FIXED INCOME STRATEGY HIGHLIGHTS

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"No matter how serene today may be, tomorrow is always uncertain. Don't let that reality spook you. …America's best days are ahead."
Warren Buffet: Berkshire Hathaway's 2011 annual letter to Shareholders

GLOBAL LANDSCAPE:

Economic Expansion Still On Track Despite Some Near Term Uncertainty

As investors face times of uncertainty, the guiding spirit and encouraging optimism of the great "Oracle of Omaha" helps us to focus our efforts on uncovering exceptional investment opportunities.

Recent events in the Middle East have shaken confidence in some emerging markets, as significant outflows occurred in that sector during the tail end of the quarter. We have concluded that this unrest combined with the environmental disaster in Japan last month should slow global growth in 2011. The geographic area in Northeastern Japan that was hit with the earthquake, tsunami, and nuclear radiation accounts for about 8% of Japan's GDP, but the overall economic damage should have a temporary negative affect on the whole country. Despite growth from the rebuilding efforts, Japan will most likely suffer some near term economic and financial stress against a background of high debt in relation to its GDP.

With respect to the rest of the world, the outcome of the war in Libya and the unrest in Bahrain and Yemen, as well as the formation of new governments in Egypt and Tunisia, still represent economic and financial uncertainties in the short-run. From a global perspective, investors remain concerned about the security of oil supplies from Saudi Arabia which account for 20% of global oil reserves. Overall, we remain positive on the long-term outlook for more representative governments in the Middle Eastern countries despite the uncertainties. Most Asian countries are experiencing strong economic growth with some increase in inflation, much of it in food, exacerbated by weather conditions. This has had the effect of pushing interest rates higher in Asia to combat the inflation. This will slow economic growth globally.

The current consensus forecasts of 3.5% to 4% economic growth in the U.S. for 2011 will probably come down by 1/2%, due to the aforementioned problems in the rest of the world. Keep in mind that 8.8 million jobs were lost during the great recession, and it could be several years before pre-recession levels of employment are reached. At present wages are up only 2.3% from year ago levels against a background of consumer inflation of 2.7%. This combination of slow employment growth and potential rising inflation makes it more difficult to grow the economy at more typical rates experienced in prior cycles. On the positive side, in the U.S. the manufacturing sector has been particularly strong against a backdrop of rapid export growth. We clearly see this with the rising ISM Manufacturing Index which now exceeds levels reached in the spring of 2004. The Non-Manufacturing Index (services) has also been strong hitting levels experienced back in the summer of 2005. In both indices there is strength in employment, new orders, and production. Prices are increasing with the Producer Price Index up 5.6% over the past twelve months, Import Prices up 4.3% and the Consumer Price Index up 2.7% during the same time period.

Although it might seem that the risk of deflation has abated, oil is still up 36% year over year through mid-April due to the foregoing uncertainties and the strong demand from emerging markets. As we've mentioned before, oil trading above $100 per barrel starts to act as a tax on consumption spending through its effect on gasoline and heating oil prices. We, however, do not expect the recent spike in prices to persist into the second half of the year.

Employment gains although sluggish are still moving in the right direction with monthly increases in payrolls of about 200,000. State and local governments continue to reduce their workforce to address budget deficits with losses of about 450,000 workers since peak employment in 2007. The University of Michigan's Index of consumer sentiment did edged higher in April and confirming that inflation expectations have remained unchanged with the one-year and five-year inflation expectations at 4.6% and 2.9%, respectively. Despite the headline index negatively impacted for the past two months as a direct result of increased near-term inflation expectations, we expect this phenomenon is only temporary and that consumer sentiment should improve as commodity price pressures dissipate.

Many key indicators depict an economic recovery that's intact. Despite weak building permits and housing starts in February continuing, personal income (+4.6% Y.Y.), industrial production (+5.2% Y.Y.), durable goods orders (+7.2% Y.Y.), and the leading indicators (+5.2% Y.Y.) all suggest that the economy is on its steady path of recovery. Retail sales have also been improving better than 8.0% versus year ago levels. In summary, the combination of rising inflation against the backdrop of geopolitical problems suggests some caution with respect to forecasting future economic growth. Overall, we continue to remain positive for economic growth in 2011 with a current forecast of 3% real GDP growth, a 10% gain in corporate profits and a CPI of 2.5%. Our main concern at present rests with uncertainties connected to the geopolitical problems mentioned above, rising energy prices against the backdrop of the falling dollar, and the need for continued deleveraging of the U.S. consumer.

On the positive side, the U.S. corporate sector is in great financial shape and has restructured itself for higher productivity. See our recent quarterly sales and earnings record, as it compares to the S&P 500, in the *Equity Strategy* section of this report. On a longer-term basis, the federal as well as state and local governments are finally now getting serious about addressing fiscal reform measures. We believe these initiatives will be at the center of the political debate during the 2012 Presidential election.

A Closer Look at the Financial Markets

- **Despite rising commodity prices and financial security volatility, investors continue to push the U.S. stock market higher over the past several quarters resulting in another positive return for the quarter.** The CRB Index of commodities (566) was up only modestly in the last month of the quarter, with the year-to-date through March 31st showing a marked advance of 10.6% with the S&P 500 Stock Index (1336) up 5.9% over a comparable period. Foreign stocks however, as measured by the Morgan Stanley EAFE Index (1702.25), have recovered most of the losses experienced earlier in March. Although EAFE has shown some improvement, it still lags the U.S. market with a gain of 3.5% for the first quarter.

- **Gold ($1432 per ounce) has increased 9.0% since late January, as international tensions rose over the war in Libya and other events in the Middle East.** Copper has fallen about 2.0%, suggesting that economic growth might slow from earlier projections. Looking at price changes over the past year, a clearer path emerges as the effects of the economic recovery manifest themselves. Copper is up 25.4%, gold is up 30.3%, oil is up 21.5% and the CRB Index of commodities has increased 27.3% through the end of April. Through April, the U.S. stock market has gained 8.8% as measured by the S&P 500 Stock Index, and foreign stocks are up 9.4% according to the EAFE Index.

- **Bond prices have been remarkably stable over the past year and yields have fallen slightly over the past month despite increasing inflation worries.** The 10-year Treasury bond currently yields 3.3%, versus 3.6% a month ago and 3.7% a year ago. Long-term high quality corporate bonds presently yield 6%, versus 6.1% a month ago and 6.1% a year ago. 30-year mortgage bonds now yield 4.9%, compared to 5% a month ago and 5.2% a year ago.

- **A different pattern emerges with municipal bonds because of the well-advertised problems in state and local governments.** Currently, long-term municipal bonds yield 4.9% compared to 5.2% last month and 4.6% a year ago. Much of the weakness in municipal bonds occurred at the end of 2010 as the Build America Bond program ended against a backdrop of high volume. The amount of financing has fallen significantly in 2011 with current volume running at an annual rate of $200 billion versus $400 billion a year earlier. We believe that interest rates could approach the upper end of their trading ranges in 2011, as the economy continues to advance. Municipal rates, which are higher than Treasury bonds, have probably discounted many of the anticipated problems in municipal finance. At this point, any notion of widespread bankruptcies at the state level is highly unlikely.

- **The U.S. dollar index (75.0) has stabilized since quarter end** and is now down 5.1% since the start of the year. The weakness in the dollar is probably explained by the enormous merchandise trade deficit of $647.1 billion twelve months through January, or the current account deficit of $470.2 billion, which is 3.2% of GDP according to the Bureau of Economic Analysis.

- **The U.S. equity market (S&P 500 - 1319) appears reasonably priced** at 13.8 times consensus estimates of $95 per share and we are maintaining a current asset allocation in balanced accounts of 65% equities and 25% bonds (corporate and municipal), with the remainder in cash.

Initial Thoughts on Recent Q2 Market Weakness

- **The relatively limited extent and orderly nature of the market weakness in April so far does not suggest that anything more sinister necessarily lies ahead.** At seven quarters, the duration of the expansion is still well short of the 19-quarter post-war average. And while it is typical for the pace of growth to moderate as the initial recovery matures, it usually requires an advanced stage of interest rate tightening or a major exogenous shock (usually in the form of an oil price spike) for the expansion itself to be undermined. We have obviously not yet seen the former, and the worst of the uncertainty surrounding the potential market repercussions of the crises in Japan and the Middle East arguably occurred in the first quarter - a period in which markets rose. We are not, therefore, inclined to take too bleak a view on what might come next based on cyclical factors alone. But what may be of greater cause for concern is the ongoing lack of coordination among policymakers in the world's three major economic regions.

- **In the U.S., the most consequential unknown policy remains the decision over the federal government debt limit.** Most impartial observers expect the ceiling to be lifted by August 2nd, potentially by up to $2 trillion (which would be sufficient to fund the government until after the 2012 Presidential election). But voices on both sides of the debate have become more strident in recent weeks; a growing number of House Republicans are expressing doubts about the need to raise it, while Treasury Secretary Geithner and Federal Reserve members continue to stress the dangers of playing political brinkmanship over the issue. Although it still seems far more likely that the limit *will* ultimately be raised, the small probability-high cost outcome that it is not is the obvious risk. But in the interim, perhaps the most damaging effect comes from the political uncertainty cast by the debate itself and more broadly, by the gulf between the two chambers on how to tackle deficit reduction.

- **While a poor demand environment remains a large concern by investors, tax issues have surfaced as another uncertainty.** The eventual winners and losers from an overhaul of the corporate tax system, still currently being discussed in Congress, contribute to investor anxiety. These two issues have registered a cautionary effect on businesses over the last two years. We would conclude that any signs of progress towards a grand fiscal solution should therefore be viewed as a potential catalyst to boost U.S. economic activity.

- **Similarly, the failure of E.U. leaders so far to reach an agreement on how to treat Greece and Ireland's funding needs remains a weight on eurozone equity valuations and the ongoing risk that the eventual solution could be disruptive.** In spite of the recent talk of a Greek debt maturity extension, European Central Bank Governing Council members have expressed clear reservations, suggesting that a restructuring would be bad for both Greece and the eurozone as a whole, and could deepen the crisis as the possibility that other countries will be encouraged to follow suit.

- **As the U.S. political constraints continue to hinder decisive action in the eurozone, it almost guarantees that policy will remain reactive, not proactive.** Unfortunately, it would appear that the market conditions in the eurozone will have to get worse before policymakers move forward with bolder initiatives.

- **Meanwhile in emerging Asia, monetary tightening steps remain relatively gradual.** China's interest rate hikes and reserve requirement increases have not yet had a severe impact on manufacturing activity as evidenced in the most recent Purchasing Managers Index surveys. Most central banks elsewhere in Asia have also been reluctant to tighten too sharply; both Indonesia and Korea kept rates on hold last week. Consumer price inflation has not yet reached critical levels for the region and may actually moderate later in the year if food prices remain relatively stable. The absence of more determined tightening in emerging Asia, particularly with the U.S. Federal Reserve on hold, should support the current levels of commodity prices.

Recent Economic Indicators - Positives Outweigh Negatives

(Charts and more detailed analyses are available later in this report in *"A Closer Look at Current Economic Statistics"*)

Positives

- Employment and production components continue to support positive ISM Manufacturing Index data in March, confirming the slowdown in GDP.

- The Fed reiterated in April that they will continue to maintain an accommodative policy, sighting that the recent rise in food and oil is due in part to rising demand and supply disruptions.

- Philadelphia Fed Manufacturing index moderates in April - but still a healthy pace of growth.

- The leading Index of Economic Indicators continues to indicate expansion, with an annualized three-month gain of 6.6% in March.

- We view the ongoing recovery of trade flows as a positive signal of global economic strength.

- Without further substantial increases in oil prices, the CPI should remain well below the last peak seen in 2008.

- We would expect the dollar to strengthen as QE2 (2nd phase of Fed's quantitative easing program) comes off line and interest rate differentials contract, as rates in Europe rise at a slower pace than what is currently anticipated.

- U.S. factory orders post a broad-based gain, increasing 3.0% in March.

- Labor market conditions continue to improve at a non-inflationary moderate pace and the strength in services payroll growth is an encouraging sign.

- The Fed will likely be patient when it comes to the eventual removal of policy accommodation.

- U.S. consumer confidence improved in April as well as year-to-date.

- In Emerging Asia, monetary tightening steps remain relatively gradual.

Negatives

- The GDP in the first quarter was softer than the previous quarter, but on closer examination looks transitory.

- U.S. productivity growth moderates as unit labor cost pressures increase, yet still a positive story.

- The Chicago PMI has retreated from its February high, but remains strong.

- Although the U.S. trade deficit widened in March, it should not materially change the first Q1 GDP which is tracking at an estimated 1.9%.

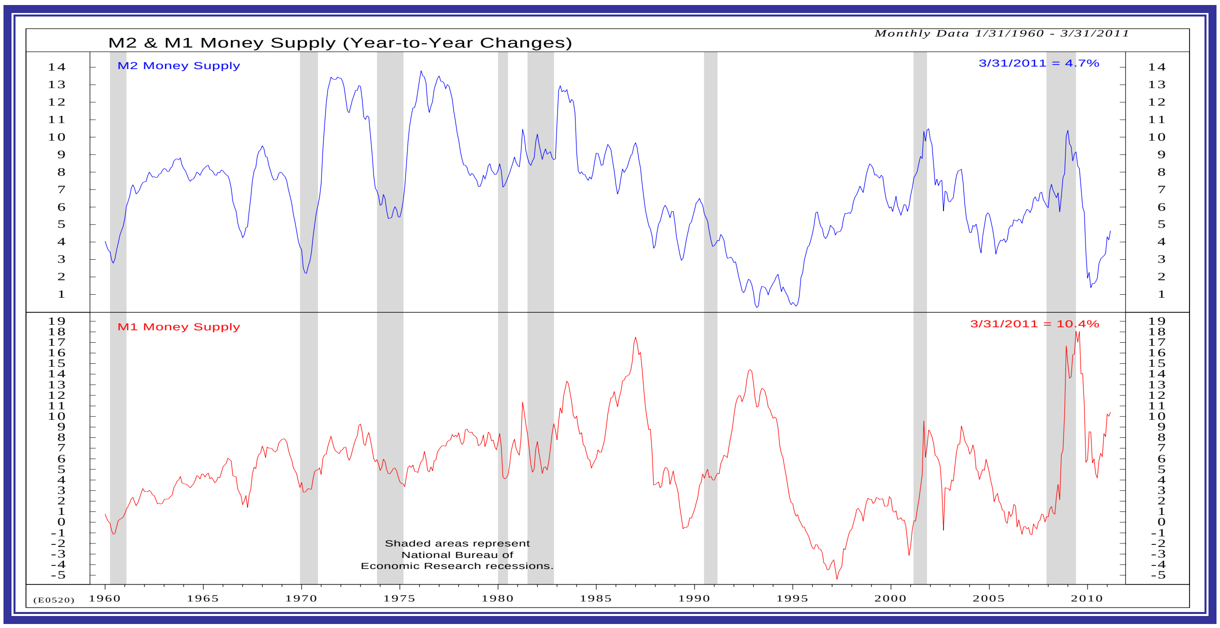
- Residential and nonresidential construction spending rebounded in March, but remains historically weak in the past quarter.

FIXED INCOME STRATEGY

Ten Year Generic Treasury Yield

Source: Altman Investment Management and Bloomberg

The heightened flight-to-quality sentiment which fueled recent gains has subsided in the past few weeks. While the Middle East and North Africa region turmoil and uncertainty in the wake of the Japanese earthquake and tsunami are likely to persist, investors have been pacified enough to refocus on risk assets. Central bank rate hikes and inflation worries have returned to center stage, boosting yields across the board. Although improving economic activity naturally correlates with higher rates, forward curves and consensus forecasts are simply too bearish on bonds, given our concerns over growth prospects. We expect that the pace of normalization via tighter monetary policy and inflation pressures will be less pronounced than markets currently expect.

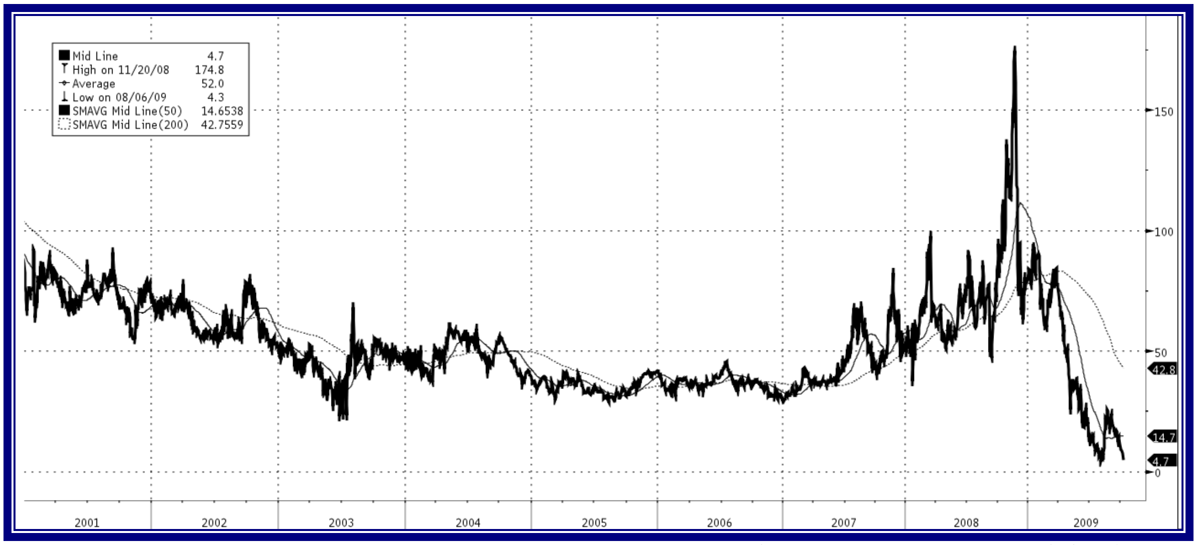


Source: Ned Davis Research

Our Interest Rate Outlook

- **We continue to recommend investors maintain a neutral duration stance, despite our expectation for higher Treasury yields over the next year.** The reason for this apparent inconsistency has to do with the interplay between the historically steep Treasury yield curve, and the "roll down the curve" effect it has on expected total returns. To review, total return can be broken down into two components—interest income and price change. Based on our forecast for a rise in Treasury yields over the next 12 months, we expect the price component of total return to be negative for all maturity points at current yield levels. However, we believe the interest component could more than offset the expected price decline for maturities shorter than 8 years. At the 8-year maturity mark and beyond, the projected price loss is great enough to more than offset the income component of total return. Assuming a one year holding period, a horizon analysis indicates that the highest expected total return would be around the 5-year maturity point, i.e. around the average maturity associated with our strategic asset allocation. Consequently, we recommend investors maintain a neutral duration stance, and favor maturities in the 3 to 5-year maturity range.

10-year U.S Agency (Fannie Mae) Yield minus 10-year Treasury Yield

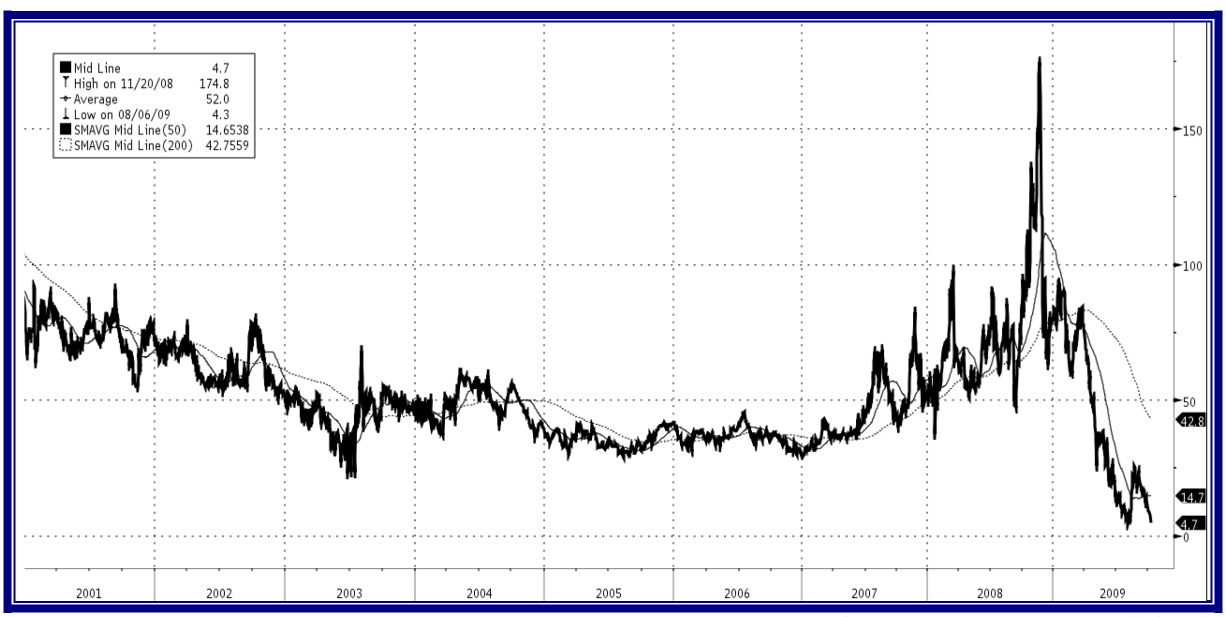


Source: Altman Investment Management and Bloomberg

Government-Related Debt/MBS

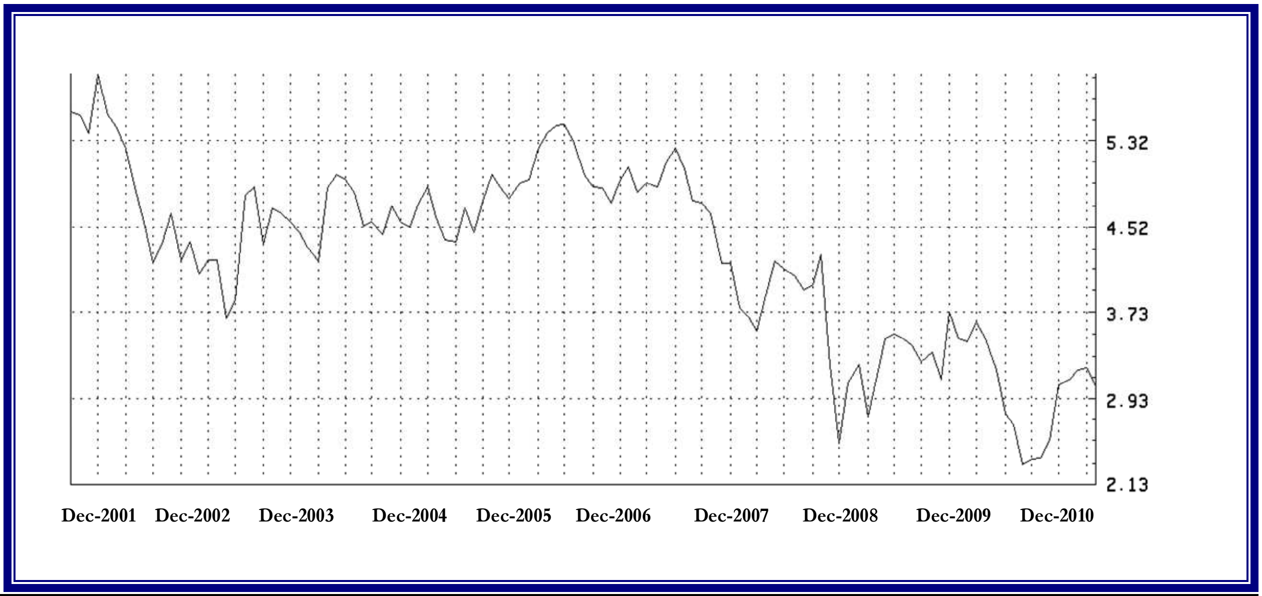
- **The U.S. Federal Reserve will not curtail its $600 billion quantitative easing program, in our view, and will continue to largely absorb the net supply of Treasuries through the end of June.** If energy prices remain elevated, we expect growth prospects to ratchet lower. Although recent data has been encouraging, it is not yet evident that the nascent U.S. recovery could sustain much higher interest rates than it currently has. Low core inflation and high unemployment still suggest the Fed won't raise rates before next year. Thus, the Treasury curve should remain steep relative to the euro zone and UK. Short-term rates will be anchored by the central bank and long rates should remain anchored by range-bound inflation expectations.

10-year U.S Agency (Fannie Mae) Yield minus 10-year Treasury Yield



Source: Altman Investment Management and Bloomberg

7-10 Year U.S. Treasury/Agency Yield

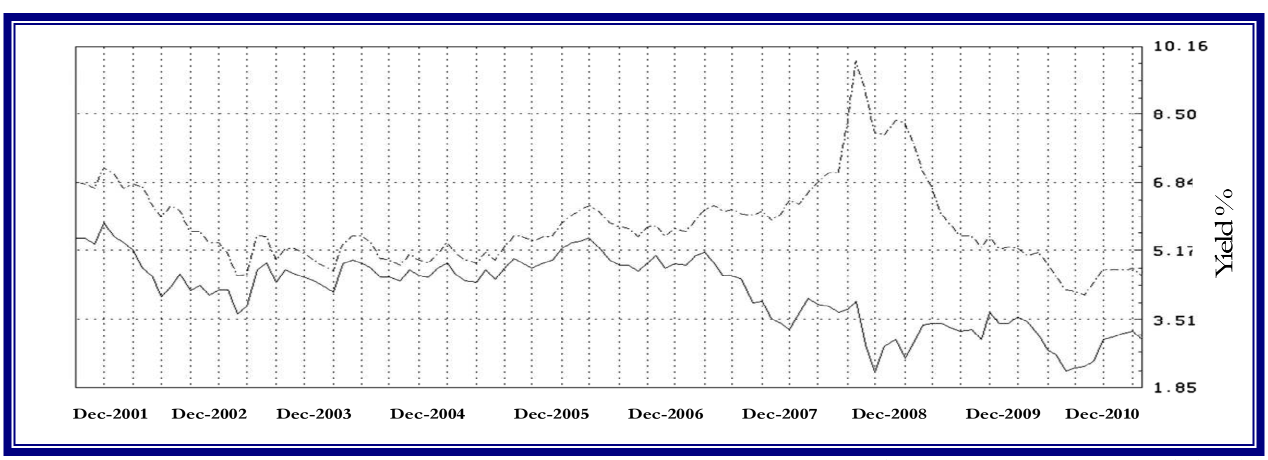


Source: Altman Investment Management and Bloomberg

High-Grade Corporate and Preferreds

- **High grade bonds have been the beneficiary of that investor preference shift.** But from nearly 20% returns in 2009 to 10% in 2010, we forecast only 2.5% for 2011. With better alternatives in equities, the flows will follow the returns fueling asset inflation in stocks. In terms of spreads, higher rates initially will lead to compression, and asset flows into equities should be positive over this period. We forecast 60 basis points of tightening, ending the year with approximately 120bps spread to Treasuries. As money market yields collapsed during the credit crisis due to monetary policy induced declines in the front end of the yield curve, investors have been forced to search for more-than-zero yields elsewhere. Debt returns having exceeded equity returns in 2009 and the first half of 2010 have attracted most of the flows out of money market funds so far. However, more recently (since September) equity returns have been higher than investment grade fixed income.

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

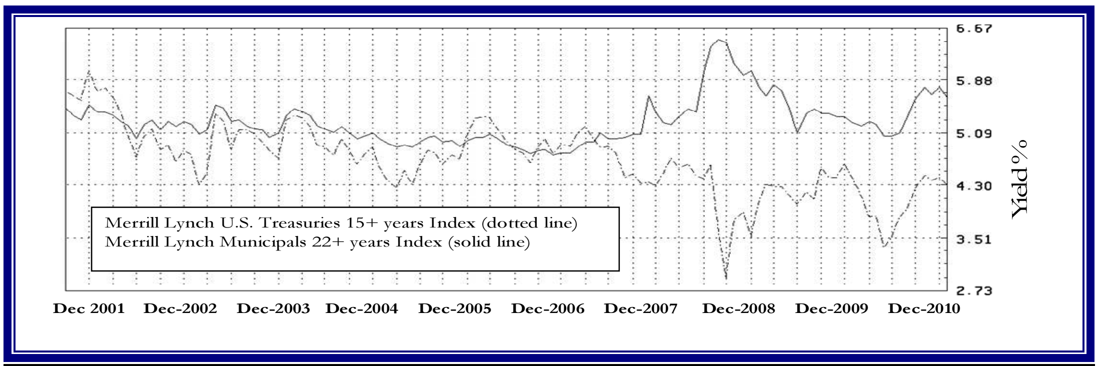


Source: Altman Investment Management and Bloomberg

- **In 2011, we expect Preferreds to primarily serve as income-generating vehicles.** We believe prices are likely to experience intra-year volatility, but end the year without significant downward deviation from these historically high averages. Preferreds have the potential to narrow by roughly 50bps, providing a cushion should Treasury rates edge higher. Our individual security recommendations are therefore focused on segments of preferreds that we believe have higher probabilities of being called such as U.S. Bank Trust Preferreds and high coupon perpetuals. For those Preferreds with a lesser chance of being called, we'd favor floaters with coupon floors since they exhibit lower interest rate risk relative to higher duration fixed coupon Preferreds.

Municipal Bonds

Long Term Municipal to Treasury Spreads



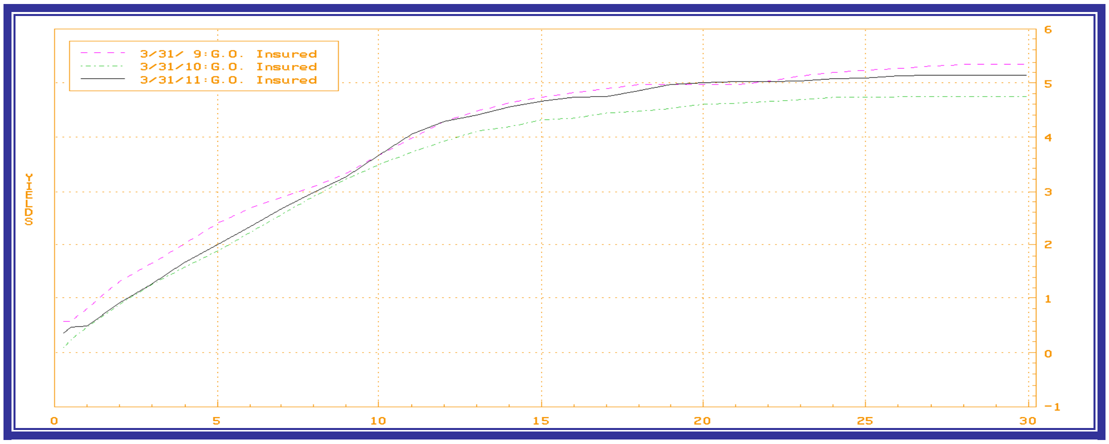
Source: Altman Investment Management and Bloomberg

- **Last year was the year of heavy new issuance.** This year has commenced with the focus on the secondary market. There has been considerable trading activity in the first days of the year. Many times in the past, this level of activity has taken place at year end. But there are a number of factors that are in the mix. Municipals have often been highlighted in the recent media and usually with a negative view. Some investors have developed new economic and rate views that will affect their approach to the business this year. Steepening of the yield curve and concerns over liquidity appear to be the current focus, even though credit concerns have often been cited as the primary preoccupation.

- **Among the groups of investors who are taking a particular interest in our market are the hedge funds.** The primary concerns have been the probabilities of default and bankruptcy. These topics have concerned all market participants to varying degrees. It is our opinion that the probability of a state defaulting is remote. On the other hand, we readily acknowledge that the budgetary challenges are very great this year. The new governor in New York has given us a glimpse of some of the actions that may be expected when the budget is formally released. Reducing Medicaid expenditures has become a clear priority but what to cut has not been spelled out or fully decided.

- **One person's cut is someone else's entitlement.** Wage freezes and hiring freezes are an often employed technique to contribute to closing budget gaps. Imposing expenditure limits on the local governments will force more discipline on the localities to comb their budgets for savings and for more efficiencies. The cap on spending growth would also serve to take some of the pressure off the continuous demand for additional state aid over time.

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



Source: Altman Investment Management and Bloomberg

Takeaway from Chairman Bernanke's Press Conference

- **As expected, the committee definitively declared that the current round of asset purchases is coming to an end,** stating that the Fed "will complete purchases of $600 billion of longer-term Treasury securities by the end of the current quarter." This is a change from previous statements, whereby the Fed only signaled its "intent" to purchase $600bn in Treasury securities, but made the completion of these purchases conditional on evolving economic conditions. The committee maintained its policy of reinvesting principal payments from securities holdings and refrained from giving any guidance about the status of this policy after the conclusion of purchases in June. They stated that the committee would regularly review the size and composition of its balance sheet in light of incoming economic information. We look to the upcoming press conference from the chairman for any guidance on the FOMC's preference about the reinvestment policy going into the second half of this year.

- **Regarding inflation, the committee acknowledged that higher oil and other commodity prices have led to acceleration in inflation,** but continues to indicate that such pressures should ultimately prove transitory and sees longer-term inflation expectations as remaining stable. In addition, the committee continues to characterize measures of underlying inflation (i.e., core inflation) as "subdued." If long-term inflation expectations were to rise to uncomfortably high levels, the chairman said "there is no substitute for action" and the FOMC would respond through a tightening of policy.

- **In response to a question about the length of time implied by the use of "extended period" in the FOMC statement,** the chairman also said that "extended period" language is conditional and is not meant to refer to a specific length of time. In particular, he said that "extended period is conditioned on resource slack, on subdued inflation and on stable inflation expectations." However, he then said that an extended period "suggests it would be a couple of meetings probably before action." We take this to mean that the removal of the "extended period" phrase would suggest that increases in the federal funds rate would likely occur in relatively short order.

- **Altogether, the statement, press conference, and updated set of economic projections tell us that the Fed will likely be patient when it comes to the eventual removal of policy accommodation.** The committee sees a modest recovery in place, underpinned by an ongoing expansion in household and business spending, and believes unemployment and inflation will only gradually return to mandate-consistent levels over the forecasted horizon. In addition, the committee is not inclined to lean against commodity price pressures, as long as inflation expectations remain stable. We view Chairman Bernanke's comments as indicating that the committee will likely decide to keep the reinvestment policy in place after purchases conclude in June to prevent a passive tightening of policy. We do not expect an increase in the federal funds rate until July 2012.

- **In summarizing FOMC participants' projections, the chairman said that the slowdown in Q1 would likely prove temporary** and was related to slower defense spending, lower exports, and weather-related dampening of construction spending. Our own view is that the slowdown is also related to the surge in headline inflation, which depressed real expenditures. Second, the chairman reiterated that participants continue to view the natural rate of unemployment as somewhere around 5.5% and that the level of economic slack remains elevated. He said that hysteresis, or the loss of job skills from extended stays on unemployment, is happening, but very slowly. We will continue to monitor changes in participants' projections for any evidence that would suggest the Fed has changed its view on the labor market. Lastly, the chairman said the main transmission channel from the earthquake and tsunami in Japan would likely occur through the supply chain, which the Fed estimates as moderate and transitory.

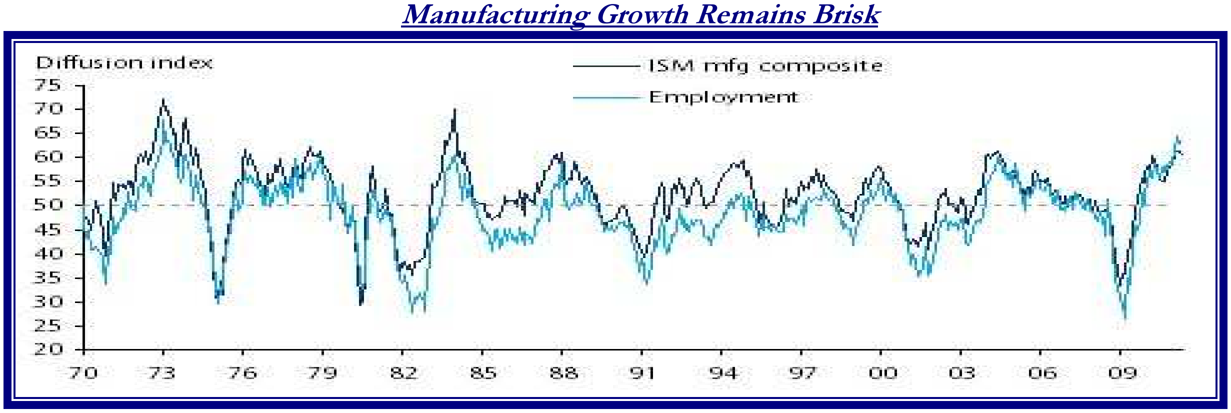
A CLOSER LOOK AT CURRENT ECONOMIC STATISTICS

- **The GDP in the first quarter was softer than the previous quarter but on closer examination looks transitory** In the fourth quarter of 2010, the GDP did beat consensus forecasts, growing at the moderate rate of 3.1%. The final number was driven by inventory investments, residential investments, equipment and software spending and non residential structures. The pace of GDP growth slowed in the first quarter of 2011 to an annualized rate of 1.8% as compared to the final quarter of last year. Recent inflationary pressures negatively impacted consumer confidence and personal spending, the latter of which slowed to a 2.7% pace as compared to a 4.0% pace in the 4th quarter. Although disappointing, the first quarter residential investment in structures was additionally hindered by poorer weather conditions as compared to the same time last year. Lastly, the drop in government consumption of 5.2% subtracted an estimated 1.1% from overall GDP growth.

- **On the positive side, the 11.7% drop in national defense spending should be at least partially reversed in the second quarter.** External demand was broadly neutral this time around, as imports and exports remained in balance during the quarter. It is important to note that the drop in state and local government spending of 3.3% reflects the ongoing budget problems that will continue to be a drag on the overall economy for the foreseeable future.

- **Although investors continue to be concerned with the prospect of a contraction in Federal spending, the recent quarter still benefited from current monetary and fiscal stimulus.** All in all, while this represents a soft start to the year for GDP growth, we are encouraged that the main sources of weakness (particularly the declines in structures investment and defense spending) are generally supportive of our view that temporary factors played a significant role and that GDP growth will rebound in Q2. Fed Chairman Ben Bernanke confirmed our view in his recent FOMC press conference, stating that those factors that hindered GDP growth in the quarter are mostly "transitory" and he concluded his remarks indicating that growth should pick up again over the next couple of quarters.

Manufacturing Growth Remains Brisk

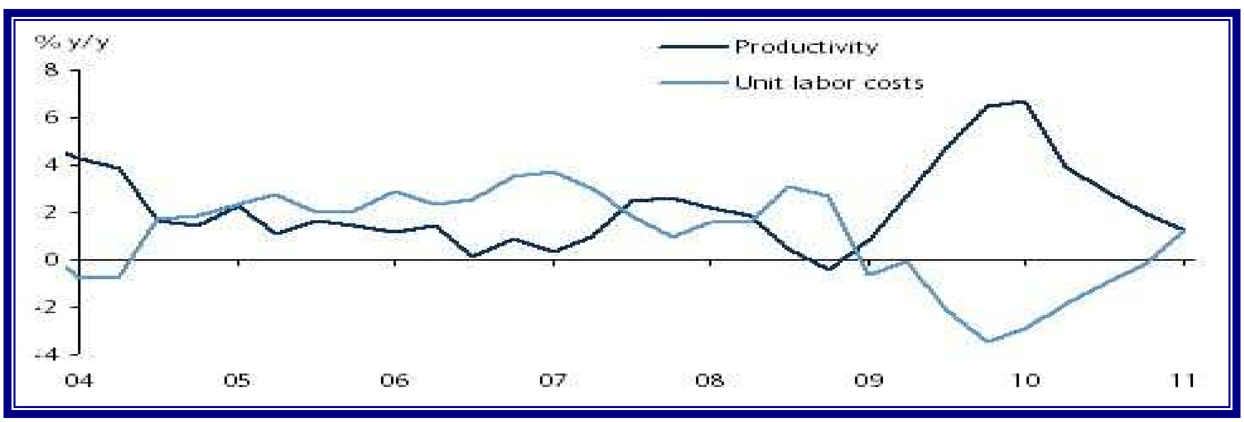


Source: ISM, Haver Analytics

- **On the positive side employment and production components continued to support the solid ISM data in March,** confirming that the slowdown in GDP realized in the first quarter should be only temporary. We remain optimistic, as long as the ISM manufacturing Index remains above the 60 mark for a fourth consecutive month and at a level consistent with GDP growth of 5% annualized. Although the ISM non-manufacturing index can be somewhat volatile as a reliable lead indicator, any coincident weak report that may signal a slow down in monthly growth in non-manufacturing industries should not overshadow the strength of this index in the first few months of the year. We are hesitant to read too much into one month's data as the beginning of a slowdown, as it may be merely a bump in the road. Despite some potential slippage in new orders index, and the production and employment index could show some near term weakness, they are still at very healthy levels.

- **We would expect the supplier deliveries index to fall to 60 from 63.1, suggesting that the short-term supply disruptions stemming from the Japanese disaster will be minimal with electric/electronic components in shorter supply.** The prices paid index is near a three-year high and suggests that the surge in commodity prices is hampering profitability. This may have the opposite effect of boosting orders, as firms try to stockpile raw materials before prices rise. Whether companies will have any success in passing cost increases on to customers is still in question. If producers are able to pass through these prices, the Fed will view this unfavorably. Overall, manufacturing is still going strong, although it can't be said for the construction sector. Admittedly, construction spending rebounded by 1.4% m/m in March, but only after a 2.4% decline in February.

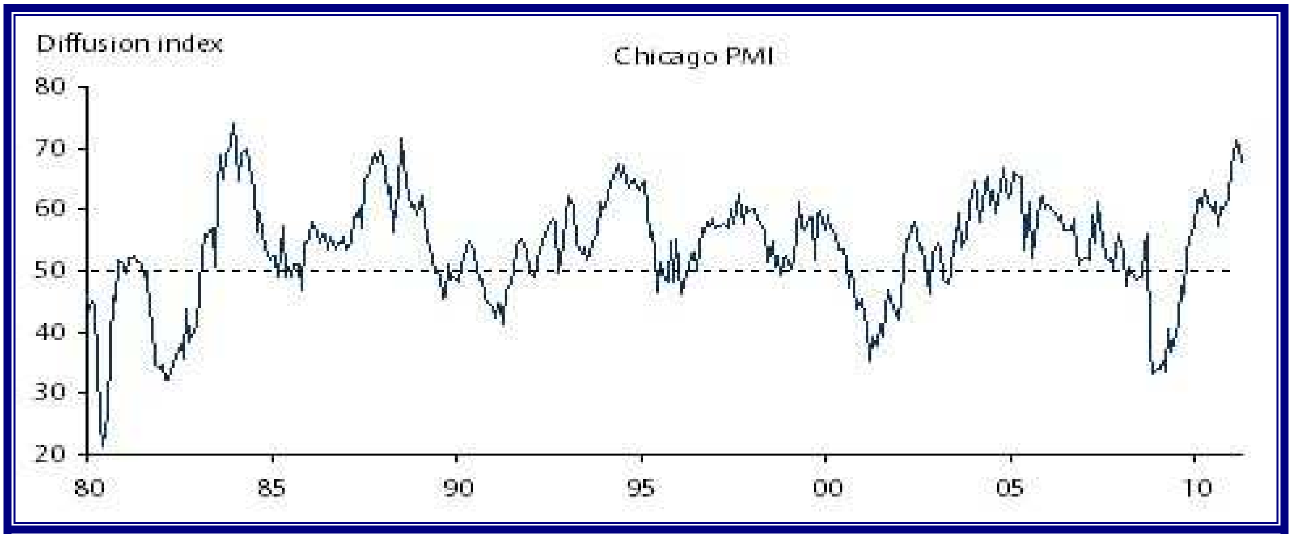
U.S. Productivity Growth Moderates as Unit Labor Cost Pressures Increase



Source: Bureau of Labor Statistics, Haver Analytics

- **US: Chicago PMI moderates in April**. The Chicago Purchasing Managers Index decreased to 67.6 in April from 70.6 in March, below our (68.0) and the consensus (68.2) forecasts. The new orders index dropped to 66.3 from 74.5, the production index decreased to 70.0 from 74.2, the employment index slipped to 63.7 from 65.6, and the order backlog index fell to 62.4 from 69.6. The only one of the five weighted components of the headline index to improve was the supplier deliveries index, which jumped to 68.4 from 62.7. The inventories index slid to 53.5 from 60.5, and the prices paid index decreased to 81.8 from 83.4. Despite the decrease in the headline index, this is a fairly strong report. The Chicago PMI surged to a 22-year high of 71.2 in February, and we are not surprised to see some moderation, bringing growth in the Chicago area more in line with the national trends seen in the ISM indices. The April Chicago PMI is still consistent with robust business growth as the overall economic expansion continues.

The Chicago PMI has Retreated from its February High, but Remains Strong



Source: Kingbiz, ISM, Haver Analytics

- **The index of U.S. leading indicators rose 0.4% in March, above the consensus forecast of 0.3%.** As expected, the gain was driven by the wide interest rate spread, a jump in building permits, and an increase in supplier delivery times. Improvement in the average work week and jobless claims also bolstered the index. A drop in consumer expectations provided some offset, along with declines in the stock market and the estimated real money supply. The Conference Board's estimates of consumer goods and nondefense capital goods orders were weaker than we had expected, summing to a modestly negative contribution. On a trend basis, the leading index continues to indicate expansion, with an annualized three-month gain of 6.6% in March.

Leading Indicators Continue to Rise

Note: Shading indicates recession. Source: The Conference Board, NBER, Haver Analytics.

A More Moderate April, but Still a Healthy Pace of Growth

Source: FRB of Philadelphia, Haver Analytics

- **US: Philadelphia Fed Manufacturing index drops in April**. The Philadelphia Fed Manufacturing index fell to 18.5 in April from its 28-year high of 43.4 in March, much further than the consensus expected. The components, which do not directly influence the headline index, were also weaker in April. On the inflation front, the prices paid index moderated somewhat, while the prices received index increased. While the headline index and many of the components were much weaker than expected, we see this as a moderation of the feverish pace of growth reported in February and March, but not a reversal of the overall trend of expansion. The April headline number of 18.5 is consistent with a healthy pace of improvement in the Philadelphia-area manufacturing sector, and more in line with national trends.

- **The Fed's 2nd Phase of Quantitative Easing Program (QE2) is due to expire in June 2011.** It is becoming increasingly evident that the Fed will most likely end its buying programs as scheduled. It remains to be seen whether this is already priced into the markets. Data underscoring the strengthening economic recovery, rising inflation and an improving job market lend support by some Fed officials that an exit strategy, or reduction in monetary accommodation, is an appropriate pre-emptive approach. We however believe that the Fed will delay tightening into 2012, as evidence that rising commodities are mere transitory events. *Capital Economics* reports that while they maintain a forecast for flat interest rates through 2012, the market expectation is for several rate hikes up to 1.5%. We believe the market's current expectation is far too severe. In fact, the Fed reiterated in April that they will continue to maintain an accommodative policy, sighting that the recent rise in food and oil is due in part to rising demand and supply disruptions.

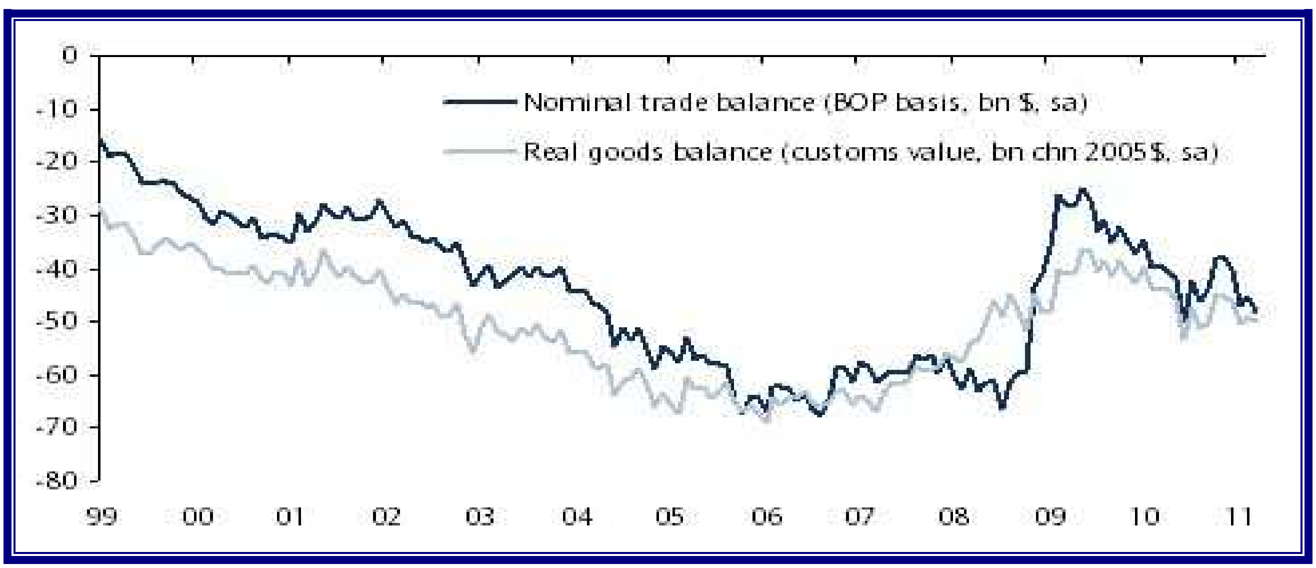
- **The Producer Price Index (PPI) did retreat in March to .7 down from 1.6 in the prior month**. Although the report was better than analysts had predicted, the level remains elevated with pressure coming from higher oil and food prices. At this level, the Fed does not consider the recent inflationary pressures as enough to derail the economic recovery. We expect oil to back off in the coming months as evidence that global growth continues to moderate. However, we do expect that the Fed's first step in relieving market inflationary concerns is to end the asset purchase program in June. Yet we do not believe this will be followed by a hike in rates until there is considerable improvement in unemployment and confirmation of the durability of the recovery.

- **Positive comments came from G-20 finance ministers and bankers in April about the broadening and stability of the recovery,** despite downside risks including the fallout from the Japanese earthquake, the price of oil above $100, Chinese monetary tightening, and European debt crisis. As a result, seven countries including the United States will face greater scrutiny by the group to ensure the global recovery underway is not derailed. The finance ministers will preemptively identify any economic imbalances and recommend the appropriate corrective policy.

- **The U.S. trade deficit widened in March but should not materially change the first Q1 GDP which is tracking at an estimated 1.9% (update).** The nominal U.S. trade deficit widened to $48.2 Billion in March, as compared to the February deficit of $45.4bn. The BEA's estimate for 2011 is 1.8%. We expect imports to climb over 5.0% in March, boosted by a surge in petroleum prices that effected close to a 14% increase in nominal crude oil imports. We expect capital goods imports to rise on strength in telecom and aircraft and automotive imports coupled with somewhat higher food prices. Consumer goods imports could dampen the picture somewhat as pharmaceuticals and apparel put some pressure on the overall numbers.

- **Total nominal exports are expected to also be strong in March**. As import price growth of close to 3.0% should outpace export price growth of an estimated 1.5%, the real goods deficit should widen more modestly than the nominal deficit. We expect this number to approximate $50 billion. Although we expect the widening U.S. trade deficit to be a modest drag on domestic growth in an accounting sense over the next few years, we view the ongoing recovery of trade flows as a positive signal of global economic strength.

The Widening Trend Continues as Trade Flows Improve



Source: Barclay's Research, Census Bureau, Haver Analytics

- **On April 18th, the S&P revised its outlook from stable to negative** on U.S. government long term AAA credit. The stock market initially traded down over 1% on the day but has stabilized. It is curious to note that both treasuries and the dollar ended the day positive on the news. The market appears to have ignored this for now, but continued congressional indecision may cause the markets to respond more negatively in the coming months.

- **Although Brent crude is trading around $122-125 /bbl, we have seen this spike before.** In the spring of 2008, oil prices hit these levels on their way to top out at $145 /bbl. Today, oil inventories are higher as is OPEC spare capacity. Supply / demand is not as tight was it was in 2008. Goldman Sachs estimates that a speculative sell-off could bring the price of the commodity back into the $105 range.

- **A rise in Gold may be no more than a response to uncertainty rather than inflationary tendencies rising above $1,500 an ounce.** The recent advance of over 5% during the first three weeks of April appears to be responding to inflationary concerns in the United States coincident with the a rise of .27% by the CRB index over the same time period. We believe the Fed's asset purchase program (QE2) ending in June elevates this concern. Rather it is the unease surrounding geopolitical events, such as the European sovereign debt crisis, the Libyan uprising, as well as the aftermath of the earthquake in Japan, that may have had a greater influence on pushing the price of gold to the current elevated levels. Higher gold prices may also be the end result of low yields realized on U.S. Treasuries.

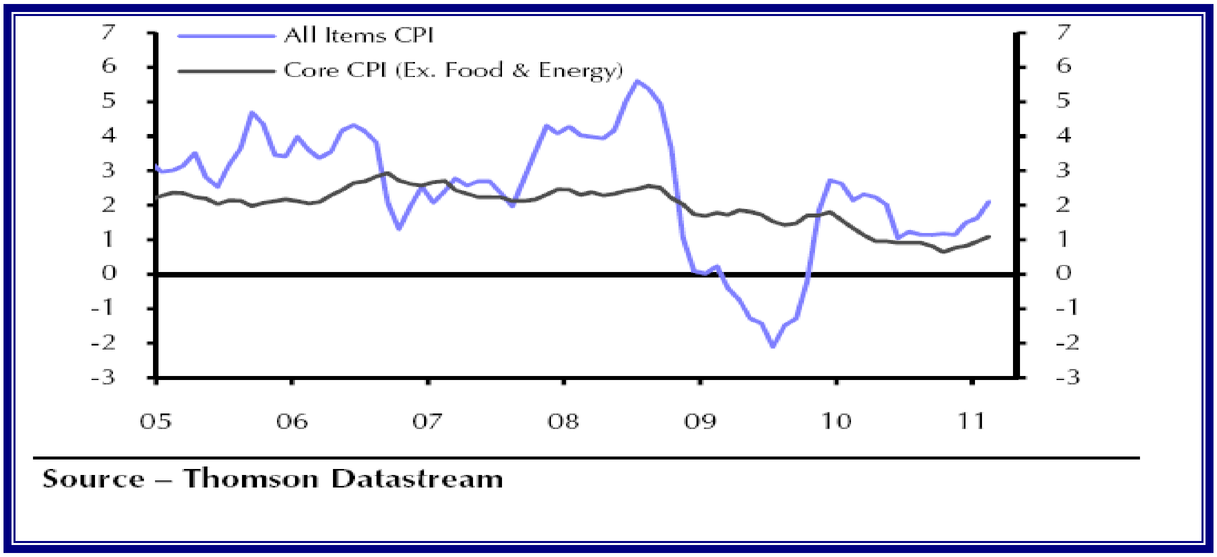
The dollar is expected to strengthen, as QE2 comes off line

Source: Altman Investment Management and Bloomberg

- **The dollar, which tends to trade inversely with commodities, continued to lose ground** throughout the first quarter of 2011, due to the extension of quantitative easing and mounting expectations for higher rates in Europe. We would expect the dollar to strengthen as QE2 comes off line, and interest rate differentials contract as rates in Europe rise at a slower pace than what is currently anticipated.

- **The Consumer Price Index (CPI) in March rose 2.7% year-over-year, while excluding food and energy inflation increased 1.2%.** The following chart of historical CPI figures helps illustrate the point that without further substantial increases in oil, the CPI will remain well below the last peak seen in 2008.

CPI - inflation (%) still moderating

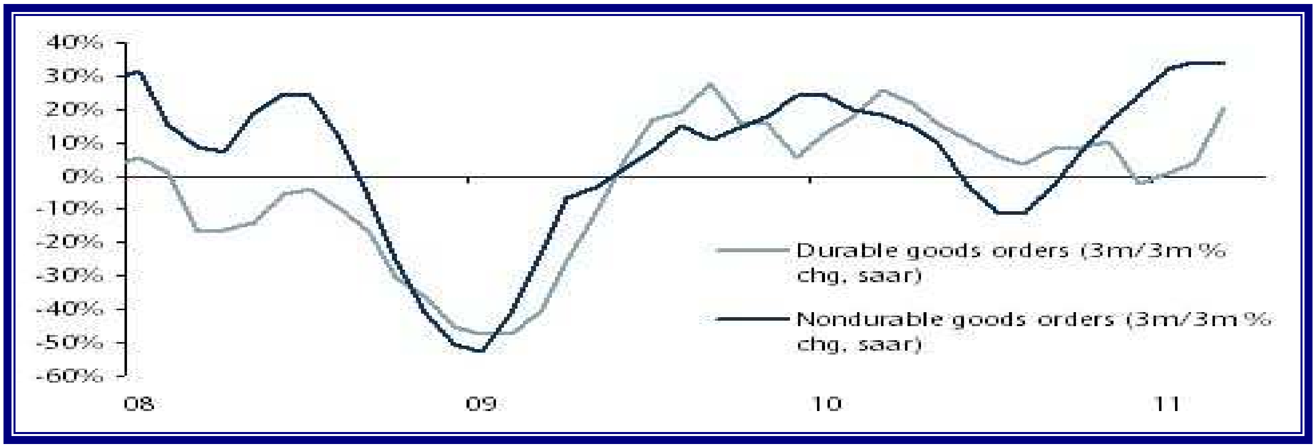


Inflation Pressures Continue to Build

Source: NFIB, Haver Analytics

- **Another broad-based rise in the U.S. is import prices,** with an increase of 2.2% in April, above the consensus of a rise of 1.8%. The rise was broad based - petroleum prices were up 7.2% with non-petroleum prices up a modest 0.6%. The latter narrower ex-fuels measurement contained strong gains in industrial supplies (5.0%) and food and beverages (1.8%), as well as smaller increases in consumer goods (0.4%) and capital goods (0.1%). On a y/y basis, headline import price inflation was up to 11.1% from 9.9%, and ex-petroleum to 4.3% from 4.1%. Some further upward pressure on core import price inflation is likely in the coming months, reflecting the weakening in the dollar and signs of domestic inflation pressures in emerging markets.

Factory Orders Continue to Grow



Source: Barclay's Research, Census Bureau, Haver Analytics

- **U.S. factory orders post a broad-based gain,** with an increase of 3.0% in March following an upwardly revised 0.7% in February (previous: -0.1%). This was above consensus forecasts of 2.0%. The strength in the headline was broad-based as durable goods orders increased 2.9% and nondurable goods orders rose 3.1%. Most major components within nondurable goods gained, with increases in food paper and chemical products. Furthermore, orders and shipments for nondurable goods were also boosted by a 7.8% pop in petroleum and coal products. However, this likely owed to rising energy prices. Total shipments increased 2.7%, the seventh monthly consecutive gain, and inventories rose 1.1%. Both core capital goods orders and shipments were revised higher over the past two months, totaling 0.8pp and 0.2pp, respectively. This was a broadly favorable report and suggests slightly stronger equipment and software spending in Q1 than was previously expected.

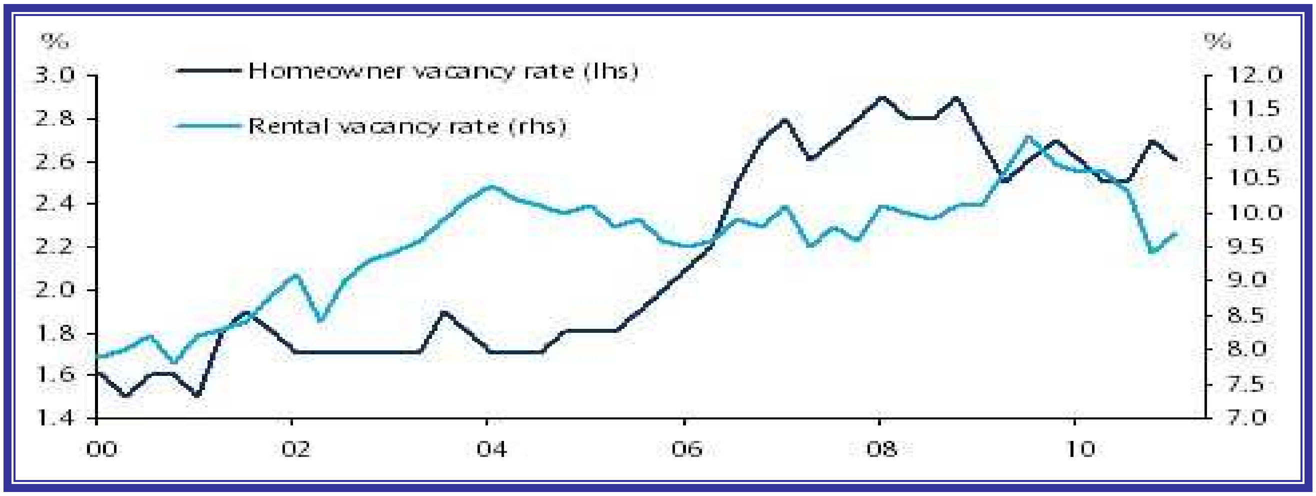
Core Capital Goods Orders Continue to Expand, but at a Slower Pace

Source: Census Bureau, Haver Analytics

- **The improvement in core capital goods orders and shipments in March is a reassuring signal** that equipment and software spending continues to expand, though the figures do not change our yearend forecast of 3.0% annualized real GDP growth in 2011. All in all, while this represents a soft start to the year for GDP growth, we are encouraged that the main sources of weakness (particularly the declines in structures investment and defense spending) are generally supportive of our view that temporary factors played a significant role and that GDP growth will rebound in Q2**.**

Construction Markets Remain Weak

Homeowner Vacancies are as High as a Year Ago, while Rental Vacancies have Fallen



Source: Census Bureau, Haver Analytics

- **U.S. homeowner vacancy rate remains elevated** .The homeowner vacancy rate slipped to 2.6% in Q1 from 2.7% in Q4. Though the rates are not seasonally adjusted, quarter-to-quarter comparisons could be misleading, returning to the middle of the 2.5-2.7% range that has held since the beginning of 2009. Despite the overall for first quarters 2010 and 2011 are even, homeowner vacancy rates in the Northeast and Midwest are still up compared with a year ago. While availability of vacant homes has retreated from its peak of 2.9% in late 2008, it is still well above the 1.6% average of 1985-2005. The rental vacancy rate is still high at 9.7%, but lower from the first quarter 2010 when the national rental vacancy rate stood at 10.6%. Slack in the rental market has diminished considerably, as evidenced by the 1.3% rise in the CPI rent index from its trough in February 2010 through the most recent report. We expect this trend to persist as the economic expansion continues.

Underlying Home Sales Index Recovers Further

Source: NAR, Haver Analytics

- **We look for the housing market to recover further in the near term, albeit at a gradual pace, as the economy continues to grow.** U.S. pending home sales increased 5.1% in March, above consensus estimates of 1.5%. On a y/y basis, however, the index declined 11.4%. This likely reflected the dissipating effects of the government stimulus on the housing market, which boosted activity in the February-April period of last year. On closer examination, the strength in March was primary concentrated in the South where pending home sales increased 10.3% m/m. The Midwest and West also made positive contributions, increasing as much as 3.0%. However, pending home sales in the Northeast fell again 3.2%. The data is broadly consistent with the strength seen in March mortgage applications. Despite some volatility over the past few months, the March report indicated that pending home sales have continued on an upward trend after the trough in June of last year.

Residential and Nonresidential Construction Spending Rebound in March but Remain Weak in Q1

Source: Census Bureau, Haver Analytics

- **U.S. construction spending rebounded in March, but underlying new home construction remained weak.** Construction increased 1.4% m/m in March, much stronger than we (0.3%) and the consensus (0.4%) expected, although some of the strength relative to our forecast came from a further downward revision to the February data as construction spending is now estimated to have declined 2.4% in that month versus the original 1.4% estimate. Both residential and nonresidential construction spending rose in March, with residential spending rising 2.4% and nonresidential spending rising 0.9%. The rebound in residential construction spending mirrored other March data on the housing sector and retraced some of the 6.9% decline in that series in February, suggesting that some of the weakness to February's construction activity may have been weather-related.

- **However, new housing construction was down 1.1% on the month,** with single-family construction falling 1% and multi-family construction spending falling 2.2%, suggesting that a boost to remodeling spending was behind much of the rebound. Total private construction spending was up 2.2% on the month, much stronger than our forecast, and the increase was broad-based as private residential (+2.6%) and nonresidential (+1.8%) spending rose. Public construction spending also rose a modest 0.1% after declining for five consecutive months on weakness in state and local construction put in place. Today's report, plus the downward revisions to the February numbers, presents a slightly better outlook for construction spending than the BEA had forecasted in its first release of Q1 GDP; we have increased our tracking estimate to 1.9% for the quarter.

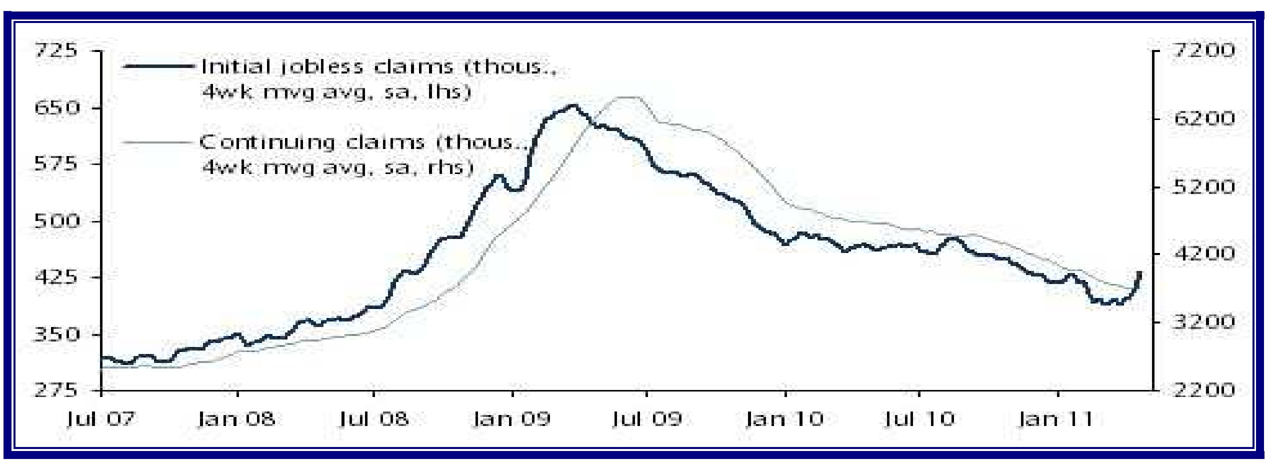
S&P / Case-Shiller Composite 20-city Home Price Index still Down 3.3% Year-on-Year

Source: S&P / Case-Shiller, Haver Analytics

- **While this is the eighth consecutive monthly decline in the series,** the monthly declines in November through February are more modest than those observed between August and October of last year. This suggests that the weakness in home prices following the expiration of government stimulus last year continues to abate. In the near term, we see the fading of post-stimulus weakness as having run its course. We expect home prices to continue to face headwinds from the large pipeline of foreclosures entering the market. For example, distressed sales accounted for 40% of existing home sales in March, and some of the more recent weakness observed in other national home price indices may begin to show up in the S&P / Case-Shiller 20-city home price index as a result of its three-month moving average construction. We expect the share of distressed properties to decline gradually over the course of the year. In addition, some of the downward pressure on home prices nationally should be offset by increased housing demand from an improving job market.

U.S. Employment: Moderate Improvement in Longer Term Trends

Initial Claims Surge, Returning the Four-week Average to January Levels

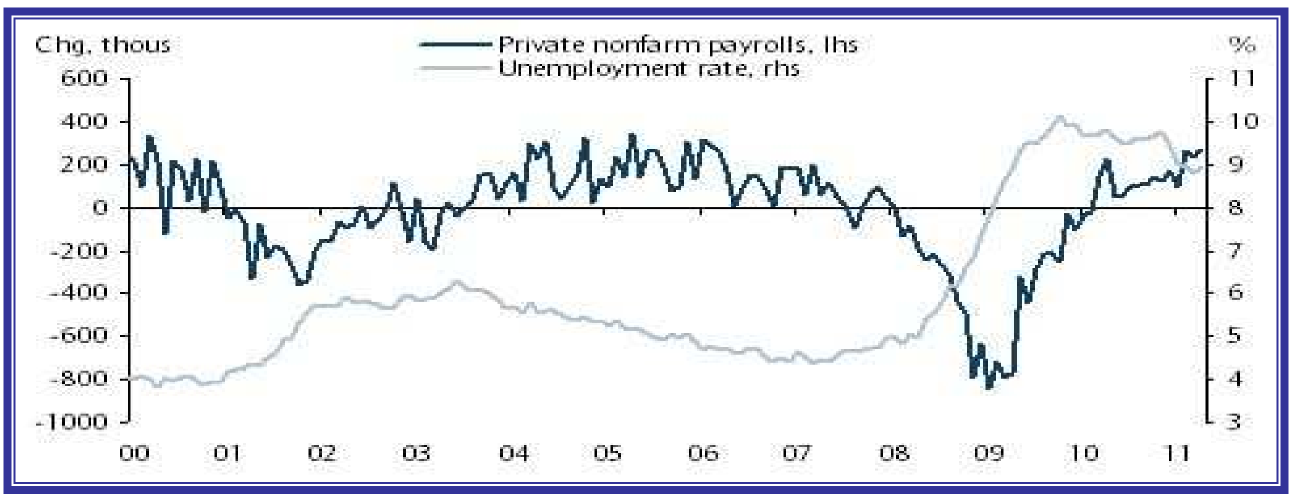


Source: Department of Labor, Haver Analytics

- **Jobs growth was slightly weaker in April, with payrolls increasing by around 175,000,** down from the average rise of 200,000 in the previous two months. This may not be enough to reduce the unemployment rate from 8.8% in March. Meanwhile, we don't expect to see any significant evidence that higher consumer prices are feeding through into faster wage growth. U.S. initial jobless claims rose and remain above 400k for the third straight week. Initial jobless claims rose to 429k in the week ending April 23, and were unexpected with consensus expectations closer to 395k. The trend in initial claims data clouded by seasonal-related volatility still obfuscates the health of the labor market. Therefore, we are hesitant to reverse our labor market forecast based on the recent increase in claims data, until we can determine that the uptick in claims is a sign that the labor market is losing momentum.

- **On a trend basis, labor market conditions continue to improve at a moderate pace and the strength in services payroll growth is an encouraging sign** that job creation is becoming firmly entrenched. Moderate recoveries are often choppy and it is rare to have all indicators pointing in one direction at the same time. We continue to expect that the softness in recent data and in Q1 will be transitory and not reflective of a change in the overall course of the recovery. The mixed nature of the recent employment report and the choppiness in incoming data are also likely to keep the Fed patient when it comes to executing its exit strategy. We continue to expect the Fed to maintain the reinvestment policy into the second half of this year, before letting its balance sheet passively shrink.

Solid Payroll Growth, but a Drop in Household Employment, Pushes the Unemployment Rate to 9.0%

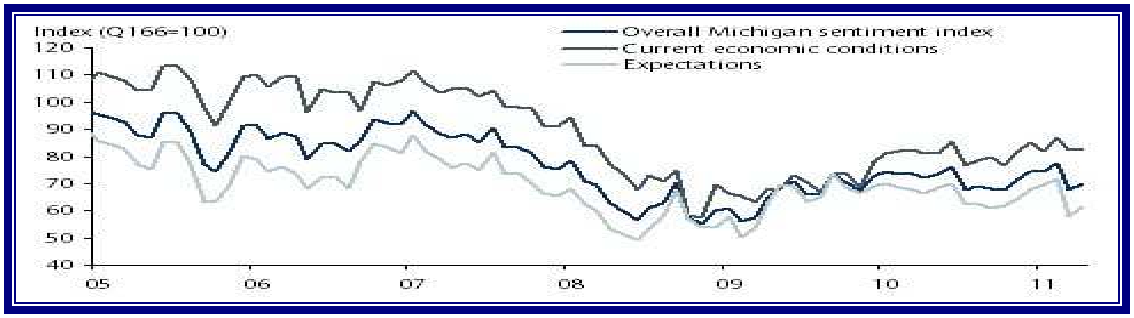


Source: BLS, Haver Analytics

Consumer Sentiment

- **Personal Consumption edged up in February** (March 28 report) due to higher oil prices and auto sales. We will need to see a stronger advance in personal incomes, and inflation kept in check, for the consumer sentiment to continue to strengthen further. For that to happen we will need to see an improvement on the employment front that lifts personal income levels in both absolute and relative (to inflation) terms.

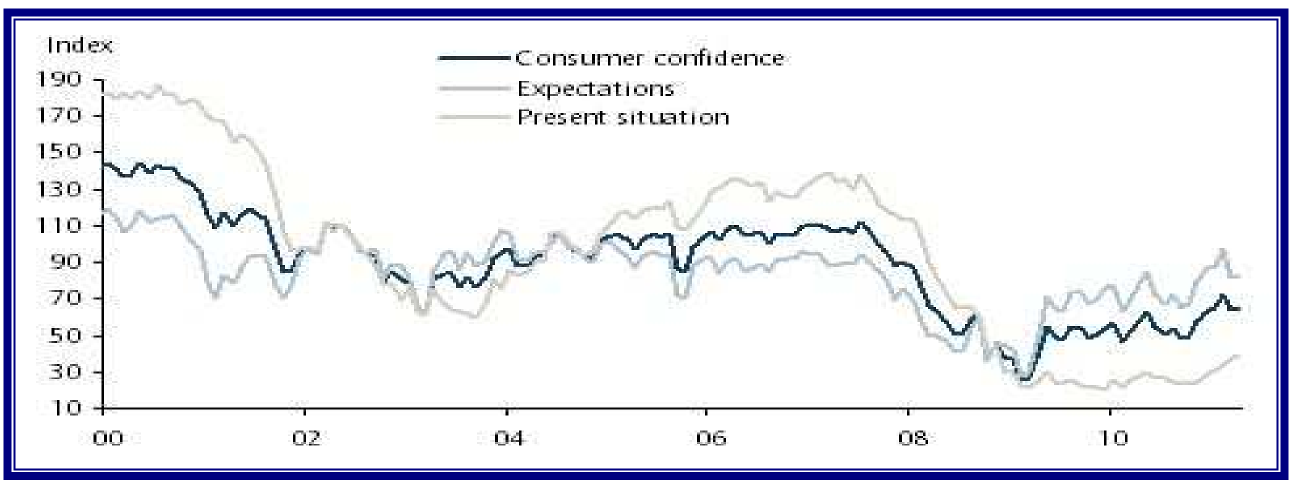
Consumer Sentiment still Below February Reading



Source: University of Michigan, Haver Analytics

- **U.S. consumer sentiment sees little change in the April final report.** The University of Michigan's index of consumer sentiment edged slightly higher to 69.8 in the April final release. The slight increase in the headline index owed to an uptick in expectations to 61.6 from 61.2 previously. The index of current conditions dipped slightly lower to 82.5 and inflation expectations remained unchanged with the one-year and five-year inflation expectations at 4.6% and 2.9%, respectively. The headline index has been fairly depressed for two months after falling from February's level of 77.5. This has been a direct result of increased near-term inflation expectations attributed to recent increases in gas prices. However, we expect this to be temporary and for sentiment to improve as commodity price pressures dissipate.

The Present Situation Continues to Improve



Source: The Conference Board, Haver Analytics

- **U.S. consumer confidence improves in April.** The present situation index increased to 39.6 from 37.5, the highest since November 2008, as pessimism regarding present business conditions waned and the labor market differential (jobs plentiful *less* jobs hard-to-get) rose. The expectations index also rose to 82.6 as improvement in expected personal income outweighed moderation in expected labor market and business conditions. After a dip in March, the April report confirms that the recovery in consumer confidence has not been derailed, despite volatility in commodities and the stock market. The ongoing improvement in labor market perceptions is especially encouraging, and we look for consumer confidence to continue to build with ongoing payroll expansion. Forecasts for a continued decline in the unemployment rate which should help with confidence, but pressures from the housing sector remain a burden to consumers.