SEPTEMBER 2009 QUARTERLY RESEARCH REPORT

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Report Overview

Goal of the Quarterly Research Report

The whole point of providing advice for a living is to give good advice. We believe good advice is rationally deduced, thoughtfully considered, and grounded in scientific process. This means we must avoid focusing on the short term which always plays out randomly and unpredictably, and instead look forward over the long term where we can achieve a reasonable degree of certainty. We must create a balance between action and inaction in order to offer truly useful advice.

We believe a top down view of economic and capital markets conditions is the appropriate starting point for institutional investors managing either long term or perpetual pools of assets. Thereafter appropriate courses of action can be formulated to capitalize on long term trends and implemented through investment managers.

History tells us aggregate risk exposures are the primary drivers of returns, and therefore should warrant the bulk of planning efforts. This is the goal of this report, to educate our clientele and help make the best policy decisions possible for their unique return needs.

Report Overview

Wurts & Associates' Philosophy on Strategic Asset Allocation

We believe the most important service a consultant can provide its clientele is guidance in structuring an asset allocation policy that not only incorporates unique return needs, but is reflective of prevailing macroeconomic and capital markets conditions. In our estimation, static portfolio structure is an ineffective means of managing risk and achieving goal returns. So we believe dynamic portfolios are necessary. The challenge is judiciously responding to changes in capital markets while avoiding fruitless market timing activities.

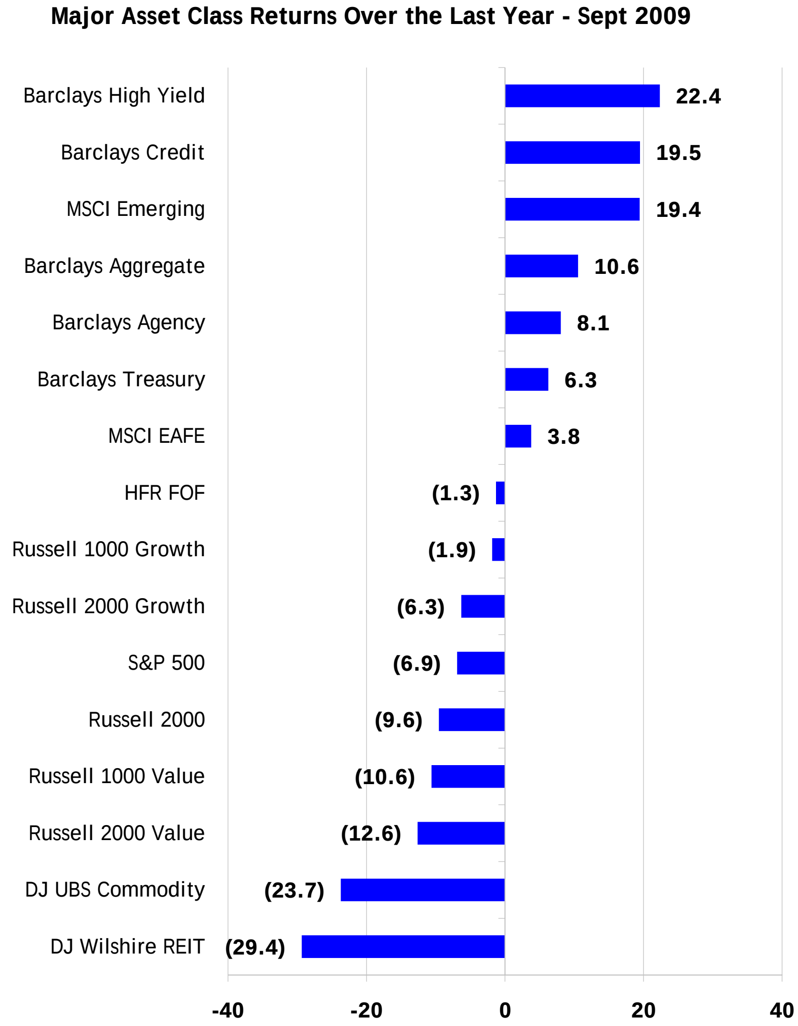
We believe market timing can be defined as any action designed to capitalize on short term movements in capital markets, or an implicit attempt to anticipate changes in investor sentiment. This of course is not a systematically achievable goal.

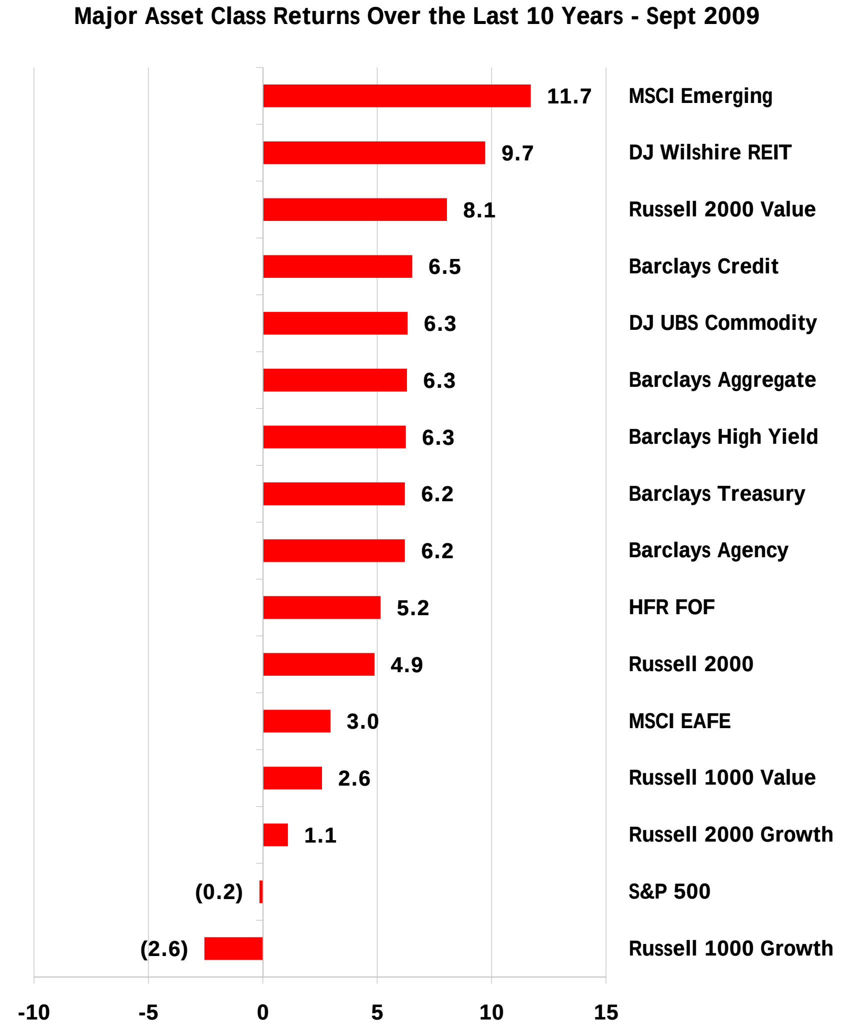
Instead we believe a straightforward approach of marginally shifting away from expensive assets and into cheap ones offers a means to systematically outperform a static approach to asset allocation. We do not see this as market timing, but view it as simply taking a rational long term approach to investing. This philosophy could be perceived as contrarian in nature as opportunities are invariably created when investors flee certain asset classes, and vice versa. However, this is merely a coincidence that results from our process, which is far more thoughtful.

When formulating our views and recommendations, we strive to be objective and scientific, focusing on equity valuations, fixed income yields, credit spreads, inflationary expectations, government policies, and overall macroeconomic conditions in relation to historic norms and averages. We believe this approach not only serves to maximize expected returns through the acquisition of attractively priced assets, but also minimizes downside potential by avoiding lofty valuations that inevitably correct.

Because capital markets conditions are ever changing, our opinions will be ever changing as well, meaning the market dictates the pace of change in asset allocation policy, not an arbitrary timeframe.

Major Asset Class Returns

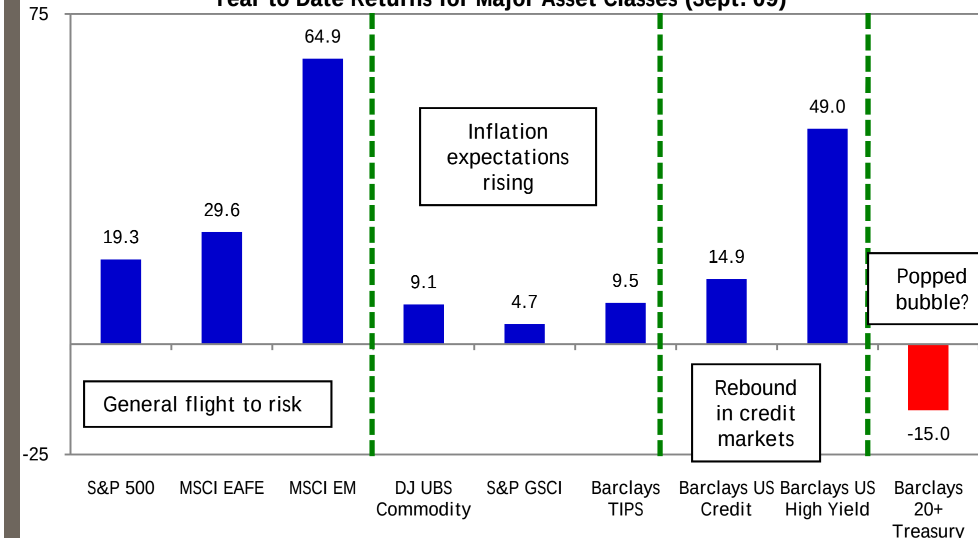




Progress Review of Recent Strategic Initiatives

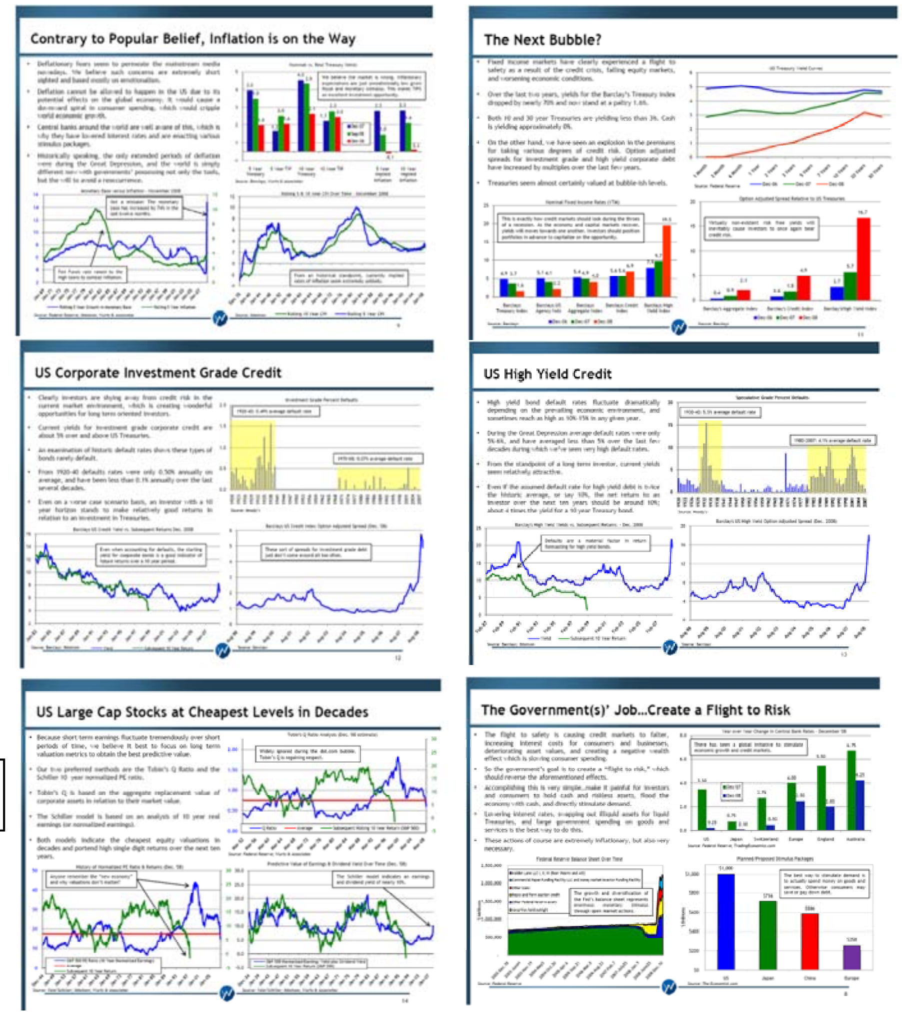
- Wurts & Associates believes tremendous value can be added through rational and disciplined asset allocation decisions.
- As such, we continuously monitor macroeconomic conditions and valuations in equity and credit markets to identify strategic opportunities.
- Though we always view such decisions through the prism of a 10 year outlook, we never know how quickly or slowly capital markets will respond.
- Our most recent strategic initiatives have generally met with good results year to date.
- We must admit however, capital markets responded far quicker than we would have imagined six months ago.

Year to Date Returns for Major Asset Classes (Sept.'09)



Source: Ibbotson

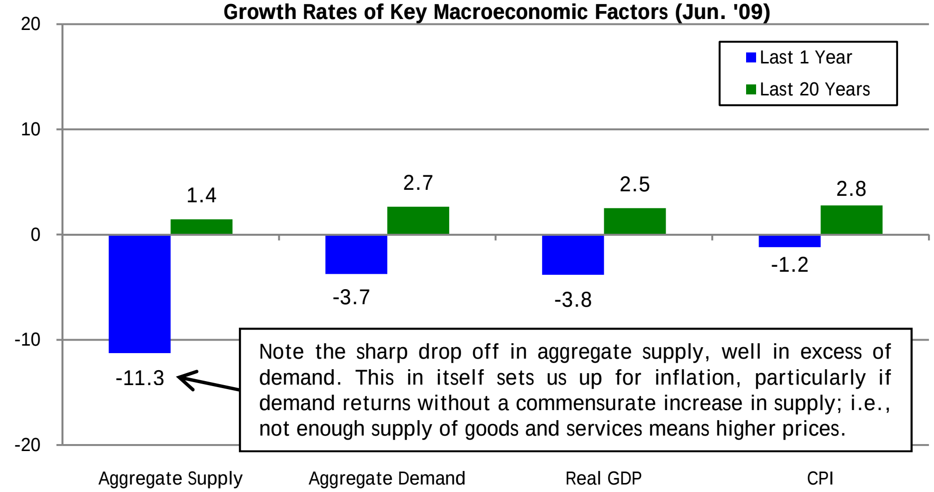
Opportunities Identified in 4th Quarter 2008 Research Report



Setting the Stage for an Economic Rebound *(and inflation)*

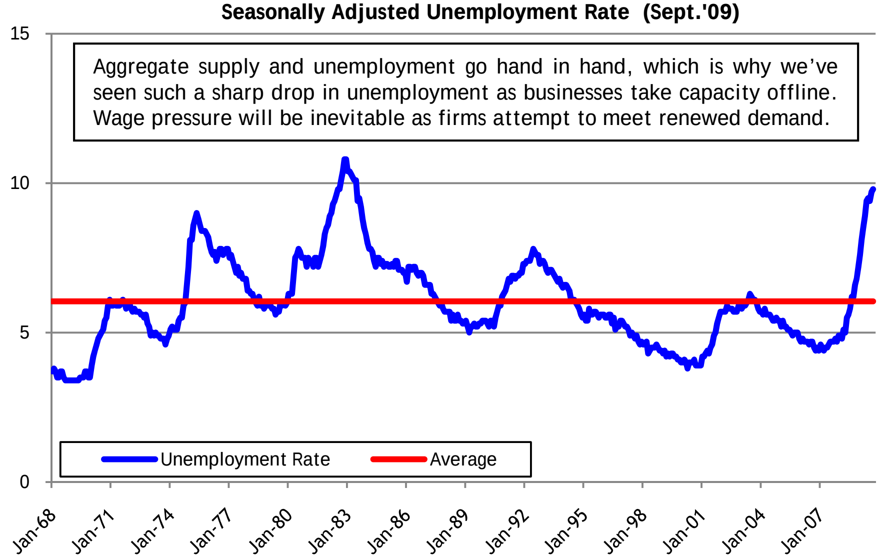
- As noted in last quarter's report, it appeared as if we were reaching the lower bounds of economic activity. Since then Fed Chairman Bernanke announced his belief we had reached an inflection point in this recession, and that it may have already ended but has yet to show up in GDP data.
- We know there is tremendous political attention being paid to reinvigorating the economy, not to mention trillions in stimulus of one form or another. Moreover, it is only natural for economic activity to revert to the mean over time and we know the economy cannot "go to zero."
- Therefore, a resumption of economic growth does not really seem to be in question. However, the questions of the pace of growth and resulting inflation are of primary concern.

Growth Rates of Key Macroeconomic Factors (Jun. '09)



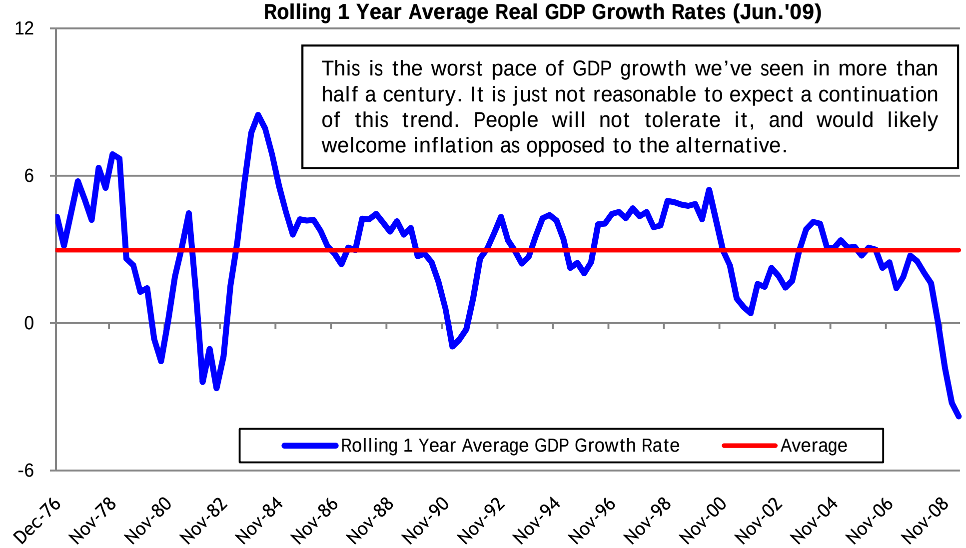
Source: Federal Reserve, BLS, BEA, Wurts & Associates

Seasonally Adjusted Unemployment Rate (Sept.'09)



Source: BLS, Wurts & Associates

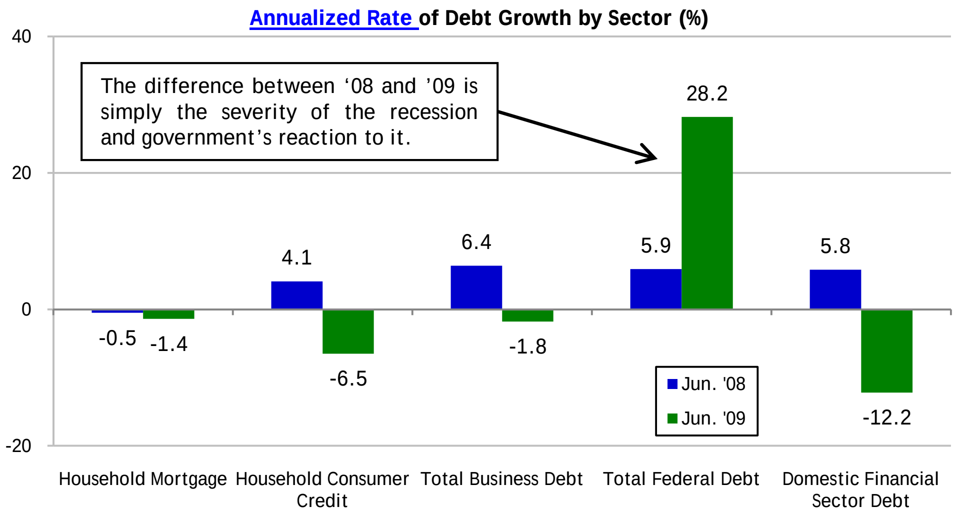
Rolling 1 Year Average Real GDP Growth Rates (Jun.'09)



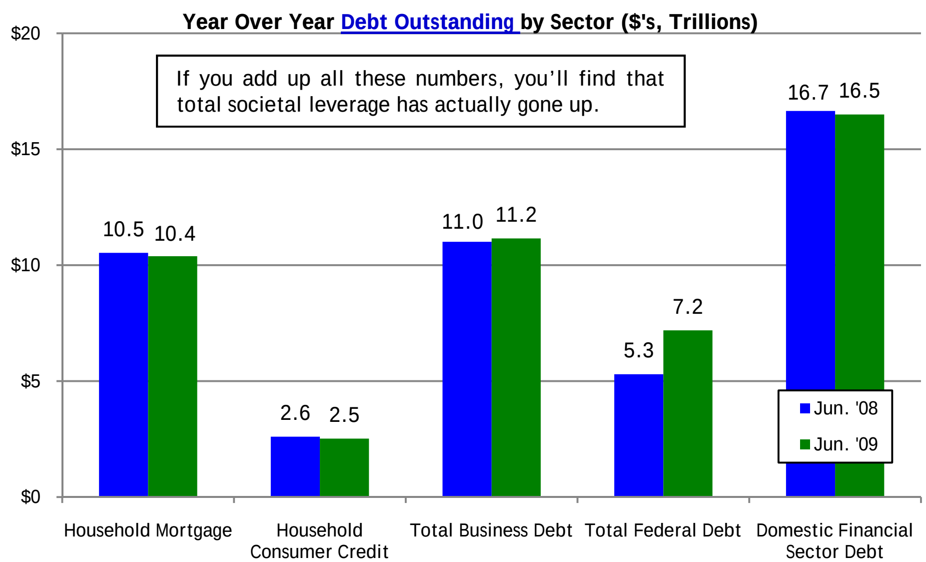
Source: BEA, Wurts & Associates

The Government Continues to Supplant Lost Leverage

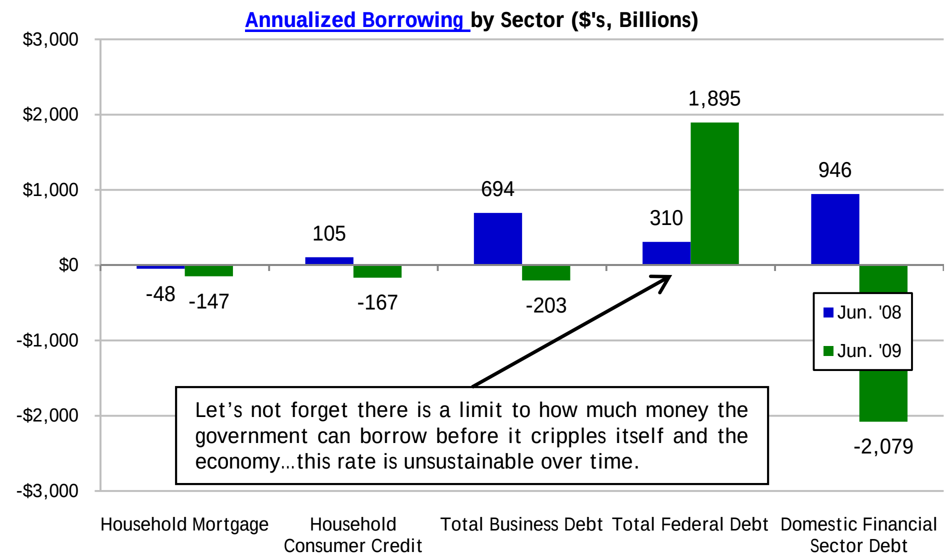
- We continue to point out the composition and pace of total societal leverage because these data continue to be a very important aspect of the mosaic of economic activity.
- A common misconception heard nowadays is the "de-levering" of the US economy. This may very well be true for hedge fund strategies and bank balance sheets, for now at least, but it is by no means true at the total societal level.
- The good news is households and businesses appear to be slowly but surely repairing their balance sheets. As we discussed last quarter, stronger balance sheets tend to lead to stronger consumer demand over time.
- However though, let's not fool ourselves. Federal borrowing at these levels is not without its long term repercussions.



Source: Federal Reserve



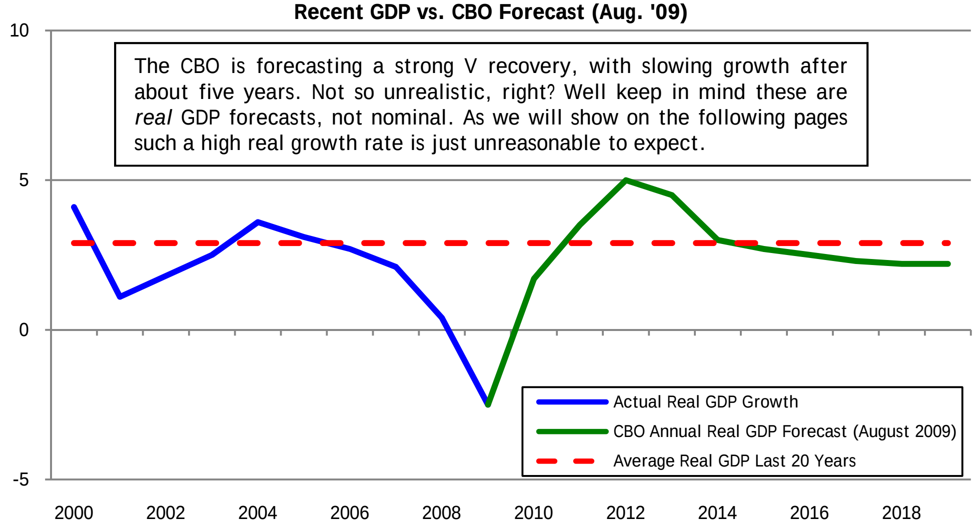
Source: Federal Reserve



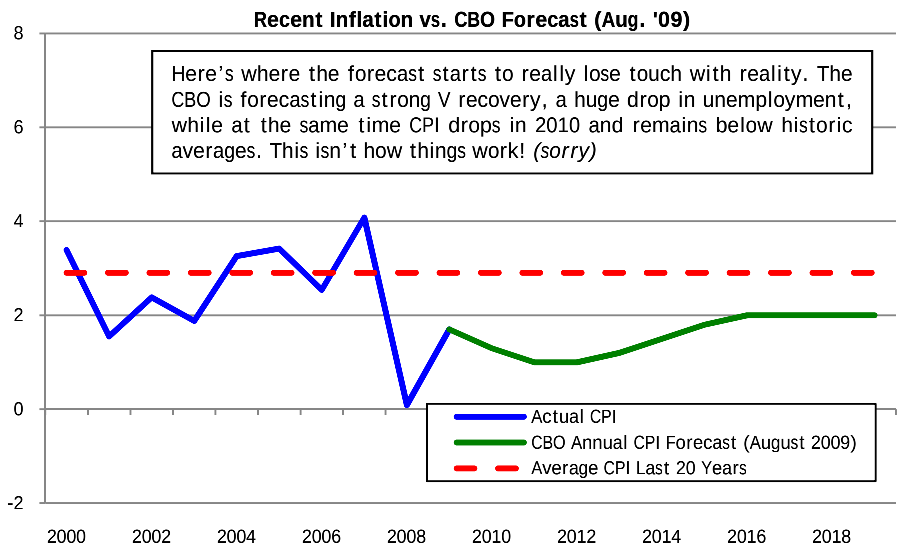
Source: Federal Reserve

Though Pleasant to Ponder, the CBO's Forecast is Unrealistic

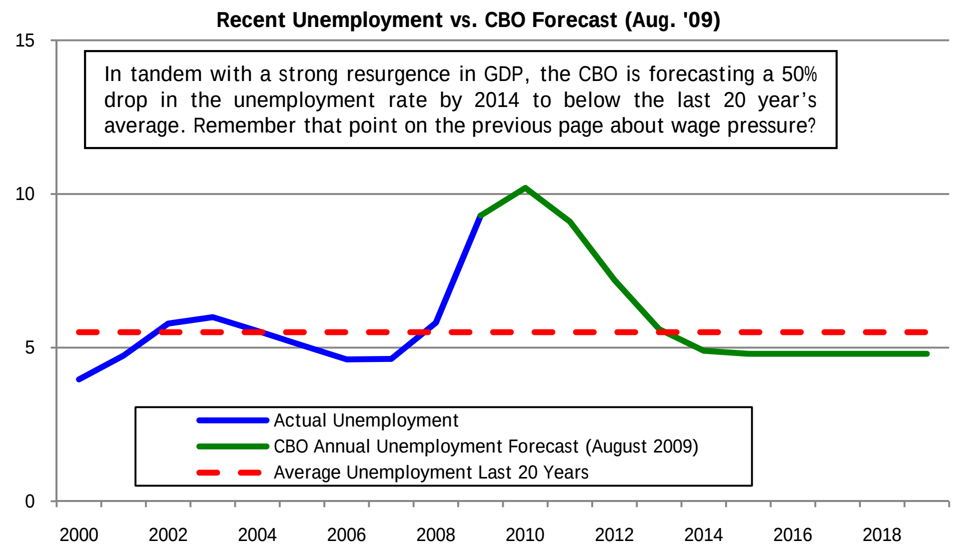
- Do we really believe that even under normal circumstances the Congressional Budget Office (CBO) will accurately predict the future of our economy? Of course not!
- However, we must keep in mind the President and US Congress not only pay attention to these forecasts, but formulate their economic policies around them.
- So if we had our choice of whose estimates to pay attention to, it should probably be the one government policy makers use to base their decisions. This is because the government is the single most powerful influence on the economy.
- Just look at these forecasts and you'll see what we mean by the title of this page.



Source: CBO, BEA



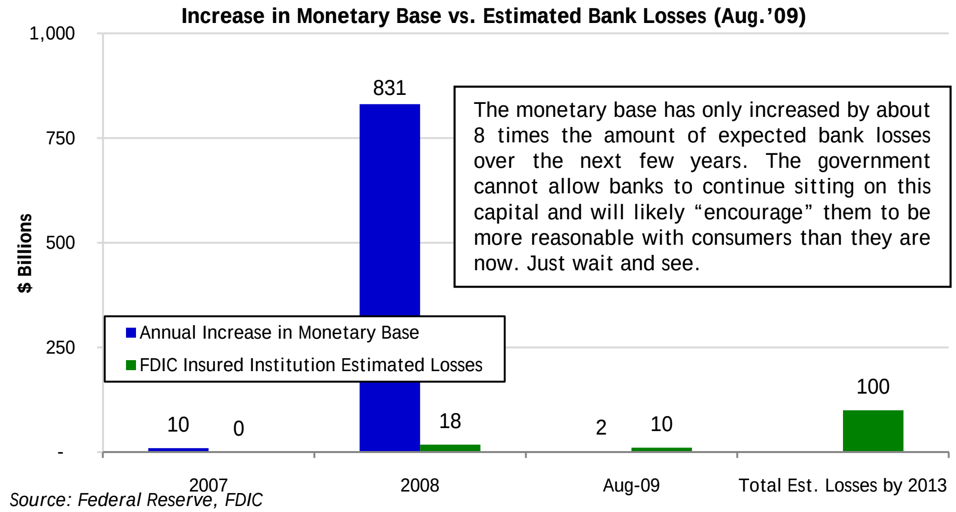
Source: CBO, BLS



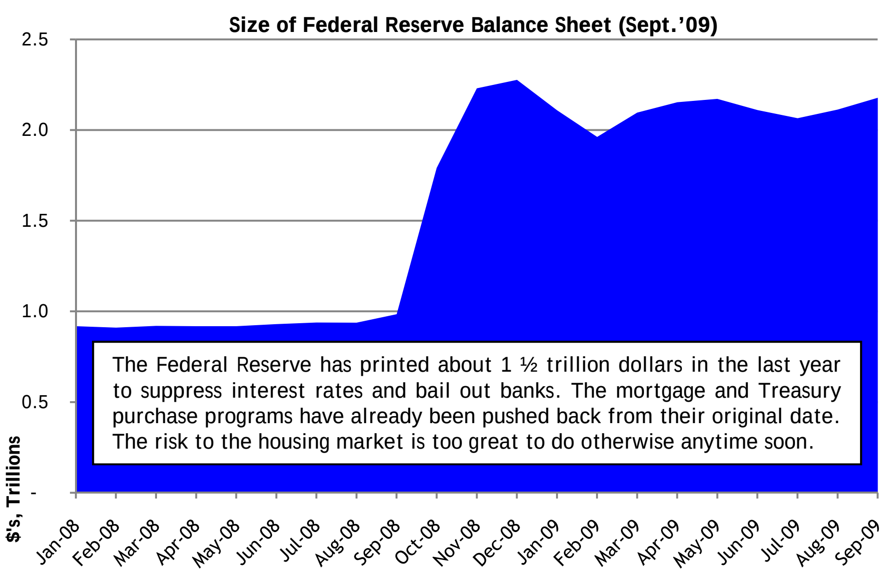
Source: CBO, BLS

The Amount of Government Stimulus is Just Staggering

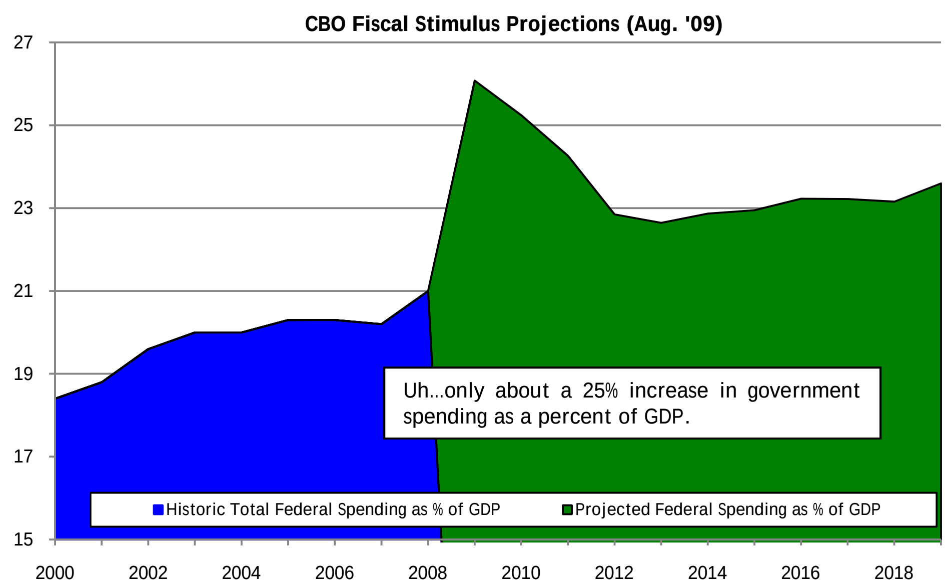
- A resumption of economic growth seems inevitable when you consider how much money has been thrown at this problem.
- We have huge growth in the monetary base, the Federal Reserve is printing money to suppress mortgage and Treasury rates, and government spending is slated to go up substantially.
- This is yet another instance where investors need to sit back, set aside short term concerns, and think about how this much stimulus will play out over time. And the answer is through serious inflationary pressures.
- The only way inflation could be averted is through an almost perfectly executed scaling back of stimulus across all spectrums of the government. What do you think the chances are of that happening?



Source: Federal Reserve, FDIC



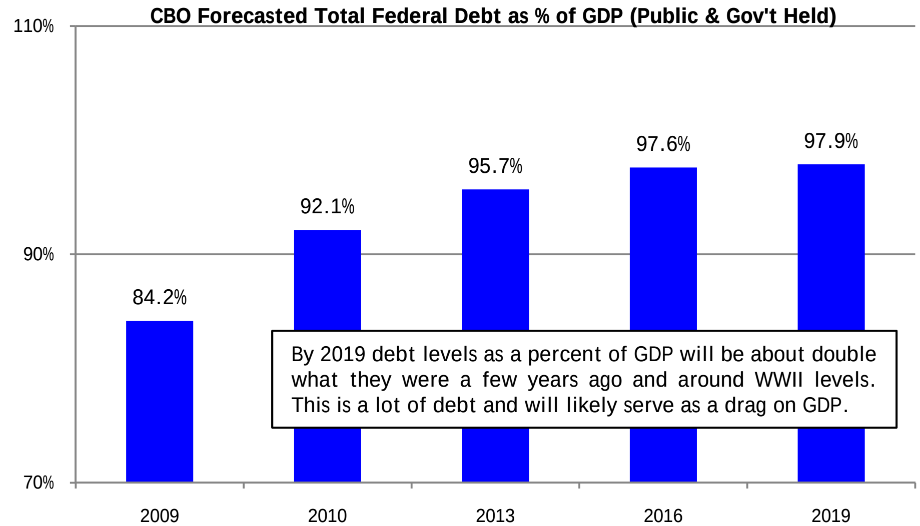
Source: Federal Reserve



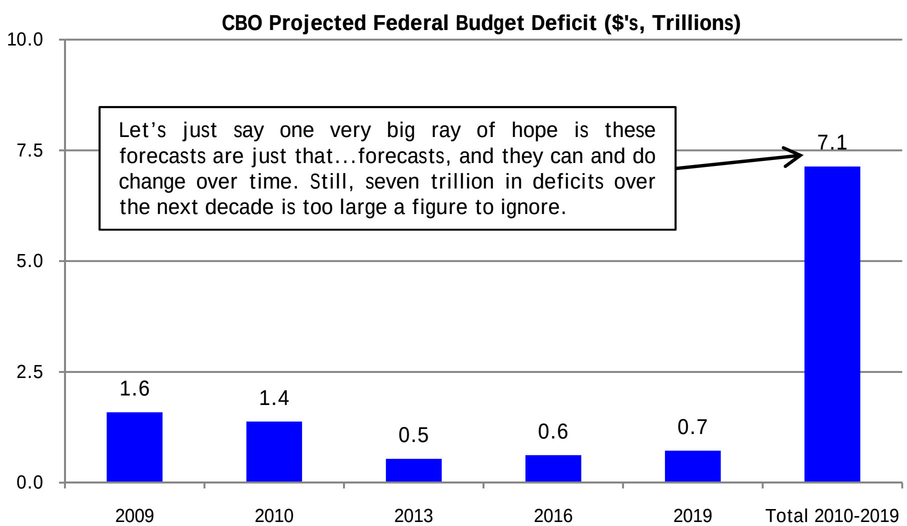
Source: CBO

Serious Thought Should be Given to the Side Effects of Stimulus

- When analyzing stimulus plans and economic forecasts, we must keep in mind the government is not capable of creating wealth. However it is capable of shifting wealth amongst portions of society both today and tomorrow in the hopes of mitigating economic volatility.
- In all fairness to the government, this is what they're supposed to do to prevent economic disruptions that can destroy peoples' financial lives. Stability is generally welcomed by most.
- Nonetheless, there are long term repercussions of these actions that need to be taken into consideration. Because GDP growth materially impacts interest rates, credit spreads, and PE ratios, this sort of analysis is critical to the asset allocation process.
- Long story short, deficits, debt levels and taxes are all headed higher. In a few pages we discuss the implications thereof.



Source: CBO



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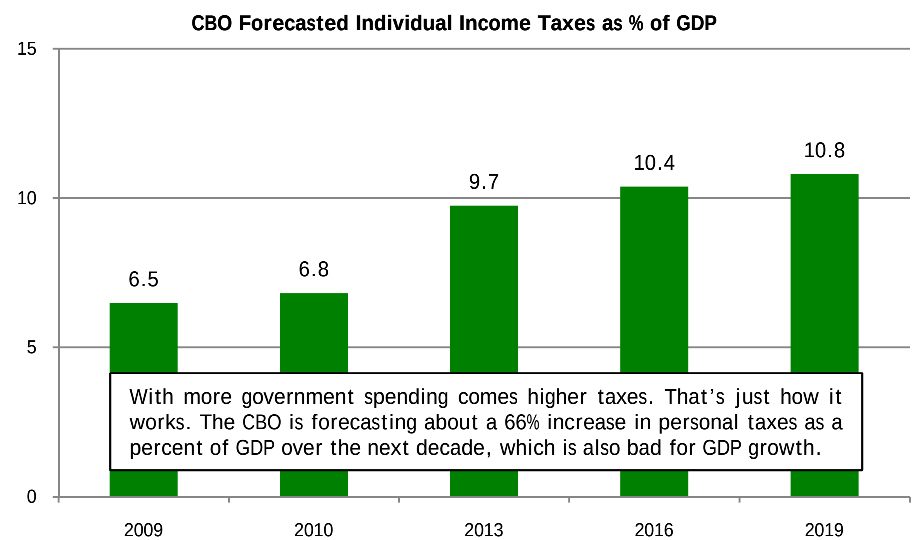
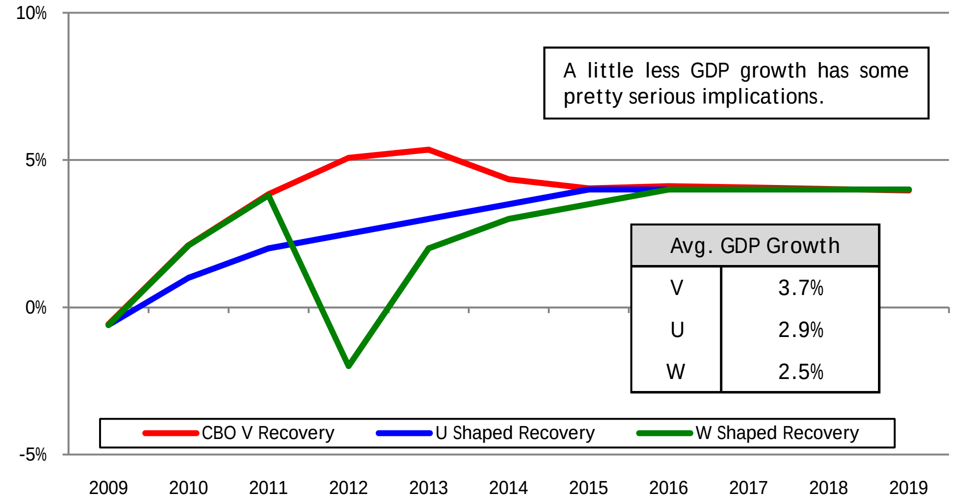


Source: CBO

What if Things Don't Go According to Plan?

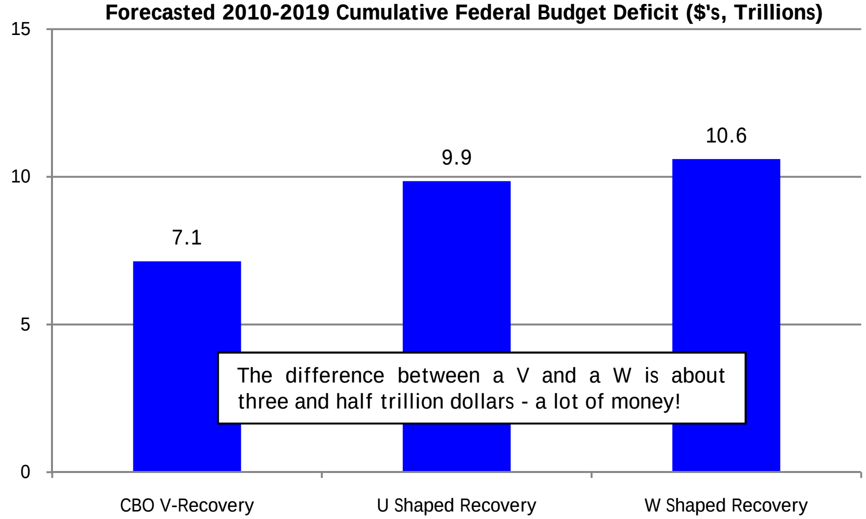
- Don't misunderstand us. We'd love to see a strong V recovery in our economy and an associated bounce in capital markets, but we just can't assume this is going to happen.
- So we conducted a rudimentary sensitivity analysis to demonstrate how various economic scenarios could play out with respect to oustanding debt levels and Federal deficits.
- The beauty of this analysis is that it doesn't need to be accurate to teach us about the future. Just put yourself in the position of Federal policy makers and ponder the risk of a W-shaped economic recovery. It's something the country really needs to avoid to help remain financially solvent.
- What would you do with respect to stimulus and inflation? Cut off stimulus to avoid inflation and risk another recession, or bear inflation to ensure a solid economic recovery?

GDP Growth for CBO V, U, and W Shaped Economic Recoveries (Nominal)



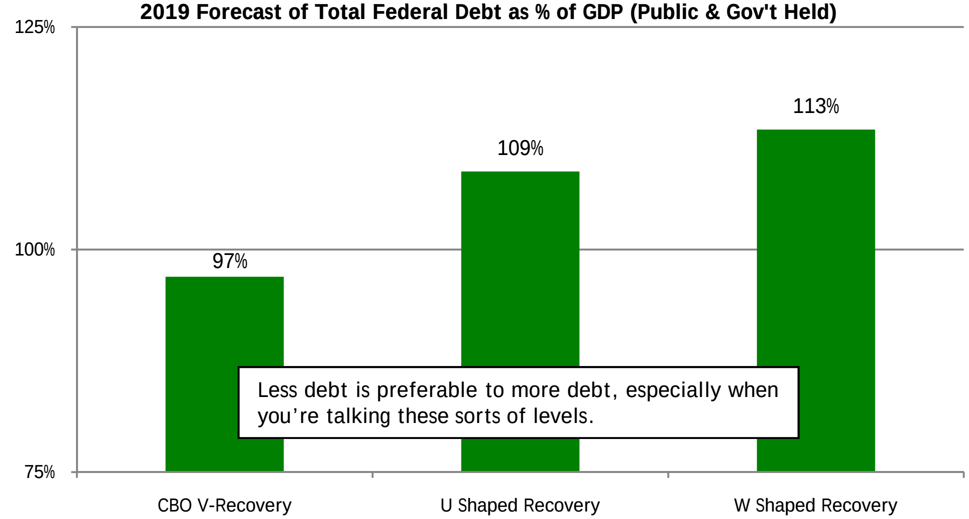
Source: CBO, Wurts & Associates

Forecasted 2010-2019 Cumulative Federal Budget Deficit ($'s, Trillions)



Source: CBO, Wurts & Associates

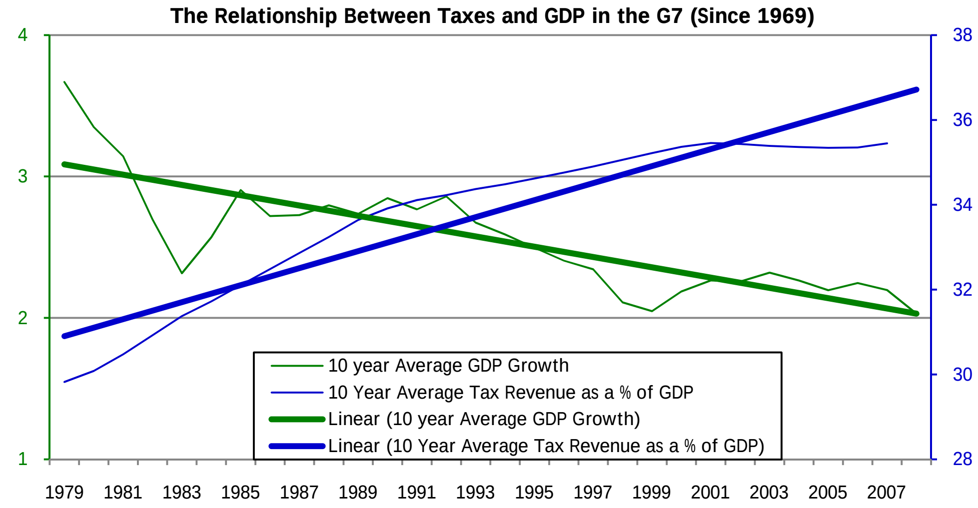
2019 Forecast of Total Federal Debt as % of GDP (Public & Gov't Held)



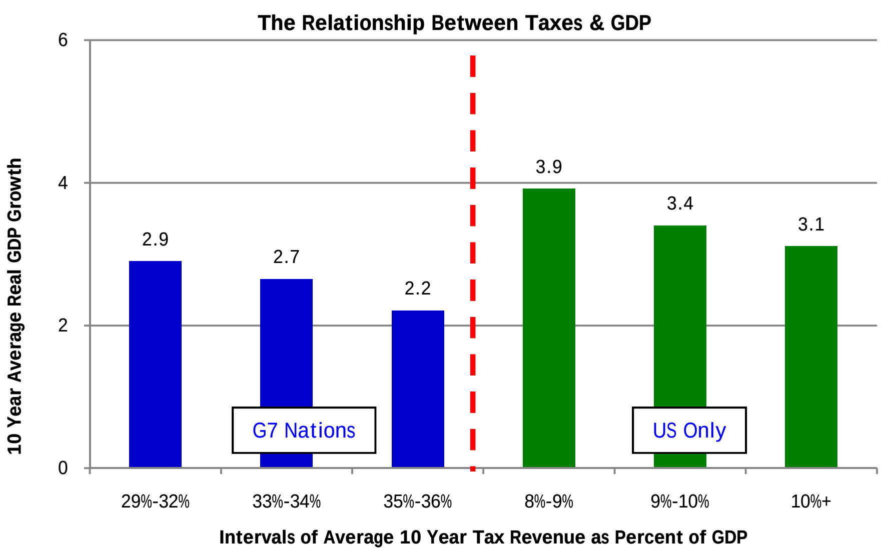
Source: CBO, Wurts & Associates

Taxes & GDP - Not a Political Commentary, An Economic Reality

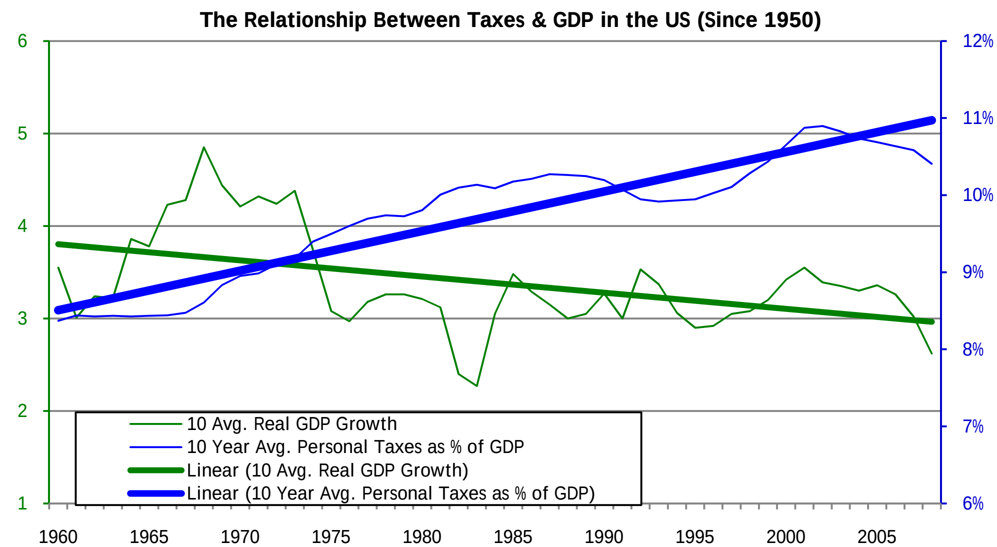
- We fully understand how sensitive the subject of taxation is to virtually everyone, especially nowadays.
- Questions over who pays taxes, how much they pay, who benefits, who doesn't, how to equitably redistribute wealth, etc., are all questions we don't care about from the standpoint of making forecasts and decisions.
- All we need to know is that tax rates are expected to go higher, much higher, and this will have a negative impact on GDP. How much of an impact is hard to say for sure, but it seems fair to say GDP growth will likely be reduced relative to periods of lower taxation.
- The key lesson is this: there is at least one very significant downward pressure on economic growth.



Source: IMF, Wurts & Associates



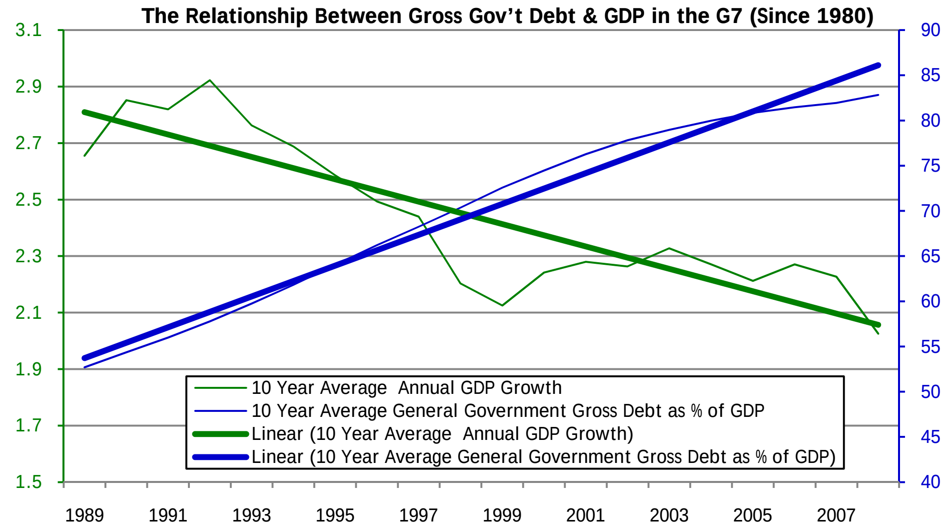
Source: BEA, IMF, Wurts & Associates



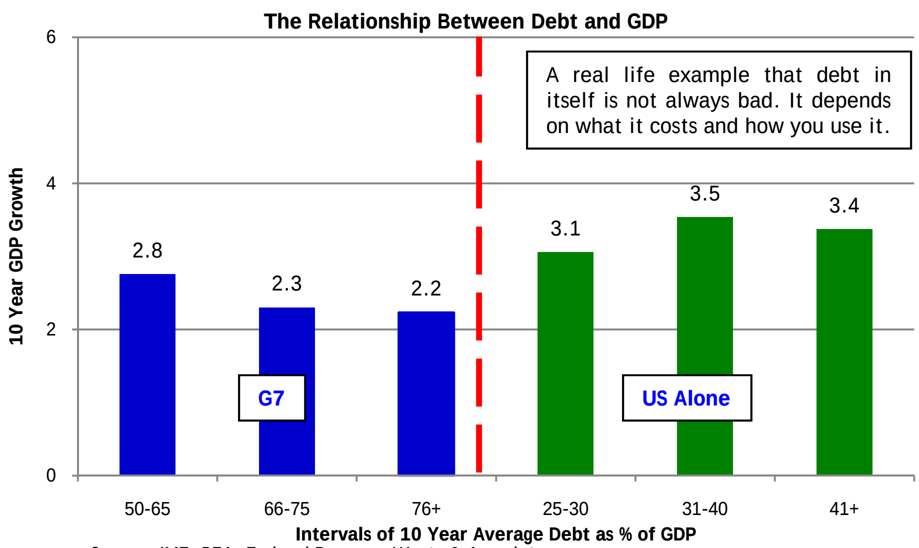
Source: BEA, Wurts & Associates

Debt in Itself is Not Bad, But Too Much of Anything Is

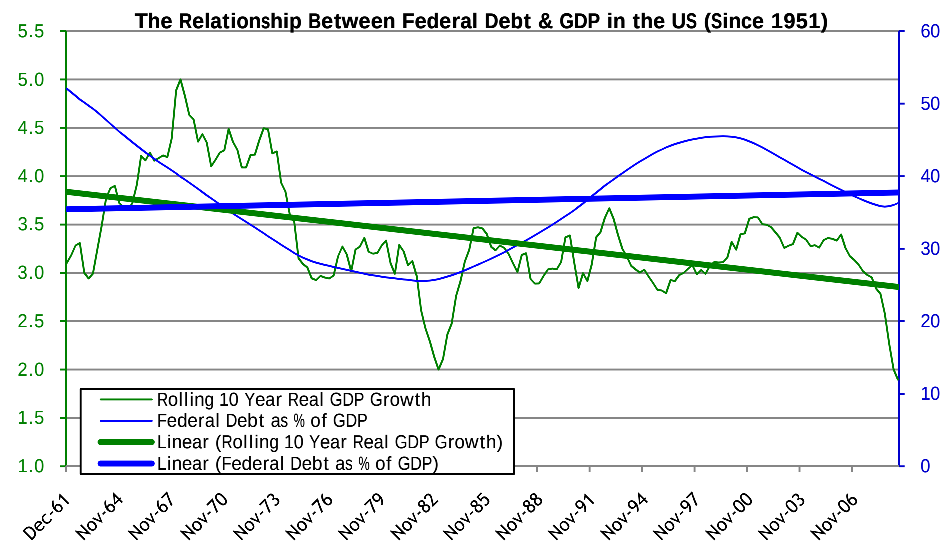
- As identified earlier in this report, we know Federal debt levels are headed substantially higher.
- Debt is not something that is always either good or bad. The fact of the matter is debt *can* actually be a good thing when used properly. More specifically, the cost of debt is a major factor in the benefits derived.
- For example, as we demonstrated in our June 2009 QRR, during times the US government borrowed at a lower rate than which GDP subsequently grew, it was a positive for household net worth; yet another reason to inflate the economy.
- Nonetheless, we are entering essentially uncharted territories with expected debt levels nearing 100% of GDP by 2019. Being realistic, at these levels we must assume debt will serve as a burden on the growth rate of GDP.



Source: IMF, Wurts & Associates



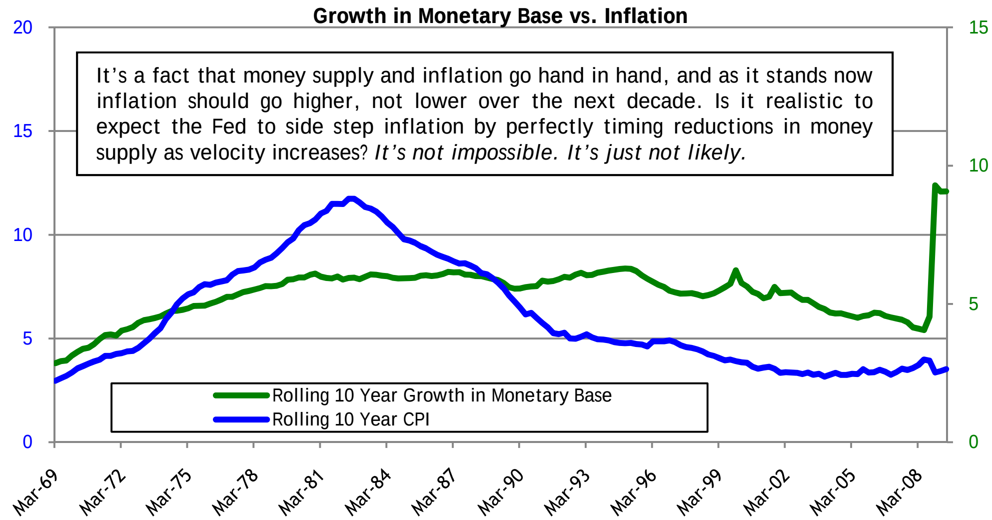
Source: IMF, BEA, Federal Reserve, Wurts & Associates



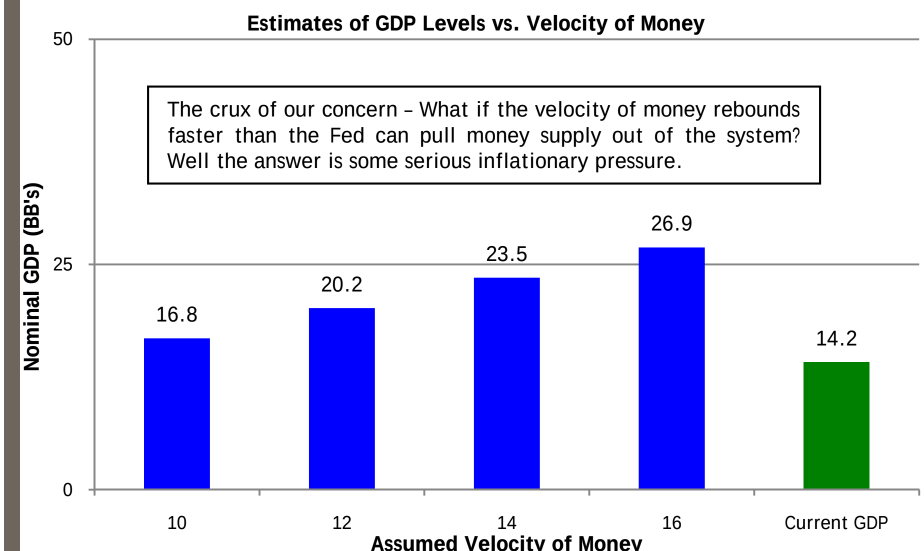
Source: BEA, Federal Reserve, Wurts & Associates

Yet Another Reason to Expect Higher Inflation

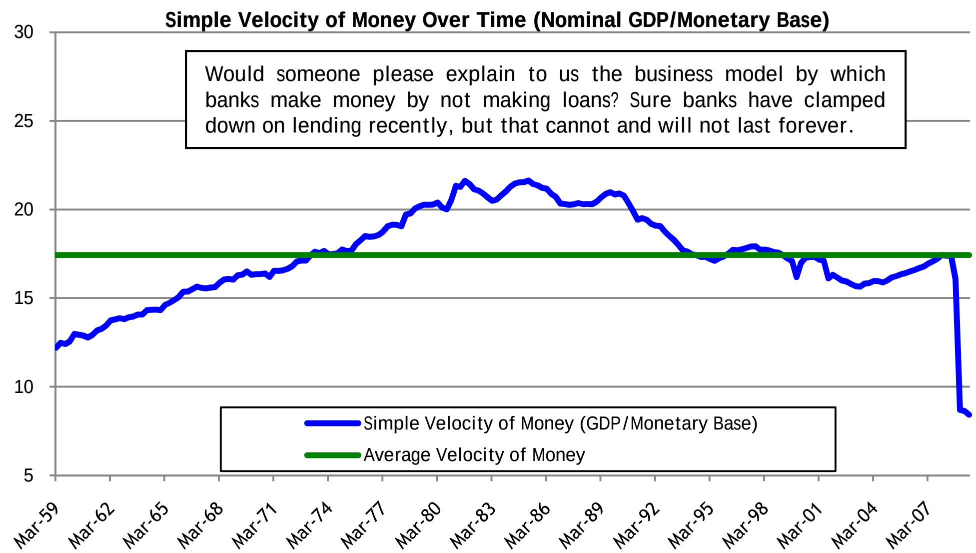
- One of the primary arguments used by the "anti-inflation" hawks nowadays is the velocity of money has fallen and that to make the inflation argument we must predict and prove what will make it go higher…huh?
- Our response to this argument is what could possibly make the velocity of money stay so low forever? What could possibly lead us to believe this fundamentally pervasive aspect of economic behavior would simply change overnight?
- We are not about to entertain the concept of a sudden new paradigm in the velocity of money. Though we believe it will revert to historic norms and understand the Fed can always reduce money supply to head off inflation, the question is how successfully they can do this, and whether they'll err on the side of inflation or recession when doing so.



Source: Federal Reserve, BLS, Wurts & Associates



Source: Federal Reserve, BEA, Wurts & Associates

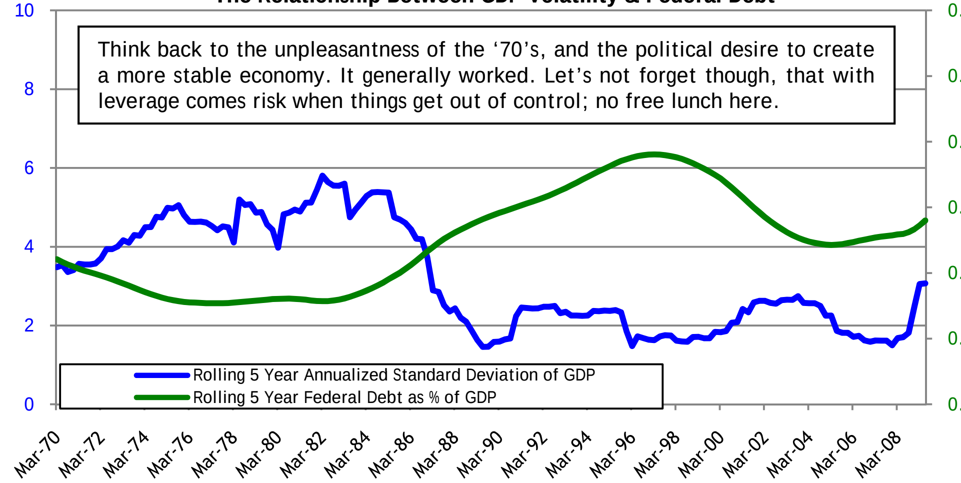


Source: Federal Reserve, BEA, Wurts & Associates

Growth is Only One Side of the Equation…Volatility is the Other

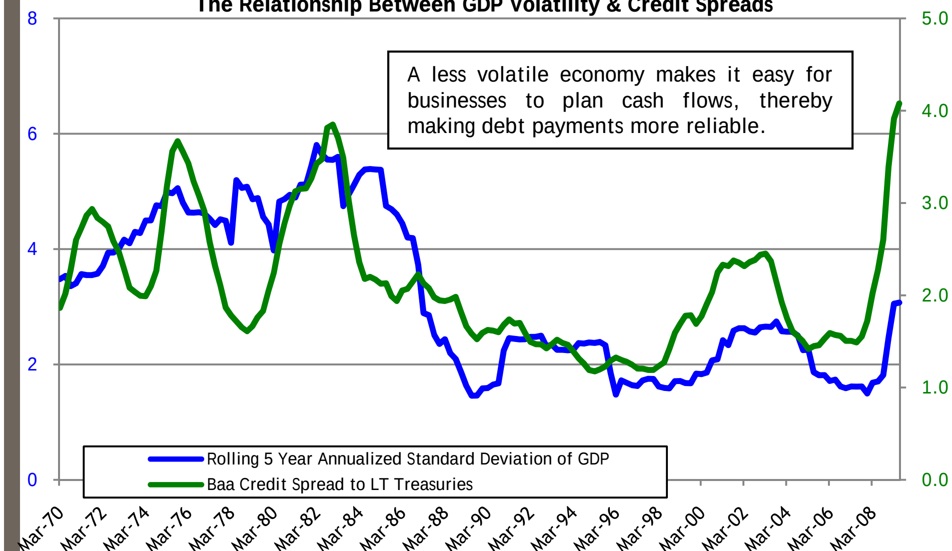
- As mentioned earlier, one of the most important roles of the government is to foster economic stability and prevent financial disruptions to protect the average citizen.
- Most notably this is done by the Federal Reserve via interest rates and money supply. However, it also can be done through government deficit spending (or the use of leverage).
- With deficit spending (leverage) going higher, we can reasonably argue this may result in lower economic volatility through greater government influence.
- This is good for key drivers of returns such as credit spreads and PE ratios. But let's not forget about the susceptibility of the economy to "fat tails" when more leverage is involved…a complication in risk budgeting to be sure.

The Relationship Between GDP Volatility & Federal Debt



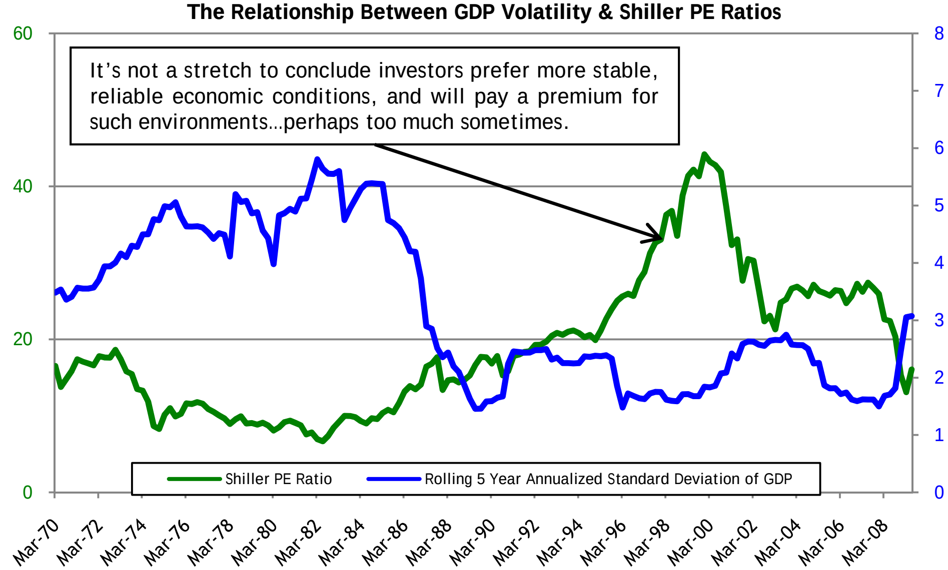
Source: BEA, Federal Reserve, Wurts & Associates

The Relationship Between GDP Volatility & Credit Spreads



Source: BEA, Moody's Wurts & Associates

The Relationship Between GDP Volatility & Shiller PE Ratios



Source: BEA, Shiller Wurts & Associates

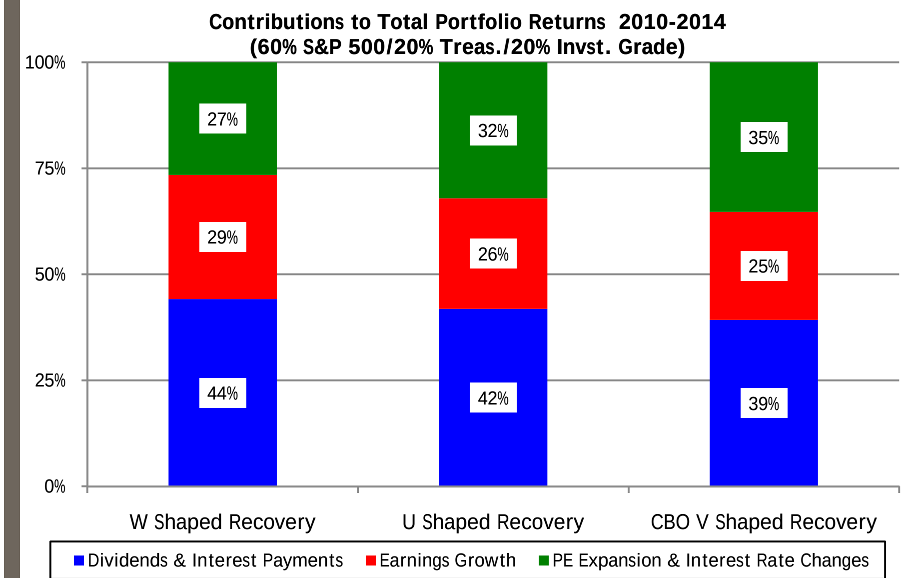
General Implications on Strategy Through Scenario Analysis

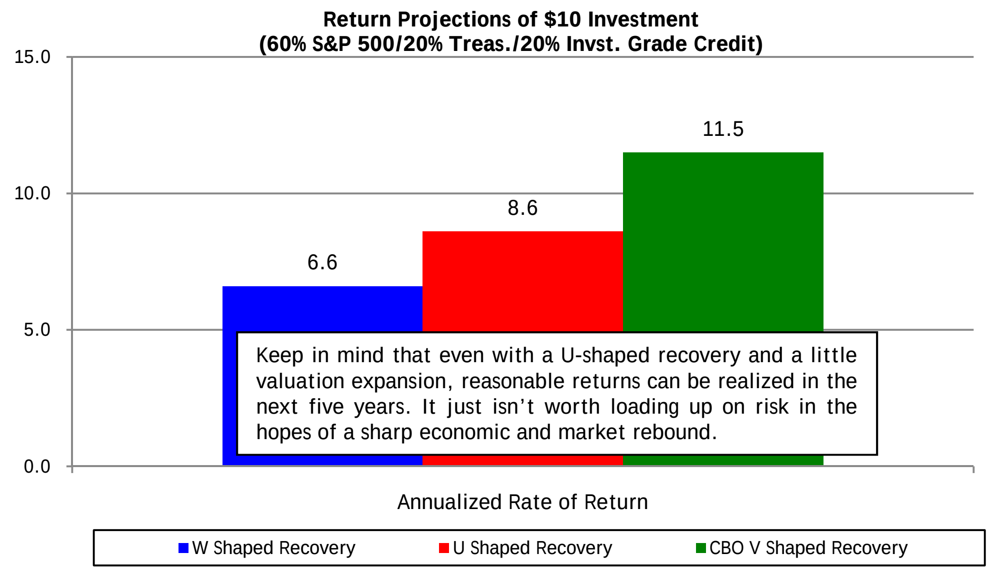
- In a V-shaped recovery, valuation expansion and credit spread reductions would drive a large portion of returns. Asset allocation for a V would entail loading up on risky assets to capture valuation upside. Though tempting to regain recent losses, such a strategy could result in poor risk adjusted returns given the aforementioned factors that will work against strong GDP growth.
- If planning for a W-shaped recovery, then load up on cash flowing assets because dividends and interest payments dominate returns in lieu of large valuation expansion. However, such a strategy seems a little too defensive given the economic outlook.
- For a U-shaped recovery, use a more normal balance of risky assets. Valuation expansion should happen, but not enough to warrant excessive risk taking. A U recovery seems the most likely.

Generalized Economic Scenario Assumptions (2010-14)

	3rd QTR Levels	CBO V Shaped Recovery	U Shaped Recovery	W Shaped Recovery
Shiller PE Ratio	18	25	22	20
10 Year Treasury YTM	3.25	5.5	4.5	4.0
Barclay's Credit - Spread to Treasuries	2.5	0.5	1.0	2.0
Earnings Growth/Avg. GDP Forecast	-	4.1%	2.4%	1.8%

Note: Inflation assumed to be 2.5% for all scenarios; KISS; Wurts proprietary assumptions.





Summary of Macroeconomic Considerations

The Shape of Things to Come

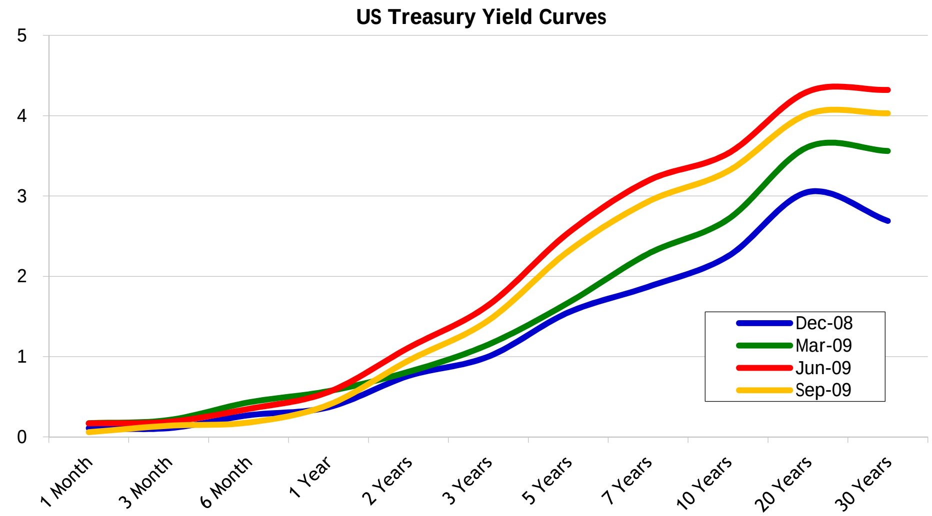
- Seemingly, the economy is reaching its lower bounds of activity. Most would agree a rebound of some form or another is forthcoming. The question is how robust or sustained the recovery will be. The Fed has a delicate balancing act on its hands.
- It is unlikely the CBO's forecast for a strong V recovery alongside historically low inflation will occur. High debt and tax burdens will more than likely pull real GDP growth below their expectations. Massive increases in money supply, expansion of the Fed's balance sheet, and a resurgence in the velocity of money all point to the threat of higher inflation.
- Of course it is possible to see the CBO's expected recovery take place. However, this would require virtually perfect market timing skills across the entire spectrum of the Federal government to scale back monetary and fiscal policy in sync with increasing GDP growth. It is just not realistic to expect such a feat from the government…would be nice though.
- What is more likely is a steady recovery that will eventually begin to produce higher than expected inflation. At such a point the Fed will be forced to choose between raising rates and risking another recession, or continuing stimulus to sustain a recovery while risking higher inflation. What would you do as a policy maker? Err on the side of recession, or inflation?
- The societal cost of a W shaped recovery is likely too much to bear, making the aforementioned choice even easier to make. Coincidentally, inflation will erode the real value of US debt and improve the societal balance sheet. This would be bad for those who lent us the money, but inflation risk is part of lending so you can't feel too sorry for them if this happens.

Implications to Investors

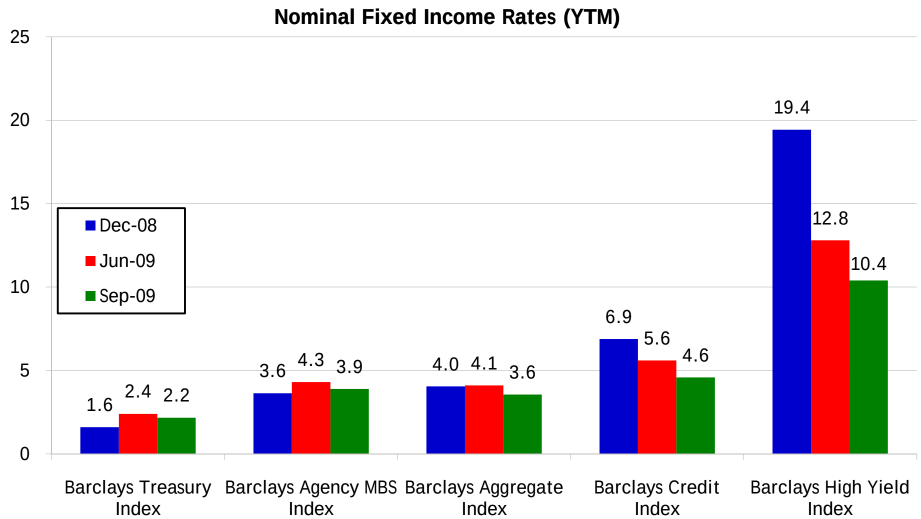
- Planning for a strong V recovery is just not a realistic course of action. Loading up on market risk and/or embracing leverage through alternatives will likely result in disappointing risk adjusted returns. Don't forget levered investments need low credit spreads and easy access to capital, and you're not going to see such an environment without robust and stable economic growth.
- A U recovery alongside higher than expected inflation is the most likely outcome. This means a more moderate (normal) allocation to risk, but most importantly exposure to assets that will benefit from inflation. Keep in mind inflation represents a risk to some investors (i.e., endowments and foundations) and an opportunity to others (i.e., pension funds with a capped COLA).
- Though undesirable and less likely, a W shaped recovery is possible and would imply a defensive posture. To plan for such an outcome, shy away from risky assets that will not see large valuation expansion and instead focus on those that provide reliable cash flow. The main risk with this strategy is opportunity cost should we see a U-shaped recovery and associated inflation.

Fixed Income Opportunities are Slowly Being Priced Away

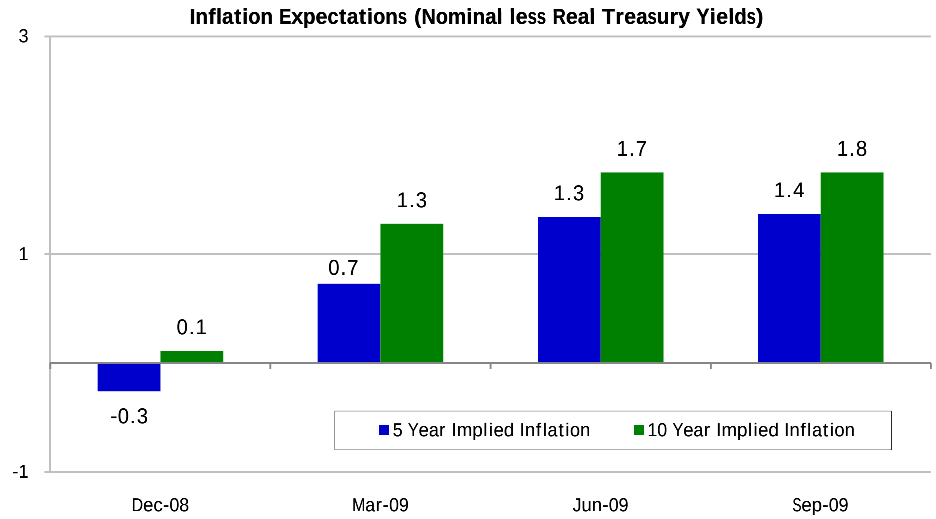
- We can see the spreads between credit-based and risk free fixed income assets have narrowed substantially relative to the flight to safety of '08. Nonetheless, the opportunity to garner superior risk adjusted returns relative to Treasuries is still there for investors willing to bear credit risk.
- Though we believe a significant portion of the Treasury bubble forecasted back in Dec. '08 has deflated, keep in mind the Fed continues to artificially suppress Treasury and Agency interest rates. So don't forget there is a lot of pent up selling waiting to happen when the Fed eventually decides to reduce their balance sheet. Also, don't forget about the influence of foreign governments. *(next page)*
- Implied inflation rates for TIPS seem too low given our economic outlook. So there is still value to be found in these securities relative to other risk free bonds.



Source: Federal Reserve



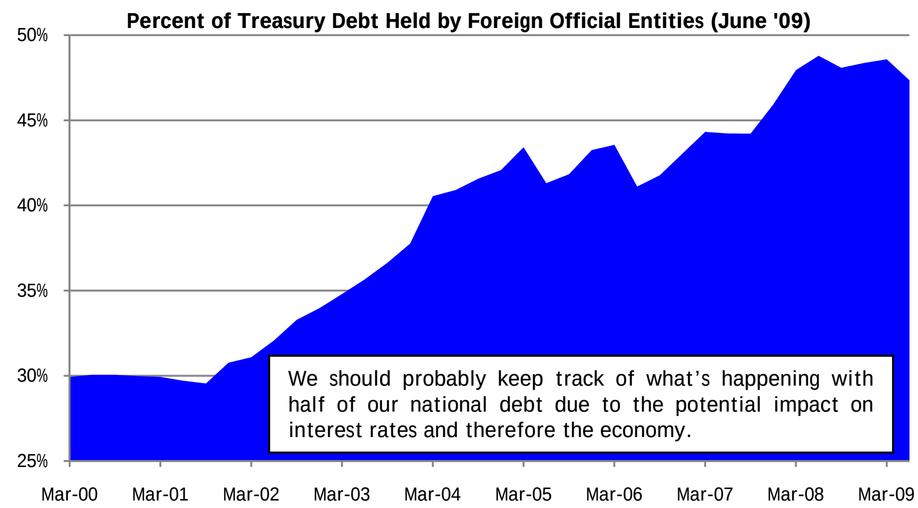
Source: Barclays



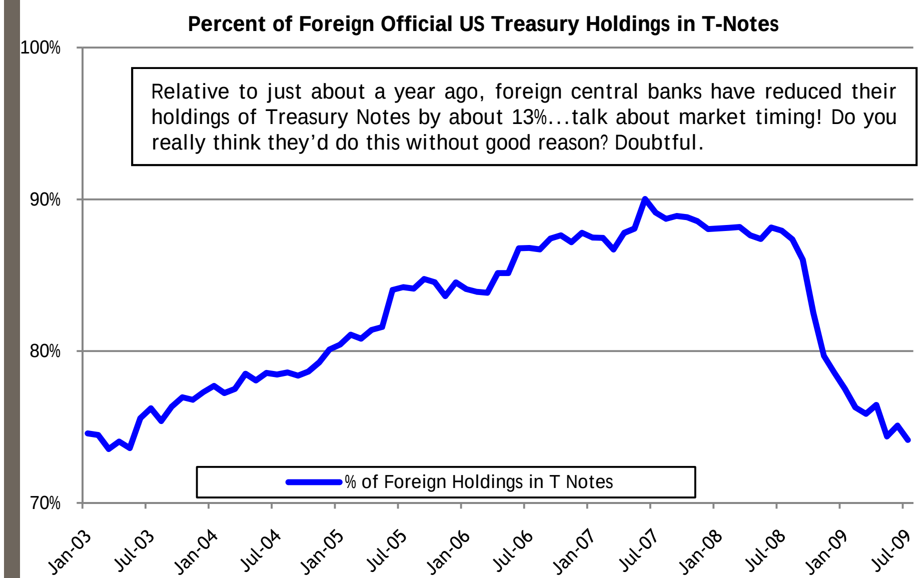
Source: Federal Reserve, Wurts & Associates

They're Nobody's Fool

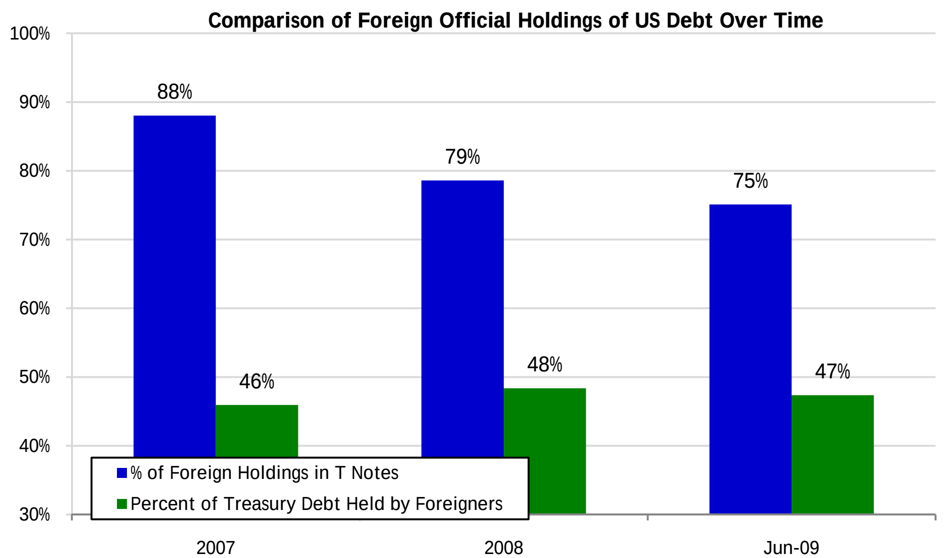
- Recently foreign "official" investors *(central banks)* have been demanding the US government issue more TIPS instead of nominal US Treasury bonds, presumably over inflationary fears.
- Additionally, we can also see that foreign investors have dramatically scaled back their holdings of Treasury Notes in favor of Treasury Bills which will do a much better job of protecting their assets against losses should inflation occur.
- In addition to inflationary concerns, we must also assume these investors are well aware of the manipulation of the Treasury markets by the Fed. Ignoring such actions would be unwise.
- Foreign investors hold around half of our debt and could potentially wield significant influence over our economy, which is why we are paying attention to these statistics.



Source: US Treasury, Federal Reserve, Wurts & Associates



Source: US Treasury, Ibbotson, Wurts & Associates

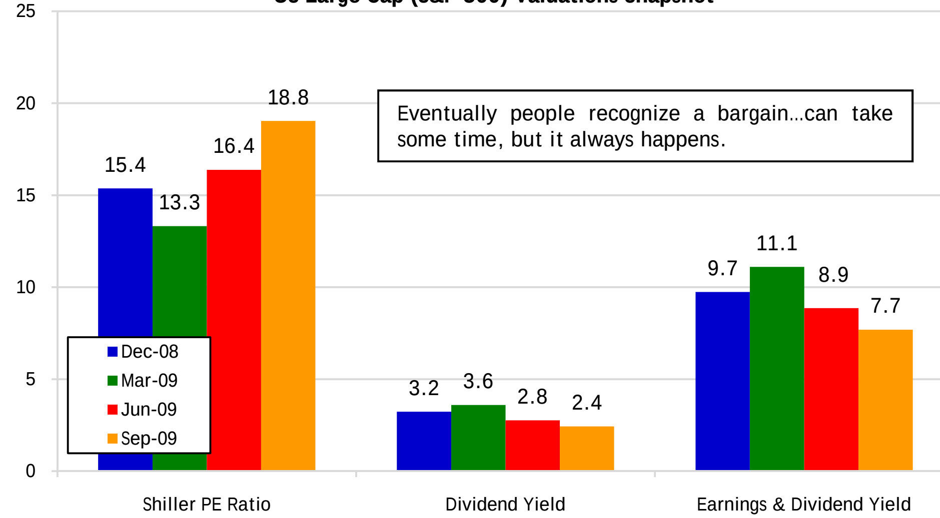


Source: US Treasury, Wurts & Associates

Still Looking at High Single Digit Returns for US Large Caps

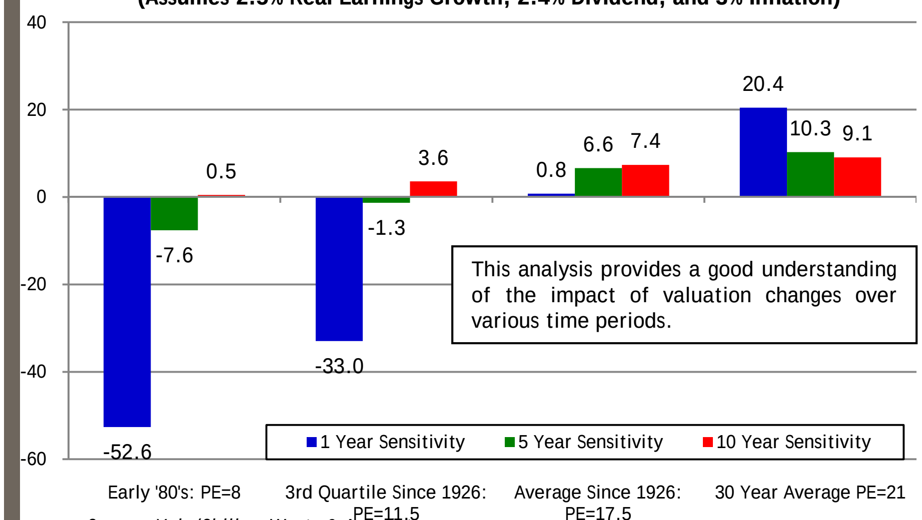
- There are many ways to forecast equity returns within the investment industry. Some are better than others.
- The most common way is to look backwards and blindly expect history to repeat itself, generally involving a 50 year look back for a 10 year return forecast…a bit intellectually inconsistent.
- Another is to do Monte Carlo simulations that generate random returns based on the assumptions equity returns are indeed random and not serially (or sequentially) correlated, which of course they are not, making this method a little nonsensical.
- The last method is to make assumptions for earnings growth, inflation, dividends, and valuations. This method seems to make the most sense and is telling us to expect high single digit rates of return for US large caps.

US Large Cap (S&P 500) Valuations Snapshot



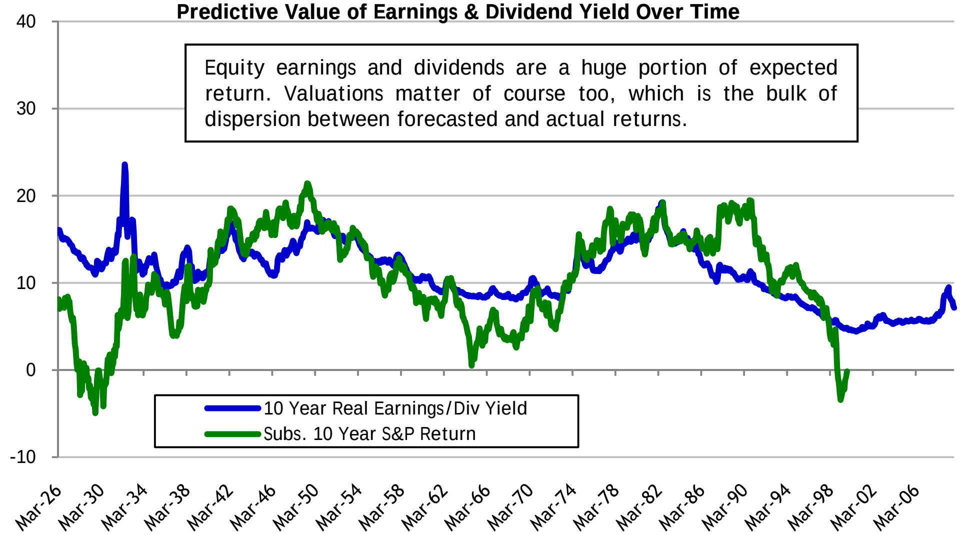
Source: Yale/Shiller, Wurts & Associates

Sensitivity of S&P 500 Returns to Shiller PE Ratio (Assumes 2.5% Real Earnings Growth, 2.4% Dividend, and 3% Inflation)



Source: Yale/Shiller, Wurts & Associates

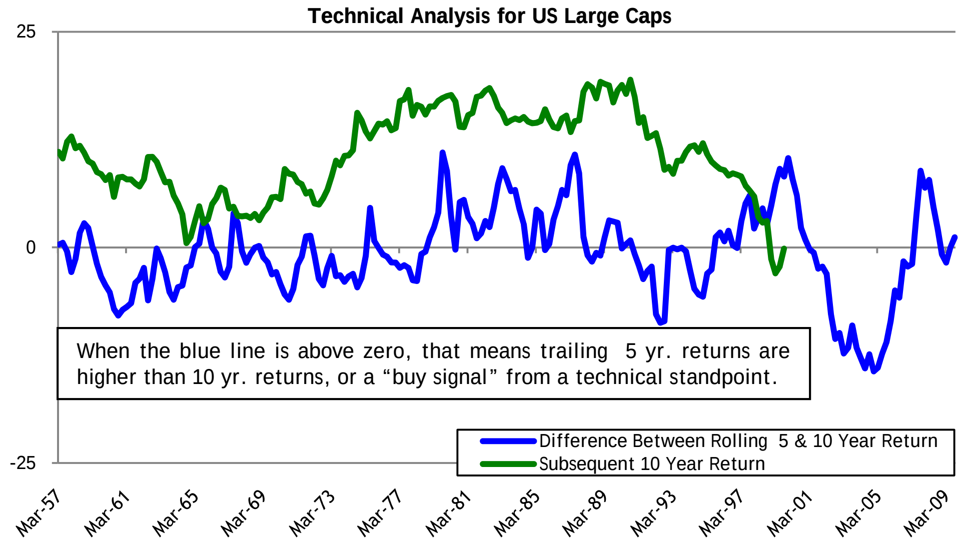
Predictive Value of Earnings & Dividend Yield Over Time



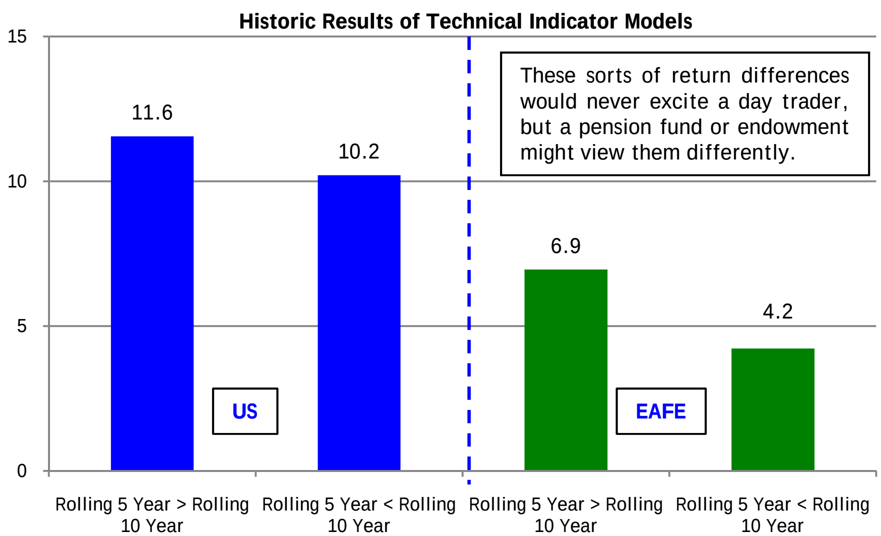
Source: Ibbotson, Yale/Shiller

How About Technical Analysis on an Institutional Time Horizon?

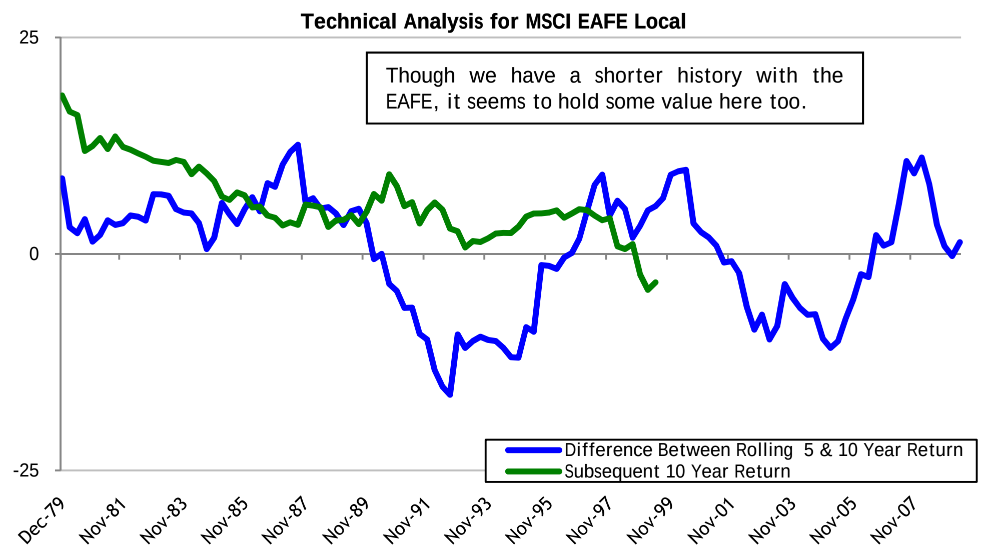
- Technical analysis is probably one of the most popular methods of analysis amongst investors. There are a few problems though with the way most people do it.
- To begin with, most technical analysis is done over days, weeks, and sometime months, which is a little chaotic. Moreover, if and when some sort of a trading pattern is found, any profit will be quickly priced away by like-minded short term investors. So the question is whether such analysis could be useful by looking at longer term time frames.
- The basics of technical analysis is looking at fast vs. slow moving returns (or lines). When a fast line crosses a slow line, a "buy" or "sell" signal is generated…hmmm…anything to this? Well it looks as if there is, and we may have very well added a nice complimentary analytical tool. At the very least it's interesting to think about.



Source: Ibbotson, Wurts & Associates



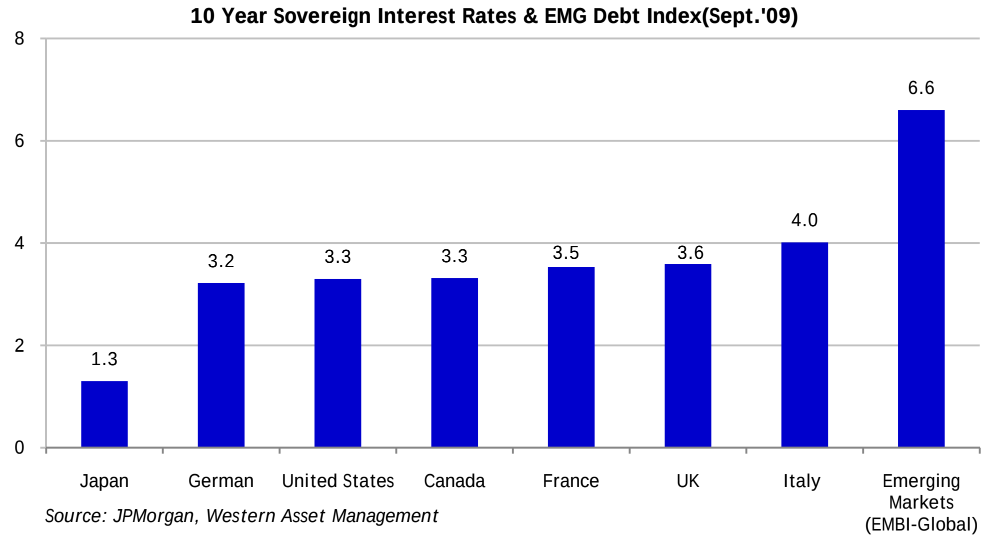
Source: Ibbotson, Federal Reserve, Wurts & Associates



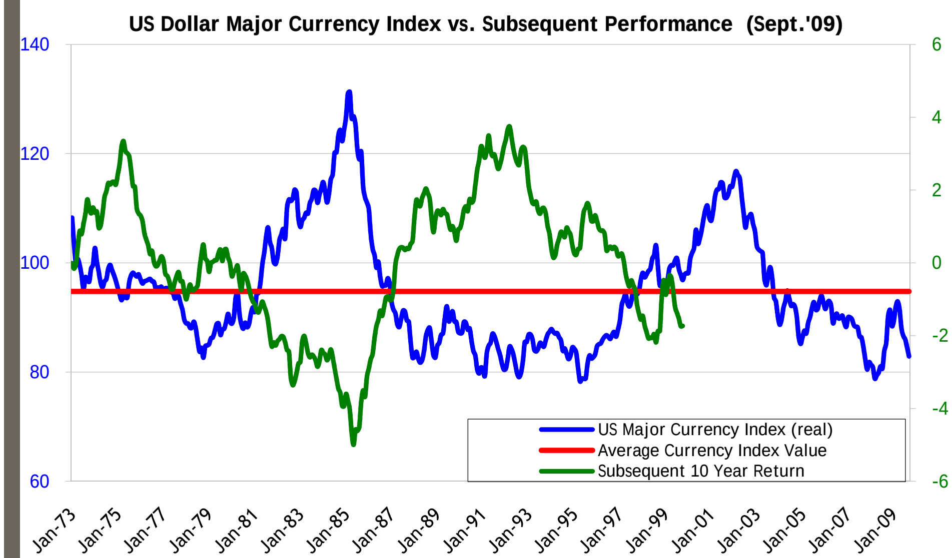
Source: Ibbotson, Wurts & Associates

Global Markets at a Glance

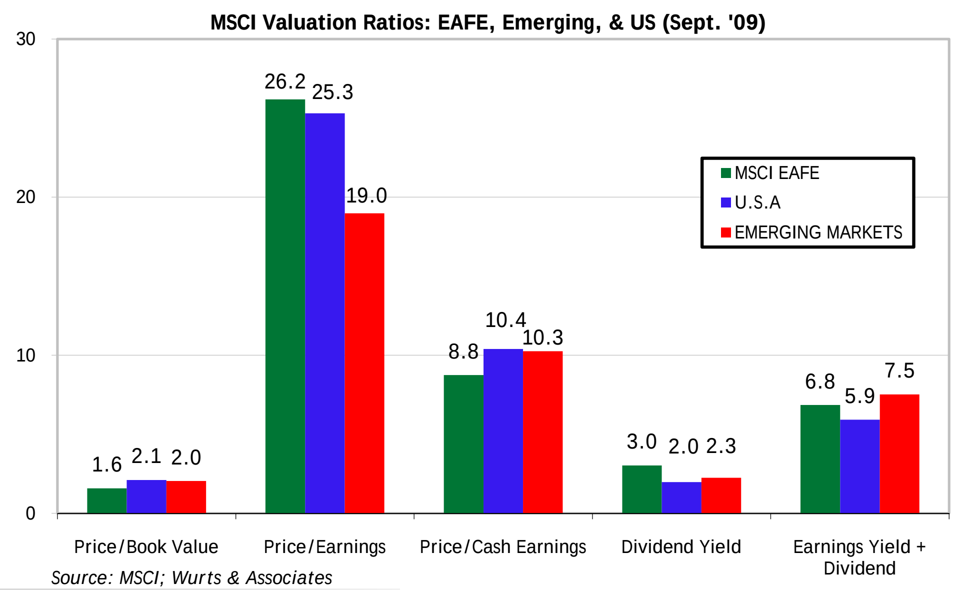
- We can see global risk free interest rates are pretty much in line with one another, as well as the US. Emerging markets however are offering up a premium of about 3%.
- US equities are priced to provide the lowest expected returns based on MSCI valuations, and emerging markets are priced to provide the highest expected returns. Keep in mind these are one set of valuation metrics and are just another tool by which to make decisions.
- The US dollar is falling again as the '08 flight to safety has ended. A weakening dollar boosts returns to US investors abroad, and there are a lot of reasons to believe this may continue given potential inflation and rising debt levels.
- Are we ready to say the US dollar will lose its reserve currency status? No. But we should be thinking about it.



Source: JPMorgan, Western Asset Management



Source: Freelunch.com; Wurts & Associates



Source: MSCI; Wurts & Associates

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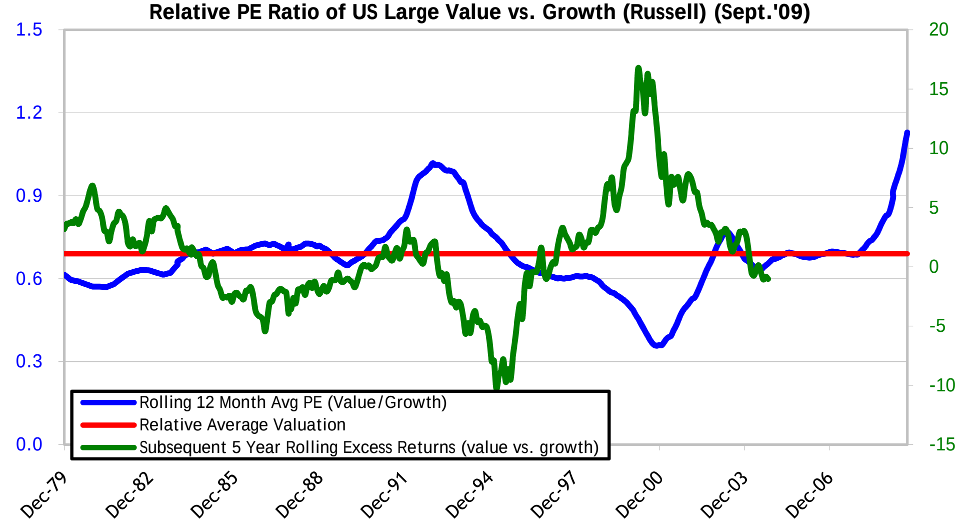
Style Tilts: *US Large Value vs. Growth*

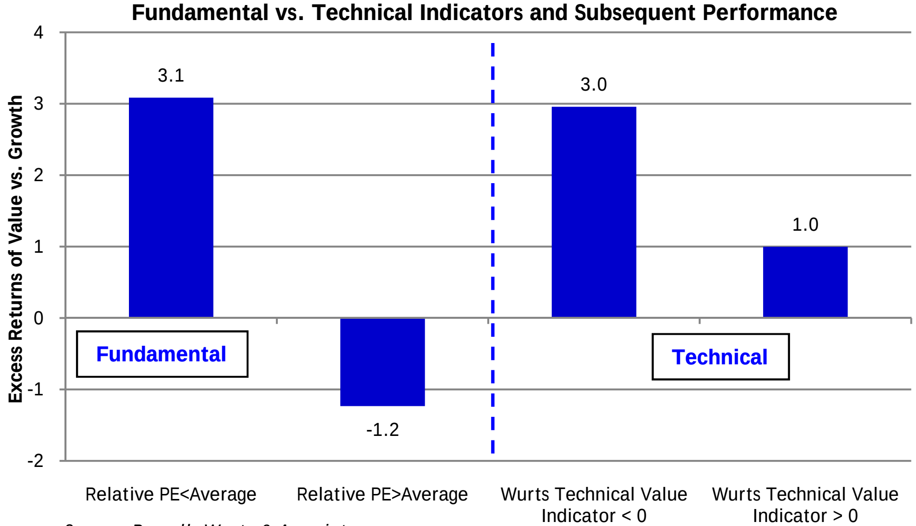
- As was the case for US and int'l large cap stocks, we have decided to introduce technical analysis into our views of US large value vs. growth.
- One of the primary reasons we did this was because of recent fluctuations in the balance sheets of value stocks as a result of large and potentially reversible accounting write offs.
- For all intents and purposes, our normal valuation based analysis has become, candidly, much less useful in this environment. This is easily demonstrated by a huge shift in relative valuations over the last several quarters.
- Interestingly, the fundamental analysis tells us to shy away from value, but the technical analysis tells us the opposite. There seems no compelling reason to take a large stand one way or the other. Therefore, a neutral weighting is in order.

Relative PE Ratio of US Large Value vs. Growth (Russell) (Sept.'09)



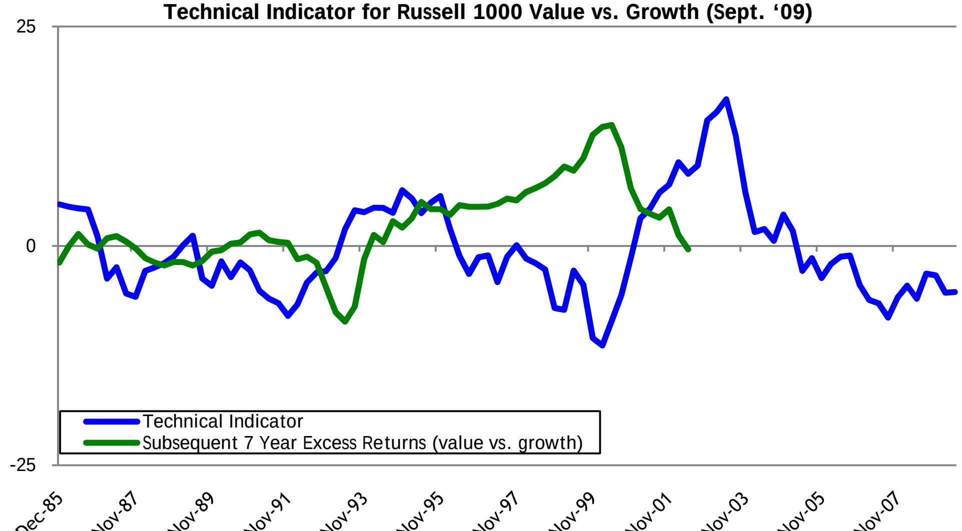
Source: Ibbotson, Wurts & Associates

Fundamental vs. Technical Indicators and Subsequent Performance



Source: Russell, Wurts & Associates

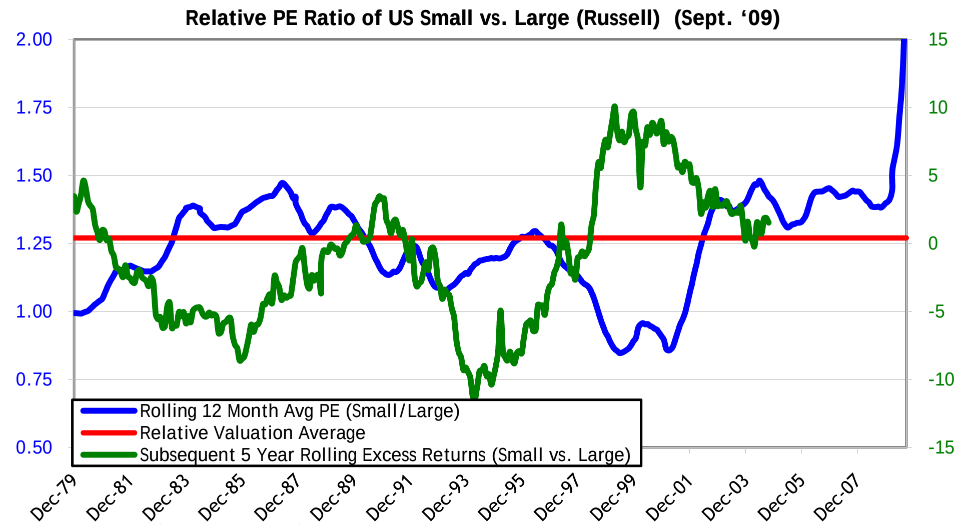
Technical Indicator for Russell 1000 Value vs. Growth (Sept. '09)



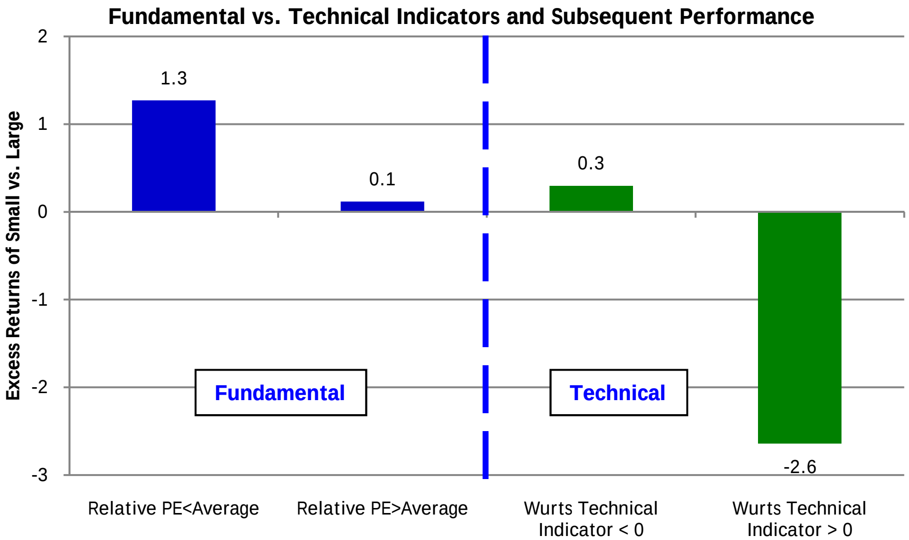
Source: Ibbotson, Wurts & Associates

Capitalization Tilts: *US Small vs. Large*

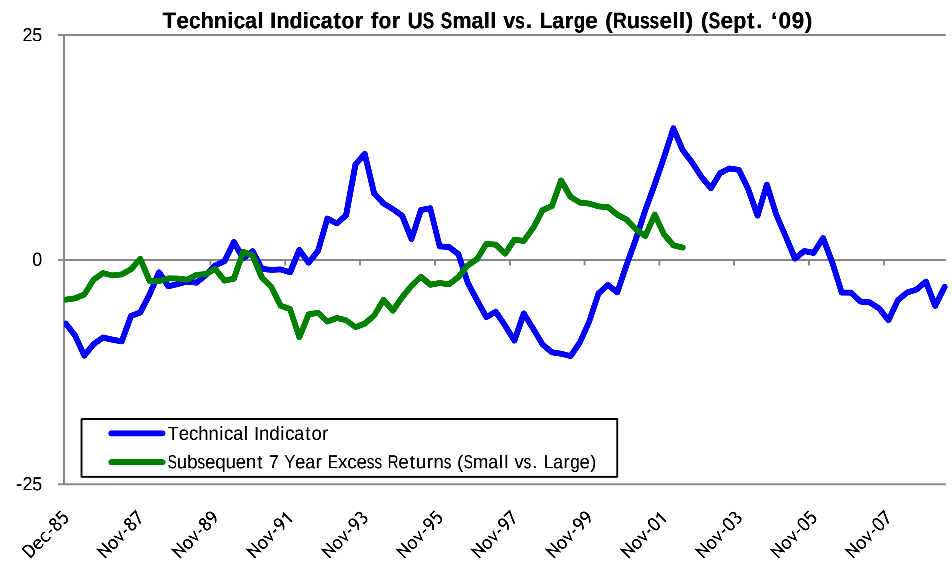
- As mentioned on the previous page, accounting irregularities are rendering fundamental valuation analysis less useful until things return to more normative levels.
- For example, seeing a PE ratio for the Russell 2000 Value of 1264 kind of caught our attention…not a typo. So you can imagine why the relative valuation shot off the charts over the last quarter.
- Let's not forget that small cap stocks should trade at cheaper levels than large caps due to their inherent riskiness, and they were not cheaper going into the recent market crisis. On the other hand, our technical indicators are telling us small stocks may be a little oversold relative to large.
- Overall, because small caps are not trading at compellingly cheap valuations or experiencing significant technical weakness, a market weighting (or lower) seems appropriate at this time.



Source: Russell, Wurts & Associates



Source: Russell, Wurts & Associates

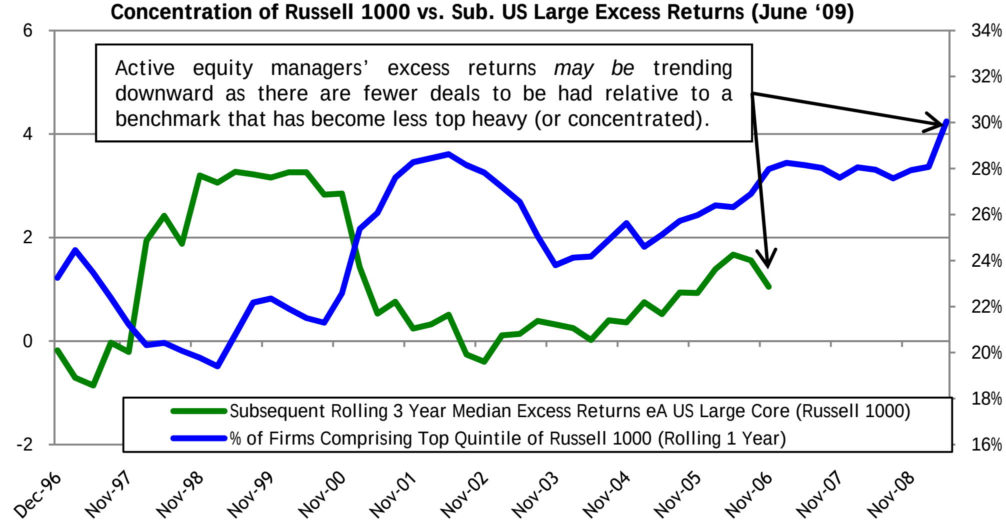


Source: Ibbotson, and Wurts & Associates

Who Says Active Management Returns Can't Be Forecasted?

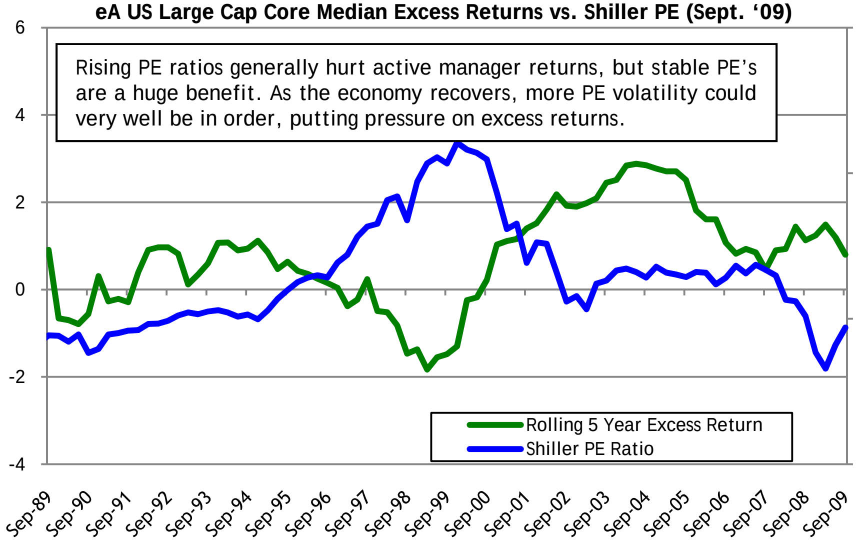
- The fact of the matter is the bulk of active manager returns are driven by market betas. After all, what else could they possibly be driven by? There's not enough "alpha" to be found for anything else to be true.
- Because active managers are a collection of betas, we can draw some general conclusions about their behavior during various market environments. This helps us to not act rashly by assigning blame or credit where it is undue. Furthermore, it allows us to bring a more meaningful evaluation tool to the table than just looking at returns relative to another arbitrary portfolio (or a benchmark).
- The most important thing to understand about active management and indexing is that neither is the absolute answer. It's just not a black and white issue.

Concentration of Russell 1000 vs. Sub. US Large Excess Returns (June '09)



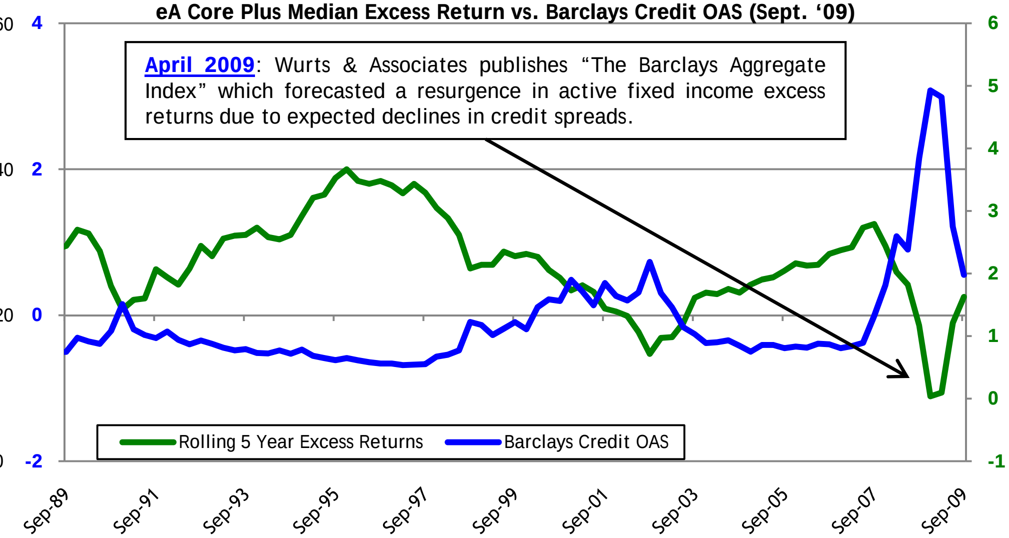
Source: eVestment Alliance, Russell, Wurts & Associates

eA US Large Cap Core Median Excess Returns vs. Shiller PE (Sept. '09)



Source: eVestment Alliance, Yale/Shiller, Wurts & Associates

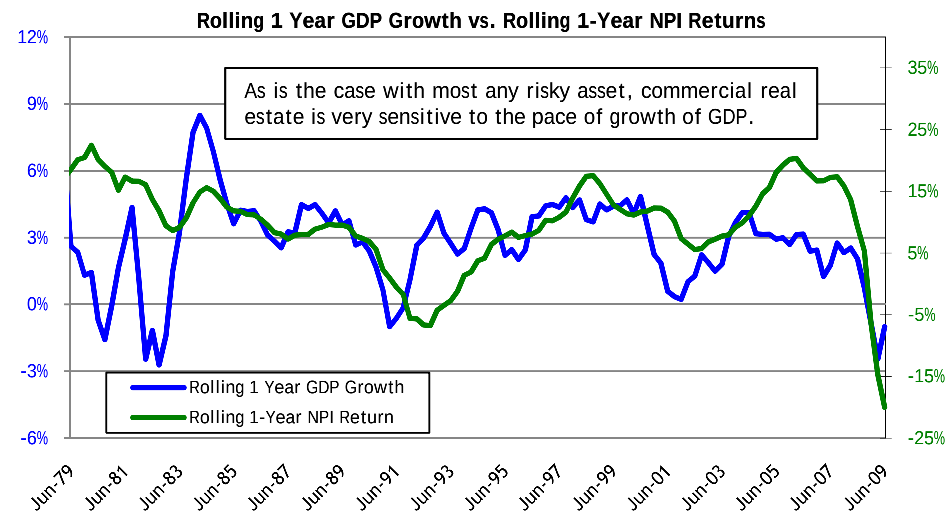
eA Core Plus Median Excess Return vs. Barclays Credit OAS (Sept. '09)



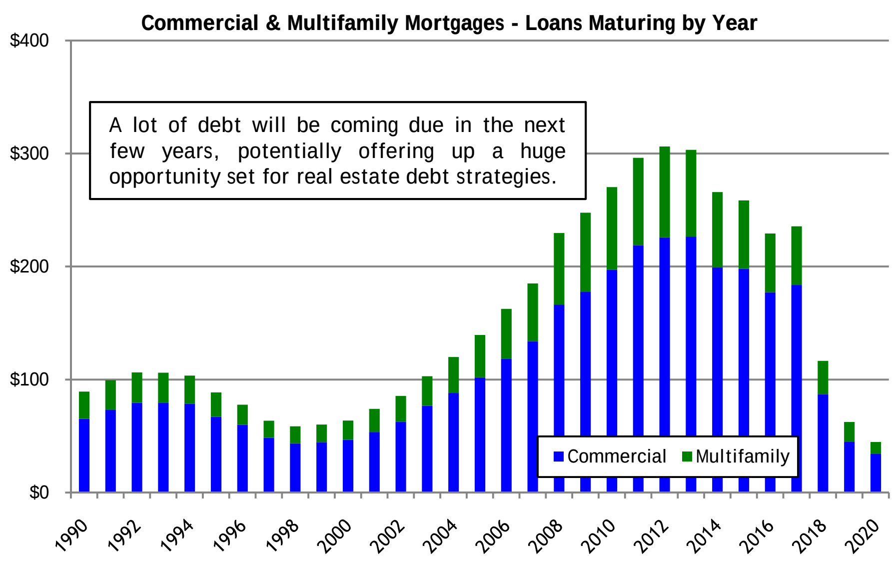
Source: eVestment Alliance, Barclays, Wurts & Associates

One Last Area of Opportunity – Private Real Estate

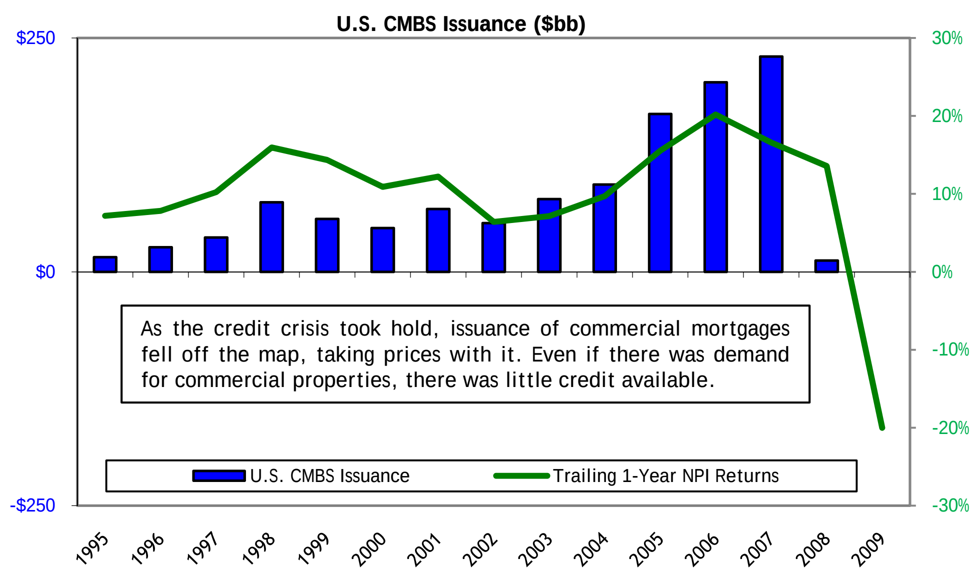
- Recent returns have been some of the worst in the history of the NCREIF index. Given the sensitivity to macroeconomic factors such as GDP growth and unemployment, the results are not completely unexpected.
- Relaxed lending standards along with cheap credit led to increased investor demand which clearly bolstered returns in recent years. As transaction volumes went up, so did prices. When credit markets crashed, the momentum of this asset class came to an abrupt halt. Very few transactions have been taking place. The majority of those are distressed sellers.
- Given the massive leverage undertaken over recent years, now may be an attractive time to allocate to distressed real estate and debt-related strategies as many investors look to get out.



Source: *BLS, NCREIF (National Council of Real Estate Investment Fiduciaries), Wurts & Associates*



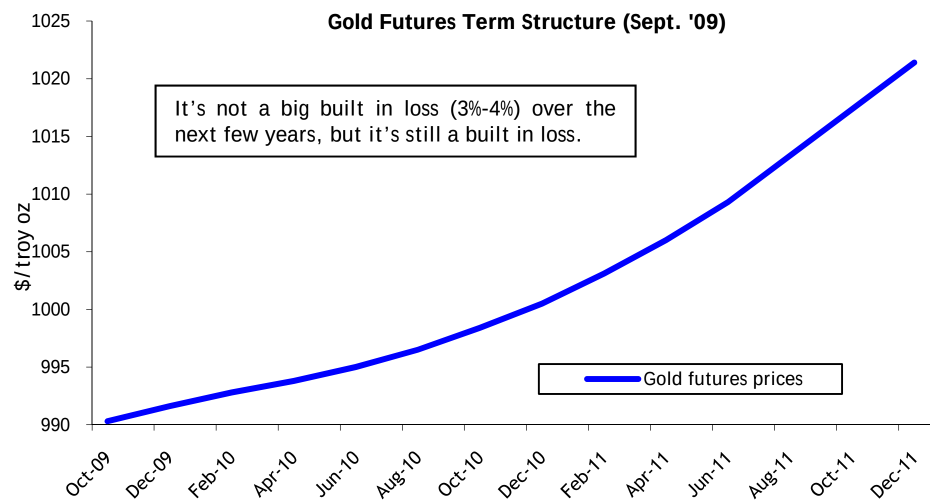
Source: *Federal Reserve Foresight Analytics, INVESCO Real Estate*



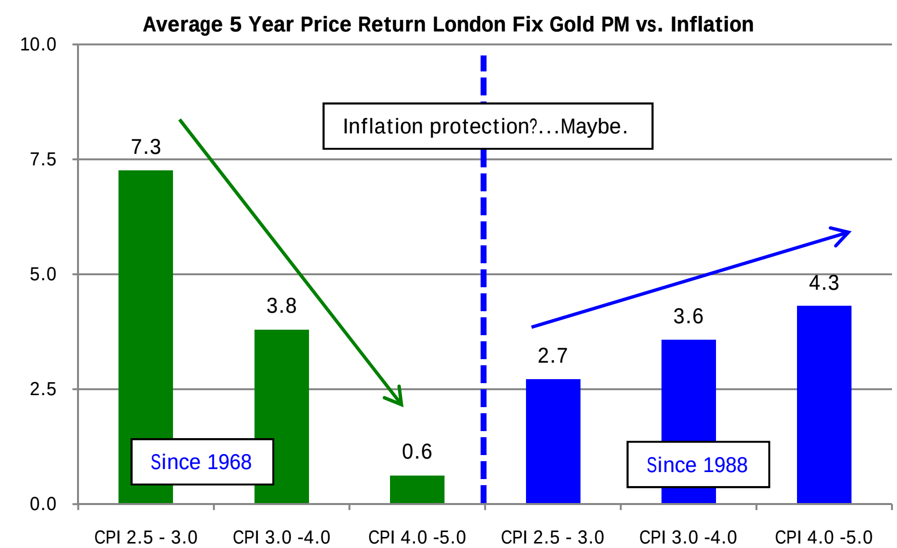
Source: *CMAlert, NCREIF, Wurts & Associates*

A Reality Check on the Investment Merits of Gold

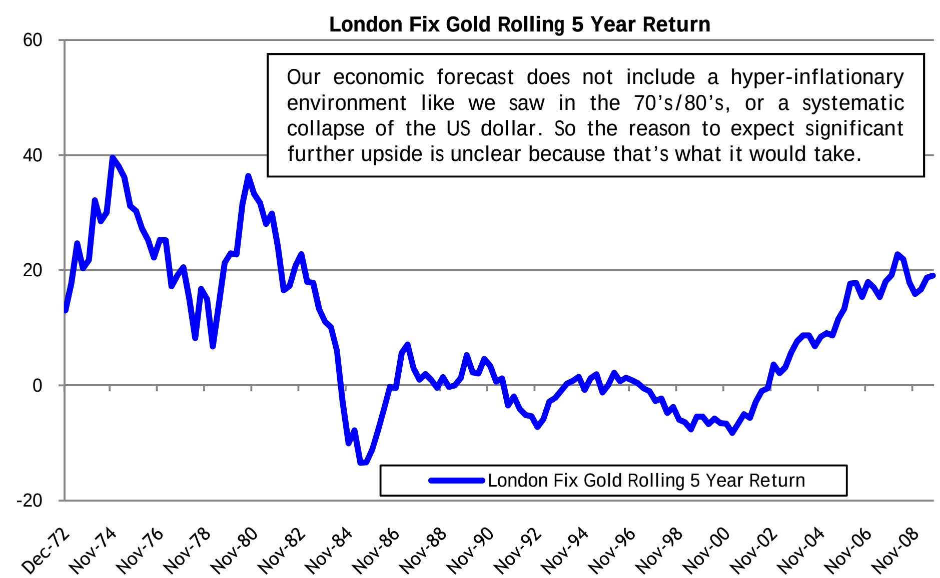
- Nowadays gold is a very popular discussion item given all the concerns over inflation and value of the US Dollar. Some institutional investors have even gone so far as to make dedicated allocations. This seems a little unwise from our point of view.
- For starters, gold futures markets are in contango, meaning they have a built in loss for investors. Second, trailing period returns are the highest we've seen in decades. Do you really think five year returns of 20% annualized are sustainable going forward? Finally, the inflation protecting powers of gold are dubious and depend on the period in question.
- Now don't get us wrong, we are actively recommending passive commodities as an inflation hedge, including gold. But a dedicated allocation to a highly volatile and speculative metal with little industrial use…we're not going to recommend that.



Source: BGI



Source: Ibbotson, Wurts & Associates



Source: Ibbotson

Concluding Thoughts

Macroeconomics

- Forecasting macroeconomic conditions is not something that can be done with precision, and the complexity of doing so will have no impact on the accuracy of the results. In our estimation, the most reliable means of looking forward is to put yourself in the shoes of key policy makers that have a direct and significant impact on the economy. This should be done on top of an academically based understanding of macroeconomics. Because we know the economy drives every major portfolio risk factor, such analysis is essential. *No asset allocation modeling system can overcome the effects of poorly derived risk and return estimates.*
- Given available data, we believe a U-shaped recovery alongside higher than expected inflation is forthcoming. Of course our crystal ball could be a little cloudy and we could be wrong, but the evidence just doesn't support any other likely conclusion. And we surely can't bury our head in the sand or refuse to state an opinion. This stuff is just too important when setting portfolio policy and asset allocation targets. We can't accurately predict the future of course, but that doesn't mean we can't get it directionally correct.

Fundamental & Technical Analysis

- Generally speaking, capital markets seem to have recovered from the flight to safety in '08 as equity valuations are on the rise, credit spreads have narrowed, and risk free interest rates are higher. As we stated in our 4th quarter 2008 research report, the world's governments had no choice but to create a flight to risk, and did so with apparent success.
- Equities seem poised to provide high single digit rates of return. We do not see any compelling reason to adopt significant style or capitalization tilts within domestic equities. Globally, we urge a more diversified equity allocation to capture reasonable valuations in developed markets, higher growth potential in emerging markets, and an overarching hedge against potential dollar depreciation.
- We continue to believe nominal risk free fixed income remains poised to noticeably underperform credit opportunities. This margin has narrowed substantially from our original recommendation earlier this year, but still remains attractive.

Tying It All Together

- We do not see a good chance of being rewarded for taking large amounts of risk in this environment. The GDP growth necessary to see big valuation expansions, tight credit spreads, and an environment conducive to levered investments just doesn't seem likely. What we do see is a steady recovery in major risk factors and a significant threat of inflation that should be acted upon.
- Most importantly, don't be convinced to translate wishful thinking into investment strategy in the hopes of making up lost ground. We know such thoughts are being circulated amongst the institutional community. Make plans based on what you see in the world around you, not what you want to see, or what others would like you to see for their own purposes.

Appendix

Periodic Table of Returns – September 2009

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 (YTD)
Best	29.5	35.9	17.5	51.2	29.1	32.9	8.1	38.3	23.1	35.2	38.7	43.1	22.8	14.0	10.3	48.5	22.3	18.9	26.9	15.8	5.2	29.6
	28.6	25.2	8.9	41.7	13.8	26.3	6.4	37.2	21.6	31.8	20.3	33.2	12.3	8.4	6.7	46.0	20.7	14.0	23.5	11.8	1.8	29.1
	23.2	20.2	7.9	41.2	12.3	23.8	4.2	31.0	21.4	30.5	16.2	27.3	11.6	7.3	1.7	38.6	16.5	7.5	22.2	11.6	-6.5	27.1
	20.4	18.8	2.6	24.6	8.0	18.1	2.7	25.8	14.4	18.6	15.6	26.5	7.0	4.1	1.0	30.0	14.3	7.1	16.1	10.3	-20.7	16.4
	11.7	14.5	2.3	21.7	7.8	13.4	-0.8	24.6	14.1	16.2	13.6	13.0	6.0	2.8	-8.6	29.7	13.1	7.1	13.4	7.9	-24.0	15.9
	11.3	12.4	-0.3	16.0	7.4	11.5	-1.5	18.5	11.3	13.9	8.7	11.4	4.1	-2.7	-11.4	21.6	11.1	5.3	12.8	7.1	-28.9	14.8
	9.6	10.8	-8.1	14.5	5.0	9.8	-2.0	11.6	10.3	12.9	5.1	7.3	1.9	-5.6	-15.5	11.6	6.9	4.7	10.4	7.0	-36.9	9.8
	7.9	8.6	-17.4	12.5	3.6	3.1	-2.4	11.1	6.4	9.7	1.2	4.7	-14.0	-9.2	-15.7	9.0	6.3	4.1	9.1	4.7	-38.4	5.7
	6.8	7.8	-21.8	5.8	-4.3	2.9	-2.9	7.5	5.3	5.3	-5.1	-0.8	-22.4	-20.4	-27.9	4.1	4.3	3.0	4.8	-0.2	-38.5	0.1
Worst	N/A	N/A	-23.2	-5.6	-11.9	1.4	-3.5	5.8	3.6	2.1	-6.5	-1.5	-22.4	-21.2	-30.3	1.1	1.2	2.4	4.3	-9.8	-43.1	-15.1

- Large Cap Growth US Stocks (Russell 1000 Growth Index)
- Large Cap Value US Stocks (Russell 1000 Value Index)
- Small Cap Growth US Stocks (Russell 2000 Growth Index)
- Small Cap Value US Stocks (Russell 2000 Value Index)
- Hedge Fund of Funds (HFRI Fund of Funds Index)
- International Stocks (MSCI EAFE Index)
- Domestic Fixed Income (Barclays Capital Aggregate Bond Index)
- Real Estate (NCREIF Property Index)
- Cash (Citigroup 3-Mo Treasury)
- ICC Universe Median (Total Funds)

Data: Ibbotson Associates, As of 9/30/2009; Independent Consultants Cooperative.

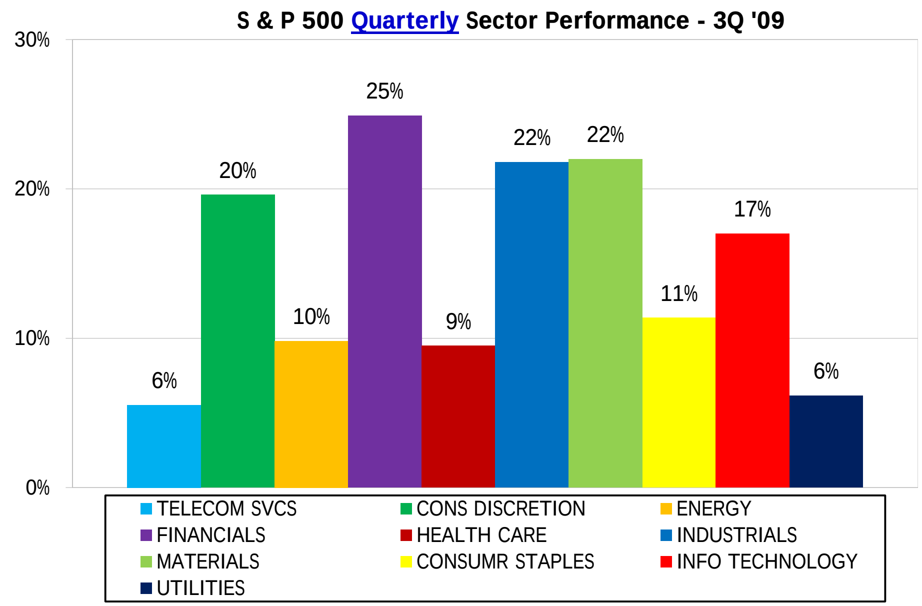
Detailed Equity & Fixed Income Returns

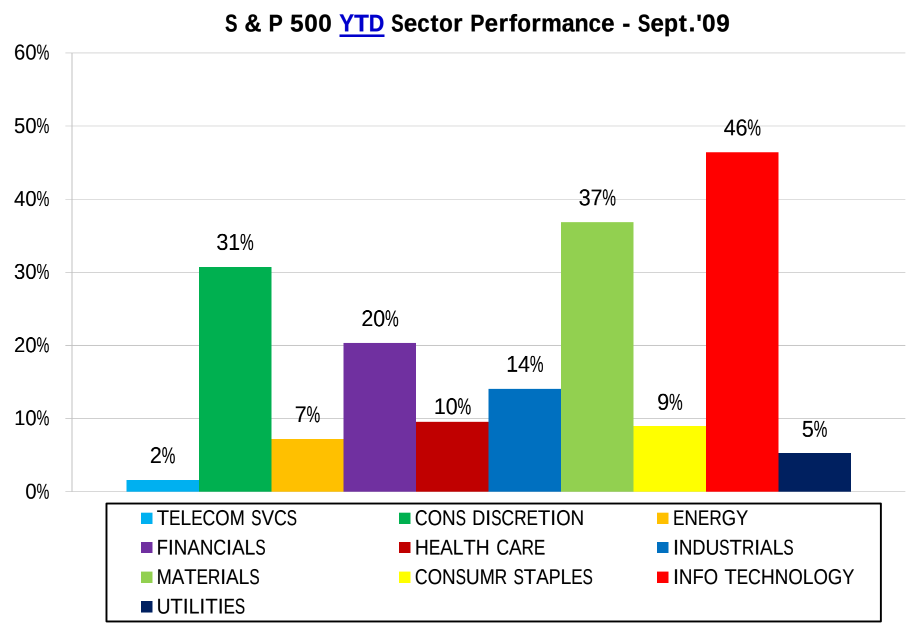
Domestic Equity	3Q	YTD	1-Year	3-Year	5-Year	10-Year
Core Index Performance						
S&P 500	15.6	19.3	(6.9)	(5.4)	1.0	(0.2)
S&P 500 Equal Weighted	21.6	37.5	0.9	(3.4)	3.4	5.6
DJ Industrial Average	15.8	13.5	(7.4)	(3.3)	1.9	1.6
Russell Top 200	14.4	17.0	(7.1)	(5.5)	0.6	(1.4)
Russell 1000	16.1	21.1	(6.1)	(5.1)	1.5	0.4
Russell 2000	19.3	22.4	(9.5)	(4.6)	2.4	4.9
Russell 3000	16.3	21.2	(6.4)	(5.1)	1.6	0.7
Russell Mid Cap	20.6	32.6	(3.6)	(4.1)	3.9	6.1
Style Index Performance						
Russell 1000 Growth	14.0	27.1	(1.9)	(2.5)	1.9	(2.6)
Russell 1000 Value	18.2	14.8	(10.6)	(7.9)	0.9	2.6
Russell 2000 Growth	16.0	29.1	(6.3)	(2.6)	2.9	1.1
Russell 2000 Value	22.7	16.4	(12.6)	(6.7)	1.8	8.1

Fixed Income	3Q	YTD	1-Year	3-Year	5-Year	10-Year
Index Performance						
BC US Aggregate Bond	3.7	5.7	10.6	6.4	5.1	6.3
BC US Treasury US TIPS	3.1	9.5	5.7	5.6	4.8	7.5
BC US Treasury Bills	2.1	(2.3)	6.3	6.9	5.2	6.2
Maturity Evaluation						
BC US Treasury 1-3 Yr	0.8	0.8	3.6	5.2	4.0	4.6
BC US Treasury Interm.	1.7	(0.8)	5.6	6.6	4.8	5.5
BC US Treasury Long	4.5	(8.0)	9.1	8.0	6.6	8.0
Issuer Performance						
BC US Agcy Intermediate	1.6	2.2	7.9	6.6	5.1	6.0
BC US Credit	7.5	14.9	19.5	5.8	4.7	6.5
BC US Mortgage	2.3	5.3	9.9	7.4	5.9	6.4
BC US Corporate High Yield	14.2	49.0	22.4	5.3	6.1	6.3
BC Emerging Markets	11.3	31.1	18.9	6.9	8.8	11.6

International Equity	3Q	YTD	1-Year	3-Year	5-Year	10-Year
Broad Index Performance						
MSCI EAFE	19.5	29.6	3.8	(3.1)	6.6	3.0
MSCI AC World	19.8	37.0	6.5	(0.8)	8.6	4.5
MSCI Emerging Mkts	21.0	64.9	19.5	8.3	17.7	11.7
MSCI EAFE Small Cap	22.2	48.8	15.9	(3.4)	7.5	7.0
Style Index Performance						
MSCI EAFE Growth	16.8	24.7	(0.4)	(2.8)	6.1	0.9
MSCI EAFE Value	22.2	34.6	8.1	(3.5)	6.9	4.9
Regional Index Performance						
MSCI United Kingdom	18.5	34.0	(1.3)	(6.1)	3.5	
MSCI Japan	6.6	9.4	(0.4)	(8.0)	2.3	
MSCI EM Asia	19.8	63.2	28.1	7.9	16.2	
MSCI EM Latin America	24.8	81.5	19.8	17.6	28.3	19.6

S&P 500 Sector Returns

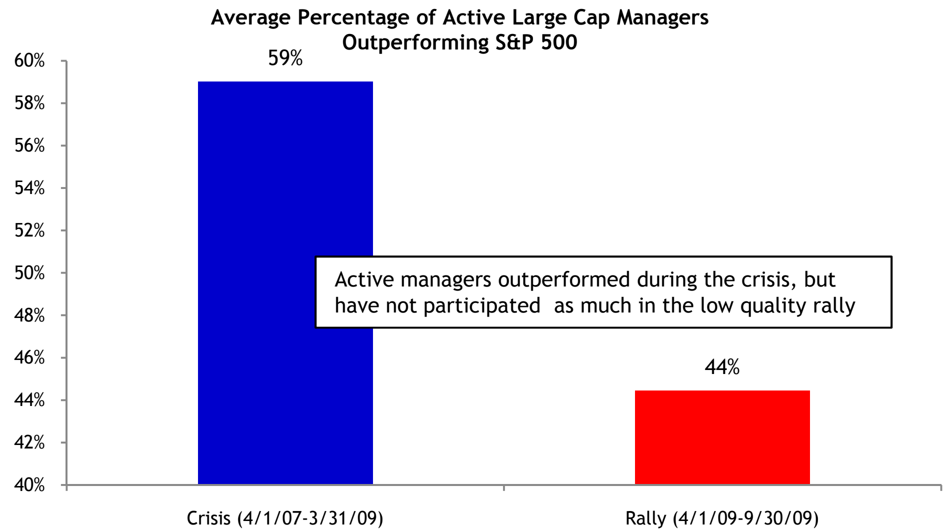




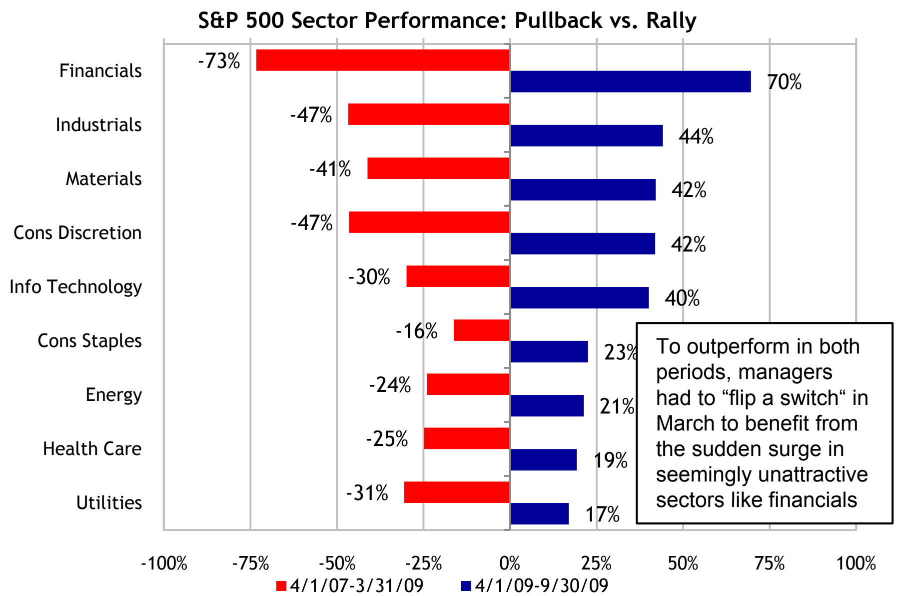
Source: ICC

Financial Crisis and Low Quality Recovery: Large Cap Equities

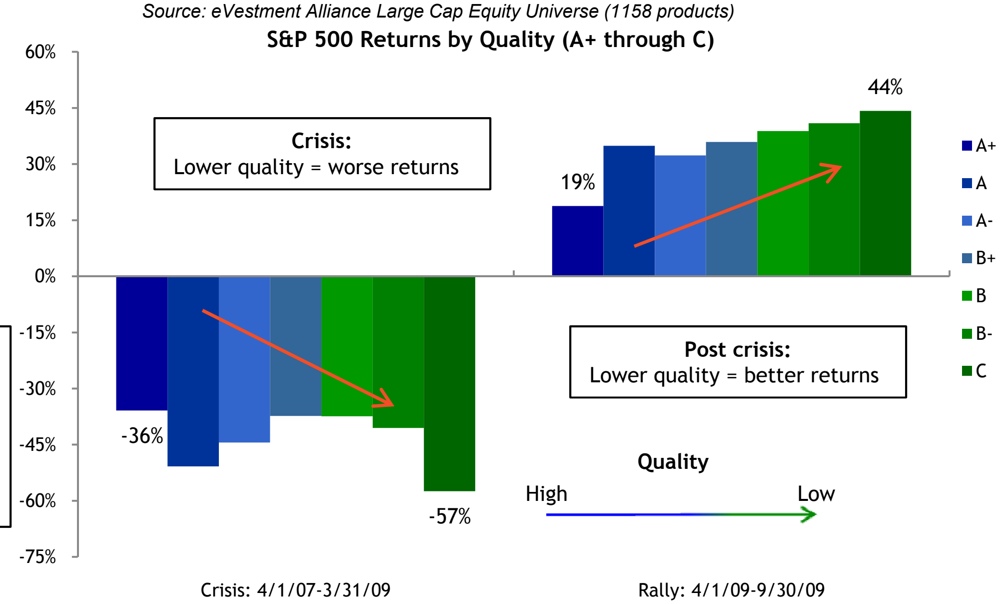
- During the financial crisis, companies with the worst balance sheets were hit hardest on bankruptcy fears.
- However, since the market bottomed in March, the low quality stocks that lagged during the crisis have rallied the strongest.
- The run-up in low quality stocks has been primarily due to worst-case scenarios being ruled out, rather than on sustainable catalysts like earnings growth and quality of management.
- This environment, dubbed a “low quality” or “junk” rally, has been especially difficult for active managers who focus on high quality.
- Sectors with the strongest ties to economic growth (Industrials, Materials, Consumer Disc. and Info. Tech.) have been top performers in the rally, despite the lack of actual growth.



Source: eVestment Alliance Large Cap Equity Universe (1158 products)



Source: Standard & Poor’s, Wurts & Associates

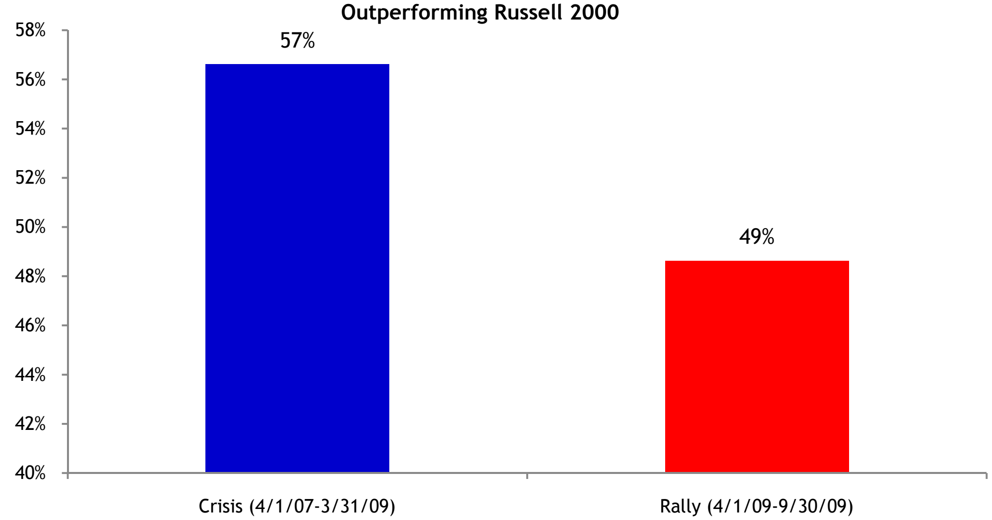


Source: Atlanta Capital, Wurts & Associates

Small & Mid Cap Equities

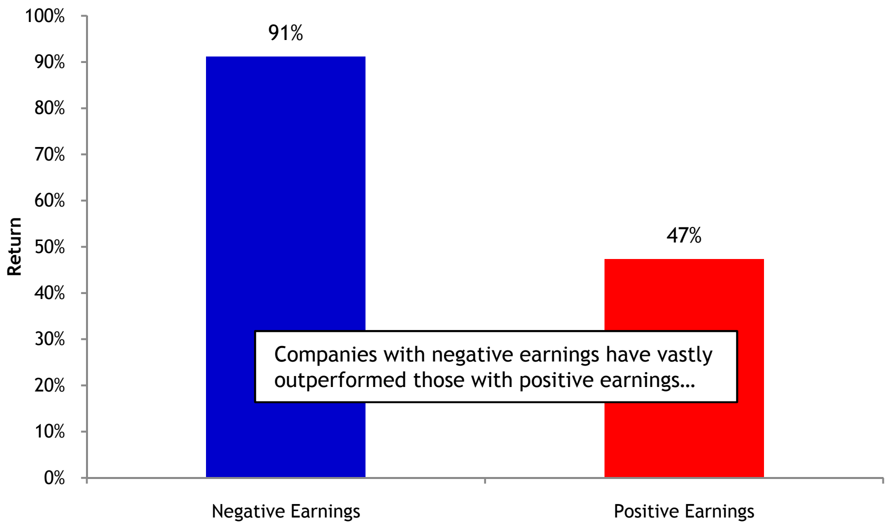
- Small and mid cap equity managers also outperformed during the crisis but have been underperforming during the recent rally.
- Similar to large caps, high quality stock performance was constrained while the lowest quality companies have rallied the fastest.
- Companies that have reported negative earnings have actually outperformed companies with positive earnings during the rally. This is obviously not sustainable in the long term.
- Managers that place a heavy emphasis on quality have had a difficult time keeping pace recently.

Average Percentage of Active Small Cap Managers Outperforming Russell 2000



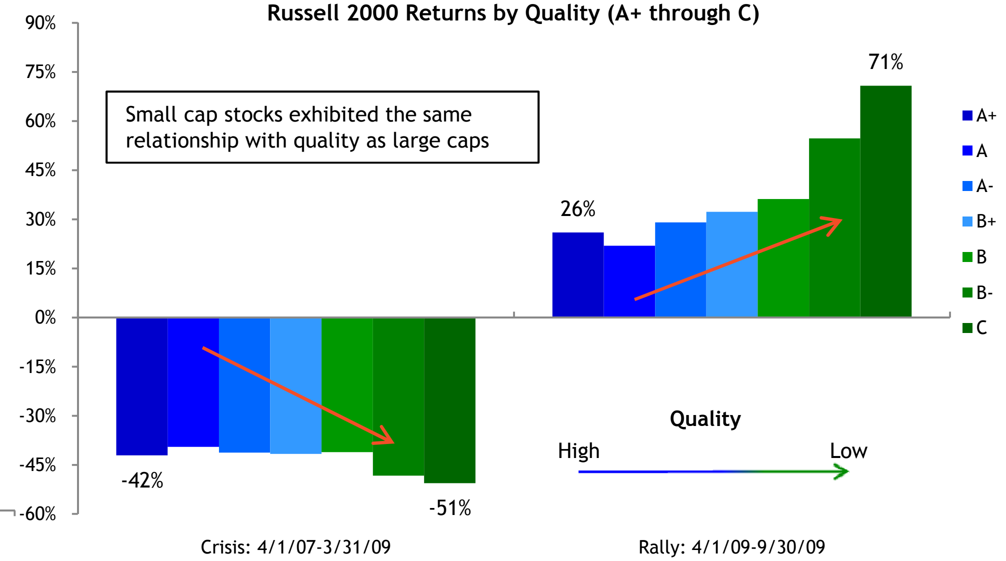
Source: eVestment Alliance Small Cap Equity Universe (Count: 598), Wurts & Associates

Russell 2500 Performance by Positive vs. Negative Earnings 3/1/09-9/30/09



Source: Rothschild, FactSet Research Systems, Russell Investments

Russell 2000 Returns by Quality (A+ through C)



Source: Atlanta Capital, Wurts & Associates