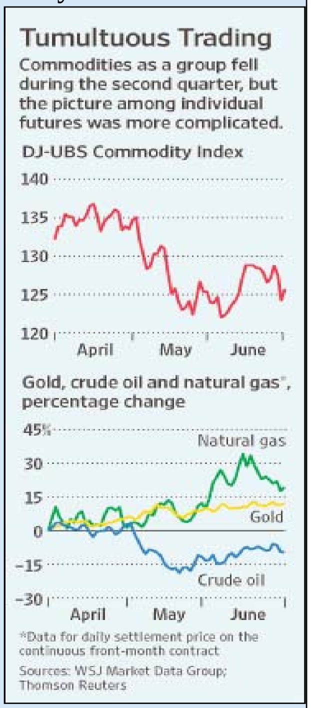
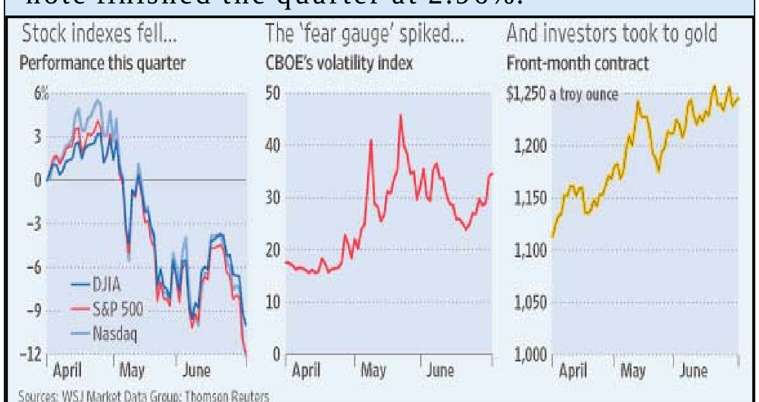
Quarterly Letter to Investors: *July 2010*

Second Quarter Review

The dominant investment theme in the second quarter was the return of volatility. With investors facing a growing list of macroeconomic concerns, the response was a flight from riskier assets that had been rising since global financial markets began recovering in March 2009. As depicted in the chart below, the renewed worries caused the VIX "fear gauge" to more than double from below 20 to more than 40 at times during the quarter. The Dow Jones Industrial Average ended the second quarter down 1,082.61 points or 10% at 9,774.02. The S&P 500 fell 11.9% and Nasdaq declined by 12%. These quarterly declines leave all of the benchmarks with losses for the year ranging from a 6.3% decline for the Dow to a 7.6% loss for the S&P 500. Other assets also sustained big declines during the quarter as well including copper, a key industrial commodity, down 17% and oil down 9.7%. Overall, commodities lost 4.9% in the second quarter. Meanwhile, investors sought investments considered safe havens. Gold rose nearly 12% per troy ounce to $1,245.50, reflecting renewed concerns about the stability of the global monetary system. U.S. Treasury securities prices also rose sharply, pushing yields significantly lower. After briefly touching 4% in early April, the yield on the ten-year U.S. Treasury note finished the quarter at 2.96%.





The seeds of the second-quarter tumult were sown in the first quarter when the Greek debt crisis was initially exposed. As the second quarter progressed, the Greek crisis deteriorated rapidly and worries that it would spread beyond Greece, especially to other highly indebted countries such as Portugal, Spain, Italy and Ireland, caused investors to run for safety. At the same time, concerns that China, in an effort to slow its economic growth, would end up derailing a key engine of growth became an issue for the financial markets. In the midst of these anxieties, the May 6 "flash crash," when the Dow dived 700 points in eight minutes, raised concerns about the integrity of the U.S stock market. With housing, consumer and labor market data all signaling a slowdown in the rate of economic expansion, the key concern as the quarter ended was whether we would suffer a double-dip recession.

Economic Outlook

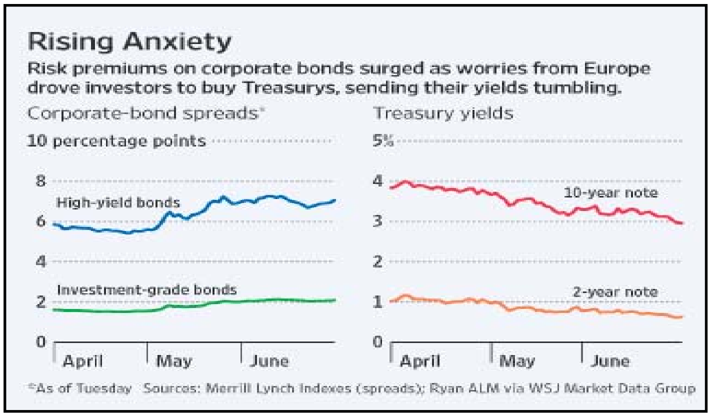
Recent economic data has indicated a slowing in the rate of economic activity from the more rapid pace of the prior two quarters. Employment, while growing, has been disappointing. Job growth, excluding census workers, has averaged less than 100,000 net new monthly hires this year. While this rate of growth may be consistent with 3-4% annual GDP growth, it is slightly less than the underlying growth in our labor force. This means that the unemployment rate should hover near the current level of 9.5% for a while longer, which is troubling at this point in the economic cycle. The surge in consumer spending we witnessed earlier this year has moderated in the last few months amid concerns about jobs and the sustainability of economic recovery.

The housing market recovery appears to have stalled after the expiration of the $8,000 homebuyer tax credit at the end of April. Preliminary data suggest that we experienced a huge surge in sales prior to the deadline followed by a dramatic drop in sales activity after the expiration. With mortgage rates near record low levels and housing prices having corrected 20-50%, depending on the region, buyers are likely to return once they become more confident about the job market and overall health of the economy. Slower growth trends are also evident in recent manufacturing, service and export reports. Disappointing export sales are likely being impacted by the renewed strength of the U.S. dollar.

Although risks have risen, we do not believe the current economic slowdown will degenerate into a renewed business-cycle contraction. In our opinion, concerns regarding China suffering a "hard landing" are overblown and we believe Europe will avoid slipping back into recession as well. Global economic recovery will likely continue, but at a much subdued pace than is normal at this stage of an economic expansion.

Financial Market Outlook

The aforementioned macroeconomic risks, renewed fears about the integrity of financial markets and spreading worries that fiscal austerity measures would choke off economic recovery have caused investor sentiment to shift sharply negative. In the early stages of an economic cycle, after an initial surge in asset prices and economic activity, a period of deceleration is normal. Equally common are fears that decelerating growth might lead to an end to economic expansion and a return to contraction. If growth continues, even at a subdued pace as we expect, financial markets should regain some of the ground lost during the second quarter. With the headwinds of higher taxes, increased government regulation and decelerating corporate earnings growth looming, stocks may struggle to regain the levels attained at the early April peak. As it becomes clearer that double dip recession fears are exaggerated, bond yields are likely to rise as well,



although not back to the highest levels realized in April. An interesting trend worth watching is the increasing correlation of individual stocks to one another. As more money pours into exchange traded funds (ETFs), stocks in the S&P 500 stock index and other indexes have shown an increasing tendency to move in the same direction at the same time. It has been suggested that high frequency traders, instead of picking individual stocks to hold over a period of time, are using ETFs to trade in and out of the market as their perception of risk vs. reward changes, sometimes on a daily basis depending on news flow or economic reports. During periods of escalating volatility as seen recently, trends in markets tend to be exacerbated by this trading behavior.

Major Risks

Intensifying sovereign debt crises, particularly in Europe pose the greatest risk to global economic expansion. If these crises lead to a destabilization of the European banking system, it would remind investors of the financial crisis of 2008. A silver lining that may be emerging is that Germany and France may be benefitting from a cheaper euro. The second major risk is China's strong actions to burst their real estate bubble. If these actions trigger the unintended consequence of driving China's economy into recession, it could have a

devastating effect on global economic activity and financial markets. A third risk is that many developed government authorities around the world have embraced fiscal austerity. While maintaining highly stimulative monetary policies, many countries are reigning in their borrowing and spending. Premature withdrawal of fiscal stimulus has the potential to increase deflationary concerns and create additional economic uncertainty. Finally, if the slowdown in U.S. economic activity were to indeed deteriorate into contraction, global economic growth expectations would suffer and stock prices would have further to fall. Potential upside lies within the U.S. political scene. Legislation passed by Congress and signed into law by President Obama has been viewed as particularly unfriendly to business. Further anti-business legislative initiatives, such as energy regulation and tax increases will likely be attempted. Should Republicans capture one or both houses of congress or even make significant inroads in the Democratic majority, it may produce a positive impetus for markets as history has proved that stocks do well during periods of legislative gridlock. There may also be some economic benefit as current legislative and regulatory uncertainties are impeding investment and hiring. None of these major risks are likely to disappear quickly and we should expect markets to continue to respond to these trends. The critical issue is whether these forces will gather momentum and culminate in additional economic and financial market instability.

Investment Strategy

We first raised the possibility in our first quarter 2009 Investment Outlook that we are in the midst of a multi-decade long consolidation in U.S. equity prices. The recent stock market correction has increased our conviction that it will take several more years, at a minimum, before we return to a consistently upward trending bull market. A broad range of 6,600 – 14,000 for the Dow sets the outer bands of the current consolidation phase which began in 2000. Interim levels of 8,400 on the downside and 11,600 on the upside appear likely for the intermediate term unless we sustain unseen risks or the economic expansion exceeds consensus expectations. At 10,000, we are at the approximate mid-point of the trading range, which suggests investors should maintain normal asset allocation exposures. Depending on your risk appetite, equity exposure should be gradually reduced above 11,000 and increased below 9,000. With interest rates hovering at historically low levels, consideration of high dividend stocks and preferred stocks should be considered in your asset mix as an alternative to bonds. Selected foreign markets appear more attractive with better demographics, healthier country financial conditions (lower debt levels) and faster growth rates.

We extend our best wishes for an enjoyable summer and look forward to meeting or speaking with you to review your individual circumstances and modify strategy if necessary. As always, please do not hesitate to contact us with any questions, comments or insights.

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Dow Jones Industrial Average 1900-Present

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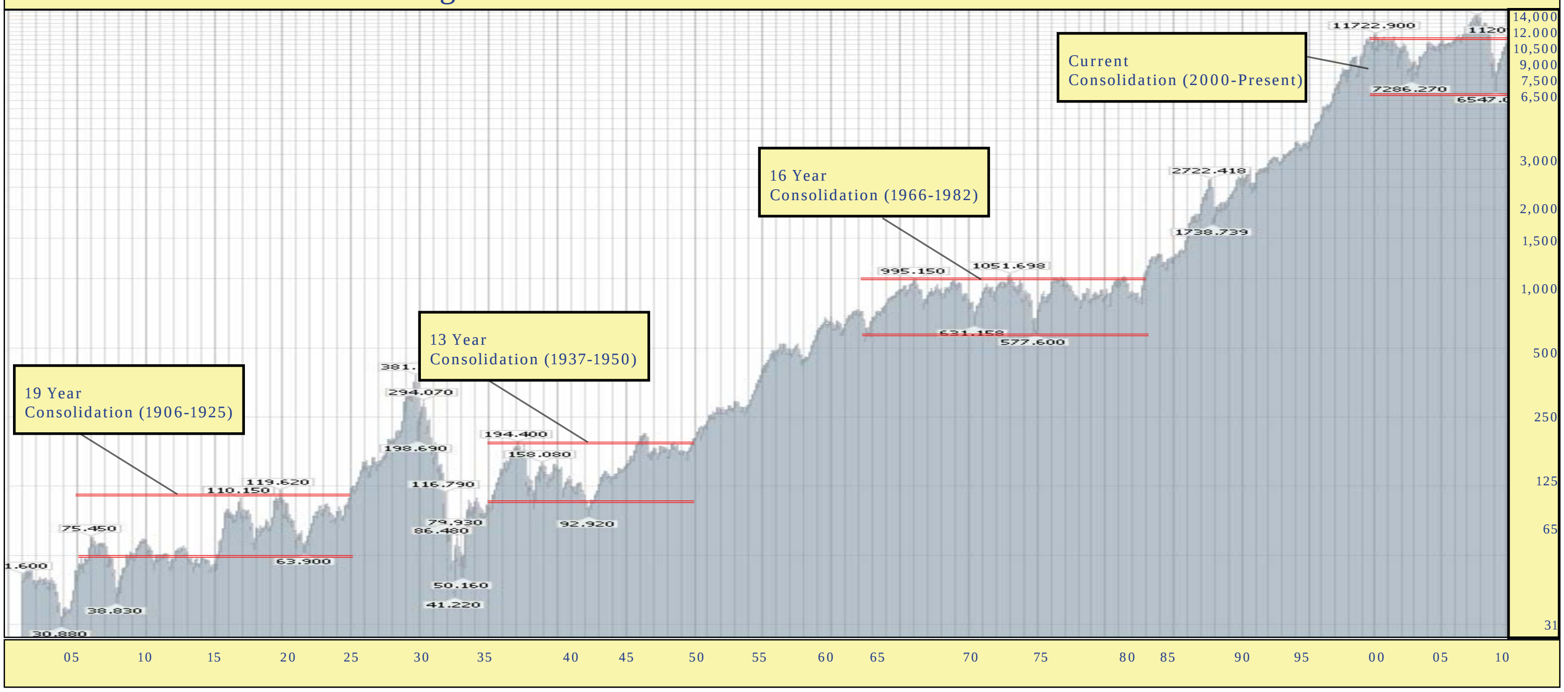

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