



MONTHLY MARKET COMMENTARY

March 2011

Bond Rates	4/1/2011	12/31/2010
U.S. Federal Funds Target Rate	0.25%	0.25%
U.S. Two-Year Treasury Yield	0.81%	0.60%
U.S. Ten-Year Treasury Yield	3.45%	3.30%
U.S. Ten-Year Muni Yield	3.87%	3.75%
High Yield	6.99%	7.51%

Exchange Rates	4/1/2011	12/31/2010
\$ per €	1.41	1.34
\$ per £	1.60	1.57
¥ per \$	84.35	81.11

Latest Returns						
EQUITIES						
Index	Mar-11	3 months	YTD	1 Year	3 Years	5 Years
S&P 500	0.04%	5.92%	5.92%	15.64%	2.35%	2.62%
S&P 400 Midcap	2.45%	9.36%	9.36%	26.95%	10.00%	6.07%
S&P 600 Small Cap	3.01%	7.71%	7.71%	25.26%	8.36%	3.68%
MSCI EAFE	-2.24%	3.36%	3.36%	10.42%	-3.01%	1.30%
MSCI Emerging Markets	5.88%	2.05%	2.05%	18.46%	4.32%	10.70%
FIXED INCOME						
Index	Mar-11	3 months	YTD	1 Year	3 Years	5 Years
BC Aggregate Bond	0.06%	0.43%	0.43%	5.14%	5.31%	6.03%
BC Muni Bond 1-10 Yr	-0.01%	0.77%	0.77%	3.05%	4.59%	4.76%
BC High Yield	0.32%	3.88%	3.88%	14.30%	12.93%	9.13%
BC Global Aggregate Bond	0.47%	1.24%	1.24%	7.16%	4.05%	7.02%
CSFB Bank Loan Index	0.14%	2.64%	2.64%	8.18%	7.31%	4.52%
OTHER						
Index	Mar-11	3 months	YTD	1 Year	3 Years	5 Years
DJ UBS Commodity	2.06%	4.44%	4.44%	28.48%	-5.20%	2.56%
DJ Wilshire US REIT	-1.46%	6.70%	6.70%	24.45%	1.48%	0.64%
S&P Developed World Property	-1.64%	3.00%	3.00%	20.24%	-1.31%	0.71%
LPX 50 TR	0.93%	9.25%	9.25%	27.99%	-6.98%	-3.92%
HFR1 Fund of Funds Index	-0.13%	0.84%	0.84%	5.13%	-0.81%	1.61%
3 Month T-Bills	0.03%	0.05%	0.05%	0.16%	0.51%	2.23%

* Returns provided by outside vendor. Innovest not responsible for accuracy of numbers presented.

The Economy

In Shakespeare's Julius Caesar, the soothsayer warns Caesar of impending trouble. "Beware the ides of March" is the warning that foreshadows Caesar's impending death. The ides of March in 2011 provided its own troubles, though this time not for our favorite Roman emperor but for the world economy. Conflict in Libya has caused bloodshed and political confusion, with no real resolution in sight. Political unrest across the Arab street continues to be a concern. The massive earthquake in Japan and the subsequent damage to the nuclear facility at Fukushima was the worst nuclear disaster since Chernobyl. Spot prices for WTI crude oil reached \$108. Europe continues to confront its own financial problems with respect to Portugal, Spain and Greece. The list is long and scary.

And yet despite this slew of terrible geopolitical headlines, U.S. and global economic data remained reasonably positive. How could this be? Economic conditions continued to improve, albeit slowly. As witnessed by record low interest rates and quantitative easing, Fed Chairman Bernanke has kept monetary policy extraordinarily

accommodative—a primary reason the U.S. economy is on the mend.

Financial data points were mostly encouraging. In the U.S., March's ISM manufacturing survey came in at 61.2. This is the third month in a row with the survey over 60, indicating real expansion in the U.S. economy. Corporate balance sheets remain healthy, holding record levels of cash. Despite innumerable hiccups, the U.S. housing market has improved. Pending home sales data surprised to the upside, seeing growth of 2.1% month on month compared to a projected 0.0%. Case Shiller data surprised us positively, with residential price declines continuing but at levels lower than expected (-0.22% vs. projected -0.44%). US GDP growth for Q4 2010 was 3.1% and the U.S. unemployment rate fell to 8.8%.

At the risk of sounding too optimistic, there remains much wood to chop. Oil is moving higher, with no apparent reprieve in sight. The European sovereign debt crisis will continue, with Germany facing difficult decisions regarding the assistance of their less financially disciplined European brethren. At home, U.S. fiscal laxity is a real problem and we are only beginning to see effects of our trillion dollar budget deficit. The past week's showdown in

congress between Republicans and Democrats is symptomatic of a much larger structural issue: can we muster the political will to return to fiscal responsibility?

The Markets

Equity gains were a welcome event this past month, given the worldwide uncertainty that we witnessed. In the U.S., the S&P 500 posted a .04% return. Happily, the S&P 500 registered a 5.92% first quarter gain: the best first quarter performance since 1998. Over a one year period, the S&P 500 has registered a none-too-shabby 15.64% return. Mid cap equities were up 1.5% for the month, while small cap equities posted 2.6% gain.

Global equity markets were more of a bifurcated story. The EAFE index was down 2.24% for March, largely due to the crisis in Japan. Emerging markets were up 5.88%. Owing much to accommodative fiscal policy in the U.S., emerging markets have experienced a flood of capital inflows since the recession. The so called “wall of money” has stoked asset valuations across much of the emerging market index.

Fixed income experienced a flattish month of returns. The U.S. aggregate bond index registered a .06% gain, while the high yield index was up .32%. Predictably, U.S. treasuries increased in value when global headlines were at their worst. As global conditions improved and the “flight to safety” lessened, treasury yields inched back up.

Other asset classes were decidedly mixed in their performance. The HFRI fund of funds index, measuring hedge fund performance, was down .13% for the month. U.S. REITs were down 1.46% cumulatively. Commodity prices rose 2.06% for the month, mostly in light of increased energy and food prices.

Outlook

A long term perspective is helpful when trying to digest the latest headlines. While we can't predict the geopolitical outcomes of the upcoming months, we can predict investment outcomes over the course of a full economic cycle. We remain patient investors and feel comfortable with the talented managers with whom we work.

Commodity prices and risk assets have moved up concurrently over the past twelve months. At some point this relationship is likely to change. If commodity prices continue to rise, equities will likely suffer. A fall in commodity prices would benefit producers and corporate margins.

Inflation expectations have risen in the U.S. and Western Europe. The U.S. Treasury yield curve has adjusted upward in the past few weeks. The latest round of quantitative easing ends in June. We are likely to see treasury yields go even higher as the government slows down its program of keeping yields artificially low. The European Central Bank raised rates last week for the first time in a long time. The U.S. will likely follow suit by the beginning of 2012.

Since the market lows of 2009, we have witnessed a remarkable run in the equity markets. A rising tide has lifted all boats, though this can't last forever. Going forward, an emphasis on quality earnings will be important. Great companies with proven operating excellence will likely outperform relative to their peers.