

MONTHLY MARKET COMMENTARY

June was another difficult month for US and international equity markets. The S&P 500 was down 5% in the month of June after dropping 8% in May and is now down 7% for the year. International equity markets generally held up better in June with most experiencing declines in the 1% to 3% range but many are down more than 10% so far in 2010. As we saw in May, the only bright spots were US Treasuries, bonds, cash and gold.

Numerous worries are weighing on equity and commodity markets. I'll discuss a few below. One thing all of these concerns share is that their resolution will not come quickly – most can only be addressed over time. As often occurs in periods of rising uncertainty, investor capital will flow from risky assets to less risky assets until the prices of the risky assets decline to where those prices reflect the uncertainty. In more general terms, this means that stocks go down and bonds go up as investors seek return of capital over return on capital.

As we discussed last month, investors continue to worry over Europe. Many European countries have implemented austerity programs to reduce their fiscal deficits and government debt obligations. In other words, they will be raising taxes and cutting benefits. This will curtail or even eliminate growth in most European economies which will have a direct reduction in the rate of global economic growth. These austerity plans have gotten the various European unions in an uproar which will mean more general strikes which will, in turn, further curtail economic activity. Further, these plans only partially address the concerns over sovereign default as a number of European countries will still have to sell new government debt to replace expiring bonds. For some of these countries, a default on government debt is a possible outcome which would further strain the European financial system (many European banks hold European government debt).

Closer to home, the rapid increase in taxes and regulations is impacting the willingness of businesses, large and small, to hire workers. The recent health care legislation is a tax on business as well as an increased administrative burden. With legislation like this as well as financial regulation, cap and trade, and card check combined with increasing anti-business rhetoric from administration officials, the Obama administration is showing itself to be very anti-business. These pieces of legislation directly and indirectly increase the cost of doing business as well as make the business environment more uncertain which in turn makes businesses less willing to take on the risk of hiring new employees. The US economic recovery will not continue without the economy creating new jobs and putting the tens of millions of un- and under-employed back to work.

The continued oil well leak in the Gulf of Mexico has not been resolved and likely will not be until September when relief wells should be completed. If these fail, then the most likely alternative is something the Russians have done several times with success which is a small nuclear explosion to cap the well. This issue will continue to be front page news for a while as will the impact of the oil spill on the economies of the Gulf coast states.

US investor mindsets continue to be impacted negatively by a number of other factors, many which we have discussed in recent months. May's flash crash in the US equity markets highlights an increasing lack of liquidity in those markets and has hurt investor confidence. The Chinese government continues to attempt a soft economic landing – a difficult feat to pull off and the public perception of their likely success or failure will tend to change often. The Obama administration is seeing its public approval drop over a number of issues but mainly due to the lack of new jobs and the perceived incompetence of the handling of the BP oil well disaster. Congressional public approval is at or near all time lows over these issues plus others. Mid-term congressional

elections are coming in the fall and expect to see incumbents up for re-election scrambling to save their seats. The political rhetoric will increase, many Democrats will likely try to distance themselves from Obama, and Republicans will likely gain some seats in both houses. How many seats and how much emphasis on job creation are open questions which only add to the uncertainty investors feel.

As if all that were not enough, numerous economic indicators are hinting that the risk of deflation has increased. Deflation would most likely come with a second global recession. Of particular concern is how much impact the Federal Reserve and the US Government can have given that most of the typical tools to combat deflation have already been used. While a period of extended deflation is still unlikely, it is a risk that must be considered and weighed.

Understandably, investors have sought safe havens from these multiple areas of concern and uncertainty. One truism in stock markets is that they generally decline when uncertainty increases and go up as uncertainty decreases. Now primarily concerned with capital preservation, investors have poured money into safe havens such as cash, US treasuries and precious metals. Gold returned 2% for the month and is up 13% for the year.

While the above laundry list of concerns is enough to make anyone depressed, I will remind readers that every economic recovery has one or more periods where it looks like the recovery will fail and another recession will ensue. Such double dip recessions have been thankfully rare. Creation of jobs always lags the pace of the recovery as most businesses will not add workers until activity picks up for an extended period of time. There are still reasons for optimism that the global economy is on the track to recovery and growth.

Our Global Dynamic strategy held up generally well in the month of May. Performance was helped by our holdings in the gold ETF as well as the silver ETF. Additionally, our investment in an Indonesian ETF was a standout performer for the month. Our holdings in the small cap value ETF and in the consumer discretionary ETF detracted from performance.

As part of our disciplined investment process, we have rotated to a more conservative positioning in Global Dynamic. The many concerns listed above as well as the outperformance of certain asset classes indicate that the risks of inflation and deflation are relatively balanced and that the probabilities of continued global economic recovery and economic recession are also equally balanced. As I noted before, the resolution of these uncertainties will not come quickly and the various markets have been and will continue to re-price to reflect these uncertainties.

Global Dynamic sold its holdings in the small cap value ETF and in the consumer discretionary ETF and rotated into two bond ETFs, one short term and one long term. The portfolio now has a significant weighting in cash and bonds as we wait and watch how the various uncertainties and scenarios discussed above play out over the next few months.

In investing, letting emotion and fear over an uncertain future drive investment decisions almost always leads to sub-optimal results. In our experience, having a disciplined investment process with strong risk management leads to more objective investment decisions and better results.

As always, we believe a disciplined investment approach founded on proven, time tested investment strategies will help our investors achieve their financial goals over time.