

Second Quarter 2010
Investment Commentary



Investment Insight
Fiduciary Focus



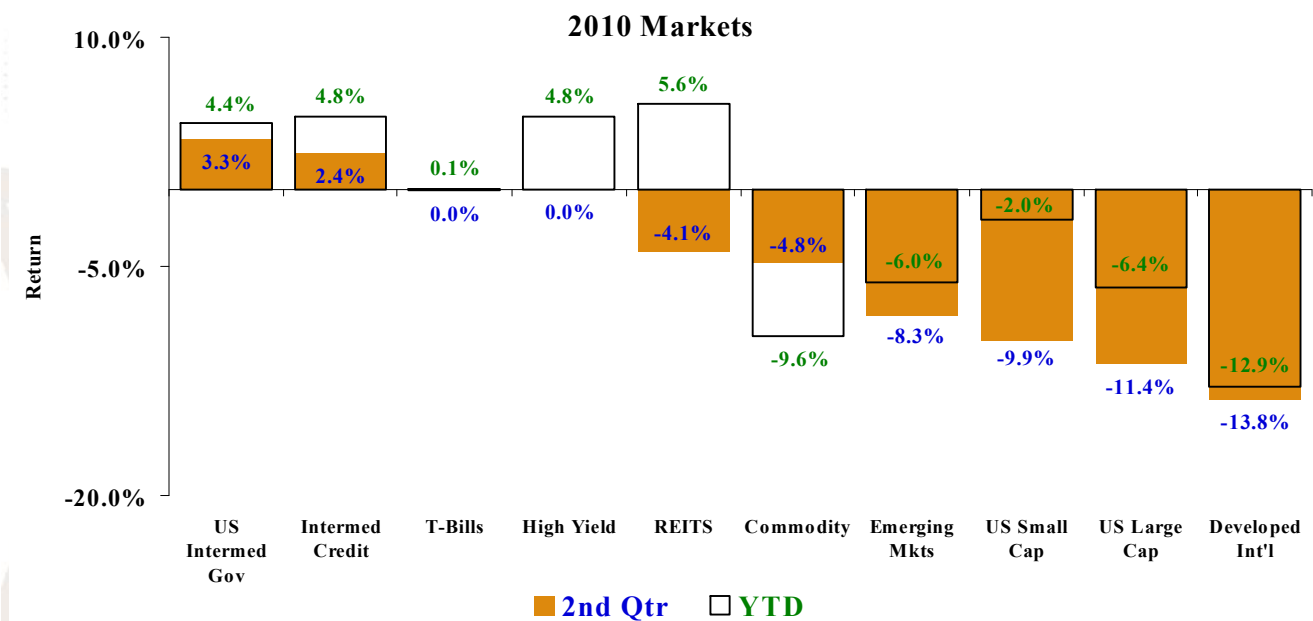
After a remarkable rebound from the 2008 financial crisis, volatility returned during the second quarter of 2010 prompting investors to seek safe haven in Treasuries and gold. Investors’ major concerns triggering the quarter’s rise in risk aversion included;

- slowing US economic momentum, possibly indicative of a double dip recession rather than a typical early recovery cycle setback,
- the risk of another calamity in the global financial system because of the European debt crisis, and
- China’s ability to sustain its growth in the face of rising wages, an appreciating currency and a housing bubble.

Global equities lost about -12% for the quarter (-9.1% YTD), with international stocks underperforming US stocks. Most bond sectors posted gains for the quarter with long duration US Treasuries adding over 12%. Most commodities lost ground with the exception of gold. The average pension plan portfolio lost about -5.6% for the quarter leaving it -2% lower in 2010. Falling yields further eroded pension plan surplus positions, though new legislation will provide some funding relief for plan sponsors.

US Stocks Slide as Economic Signals Weaken

After four consecutive quarters of positive performance and a strong start to the second quarter, US equities succumbed to escalating concerns about the possible contagion from the Greek debt crisis, a brief but still undiagnosed market crash on May 6 and weakening domestic economic signals. By quarter end the much followed ECRI *Weekly Leading Index* (WLI) which forecasts cyclical turns in growth by measuring key drivers of the economy like credit, inventories and profits, turned negative indicating a recession risk. Another widely followed index, The Conference Board, *Consumer Confidence Index* which had been on the rise March, declined sharply in June. Even the Federal Reserve downgraded the status of US economic recovery.



As a result, US equities lost -11.3% (-6.1%YTD) for the quarter per the Russell 3000 Index. Large capitalization stocks lost -11.4% for the quarter (-6.4% YTD) according to the Russell 1000 index. Large US multinationals were perceived by investors to be hardest hit by the new European austerity programs and the impact of a stronger dollar on exports and overseas revenues. In addition, large oil companies were hit by the Gulf of Mexico environmental disaster while financials sold off on fears of the “too big to fail” financial reform. Small cap stocks, with substantially less international business exposure, lost less than large cap stocks. The Russell 2000 fell -9.9% (-2% YTD).

Growth stocks generally underperformed value stocks in 2010 as might be expected when growth estimates are revised downward, though the performance differential was smaller through the second quarter than the first. As in many “flight to quality” regimes, equity correlations were high during the quarter. Materials (-15.7%), financials (-13.6%) and energy

(-13.2%) lead quarterly losses while utilities (-4.8%) and telecom (-5.7%) outperformed the index. Performance results for active managers were mixed this quarter as international diversification continued to detract and strategies levered to an economic recovery also fell behind. Value strategies and non capitalization weighted portfolios performed relatively better.

Commodities fell this quarter, another victim of concerns about flagging global economic growth. The Dow Jones UBS Commodity slid -4.8% this quarter, down -9.6% YTD. Aside from the gold reaching a new high during the quarter (\$1,246 per ounce), the oil spill in the Gulf of Mexico was the other big commodity story. While this event had little impact on spot prices, it is reasoned to have a longer term impact due to heightened compliance and environmental costs associated with drilling. Real estate fell in sympathy with the general concerns driving stocks for the quarter but by a lesser degree. REITS bounced back from last year’s lows as investors tried to get ahead of the expected recovery in commercial real estate in 2011. Apartment REITS continued to lead the sector as foreclosed real estate owners become renters. Hedge funds, the ultimate actively managed investment vehicles, had a difficult quarter losing -2.9% (.2% YTD) according to the Hennessee Hedge Fund Index.

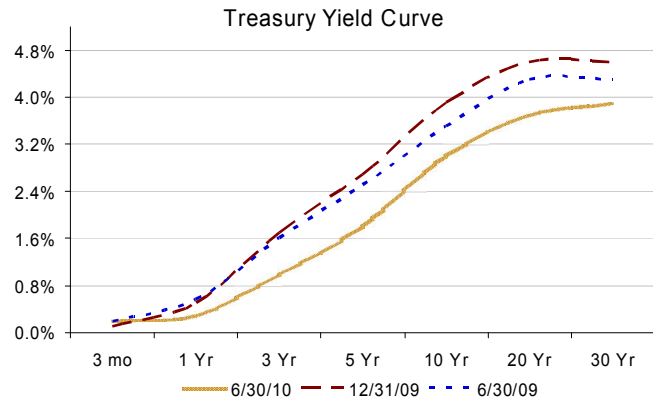
International Stocks Burdened by Euro Debt and China Growth

Concerns over European sovereign finances, particularly countries like Greece (-39%), Portugal (-21%), and Spain (-22%) which were downgraded by S&P, drove international equity returns down for the quarter. Even the \$1 trillion joint EU-IMF rescue package designed to avert a sovereign debt crisis met with market skepticism. The international developed countries markets lost -13.8% over the quarter (-12.9% YTD) per the MSCI EAFE index. The major developed countries which generated positive first quarter returns fell behind during the second quarter (Germany -15%, France -21%, UK -14%) based on the contagion effects from sovereign debt issues and the decline of the euro. International emerging markets were not spared as the world’s largest economies were perceived to be slowing. The MSCI Emerging markets index lost -8.3% for the quarter (-6% YTD). Chinese market losses steepened during the second quarter amid concern about a property bubble and the consequences of government action on economic growth. Commodity sensitive countries lost ground over the quarter as well (Brazil -15%, Russia -15%).

Bonds Provide Diversification Benefits

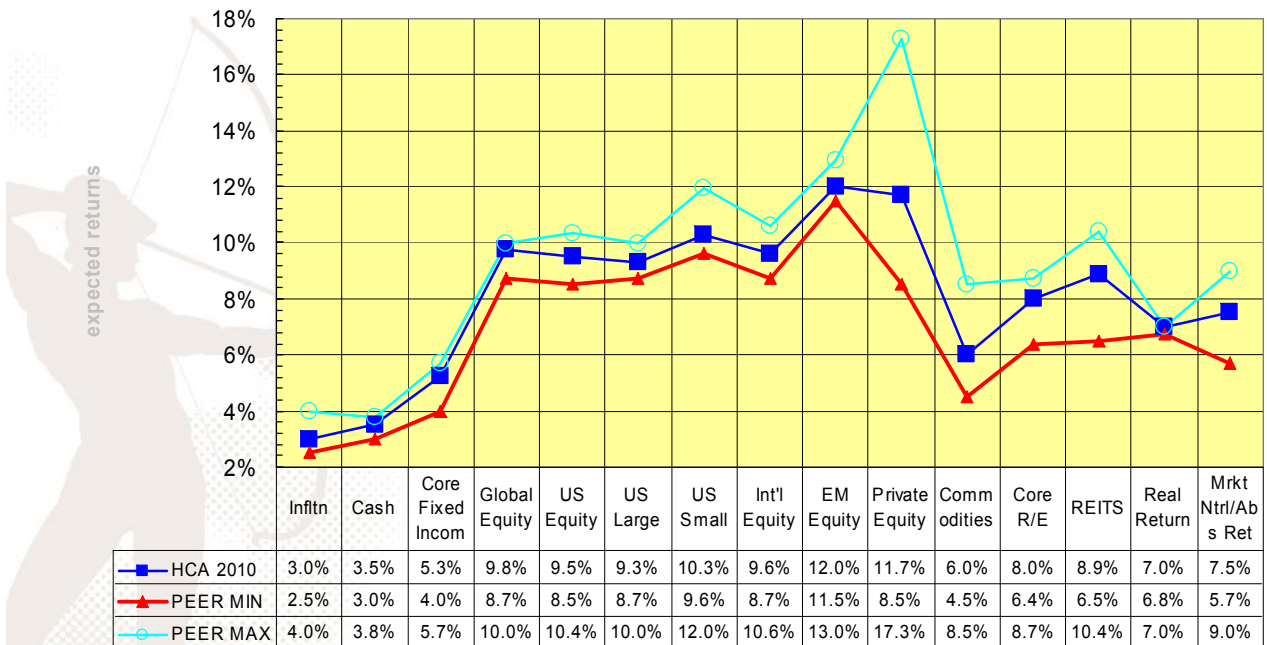
Facing mounting uncertainty, investors cut their risk exposure and moved into safe assets such as gold and bonds. The demand surge drove bond yields down providing solid returns for the highest quality fixed income sectors.

By the beginning of the second quarter, 10 year Treasury rates had risen to nearly 4%. By June 30th they closed at under 3%, the lowest since late April of 2009 when investors were most bearish about a global recovery. The Barclays Intermediate US Government index added 4.8% for the quarter as a result. Meanwhile, 30-year long bond yields fell over .80%, generating a 12.2% quarterly return per the Barclays US Long Treasury Index. Further down the yield curve, the two-year note, the Treasury maturity most sensitive to expectations about the future of short-term interest rates, traded at 0.61%, comparable to the lows touched in the peak of the financial crisis. The sell-off in risky assets has driven spreads in credit to more attractive levels. Many active fixed income managers underperformed this quarter as spread sectors and international bonds underperformed.



2010 Capital Market Assumptions

Investing has always been a matter of time horizon. This principle is fundamental to the capital market assumptions that drive our asset allocation and retirement planning strategies. We develop our capital market return assumptions utilizing a building block approach. We start with a projection of inflation for the next 10 years. Then, a Treasury curve is estimated (from T-Bills to long term Treasury securities). Based upon this projected Treasury curve, credit spreads are then developed for both domestic and international bonds. Finally, based upon the credit-spread curves developed, we estimated returns for risk assets such as domestic and international equities. Relational analysis is performed within asset classes and across asset classes to ensure proportional risk premiums are reasonable and consistent with historical norms. Finally, we survey the capital market assumptions of the leading consulting firms and money manager (Peer) to ensure our estimates are not outliers.



The time horizon we use for these capital market assumptions is an “any ten year period” meaning they represent equilibrium markets covering full market cycles. This time horizon is consistent with the long-term strategic nature of most active pension plans but may not be suitable for every plan or every individual retiree. In fact, one of the risks all investors face in forming expectations based on the historical behavior of the global economy and capital markets is that the future will not in some large way reflect the past. We are especially cognizant of that risk in the near term as the economy and capital markets face the unprecedented credit strains, mounting regulatory burdens, socialization of debt and deleveraging as a result of the global financial crisis.

When looking at asset allocation models or retirement planning models investors must have clear sense of their investment horizon and, particularly now, should examine the full range of possible outcomes and apply some subjective overlays which address the risk of forecasting error.

Pension Plan Funding Relief

On June 25, President Obama signed into law the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act. The law provides funding relief for defined benefit pension plans. Under the new law, plan sponsors may elect to extend the funding amortization period from a 7-year period to either a) a 9-year period with the first two years being interest only, or b) a 15-year period. Notification to participants and additional contributions are required if the plan sponsor makes excessive employee or shareholder payments. The relief is available for a four year period, 2008-2011, and a plan sponsor can elect relief for up to two of those years.

The new law allows plan sponsors to use the 2008 funded status in determining the applicability of certain benefit restrictions in 2009 and 2010. This includes the automatic benefit freeze when the funded status falls below 60%, as well as the availability of the social security level income form of payment.

SEC Proposes Additional Target Date Retirement Fund Disclosures

In June, the Securities and Exchange Commission proposed several changes to help clarify the meaning of a date in a target date fund’s name and enhance the information provided to investors in these funds as they invest for retirement. The changes proposed by the SEC would enable investors to better assess the anticipated investment glide path and risk profile of a target date fund by;

- requiring graphic depictions of asset allocations over the life of the fund and a statement noting when the fund’s asset allocation eventually becomes final, and the components of the final asset allocation in fund advertisements,
- disclosing a fund’s asset allocation at the target date adjacent to a target date fund’s name in an advertisement, and
- providing a statement in fund marketing materials which informs investors of the particular risks and considerations relevant to their decision to invest in a target date fund.

The SEC is seeking public comment on the rule amendments for a period of 60 days.

I hope you are having a pleasant summer.

Sincerely,

Timothy C. Burns, CFA
Hunter Capital Advisors, Inc