2011 Mid-Year Outlook Abridged

Our *2011 Outlook*, published in November 2010, was entitled A Mix of Clouds and Sun. So far in 2011, we have not seen the dark storms of 2008 or the bright skies of 2009 and 2010. From an economic and market perspective, the year 2011 can be characterized instead as having experienced patches of clouds and sun with some ups and downs in the economy and markets. Overall, the investing climate of 2011 has been favorable. Two years after the green shoots of economic growth were first evident in mid-2009, they have blossomed and taken root.

Neither bulls nor bears, LPL Financial Research continues to expect the markets and the U.S. economy will be range-bound in 2011. Bound by economic and fiscal forces that will restrain growth, but not reverse it, we adhere to our prior forecast for modest single-digit rates of return: high single-digits for stocks and low single-digits for bonds.

A Mix of Clouds and Sun: On Track

At the mid-point of the year, the key elements of our *2011 Outlook* are on track:

✓ **The job market is staging a comeback.** Our expectation for the creation of roughly 200,000 net new jobs on average per month in 2011 has been met, so far. While slowing productivity gains have driven the need to bring on new workers, slow sales growth from tepid consumer spending is keeping the pace of hiring modest. Economic growth as measured by Gross Domestic Product (GDP) in the first quarter of 2011 was below our forecast range of 2.5–3%; however, we believe growth for the year overall will remain on track to fall within our specified range.

✓ **Policymakers have delivered economic stimulus.** The Federal Reserve (Fed) has provided substantial economic stimulus, concluding the QE2 (second round of Quantitative Easing) Treasury purchase program on June 30, 2011. As the year matures, policy stimulus from the Fed will begin to fade accompanied by a gridlock-induced shrinking of the federal budget deficit.

✓ **Investors are playing it safe.** Inflows to riskier markets have continued to be anemic, contributing to modest performance for both stocks and more aggressively postured bonds. The stock market, measured by the S&P 500 index, has posted a 4% total return through early June 2011. The bond market, measured by the Barclays Capital Aggregate Bond Index, has provided a 3% total return during the same time period. We continue to expect high single-digit gains for stocks as earnings growth slows and valuations remain under pressure, and low single-digit gains for bonds as yields remain range-bound.

✓ **Currencies are influencing returns.** As we expected, the currency impact on investing has been pronounced in 2011. The U.S. trade-weighted value of the dollar has fallen 5% so far in 2011. We continue to expect a downward, volatile path for the US dollar.

During the second half of 2011, we anticipate a set of transitions will take place. These transitions include:

- The evolution in the stage of the business cycle from economic recovery to modest, uneven growth.
- The change in economic policy to the withdrawal of the fiscal and monetary stimulus provided over the past several years.
- The return of inflation that we call reflation.
- The shifting geopolitical landscape.

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Given these transitions, investors will need to utilize investment ideas that may succeed in a period where the performance of the major indexes is likely to be lackluster. Market volatility, which we expect to remain elevated, may present risks to be side-stepped and opportunities to be taken advantage of. Investors with a more opportunistic profile may benefit from a tactical approach to investing in order to invest in attractive opportunities when offered and successfully take profits when appropriate. Longer-term strategic investors should consider remaining broadly diversified.

Key Themes for Investors in the Second Half

The recovery over the past two-years has been impressive. It has resulted in a return to new highs in GDP, consumer spending, and corporate profits—not to mention the nearly 100% gain in the S&P 500. While not every aspect of the economy has fully recovered, such as jobs and housing, the recovery is largely complete and is now transitioning to a new phase: a transition to an environment of modest, uneven growth is underway.

In general, during the recovery, which is the early stage of the business cycle, each month's data was stronger than the prior month as the economy, earnings, and markets marched steadily higher. However, that characteristic is not typical of the middle stage of a business cycle where data points are uneven. In the middle stage of a business cycle, some data points are stronger and some are weaker as the economic data varies around a more modest pace of growth.

In 2011, we continue to expect modest economic growth of 2.5–3%, job growth averaging about 200,000 per month, and inflation to rebound to around 3% as the data points vary around these underlying trends. The markets have a tendency to overreact to each data point creating heightened volatility around a more modest pace of gains. We continue to believe stocks will deliver high single-digit gains and bonds low single-digit gains in 2011, coupled with above average volatility.

Key themes for investors can be found in the set of transitions unfolding in the second half of 2011. In addition to the evolution from the early to the middle stage of the business cycle, the transitions incorporated into our forecasts include: Changing Policy Prescriptions, Reflation Taking Root, and Shifting Geopolitical Landscape.

Key Themes

1. Changing Policy Prescriptions
2. Reflation Taking Root
3. Shifting Geopolitical Landscape

1. Changing Policy Prescriptions

Beginning in late 2007, both monetary policy conducted by the Federal Reserve Board and fiscal policy conducted by the U.S. Congress have been unusually focused towards stimulating economic growth. The transition from the stimulative to a restrictive fiscal and monetary policy environment has implications for financial markets and the economy.

Typically, as the economy transitions from recovery to modest, sustainable growth, it results in uneven data points creating uncertainty and driving volatility, which is true again in our current business cycle. The global economy remains out of balance, teetering back and forth between the soft spots that invoke a need for increasingly extended policy support and the growth spurts that provoke a desire to begin to pull back some of the record-breaking stimulus. The last time government spending comprised

Quantitative easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

as much of GDP as it does today (during 1945–1960), the economy went through a period of heightened volatility driven by the swings in policy action. Sharp swings in policy are likely to be forthcoming and contribute to the uneven pattern of growth for the economy and markets that we envision. The bottom line is that the economic expansion is self-sustaining, but the pace is slower.

Monetary Policy

From late 2007 through the middle of 2010, policies in major developed economies (United States, Europe, United Kingdom, South Korea, Canada, and Japan) were stimulative in order to combat the Great Recession and its aftermath. Between late 2007 and late 2009, most large emerging market economies (China, India, and Brazil) also embraced policy stimulus for the same reasons.

However, beginning in early-to mid-2010, many emerging markets (such as China, India and Brazil) and resource-based developed (Australia and New Zealand, for example) economies began to shift monetary policy by hiking interest rates in an effort to slow their growth. They did this mainly to combat rising inflationary pressures stemming from their rapidly growing economies. In the developed world, and in particular in the United States, central banks and governments are already making plans to slow growth through restrictive changes to monetary policy.

Currently, monetary policy is as stimulative as it has ever been in the United States. The policy-setting Fed Funds Rate is near zero. In addition, the Fed has recently completed a second round of quantitative easing (QE2), which is the purchase of Treasury securities by the Fed to increase cash in the banking system. QE2 was intended to put downward pressure on interest rates. In turn, this would keep mortgage rates low to make housing more affordable and keep corporate borrowing costs down to encourage hiring and investment. These easier financing conditions were intended to boost the economy, stock market, and consumer confidence leading to a transition from policy-aided recovery to independently sustainable economic growth.

As QE2 ends, many fear a repeat of the environment that unfolded after the end of QE1 back in the spring of 2010 when the markets pulled back and the economy slowed. However, there is a big difference in the backdrop between now and when QE1 ended.

- **Employment:** A year ago as QE1 ended, the economy had shed jobs during 10 of the prior 12 months, whereas this year, new private sector jobs have been added in every one of the past 12 months totaling 1.7 million (as of June 2011).
- **Inflation:** Deflation was a major concern of policy makers a year ago as QE1 ended with the year-over-year change in the Consumer Price Index (CPI) sliding to 1.1% by June; in sharp contrast the CPI is now 3.6% above the 30-year average of 3.2%.

- **Business loans:** In the spring of last year as QE1 was winding down, business lending was falling at a 20% year-over-year pace as businesses were unwilling to borrow and bank credit standards were tight. Now commercial and industrial loan demand has turned positive as businesses seek to fund growth and banks have eased standards.

The widely anticipated end of QE2 is unlikely to be a major turning point for the markets. Only after the Fed actually begins to unwind the program by selling the bonds it has purchased, draining the economy of the stimulus it has provided, and eventually begins to raise interest rates will the drags on growth begin to test the economy. While the exact timing will be dependent upon a number of factors, including the budget battles in Washington, that test is unlikely to come until 2012.

The end of QE2 does not prompt us to change our outlook. While interest rates are likely to rise modestly, we do not anticipate a spike resulting from the lack of Fed buying that would put the economy at risk. In the months ahead, we continue to forecast below average economic growth, range-bound performance for stocks and bonds, a slightly weaker dollar, and modest increases in commodity prices. We may see more of an impact in 2012 from this transition to rein in stimulus by the Fed.

Steps for the Fed to Rein in Stimulus

Step 1	Mid-2011	▪ End of QE2: Fed stops buying Treasuries, which served to expand its balance sheet
Step 2	Second half of 2011	▪ Fed maintains size of balance sheet by reinvesting interest payments and maturing debt
Step 3	2012 and beyond	▪ Fed begins to not reinvest allowing the balance sheet to start to contract ▪ Fed begins to hike interest rates ▪ Fed begins selling bonds

However, the other policy transition taking place this summer may have more of an impact. The budget and debt ceiling debate may be of more importance to investors since fiscal policy could tighten sharply or a failure to control the deficit could spike interest rates, with either case putting the economy at risk.

Fiscal Policy

Fiscal policy around the globe is becoming restrictive as governments are forced to cut spending and/or raise taxes. The dramatic shift from stimulative spending to restrictive austerity in the coming quarters is likely to have a discernable impact on growth.

In the U.S., fiscal policy is undergoing a transition away from a period of record-breaking deficit spending. Policymakers in Washington are no longer debating whether or not to cut spending, they are debating how much to

cut. However, Democrats and Republicans in Congress cannot seem to agree on the size or the composition of any deficit reduction package.

In the coming weeks leading up to early August, Congress has to agree to raise the nation's "debt ceiling," the limit on total debt issued by the U.S. Treasury to fund appropriations approved by Congress, or risk being unable to borrow to pay off maturing debt, issue Social Security checks, and fund the military, among other functions. A vote in Congress in late May 2011 made it clear that a debt ceiling increase would not occur without accompanying spending cuts or tax increases to narrow the budget deficit.

The range of potential outcomes for the debt ceiling issue is wide.

- **Unfavorable outcomes:** Of course, an extreme outcome could be a default on U.S. government debt, as the Treasury Secretary has warned. The risk of the budget battle of 2011 leading to a default, while not zero, is extremely low, as even the most cynical observers of Washington agree that lawmakers would almost certainly act to prevent such an outcome.
- **Favorable outcome:** A favorable outcome this year might be a comprehensive, long-term solution including entitlement reform. While this outcome would entail some austerity for the economy in 2011 and 2012, the long-term benefits would likely win out.
- **Most likely outcome:** The most likely result is that Congress agrees to some combination of spending cuts and tax increases of around one to two trillion dollars, along with a debt ceiling increase that will carry us into 2012. This result may simply "kick the can down the road" until after the 2012 Presidential and Congressional election.

Our view for a modest, uneven pace of economic growth and market performance incorporates this most likely outcome. While averting a default and making substantial cuts may be a positive for confidence, the boost may be undermined by the reality of not addressing the core of the problem, not resolving the issue in an enduring way and the drag on the economy created by the spending cuts.

Defining Monetary Policy

Monetary policy is conducted by central banks around the world, each with varying degrees of independence from the governments that created them. In the United States, monetary policy is set by the Fed, with its Chairman, Ben Bernanke, running the Fed's policy making arm, the Federal Open Market Committee (FOMC). The FOMC meets eight times a year to set policy. The FOMC conducts monetary policy with a mandate from Congress to pursue policies that foster low, stable inflation and full employment. Other countries' central banks have different mandates, but most involve keeping the inflation rate low. In general, central banks conduct monetary policy by raising (tightening) or lowering (easing) the rate at which banks can borrow from the central bank.

During the 2008–09 Great Recession, after cutting rates very close to zero, several central banks turned to quantitative easing, which is the purchase of fixed income securities in the open market to increase the money supply. This had the intended effect of introducing even more money into the financial system to be available for borrowing and to foster reflation, or the

return of prices of goods and services to a normal level. Monetary policy often works with a lag. So a decision by a central bank today to raise (or lower) its target interest rate may not have an impact on the economy until many months or quarters later.

Defining Fiscal Policy

Fiscal policy uses the spending, borrowing, and taxing authority of a government to influence economic behavior. As with monetary policy, fiscal policy often works with a lag. That is, a policy decision made today to raise or lower government spending or tax revenue in the future, often is not felt by the economy until months or even years later.

Tighter fiscal policy normally leads to lower budget deficits, but the path toward a tighter fiscal policy can often mean slower economic growth in the near term. However, once lower budget deficits are achieved, it can mean lower borrowing costs for governments, businesses, and consumers and lead to more robust and sustainable economic growth in the future.

2. Reflation Taking Root

When inflation gets too low, often called deflation, it is a sign that growth needs a boost. The problem with deflation is that when prices fall as output exceeds demand, it can become self-perpetuating as consumers and businesses postpone spending because they believe prices will fall further. As a result, spending and economic growth slows. But it does not stop there. Businesses' profits weaken, straining their ability to pay their debts and leading them to cut production, workers, and wages. This, in turn, results in lower demand for goods, which leads to even lower prices and so on as a destructive downward spiral takes root. Combating deflation by directly inflating the money supply through QE1 and QE2, all else equal, means that with more dollars in the system, the value of the dollar goes down and prices in dollar terms go up, resulting in a faster pace of inflation. We have termed this return of deflated prices to a more desirable level, reflation.

Although the Fed is widely expected to end formal purchases of Treasuries at the mid-point of 2011, we expect the reflation theme to remain intact over the remainder of 2011, as the Fed will be slow to remove this stimulus. The Fed will continue to reinvest proceeds from holdings of existing mortgage-backed securities into Treasuries and to also reinvest maturing Treasuries back into the Treasury market. Ceasing to reinvest bond proceeds would be one of the first signs of a less stimulative Fed, something we do not expect until 2012 at the earliest. While the Fed will not be adding to their inventory of bonds, we expect them to maintain a high level of stimulus through these reinvestment activities. When it comes to reflation, rather than easing off the gas pedal, we view the Fed as holding a steady speed.

Since QE2 was officially launched, the reflation theme became evident across a variety of market and economic indicators. Most importantly, reflation is perhaps best evidenced by rising inflation as measured by the Consumer Price Index (CPI). Inflation increased notably since the fourth quarter of 2010 and did so even after stripping out food and energy prices. We believe inflation will continue to rise in the second half of 2011, but at a slower pace than witnessed in the first half. The ongoing theme of reflation has implications for commodities, bonds, and the US dollar.

Commodities

Higher commodity prices also reflect the impact of reflation. Since the Fed hinted at QE2 in late August 2010, commodity prices rose and eventually paralleled the Fed's expanding balance sheet, which grew with Treasury bond purchases. By increasing the quantity of dollars, the US dollar weakened and commodity prices benefited. Commodities also benefited from improved economic growth prospects. Not only do commodities act as a store of value, but also serve as key inputs into a growing economy. Commodity prices declined in early May due to a combination of factors, including heightened China growth fears, increased margin requirements for some commodity contracts, and weaker economic data in the United States. However, we believe the global economic expansion while moderating, remains on track for growth, which will drive continued demand for commodities.

Bonds

Reflation, and accompanying economic growth, was evident in rising bond yields. The 10-year Treasury yield increased from a low of 2.4% just prior to the launch of expanded Treasury purchases to 3.0% at the start of June 2011. While investors may have questioned why substantial Fed Treasury purchases did not lead to lower bond yields, economic growth expectations and changes to inflation have historically been the dominant driver of yield movements, not supply/demand dynamics. We expect bond yields to remain volatile, but finish 2011 higher as the economic expansion continues.

US Dollar

The reflation theme will likely continue to manifest in a weaker US dollar and we expect additional, modest downward pressure on the dollar over the remainder of the year for several reasons:

- During the second quarter of 2011, the European Central Bank (ECB) joined the party and raised its policy-setting interest rate to 1.25% from 1.00%. Futures markets indicate the ECB may produce additional rate hikes in 2011 and the Bank of England may hike rates soon. In contrast, the Fed is expected to keep the policy setting rate unchanged at effectively zero through the middle of 2012. Downward pressure on the US dollar is likely to remain as the Fed is viewed as acting too slowly in reining in the overabundance of dollars in the world's financial system.
- The very low level of short-term interest rates in the United States may also push bond investors into foreign currencies. Treasuries are still the deepest and most liquid government bond market in the world and may benefit from bouts of safe haven buying as we expect volatility to continue in 2011. Nonetheless, as the global economic expansion remains on track, investors will be drawn to debt denominated in currencies of countries where higher interest rates exist and offer the prospect of higher returns. Lower short-term interest rates are a negative for the US dollar.
- A protracted budget battle could cause foreign investors to lose confidence in U.S. investments and pressure the US dollar lower. Alternatively, politicians may push more serious reform down the road into 2012 and

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.

Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of a fund shares is not guaranteed and will fluctuate.

after the next presidential election, which could also be received poorly by foreign investors. In sum, actions that suggest the U.S. is having difficulty getting its fiscal house in order could be dollar negative.

Taken together the above pressures on the dollar point to weakness during the second half of 2011 as the theme of reflation remains a key element of performance across the markets.

3. Shifting Geopolitical Landscape

Geopolitical and foreign policy conflicts along with regional violence escalated in the first half of 2011. We devoted a full chapter in our 2011 Outlook, published in late November 2010, to the subject of geopolitical event risk in 2011. In the publication we laid out four conclusions regarding the market impact of foreign policy in 2011:

- Increased volatility in global markets
- A tactical investing approach becomes more important
- Greater regional selectivity with global investments
- Rising opportunities for profit and loss with oil-industry investments

Evidence has supported these conclusions in the first half of the year. Geopolitical events have shaped the markets in the first half with popular uprisings toppling governments in North Africa and the defeat of Osama bin Laden with his death at the hands of U.S. forces in Pakistan.

North African Unrest

Oil prices are often driven by geopolitical events. As we noted in the 2011 Outlook: "all signs point to the strong possibility of more geopolitical risk-driven volatility in the price of oil in 2011." In late January, escalating protests in Egypt fueled by soaring prices, sagging employment, and social media sparked a series of protests and violence across Northern Africa.

The unrest spread within the region. The Libyan opposition was inspired by the ousting of Egypt's president. The Egyptians were motivated by the Tunisian uprising two weeks earlier that resulted in the ousting of that country's long-time dictator. However, the popular revolts have not spread meaningfully beyond the region. Unless it inspires major uprisings in Saudi Arabia, Nigeria, or other major oil producers, we expect the market and economic impact will be modest. With the eruption of civil war in Libya, oil prices soared over $100 per barrel, ultimately rising to $114 per barrel as the conflict lingered. Current oil prices of around $100 per barrel (as of early June) are embedded in our outlook for 2.5–3% economic growth in 2011. While we expect the spillover from the unrest in the region to be contained, we also expect more geopolitical event-driven volatility in 2011

The Defeat of bin Laden

Osama bin Laden's death at the hands of U.S. forces in early May 2011 marks a definitive defeat of al Qaeda's central figure. However, it is unclear what this means for al Qaeda's ability to continue to be a threat. The implications for the United States are more clear. This opens the door for a withdrawal of U.S. troops from Afghanistan. With bin Laden dead,

it is possible that the mission in Afghanistan to defeat al Qaeda may be considered complete.

This regional focus allowed other nations to take advantage of the distraction to create potential long-term challenges to the United States. For example, the Russians used the United States' distraction to reassert their control over the nations on their periphery. When Russia went to war with Georgia in 2008, the United States did not have the forces with which to counter Russian aggression on behalf of its ally.

As the combat troops leave Iraq and the proportional response to the threat in Afghanistan is now assessed, the United States will likely regain the resources and focus to project more effective foreign policy influence over the rest of its interests. This is a potential game changer for many countries such as Russia, Iran, North Korea, and even China, among others, that have gotten used to greater regional power than they had prior to 9/11.

This foreign policy development may have a domestic policy impact. From a U.S. spending perspective, this comes at a good time. First, it allows defense spending to be debated in the context of a withdrawal of troops from both Iraq and now Afghanistan. Second, it may give—if only briefly—Congress a reason to unite in a sense of national pride and address domestic issues such as the debt ceiling this summer.

Implications for Investors

In recent years, individual investors have favored emerging markets perceiving them to have better growth prospects leading to stronger returns and lower risks. However, the emerging markets have underperformed in 2011, as inflation, unrest, and rate hikes by central banks have created an unfavorable investment climate. In contrast, oil producers such as Russia and Venezuela have performed well.

As part of an increased emphasis on a more tactical investing approach in 2011, investors with global exposure could benefit from taking a more active and selective approach to the regions of the world. Investors may increasingly avoid the areas where international tension remains high and focus on those where the potential for conflict is fairly low.

How to Transition into the Second Half

The second half of 2011 will be a time of transition. The uncertainty this creates is compounded by the already long list of uncertainties that include the lingering aftermath of the earthquake in Japan, devastating tornadoes and floods in the central and southern portions of the United States, turmoil in the Middle East, and elevated energy prices.

The uneven data points accompanying the transitions taking place may prompt many investors to remain on the sidelines leaving a volatile, but directionless summer and fall for the major stock and bond market indexes. However, investment opportunities are still present. We believe focusing on the beneficiaries of reflation will help investors navigate volatile markets. Investments focused on this theme include:

- Commodities asset classes and precious metals
- Commodity-sensitive stocks

- High-yield bonds
- Bank loans

Furthermore, stocks and bonds have achieved much of the single-digit returns we forecasted for 2011 and total returns may be limited, putting the focus on volatility. A tactical approach adding economically sensitive investments during periods of weakness and trimming risk after periods of strength may prove valuable.

Commodities Asset Classes and Precious Metals

Perhaps the most dominant aspect of reflation is that of a weaker US dollar. We adhere to our forecast for a falling dollar in 2011 given the combination of Fed policies which are relatively different from other countries, rising inflation, lingering fiscal imbalances, and other factors. Most commodity prices are denominated in US dollars and a weaker dollar provides a favorable tailwind for returns of these investments. We favor precious metals within commodities. Not only does gold benefit as a store of value as inflation creeps higher and the dollar weakens, but also gold benefits from periods of safe-haven buying that accompany volatile markets.

Commodity-Sensitive Stocks

As a corollary to our broad commodity view, we believe commodity-sensitive stocks, such as those in the Materials, Industrials, and Energy sectors, may also provide opportunity. Profit margins of commodity-sensitive companies are likely to benefit from elevated commodity prices. These companies are also more likely to successfully pass on higher costs to end users. Commodity-sensitive stocks also benefit from the stronger growth of emerging market countries. Although several emerging market central banks have increased interest rates, we believe their economic growth path remains firmly intact. We expect emerging market economies to grow at double the pace of their developed counterparts.

In general, we recommend considering a modest portfolio underweight to stocks overall. The prospect of limited returns and volatile markets limits their appeal relative to the more attractive risk-reward opportunity of commodities and commodity-sensitive stocks. Company earnings have been impressive and we still expect 10% earnings growth for 2011. Stock market valuations, as measured by price-to-earnings ratios, are below average and we are inclined to buy stocks on weakness over the second half of 2011.

High-Yield Bonds

Several factors support our favorable view of high-yield bonds for the second half of 2011.

- Valuations remain attractive with an average yield advantage, or spread, of greater than 5% to comparable Treasuries. Such a yield spread more than compensates for the current level of defaults and provides an income advantage in what is still a low yield world.
- Default rates declined sharply and are projected to fall further over the balance of 2011.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Precious metal investing is subject to substantial fluctuation and potential for loss.

- High-yield companies have taken advantage of historically low yields to refinance existing debt obligations, extend debt maturities, and lower overall interest costs. These credit quality improvements provide a solid fundamental backdrop for high-yield bonds.

In addition, the relatively high yield on these bonds will help buffer the volatile markets that may surface over the remainder of the year and is likely to keep total returns positive.

Bank Loans

Bank loans benefit from many of the same fundamental underpinnings of high-yield bonds, but possess virtually no interest rate risk. The lack of interest rate sensitivity and moderate yields provide a potential opportunity in the environment we foresee in the second half. In particular, we view the defensive characteristics of bank loans as attractive and may benefit investors when bonds ultimately come under pressure again from rising interest rates.

In contrast to high-yield bonds, we expect high-quality bonds to remain relatively range bound, but ultimately expect prices to finish the year lower as yields move higher. In May 2011, Treasury valuations reached their most expensive levels since those seen in August 2010, when double-dip recession fears escalated, and seen again in late September/early October 2010, when enthusiasm over Fed purchases spurred valuations higher. We see neither a return to recession nor a new round of expanded Fed Treasury purchases. Therefore, further price gains are limited and we recommend an underweight to high-quality bonds in order to focus on higher-yielding segments of the bond market such as high-yield bonds, bank loans, investment-grade corporate bonds, and preferred securities.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment-grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Bank Loans are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for any individual. To determine which investments may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Stock investing may involve risk including loss of principal.

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Quantitative easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

High-Yield spread is the yield differential between the average yield of high-yield bonds and the average yield of comparable maturity Treasury bonds.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Barclays Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment-grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

Commodity Prices – While retail sales captures end user demand for goods, commodity prices reflect the demand for the earliest stages of production of goods. Commodity prices can offer an indication of the pace of economic activity. The CRB Commodity Index includes copper, cotton, etc. A rise in commodity prices acts as a positive on the CCI.

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