers rounded to the nearest hundredth.
Note: Numbers reflect portfolio allocation, not returns.
* Percentages do not total 100% due to rounding, and equity sector weights take into consideration the composite's cash allocation.
** S&P Citigroup Value Index

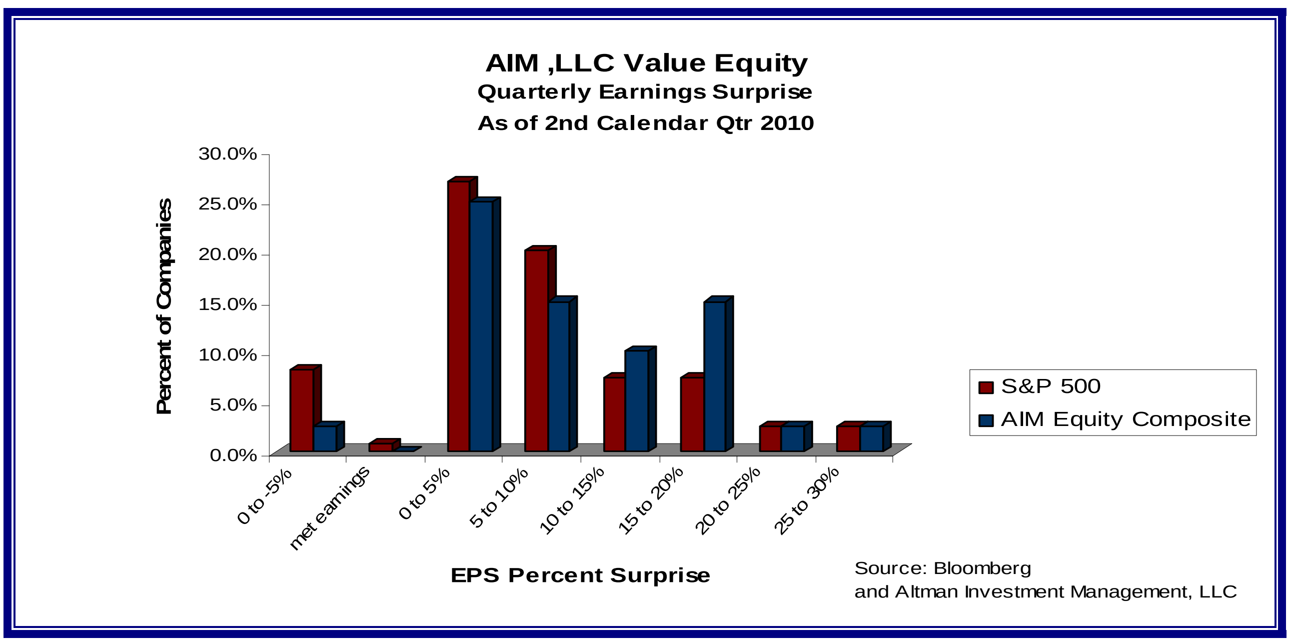
1

EXHIBITS XIII and XIV

AGGRAGATE PORTFOLIO SECTOR: SALES & EARNINGS REPORTS



The chart above illustrates the percentage of investment holdings within our value portfolio that exceeded street estimates of sales, during the 2nd calendar quarter of 2010. Most notably, 38% of our investments exceeded street sales estimates as compared to 58% of the companies in the S&P 500 exceeded street estimates. Year over Year growth in earnings was 11.6% for our composite vs. 8.9% for the S&P on a share weighted basis. As of Sept. 14, 2010, 100% of the AIM composite and 100% of the S&P companies have reported.



The chart above illustrates the percentage of investment holdings within our value portfolio that exceeded street estimates of earnings, during the 2nd calendar quarter of 2010. Most notably, 88% of our investments exceeded street earnings estimates and 81% of the companies in the S&P 500 exceeded street estimates. Year over Year quarterly growth in earnings was 65.3% for our composite vs. 48.4% for the S&P on a share weighted basis. Looking at bottom line net income, 80% of our investments exceeded street estimates as compared to 78.9% for the S&P. As of Sept. 14, 2010, 100% of the AIM composite and 100% of the S&P companies have reported.

EXHIBIT XV

ALTMAN INVESTMENT MANAGEMENT

AIM PORTFOLIO CHARACTERISTICS

As of June 30, 2010

	Value Equity	S&P 500
# of Holdings	47 stocks	500 stocks
Portfolio Beta	1.09	1.00
Wtd. Avg. Price to Book	1.57x	1.95x
Wtd. Avg. Price-Earnings (Current)	11.4x	12.5x
Wtd. Avg. Price-Earnings (FY1)	9.5x	10.8x
Wtd. Avg. Price/Sales Latest 4 Qtrs	.97x	1.05x
Wtd. Avg. Dividend Yield	2.8%	2.2%
Price to Cash Flow	5.5x	6.2x
Market Cap.	$66.7 Billion	$75.5 Billion
Ten Largest Holdings (% total)	34%	--
Approx. Portfolio Turnover	30%-40% per annum	--
Maximum Cash Position	10%	--

Sources: AIM, LLC and S&P 500 characteristics are utilizing a Bloomberg as of June 30, 2010 for weighted average book value, price/earnings, price/cash flow, and price/sales figures.

1