



The S&P 500 and most global equity markets experienced significant declines during the third quarter, erasing any gains posted the first half of the year. The European debt crisis and its affect on the international banking sector was the most prominent issue facing the markets, as investors feared the situation would tip Europe into recession. Slower growth in the U.S. and concerns about the sustainability of record corporate profits over the next year placed a further drag on domestic equities. In response to these difficulties, interest rates on 10 to 30-year U.S. Treasury bonds fell to all-time lows and Treasuries have been the best performing market sector thus far in 2011 as investors sought safety during a period of heightened volatility.

Amongst U.S. equities, utilities were by far the best performing industry sector within the S&P 500 through September 30 (up 7.2% total return) followed by consumer staples and health care. All other industry sectors posted losses year-to-date through the end of September. Not surprisingly, the financial sector fared the worst as concerns grew about the state of the economy, the risk of more write downs, and in some cases the possibility of large payouts by certain banks in the face of litigation and other regulatory actions. The more cyclical sectors also fared poorly including materials, industrials, energy, and consumer discretionary.

Some believe we are reliving the market debacle of '08-'09, but overall current conditions are far different, other than continued stress within the financial sector, than in 2008. As we describe in the accompanying market commentary, several important economic indicators do not point to economic contraction. We do not see it yet in the employment numbers, retail sales, and durable goods orders, nor within the manufacturing sector as a whole, all of which are holding steady or are up slightly. Commodities, specifically precious metals, provided only modest protection from uncertain conditions in the equity markets. Gold, for example, began the quarter at \$1,500, rose to as high as \$1,900, before dropping rapidly in late September to settle at \$1,624.

Many portfolios saw some of the potentially more volatile holdings sold and cash built up starting in July. We generally retained equities that we consider high quality and pay higher than normal dividends. Cash flow from these holdings is an important stabilizing factor and many of our clients rely on income generation for distributions. In some cases, we reentered the equity markets mid-August after identifying interesting investment opportunities typically among high quality, dividend paying companies selling at sizable discounts from valuations earlier in the year. We also have been adding to fixed income holdings when comfortable with the risk/return profile. Generally, this has been in the BB to BBB rating bands where credit spreads have widened versus Treasuries. Most holdings of gold were liquidated mid-September as the metal was sold off. The commodity markets are quite small when compared to equities or fixed income. Unusual volatility in a commodity subsector can potentially turn out quite badly for no other reason than it's a small door when a few large investors decide to make their exit.

We acknowledge that the markets are going through a rough patch at the moment, but it's important to remember that the situation and current volatility are not permanent. As we cite in the commentary, the truly awful '08-'09 experience from near peak to trough lasted nine months. It seemed like an eternity, but it was in fact a very short clip in time for the market. In difficult times, opportunities do arise. We will execute on these opportunities when appropriate on a case-by-case basis, and may not always get the timing exactly right, but over the intermediate to long term we believe the correct decisions will have been made. Thank you for your continued confidence in our abilities to provide you service, and rest assured we will work hard in evaluating and executing on opportunities that best meet your investment needs.

Sincerely,

A handwritten signature in blue ink, appearing to read "Joseph Tatusko", with a long horizontal flourish extending to the right.

Joseph Tatusko, CFA