MARKET LETTER

Investment Perspective
Everything we hear is an opinion, not a fact. Everything we see is a perspective, not the truth. – Marcus Aurelius

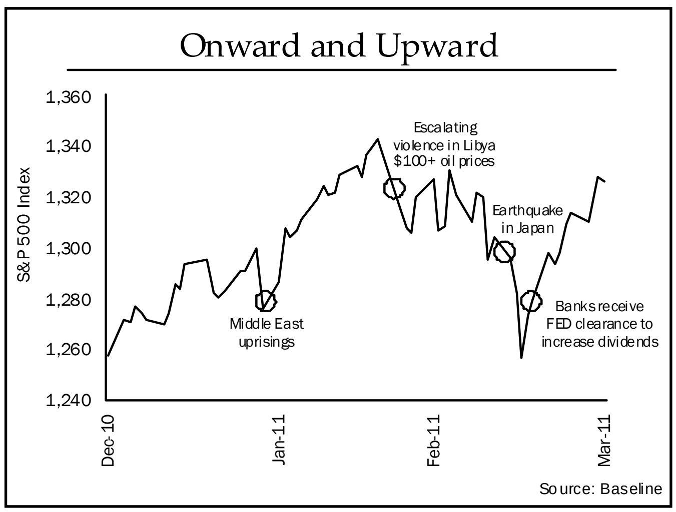
First Quarter 2011

by George W. Hosfield, CFA
Chief Investment Officer

In This Publication

Looking Back

We began the year with a belief that the preponderance of economic indicators would continue to point toward a reacceleration in domestic growth. Furthermore, we maintained that the bull market for equities was not over. In fact, our view was that the combination of economic expansion and monetary stimulus provided a favorable backdrop.



Despite all that investors had to digest in recent months, this was the best first quarter for equities since 1998. In view of the unsettling events such as the sequence of disasters in Japan, popularist uprisings in the Middle East, U.S. military involvement in Libya and a spike in oil prices—the resiliency of the equity markets has been rather impressive.

In short, investors chose to look past the aforementioned troubles and focused instead on the positive economic news that gained momentum by quarter-end. Specifically, the job market finally showed signs of sustained improvement, corporate profits continued to exceed expectations and valuations remained reasonable.

Looking Forward

- Though the tragedy in Japan and the political unrest and military action in the Middle East continue to unfold, we do not expect them to be significant drivers of the capital markets in the coming quarter.
- The spike in oil prices will not singularly jeopardize the economic expansions underway in any of the major world economies; rather, it will slow their rates of growth.
- Without a rapid improvement in jobs or an expansion of credit, problematic inflation is highly unlikely. That said, a surge in interest rates on fear of commodity inflation is a risk that we continue to monitor.
- Though the ballooning U.S. budget deficit is a long-term issue, our greatest near-term concern is U.S. monetary policy and what happens to interest rates when the Fed concludes "QE2" in June.
- Interest rates should drift higher, but we do not expect them to surge, which suggests that stocks have further to appreciate if earnings continue to meet and/or exceed expectations.
- We continue to tilt portfolios towards higher risk assets, with allocations favoring equities over bonds and cyclical sectors over defensive sectors.

Weapons of Reason
Never let the future disturb you. You will meet it, if you have to, with the same weapons of reason which today arm you against the present. – Marcus Aurelius

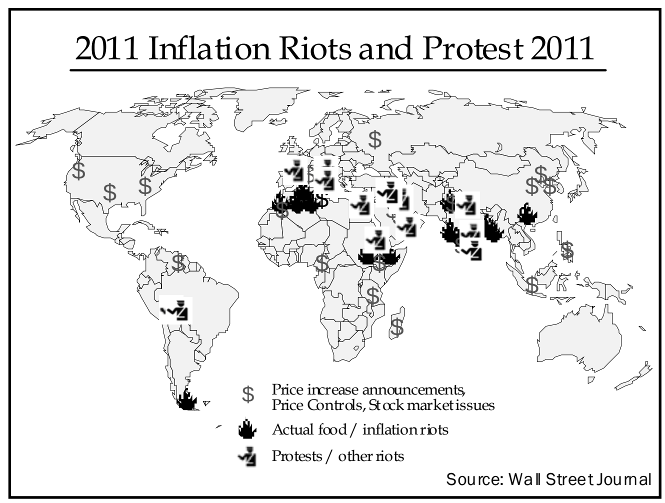
Rough Rice II: Fat Tails Wag the Dog

by Dean M. Dordevic
Principal

Lo que separa la civilización de la anarquía son solo siete comidas
Civilization and anarchy are only seven meals apart[1] *– Spanish Proverb*

There is little doubt that we are living through a period of many great global opportunities. Yet, at the same time, it is just as obvious to us that we are also living through a period of significantly heightened uncertainty. In our world, we refer to these generally unexpected events and occurrences as "fat tails" or "tail risks." In other words, we seem to be experiencing the 100-year flood every few years.[2] For anyone who's read a newspaper of late, both the likelihood and frequency of extreme events appears to be increasing.

Perhaps the most interesting phenomenon we have observed over the last few years is the circuitous relationship between food, fuel and politics. In mid-2010, world grain prices soared. In only eight months, global prices for wheat doubled (a staple in the Middle East). These soaring prices quickly filtered through to consumers, many of whom were unemployed, and created the foundation for unrest.



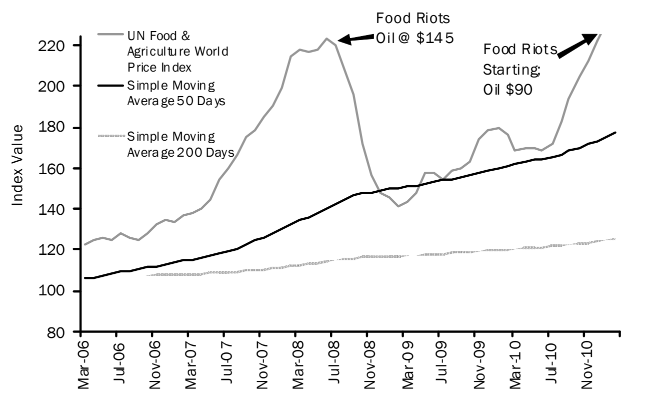
As we wrote in our second quarter 2008 *Market Letter* titled "Rough Rice," we believed then – as we do now – that high and rising food prices could shape global politics for decades. Quoting *New York Times* columnist Thomas Friedman, "*The current global energy-food crisis is, understandably a pocketbook issue in America. But when you come to Egypt, you see how in a society where so many people live close to the edge, food and fuel prices become enormously destabilizing. If these prices keep soaring, food and fuel could re-shape politics around the developing world as much as nationalism or Communism did in their days.*" He adds, "*The good news: More Egyptians today can afford to live like Americans. The bad news: Even more Egyptians can't even afford to live like Egyptians anymore.*"[3]

The last round of food riots we witnessed were in 2008, when they occurred in two dozen countries. We have seen this again, perhaps in a more virulent form, in the Middle East. In fact, riots fueled by food scarcity are now occurring on three continents. What is driving food prices with more regularity and creating more volatility are rising global standards of living – principally in the emerging world. As people become more affluent, they choose diets that are both more rich calorically and higher in protein. This places more stress on the chain of supply. It takes eight pounds of grain to yield one pound of beef, and between two and four pounds of grain to make one pound of chicken.[4] Making this situation worse, more farmland is being dedicated to the production of biofuels. In the U.S., almost 30 percent of our farmland has migrated from food production to the production of the raw material for biofuels.

It has been projected that from 2000 to 2030, per-capita meat consumption could rise almost 50 percent in China, and 80 percent in India. It is interesting that during the worst global recession in decades, global demand for foodstuffs remained robust. In seven of the last 10 years, world wheat consumption has outpaced production. With the world's population set to increase by 38 percent by 2050, global food production must double over that time frame, according to agriculture economist Robert Thompson of the Chicago Council on Global Affairs.[4]

There can be no doubt that there will be technological offsets that will mitigate this problem. Since 1970, the amount of corn produced per acre has more than doubled in the U.S., and the amount of wheat produced per acre has increased by almost 50 percent.

UN FAO World Food Price Index



Source: Bloomberg

Biotechnology and the development and proliferation of so-called "smart seeds" should make a big difference in crop yields. Smart seeds will make crops more resistant to bugs, weeds and drought.[4] That said, we can't count on technology to address this situation in the near term, and the world will remain vulnerable to political upheaval and economic shocks brought about by the relative scarcity of food for the long term.

Hungry unemployed people are ripe for unrest or worse. While circumstances in Saudi Arabia are quite a bit different than in Egypt and Tunisia, Saudi Arabia has some of the same problems as these poorer countries – such as high youth unemployment and an aging political leadership. Wary that rising unrest in his own country could in turn metastasize into revolt, Saudi King Abdullah recently found it necessary to pledge $35 *billion* worth of "benefits" just to help promote stability.[5]

It has been three years since we first addressed this topic in our *Market Letter*. Back then, we said that agriculture and energy were both "investable" and *long-lived* themes. Today, we feel the same way, perhaps much more so. We also indicated that it was our mission to incorporate these themes in our thinking from a top-down perspective (big picture), and bottom-up at the stock selection level.

With this in mind, we have more recently initiated a commodity-based solution within the *Tactical Assets* segment of our portfolios. Using a pair of funds, the Dow Jones-UBS Commodity Index Fund and the Goldman Sachs Commodity Strategy Fund, we achieve exposure to both agricultural commodities and livestock (in addition to other key commodities). On a more granular stock-selection level, we own a wide variety of companies across our many investment disciplines including companies that produce: tractors, combines, sprayers, tillage, corn syrup, corn starch, fertilizers, phosphates and potash, farm equipment and genetically modified seeds. We will continue to monitor the futures for "Rough Rice" with interest, and believe that they will remain both a window on the world and a staple of our investment diet for some time to come.

Weapons of Reason footnotes and sources:

[1] Mark Yusko, Morgan Creek Capital Management, LLC, Hatteras Funds Strategy Conference, San Francisco, March 3, 2011.
[2] Cam Hui, "Life in Extremistan or Minskyville," *seekingalpha.com*, March 29, 2010.
[3] Thomas L. Friedman, "Letter from Cairo," *The New York Times*, June 15, 2008.
[4] Robert J. Samuelson, "Affluence and Scarcity, Rising Food Costs Tilt Global Politics," *The Washington Post*, March 14, 2011.
[5] Rachel Bronson, "How Stable is Saudi Arabia? Reasons for Anxiety," *The New York Times*, March 14, 2011.

Mindful Reminders

Let not your mind run on what you lack as much as on what you have already. – Marcus Aurelius

by Mary A. Faulkner
Vice President of Marketing

We believe that everyone can benefit from investment education. Whether you are an executive, family member or trustee – the more you know – the more confident you feel about making decisions and taking action to help achieve your professional and personal goals. A recent survey of our clients indicated that – beyond providing investment management – about 75 percent of executives and trustees of institutions listed investment education as the most important service our firm could offer. Ninety percent of all of our clients indicated they were interested in investment topics heard in the news. With that in mind, we are now providing a list of terms found throughout our *Market Letter* to remind clients of their meaning, or introduce them for the first time.

Commodities: Materials such as food, grains, and metals that are interchangeable with another product of the same type, and are traded through futures contracts. A commodity price is subject to supply and demand. (page three)

Crossover: Occurs when the price of an asset crosses through a moving average. This type of signal is regarded as an early indication of the direction of future price momentum. For example, traders wishing to enter into a long position will buy an asset when the price crosses above a moving average and sell the asset when it crosses below. (page five)

Cyclical and defensive sectors: Refers to how directly the companies are affected by economic cycles. Cyclical sectors comprise companies that are sensitive to business cycles and whose performance is strongly tied to the overall economy. They tend to make products that are in lower demand during economic downturns and higher demand during upswings – such as the automobile, steel, and housing industries. The stock price of a cyclical company will typically rise just before an economic upturn begins, and fall just before a downturn begins. Industries that tend to remain stable under difficult economic conditions are classified as defensive sectors. Examples are food, tobacco and utility companies. (page one)

Dow Jones-UBS Commodity Index Fund: Includes 19 commodities representing the following sectors: energy, precious metals, industrial metals, livestock and agriculture. (page three)

Goldman Sachs Commodity Strategy Fund: Consists of investments that provide exposure to the performance of the commodities markets and other fixed-income and debt instruments. (page three)

"QE2": Refers to the second round of quantitative easing. This is an unconventional monetary policy used by central banks to stimulate their economy when standard monetary policy has become ineffective. The central bank buys government bonds and other financial assets, with new money that the bank creates electronically, in order to increase money supply and the excess reserves of the banking system. This action also raises the prices of the financial assets bought, which lowers their yield (as long as the yield is above zero). Quantitative easing shifts monetary policy away from interest rates, toward targeting the quantity of money. (page one)

UN FAO World Food Price Index: Measure of the monthly change in international prices of a basket of food commodities. (page three chart)

Mindful Reminders Sources: Goldman Sachs, Investopedia, Investor Words, iShares, Wikipedia

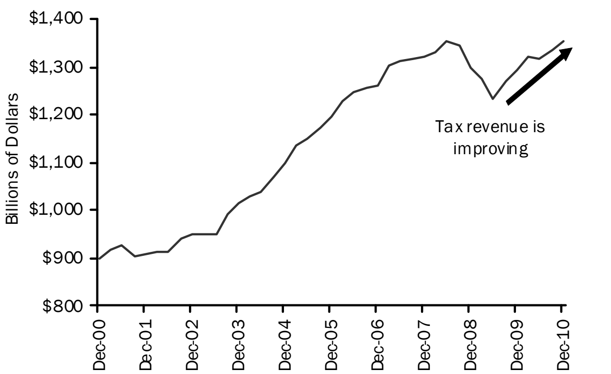
Investment Strategy Spotlight

Municipal Bonds: Many Negotiations, Few Defaults

by Deidra M. Krys-Rusoff
Fixed Income Portfolio Manager

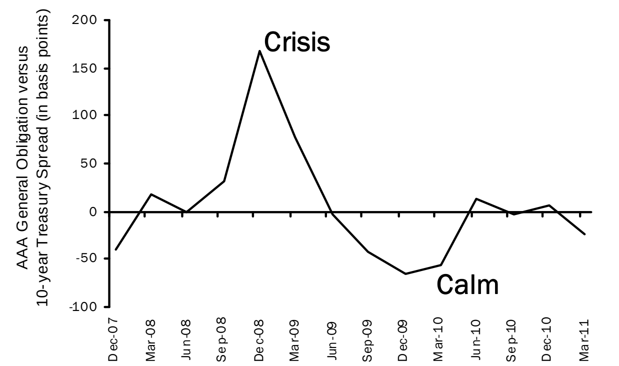
Municipal bonds are utilized to satisfy the income needs of individuals who desire tax-exempt income. From time to time, this asset class becomes undervalued and we utilize municipal bonds as a crossover asset for our institutional and tax-exempt strategies. In order to reduce risk, Ferguson Wellman diversifies municipal bond holdings both geographically and by sector. Municipal bond prices have experienced great volatility over the last year due to supply issues and dire media predications. This has resulted in some investors fleeing the market. Though there are real issues confronting some local government sectors, many are slowly being addressed.

U.S. State and Local Tax Receipts Trending Up



Source: Bureau of Economic Analysis

Spreads Reveal An Improving Muni Landscape



Source: Bloomberg

A Slowly Improving Situation

- State and local tax receipts are rising from a recent low in 2009, and have recovered back to 2008's pre-recession levels
- State and local governments have made adjustments to budgets
  - Trimmed expenses: 77 percent of states enacted budget cuts in 2010
  - Furloughed and reduced employees
  - Raised revenues: 56 percent of states enacted tax and fee increases
  - Accessed unreserved fund balances or "rainy day funds"
- Current budget deficits have opened doors for contract negotiations; City of Los Angeles negotiated for employees to contribute half of their 12 percent pension contribution

Looking Ahead

- Expect to see further cuts in services, e.g., healthcare, education and prisons
- Municipal bonds should continue to provide a secure choice for risk-conscious investors desiring tax-exempt income due to their low rates of default
- Rising federal and state income tax rates will increase their appeal, and serve to boost demand for quality municipal credits
- The price of volatility within the municipal bond market continues to provide opportunity for knowledgeable investors
- Careful credit analysis, name diversification, and sound portfolio construction will provide additional safeguards – particularly during tumultuous economic times

Investment Services Spotlight

Client Balance Sheet for Individuals and Families

by Nathan M. Ayotte, CFP®
Vice President

All of us feel we can make clearer decisions when we have all the information we need in front of us. In doing so, we can see how decisions and other important factors will affect each other – giving us the "big picture" needed to ensure that we are on track.

Often when meeting with individual and family clients, discussions ensue that go beyond investment management of their portfolio. The *Balance Sheet* is a tool that provides the framework for those discussions and is one of the first steps we now take with new clients in our wealth management framework. It is an aggregated snapshot of current and historical assets, liabilities and net worth, providing a better view of our clients' overall financial situation. The process enables clients to feel more organized and prepared to make decisions today and in the future.

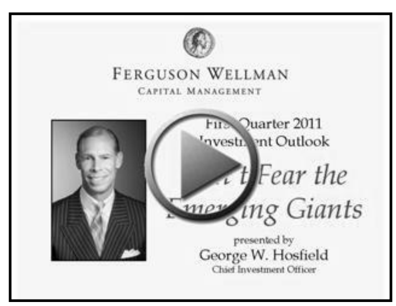
Communication and Education

Delivering our Investment Outlook: Events and Videos

by Natalie A. Miller
Marketing and Sales Associate

In the first quarter of every year, we host events in a number of the cities where our clients reside or conduct business with the goal of sharing our investment outlook for the year ahead. We closed the first quarter of the year hosting 17 *Investment Outlook* events in seven cities. We were pleased to share our outlook on the economy and the capital markets to 574 guests – 200 more than attended in 2010. Eighty of our guests comprised accountants, attorneys and other professionals who serve our clients or refer prospects to us.

As we look to the second quarter, we will continue to offer outlook events to investment clubs or organizations that our clients participate in. Trustees, board members and investment committee members for our institutional clients also make requests for outlook presentations. The information at our events is also captured in our quarterly *Investment Outlook* videos (see right graphic) that we deliver via email. Videos are typically a seven-minute presentation that is a condensed version of our more comprehensive annual outlook. Other presentations we provide throughout the year include *Investing Essentials* to new board members of institutional clients and *Retirement: Here or on the Horizon* for individuals and families.



Our logo features a bronze coin of Marcus Aurelius Antonius, Emperor of Rome from A.D. 161 to 180. According to historian Edward Gibbon, he was the only person in history in which "the happiness of a great people was the sole object of government." Marcus Aurelius was the author of meditations that reveal a mind of great humanity and natural humility.

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