Investment Overview

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Economic and Markets Summary

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Second Quarter 2011

The Economy

The economy, which was thought to be on the road from recovery to expansion, ran into some speed bumps during the second quarter of 2011. Gross Domestic Product for the quarter just ended has been adjusted down to the 2% level by economists. This is approximately the same rate of growth as the first quarter, which disappointed forecasters when GDP came in at only 1.9%. The first estimate for second quarter GDP will be released July 29.

The optimism regarding the transition from recovery to expansion that was prevalent during the first few months of the year changed noticeably with the release of a number of downbeat economic indicators after the mid-point of the second quarter. The first quarter slowdown was thought to be the result of factors that were temporary, such as bad weather, the earthquake and Tsunami in Japan on March 11, a spike in energy prices that would not be sustained, and a healthy pause in the strong pace of manufacturing that has fueled most of the economic recovery so far.

The consumer was not expected to be a strong contributor to the early part of the recovery as has been the case in past recovery cycles. Pent-up consumer demand for housing, autos, and other big ticket items in the past usually led to a strong recovery out of recession and was of course made possible by heavy consumer borrowing. Consumer borrowing has been tepid at best in this recovery cycle for good reason.

The gigantic over-extension of consumer debt, leading to the worst recession since the great depression, is still having a negative impact on consumers. The consumer is still not in a position to add to his or her debt load. This has kept housing in the doldrums for an extended period of time. Many local housing markets remain overbuilt with a lot of vacant structures and mortgage balances above declining housing values. It was reported that housing prices dropped 5.1% during the first quarter, and the negative trend continued in the second quarter.

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The mood of the consumer, economists, and stock and commodity investors took a turn for the worse when the employment report was released on June 3. The unemployment rate ticked up to 9.1%, and new job creation amounted to a gain of only 54,000. This report was a big disappointment breaking the positive momentum in job creation announced the prior two months. The early April report showed new job gains of 216,000 and additions of 244,000 was reported in May.

These downbeat indicators in housing and employment, along with a drop in consumer confidence and sub-par manufacturing and capital spending gains, had economists revising downward their growth targets for the quarter and the year. The mood turned so negative in some quarters that the less rosy outlook prompted deeper questions regarding the long term health of the U.S. economy. Has the economy emerged from the financial turmoil of 2008 and 2009 with a chronic growth problem? Due to continuing high consumer debt loads, the U.S. could be in a protracted period of sub-par growth and high unemployment, was the theory offered by some forecasters.

Until employment gets back to a favorable growth path, the economy may be stuck with sub-par growth, or until the private sector deleveraging or debt shedding process is complete. That could take considerable time. In Japan, debt reduction took the better part of 15 years according to the Wall Street Journal, and was no quicker during our great depression. Job gains appear to be the key as a growing chorus of economists say it will take strong, sustained job growth to reignite spending by households.

The Federal Reserve continued to maintain a less dire outlook for the economy. In their "beige book" report released June 8, in preparation for the upcoming FOMC meeting, the Federal Reserve Banks said the economy expanded at a "steady pace" in most of the U.S. while slowing in four of the twelve regions, as consumers contended with higher food and fuel prices. Shortages of parts reduced auto production, and some parts of the country were slowed by tornados and flooding.

The report by and large reflected the recent pronouncements of Chairman Bernanke that the slowdown is transitory and is nothing more than a "soft patch" in the recovery progression. While the Fed did not put a date on the resumption of better economic growth, many economists are pointing to the end of August or the Labor Day period before the economic indicators show a more favorable turn around.

Interest Rates

The heavy debt load carried by consumers and households is working against the Federal Reserve's expansive monetary policy as a means to stimulate economic growth. Despite pumping billions of dollars into the banking system, lending and borrowing has been anemic. Rock bottom interest rates have not enticed borrowers to a sufficient degree. However low interest rates have definitely worked against the saver and investor, as they look for low risk places to earn a decent return.

The Fed's program of quantitative easing #2, which ended June 30, has also not been particularly successful in stimulating the economy. However, partially due to this program, interest rates have declined significantly for intermediate and long term bonds over the course of the second quarter. Short term rates have declined to a lesser extent. This is to be expected, as the Fed has kept its Fed Funds rate at rock bottom levels since December, 2008 at the range of 0-.25%.

The movement of interest rates and the change in the yield curve can be seen in the table below, which shows various rates at the end of the first quarter of 2011 and June 30.

%	Treasury Bill		Treasury Notes & Bonds			FED
	3 mo.	1 yr.	5 yr.	10 yr.	30 yr.	Funds
03/31/11	0.09	0.27	2.25	3.47	4.51	0-.25
06/30/11	0.02	0.19	1.77	3.16	4.38	0-.25

In a speech given on June 7, Chairman Bernanke acknowledged the disappointing recovery. "The recovery looks to be continuing at a moderate pace, albeit at a rate that is both uneven across sectors and frustratingly slow from the perspective of millions of unemployed and under employed workers. Accommodative monetary policies are still needed. Until we see a sustained period of stronger job creation, we cannot consider the recovery to be truly established." He also expressed his views regarding an over-reliance on monetary policy to "solve the economy's lingering problems on its own. In this context monetary policy cannot be a panacea."

The absence of a sane, constructive fiscal policy to assist monetary policy has investors and creditors very concerned. The failure to deal with continual budget deficits and debt ceiling limits is calling into question the credit worthiness of the United States.

During the quarter the Standard and Poors rating service downgraded its outlook for U.S. Treasury debt from stable to negative. "Because the U.S. has what we consider to be very large budget deficits and rising government indebtedness and the path to addressing these is not clear to us, we have revised our outlook on the long term rating to negative from stable. We believe there is a material risk that U.S. policy makers may not reach an agreement on how to address medium and long term budgetary challenges by 2013. If an agreement is not reached and meaningful implementation is not begun by then, this would in our view render the U.S. fiscal profile meaningfully weaker" according to Standard and Poors.

During the second quarter of 2011 the Federal Open Market Committee of the Federal Reserve had two meetings scheduled. The first concluded on April 27. With no change expected in the Fed Funds rate, attention was focused on the post-meeting comments. The verbiage changed little from previous meetings except for the recognition of somewhat higher inflation due to the increases in the price of energy. The committee expected these effects to be transitory. The statement again included the sentence that conditions are "likely to warrant exceptionally low levels for the federal funds rates for an extended period."

The second meeting concluded June 22 and post-meeting comments included the following. "The U.S. economy has settled into a disappointingly weak recovery lasting this year and next." Chairman Bernanke in his press conference said "Maybe some of the headwinds that have been concerning us - like weakness in the financial sector, problems in the housing sector, balance sheet and leveraging issues – some of these headwinds may be strong or more persistent than we had thought."

The movement in interest rates created generally positive returns for various bond fund categories during the second quarter of 2011. Below are some examples of different bond fund returns according to the *Wall Street Journal*.

Year-to-Date Percentage Returns *(as of 6/30/11)*

Barclays US Aggregate	+2.72	Investment Grade - Short	+1.45
U.S. Gov't	+1.58	High Yield Taxable	+4.93
GNMA	+3.39	Municipal Bond Index (7-12 yr)	+5.17

Commodity prices were mixed during the second quarter of 2011. The price of oil which was priced at $106.72 per barrel on March 31, ended the second quarter at $95.42. The price of gold began the second quarter at $1,439 per ounce. On June 30, 2011 gold was pegged at $1,502 per ounce.

The Stock Market

The economic slowdown scare had a negative effect on the stock market during the latter two months of the second quarter. The quarter got off to a positive start in April with strong gains across the board. The Dow Jones Industrials rose over 4%, while the Standard & Poors 500 Index and the NASDAQ gained around 3% on a total return basis. Investors reacted positively in April as first quarter earnings reports came in better than expected. Of the 300 S & P 500 components reporting in April, 77% of the companies reporting came in above analysts' expectations. Stock investors were also encouraged by the strong gains in job growth and a stronger pace of manufacturing.

Stock market sentiment shifted to negative in May and June, as the euphoria over strong corporate profits was over- shadowed by the weakening domestic economy and heightened international tensions. Manufacturing grew at the slowest pace in more than a year caused primarily by supply disruptions brought on by the earthquake and Tsunami in Japan. May saw the major stock indices drop 1% to 1.5%. International indices fared worse, dropping 3%.

The economic soft patch and stock market growth scare carried through most of June and was accompanied by an escalation of the debt crisis in Europe. Greece again occupied the spotlight, as sovereign debt default fears rose to new heights and featured a series of street demonstrations in Athens, as new austerity measures were being debated by law makers. This nervousness put June in the negative column as far as equity performance was concerned, but a strong stock market rally at month end narrowed the losses. For the month the S & P 500 declined -1.67%.

Despite the sharp drop in stocks starting around the first of May, many stock strategists are in the camp that a new bear market is not in the offing. Bob Doll, chief equity strategist for Blackrock Investment Advisors, believes that the May, June correction is reminiscent of the mid-year correction that occurred in 2010. "The drivers in this year's downturn are somewhat similar to those that caused last year's: a slowdown in manufacturing caused by over production, falling demand levels, higher oil prices, and concern over European debt issues and Chinese policy tightening." He sees a pick-up in growth during the second half of 2011, albeit at a pace less than typically associated with economic recovery. "Monetary policy remains extremely accommodative, corporate profits are strong, inflation is low, and the labor market is slowly improving."

Brian Wesbury, chief economist with First Trust, believes the current economic soft patch is already fading. "We think the pessimism is overdone and this is a great buying opportunity." He cites seven straight months of loan expansion to small and medium-sized businesses and an increase in individual income tax payments that are 55% above May 2010. Also exports hit a record high in April, up over 18% versus year-ago levels. "Auto production and sales should bounce back, as Japan shows rebuilding momentum from their devastating earthquake." The Dow Jones Industrials ended the second quarter of 2011 at 12,414 while the S & P 500 closed at 1321.

Below is a table showing percentage returns year-to-date for various equity sectors and investment styles as computed by Lipper Inc., and featured in the *Wall Street Journal* on a daily basis.

Stock Fund Indices

	As of 6/30/11
Large-Cap Growth	+5.24
Large-Cap Core	+5.34
Large-Cap Value	+5.47
Multi-Cap Growth	+6.82
Multi-Cap Core	+6.07
Multi-Cap Value	+5.93
Mid-Cap Growth	+7.57
Mid-Cap Core	+7.34
Mid-Cap Value	+6.12
Small-Cap Growth	+9.07
Small-Cap Core	+6.18
Small-Cap Value	+4.49
Equity Income Fund	+6.40
Science & Tech Fund	+5.00
International Fund	+3.73
Balanced Fund	+4.67

Regarding the domestic stock market, below is a chart of industry sectors ranked by percentage change by Bloomberg Research at the end of the second quarter.

Percentage Gain by Stock Sector

	2nd Qtr.
1. Health Care	+7.29
2. Utilities	+5.01
3. Consumer Staples	+4.47
4. Consumer Discretionary	+3.08
5. Telecommunications	+0.82
6. Industrials	-1.21
7. Basic Industry	-1.37
8. Technology	-1.61
9. Energy	-5.07
10. Financials	-6.27

Fund Results as of June 30, 2011

Equity Funds	Quarter Return	12-Month Return
Allianz NFJ Large Cap Value	+0.11	+29.18
Allianz RCM Mid Cap	+2.05	+39.90
Fidelity Adv Eqy Income	-0.13	+30.73
Goldman Sachs Mid Cap Value	+0.26	+36.86
Janus Adv Intl Growth	-8.25	+15.00
JP Morgan Mkt Exp Idx Select	-1.18	+37.84
Lazard Emerging Markets	+0.51	+26.84
Stratus Growth Portfolio	-0.13	+24.84
Templeton Inst Foreign Equity	+0.76	+28.65
Thornburg Int'l Value	+1.22	+30.30
Vanguard 500 Index	+0.07	+30.51
Vanguard Morgan Growth	+0.66	+35.65
Vanguard Small Cap Index	-1.16	+39.26
Vanguard Strategic Equity	+0.94	+41.45
Idx: S & P 500	+0.10	+30.69
Idx: Russell 2000	-1.61	+37.41
Idx: EAFE	+1.80	+31.02
Idx: NASDAQ Composite	-0.03	+32.87

Fixed Income Funds	Fixed Income Funds	
PIMCO Total Return Fund (Inst.)	+1.86	+5.94
Stratus Gov't Secs	+1.77	+2.67
Templeton Global Bond	+2.49	+13.95
Vanguard GNMA	+2.68	+4.79
Vanguard Infl-Prot Secs	+3.40	+7.22
Vanguard Total Bond Idx	+2.24	+3.54
Idx: M.L. Int Term Bond	+1.70	+2.41

Past performance is no guarantee of future results.

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