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Investment Commentary

January 31, 2011

For several weeks, we have suggested that the macro market backdrop has been dominated by global bullish forces in conjunction with localized bearish ones, a description that largely explains last week's stock market action. Early in the week, headlines surrounding European debt issues and US municipal budget concerns faded somewhat, and risk assets (particularly stocks) experienced strong performance. Toward the end of the week, the Egyptian protests and resulting political turmoil unnerved investors, causing stock markets to experience a sharp decline. Stocks were down for the week, with the Dow Jones Industrial Average experiencing its first decline after eight weeks of gains, falling 0.4% to 11,823. The S&P 500 Index and the Nasdaq Composite also declined, losing 0.6% to 1,276 and 0.1% to 2,686, respectively.

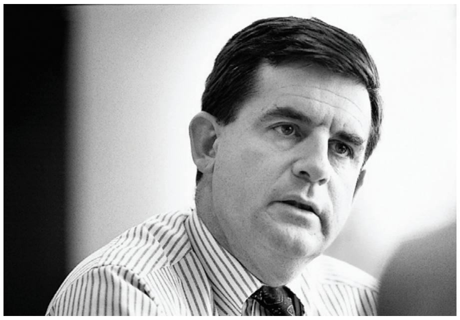
The situation in Egypt has reminded investors that geopolitical risks are always present and in this case uncertainty is high, both in terms of what will happen and what the potential impact will be. Investors are questioning whether any degree of calm can be restored, what the political future of Egypt will be, how stable the government is (and will be) and, of course, whether the unrest in Egypt will spread to other parts of the Middle East.

Meanwhile, back in the United States, the preliminary fourth-quarter 2010 gross domestic product (GDP) report was released, showing that the US economy grew at an annualized 3.2% rate, representing an acceleration over the third quarter. Importantly, many of the details within the report were stronger than the headline number. Final sales increased by an annualized 7% rate, consumer spending advanced by 4.4% and strength also emanated from export increases and business equipment and software spending.

So far, economic growth in the first quarter of 2011 has been negatively impacted by a rash of bad weather in many parts of the United States, but we believe that the positive momentum from the fourth quarter means that any disruption is likely to be only temporary. We continue to expect overall 2011 GDP growth to be on the order of 3.5%. Getting to that level will require less restrictive bank lending policies (which we have begun to see) as well as improvements in the labor market (which we are expecting to see).

In this environment of improving (but still fragile) economic growth, many are wondering when the Federal Reserve will consider adopting tighter monetary policies. In our view, the Fed appears to be awaiting economic growth that is stronger than 3.5%, a more significant decline in unemployment and rising expectations for inflation. In our opinion, we are still quite a bit away from such an environment.

Last week also featured President Obama's State of the Union address to Congress. In his remarks, the President reiterated many of the points he has been raising over the past several months, but he did not offer much that was new in terms of economic policy. The White House appears to be betting that it can appeal to political centrists by upping



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the use of free market rhetoric, making some personnel changes and highlighting meetings with business leaders without actually proposing significant policy changes. One striking absence from the State of the Union address was a focus on rising deficits – high levels of deficits was an important political point in last November's midterm elections, and it was somewhat surprising that this issue was not more prominently addressed in President Obama's remarks.

At present, most investors appear to have increased their expectations for global growth and for growth levels in the United States. The words "double dip" have virtually vanished from investors' vocabularies and while we agree with the generally optimistic tenor of the conversation, we are also somewhat uneasy about the positive shift in sentiment and growing sense of complacency. As last week's events remind us, there are a number of risks to be wary of, including one we have not yet mentioned – monetary tightening in emerging markets. While we continue to believe that the global bullish forces will dominate market action over the course of this year, we also believe that at some point we will experience a market pullback, and the declines toward the end of last week may represent the beginning of one.

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