

First Quarter 2011
Investment Commentary



Investment Insight
Fiduciary Focus



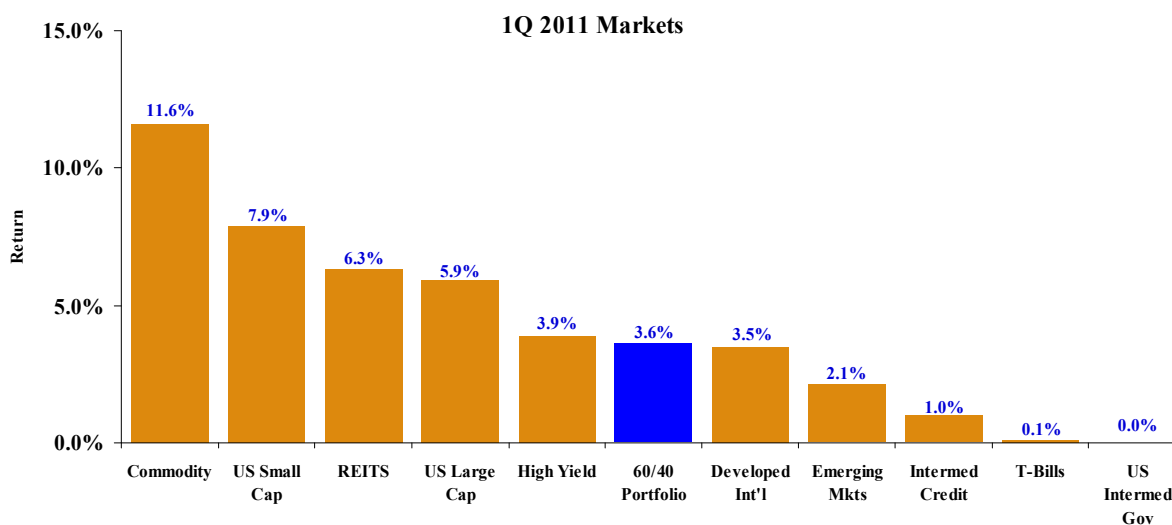
After a strong start in 2011, global stocks retreated as international events including a devastating earthquake and tsunami in Japan, social unrest in the Middle East and northern Africa, rising gas and commodity prices and continuing fiscal strains in the Euro zone triggered investor anxiety and market volatility. Most stock indices recovered and ended the quarter higher as the shock effect of these events subsided amidst renewed optimism for continued economic recovery, particularly in the US. However, the prospects for continued growth signaled rising inflation and monetary tightening to bond investors driving government bond prices lower across the developed market economies. A typical 60% equity pension plan portfolio added about 3.6% for the quarter while liabilities fell by -1.2% according to the BNY Mellon Liability Index.

US Stocks Lead Global Equities

The US stock market booked its largest first quarter rally since 1998, ending the quarter 5.9% ahead per the S&P 500 Index. From its 13-year low in March 2009, this was the biggest two-year rally since the Great Depression. This was an unexpectedly strong finish considering the macro issues facing the market as well as the international events which caused US stocks to re-price over 6% lower than their mid February high.

Signs of a strengthening U.S. economy evident in declining initial jobless claims, rising business and consumer confidence, and growing employment figures buoyed investors' risk appetites in the opening weeks of 2011. However, anxiety over the devastation from the earthquake and tsunami in Japan and resulting nuclear reactor problems as well as rising tensions in Libya and the Middle East triggered an aggressive sell-off in stocks in March. Though deeply impacted by the human aspects of these events, US investors concluded that the macroeconomic threat would be localized which allowed stock prices to rebound by quarter end.

Japan's modest share of global output and historical evidence that reconstruction might actually increase economic activity helped the markets overcome the Japanese disasters. Markets also closed the quarter seemingly unperturbed about the sudden price spike in oil due to unrest in the Middle East and northern Africa. Oil prices rose almost 17% during the quarter to over \$100/barrel which was ultimately regarded as a minor speed-bump in the US economic recovery.



Small and mid cap stocks lead large caps for the quarter as risk appetites recovered. Growing mergers and acquisitions activity along with reduced international business exposure enhanced their appeal. The small cap Russell 2000 index added 7.9% for the quarter, a little more than the 7.6% increase in the Russell Mid Cap index. Growth outperformed value in the small and mid index's but value lead growth in large caps thanks to the dominant returns of the major oil producers.

Energy Drives Index Returns

There were several very strong performance themes which drove index returns and investment manager relative performance for the quarter. All of the S&P 500 sectors produced a positive return, yet only 2 sectors, energy and industrials outperformed the overall S&P 500. The energy sector added over 16.8% as rising oil prices due to supply concerns from tensions in the Middle East boosted the profit margins for many suppliers and alternative energy firms, especially the major integrated oil and gas players such as Exxon, Chevron and Conoco. The Industrial sector rose 8.7% in anticipation of major reconstruction efforts in Japan. This had a material impact on overall index returns. Defensive sectors such as consumer staples and utilities lagged. Other commodities prices including foods, precious metals and basic materials rose over the quarter sending the S&P GSCI Commodity index up 11.6%.

S&P 500 Sector Returns	1Q 2011
Energy	16.8%
Industrials	8.7%
Health Care	5.7%
Telecomm	4.9%
Consumer Discretionary	4.7%
Materials	4.5%
Information Technology	3.6%
Financials	3.0%
Utilities	2.7%
Consumer Staples	2.5%

Equity Managers Under-perform

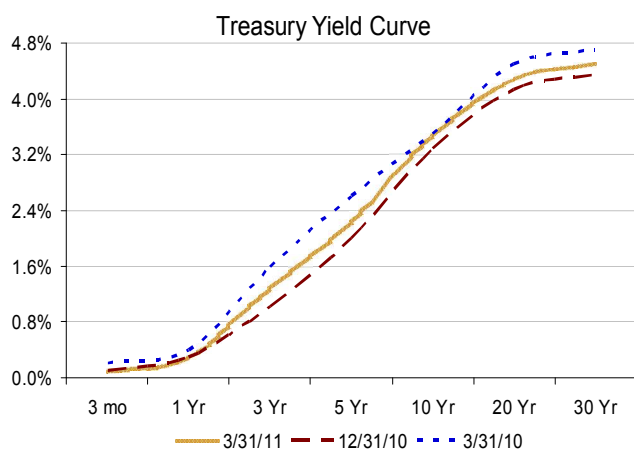
In an environment where sector return dispersion is high, investment manager return dispersion can be high as well. Since unpredictable global events heavily influenced the profile and magnitude of sector returns, many fundamental, strategically focused equity managers were not positioned to ride the spike in energy prices or global industrials.

Benchmark relative performance was highly correlated to those exposures for first quarter. Some funds generated exceptionally good returns and others lagged substantially as a result of their energy and industrials exposure. While diversification means having some exposure to the energy sector, many managers view the effects of the recent oil price hikes to be temporary and were not strategically overweight that sector. Only 35% of US equity managers in our universe beat their benchmarks for the quarter. Investment fiduciaries should be careful not to overreact to manager underperformance given how powerfully this quarter's random events impacted the markets.

International equity markets also produced gains for the quarter, though they didn't keep pace with the U.S. The MSCI EAFE Index, representing developed international markets, returned 3.5% percent for the quarter. Gains were driven by energy and the US dollar's decline against many major currencies. The prospect of higher interest rates also boosted financial shares across Europe. After an initial 16% sell-off, the Japanese market recovered though it finished the quarter with a -4.9% loss. Deviating from the recent past, the MSCI Emerging Markets Index added only 2.1%, underperforming the developed markets index. Many issues have been weighing on emerging markets including food price inflation and worries about central bank tightening. Russia benefited from commodity prices (16.3%) while China (2.9%) and India (-5.1%) slipped behind. The changing global outlook resulted in outflows from the Asia and Latin America equity markets into developed economy equity markets. Though emerging markets exposure provided international funds with a performance advantage over the past 8 quarters, it was a source of underperformance for this quarter. Forty three percent of the funds in our international universe beat their benchmarks for the quarter.

Bonds Post Modest Gains

The improved outlook on growth had a mixed impact on global bond markets. Government bond yields increased reflecting both higher expected real yields due to anticipated monetary policy tightening and higher expected inflation while credit spreads narrowed. Overall, the US investment grade bonds returned .43% for the first quarter per the Barclays US Aggregate Bond Index. Barclays Intermediate Government Index was flat, its Intermediate Credit index was up about 1% and its mortgage index was up .52%.



The US 10-year Treasury yield closed the quarter at 3.47%, 11 basis points higher than at year end. The quarter’s largest fixed income gains were in US TIPS (2%), which benefited from rising inflation expectations, and US high yield (3.9%) thanks to a high level of refinancing and lower expected default rates. Simmering European sovereign debt issues put downward pressure on sovereign debt but overall international bond returns were up 1.8% per the Merrill Lynch Global Bond Index ex US thanks in part to dollar weakness. Multi-sector Bond managers had a good quarter with 67% of the managers in our universe exceeding their benchmarks.

While the resilience of stocks must partially reflect the slowly improving health of the economy, there is something unsettling about a market that seems unperturbed by some very unfavorable macro factors and trends. The private sector is de-leveraging while government deficits are growing and global fiscal and monetary policies are or will be contracting. It is difficult to know the extent to which the markets’ recent performance is based on sustainable economic and financial fundamentals vs. the transient effect of the Fed’s targeting asset prices and a reversal of massive cash-flows from bonds back into stocks. Nevertheless, the market seems inclined to move upward so responsible fiduciaries and investors should manage the momentum risk by diversification, asset allocation and by harvesting its gains via portfolio rebalancing. Recognizing and managing uncertainty is often a better fiduciary strategy than taking portfolio action based on the illusion of certainty.

Enjoy your spring.

Sincerely,

Timothy C. Burns, CFA
 Hunter Capital Advisors, Inc

