ECONOMIC AND MARKET REVIEW – THIRD QUARTER 2011

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Economic Review

It was a tumultuous quarter highlighted by the ongoing European debt crisis and the unprecedented downgrade by Standard & Poors of the triple-A Treasury debt rating the US has held for the past 70 years.

In the statement following its September meeting, The Federal Open Market Committee indicated that economic growth remains slow with recent indicators pointing to continuing weakness in overall labor market conditions, and that the unemployment rate remains elevated. The Committee continues to expect some pickup in the pace of recovery over coming quarters but anticipates that the unemployment rate will decline only gradually. The Fed announced a new program known as “Operation Twist” that would see the central bank shift its bond portfolio into longer-dated maturities and start buying mortgage-backed securities again.

The economy in the second quarter was marginally stronger than previously believed as the Commerce Department’s final estimate for GDP growth was nudged up to 1.3%. The increase in real GDP primarily reflected positive contributions from nonresidential fixed investment; personal consumption expenditures, exports, and federal government spending that were partly offset by negative contributions from state and local government spending and private inventory investment. In the first quarter GDP increased 0.4%.

New home sales for August 2011 were at a seasonally adjusted annual rate of 295,000, 6.1% above the August 2010 estimate according to the US Census Bureau. The median sales price of new homes was $209,100 and the estimate of new houses for sale at 162,000 represents a supply of 6.6 months at the current sales rate.

The Manufacturing ISM *Report on Business* rose in September indicating expansion in the manufacturing sector for the 26rd consecutive month, at a slightly higher rate.

Whether it’s their own diminished income expectations, the inability of the economy to generate a sufficient number of jobs, or uncertainty about future taxes, spending and entitlements, the most probable outcome expected by consumers is a prolonged period of economic stagnation according to the latest Thomson Reuters University of Michigan Survey of Consumers..

Financial Markets Review

Domestic Stock Market

In a quarter we would all like to forget, major markets declined sharply with the Dow Jones Industrial average diving 12.09% to 10,913.38 posting its fifth consecutive monthly decline and worst performance since the first quarter of 2009. Year-to-date the average is down 5.74%. Following suit, the S&P 500 tumbled 14.33% for the quarter (ex dividends) and 10.04% for the year to 1,131.42 and the Nasdaq fell 12.91% for the quarter and 8.95% for the year to 2,415.40. Recent stock market activity has also been very turbulent. Over the past two months the S&P 500 has experienced a 1-day change of at least 1% in 27 of 44 trading days or 61% of the time.

Mid and small cap stocks fared even worse in the third quarter with the S&P 400 midcap index plummeting 19.88% and the S&P 600 smallcap index sinking 19.83%.

For the third quarter the best performing sectors in the S&P 500 were utilities (+0.44%), consumer staples (-4.94%), and information technology (-7.96%). The worst performing sectors included materials (-24.96%), financials (-23.12%) and industrials (-21.51%).

For the past three months the top performing US industry groups as tracked by the Dow Jones Indexes were mining stocks (+13.62%), electric utilities (+8.13%) and aerospace and defense (+4.22%). Laggards included coal (-46.26%), tires (-42.42%), and aluminum (-40.35%).

McDonalds led the 30 Dow Jones Industrials components in the third quarter rising 4.15%, followed by IBM gaining 2.03% and Coca-Cola up 0.40%. The remaining 27 stocks all posted losses led by Bank of America crashing 44.16%, Alcoa sliding 39.66% and Hewlett-Packard falling 38.32%.

Looking to the fourth quarter significant concerns remain, including the European debt crisis, stagnant domestic growth, tight credit, persistent high unemployment, and a still depressed housing market. Counterbalancing these concerns are strong corporate earnings and attractive stock valuations. We continue to recommend a prudent strategy of broad diversification across multiple asset classes consistent with your long-term goals and time horizon, to mitigate risk while providing the opportunity for market participation in the months ahead.

	Total Returns (09/30/11)			Annualized Returns (09/30/11)		
Category/Style	Third Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
S&P 500 (w/ dividends)	-13.87	-8.68	1.14	1.23	-1.18	2.82
Russell 1000 (Large Cap)	-14.68	-9.25	0.91	1.61	-0.91	3.28
Russell 1000 Growth	-13.14	-7.20	3.78	4.69	1.62	3.01
Russell 1000 Value	-16.20	-11.24	-1.89	-1.52	-3.53	3.36
Russell 2000 (Small Cap)	-21.87	-17.02	-3.53	-0.37	-1.02	6.12
Russell 2000 Growth	-22.25	-15.57	-1.12	2.07	0.96	5.45
Russell 2000 Value	-21.47	-18.51	-5.99	-2.78	-3.08	6.47

Source: Frank Russell Company/Standard and Poor’s

International Stock Markets

Against a backdrop of the continuing European debt crisis and fears of a global recession, international markets fell precipitously in the third quarter. The MSCI EAFE Index of developed countries cratered 19.01% for the period and 14.98% for the year-to-date. The MSCI Emerging Markets Index lost 22.56% for the quarter and 21.88% for the year-to-date.

In Europe, the Dow Jones Stoxx 600 Index of the largest publicly traded companies finished at 226.18, falling 17.11% for the quarter. Among individual European countries, France's CAC-40 index lost 25.12% to 2,981.96, Germany's DAX index plunged 25.41% to 5,502.02 and the UK London FTSE index declined 13.74%% to 5,128.48.

In Asia, the DJ Asia-Pacific index lost 15.74% for the third quarter to close at 117.89 and Japan's Nikkei stock average slid 11.37% to 8,700.29. Among emerging markets the India Bombay Sensex Index dropped 12.69% for the quarter to 16,453.76 and the China Shanghai Composite Index fell 14.59% to 2,359.22 reflecting slowing growth.

In the Americas, Mexico's IPC All-Share Index declined 8.36% for the quarter to 33,503.28 and Brazil's Sao Paulo Bovespa Index lost 16.29% to 52,237.42, while Canada's S&P/TSX Composite Index retreated 12.61% to 11,623.84.

Not a single country in the Dow Jones Global Indexes was in positive territory for the third quarter. The best performing (in $US) were Peru (-0.4%), Qatar (-0.8%) and Iceland (-3.0%). The bottom dwellers were Greece (-45.3%), Cyprus (-44.9%) and Hungary (-43.7%).

The top performing DJ global industry groups for the quarter were gold mining (-1.9%), tobacco (-1.9%) and travel & tourism (-2.3%), The worst performers were renewable energy equipment (-46.8%), aluminum (-37.8%), and nonferrous metals (-34.8%).

The dollar strengthened 7.7% against the Euro which ended the quarter at 1.3387(Euro/USD). The dollar fell against the yen, finishing the quarter at 77.04 (USD/Yen), down 4.38%.

World Bond Markets

The BarCap US Aggregate Bond Index gained 3.82% in the third quarter and the BarCap Municipal Index added 3.81%. For almost 50 years from January 1962 to the beginning of September 2011 the yield on the 10-year US Treasury note never closed below 2%, not once. That's not true anymore as the yield broke into record territory and the 10-year note finished the month and quarter at 1.91%. Yields also remained at record low levels for money funds with the 30-day money market average at zero percent for the quarter.

Foreign bond yields also dropped during the third quarter with the 10-year bond yielding 2.55% in the United Kingdom, 2.01% in Germany, 2.20% in Canada, and 1.00% in Japan.

Commodities

Commodity prices retreated in the quarter. The Dow Jones-UBS Commodity Index slipped 11.34% to close at 140.20. The commodity index is down 13.67% for the year-to-date. Oil dropped below $80 at quarter end with West Texas Intermediate down 17.00% for the quarter and 13.33% for the year-to-date at $79.20/barrel. After touching $1,900 per troy ounce in the third quarter, gold retreated to $1,620, still gaining 7.83% for the period and 14.02% for the year-to-date. Natural gas plunged 16.19% for the quarter to $3.666/MMBtu and is down 16.78% for the year.

Mutual Funds/Exchange Traded Funds

The average diversified domestic stock fund lost 15.8% in the third quarter and the average taxable bond fund gained 1.5% over the same period according to Morningstar, Inc.

The latest release of the Investment Company Institute showed the combined assets of the nation's mutual funds decreased by $783 billion over the past three months to $11.620 trillion. Exchange traded funds only fell $47 billion to $1.040 trillion over the same period.

Mutual Funds Overview- As of September 30, 2011

	Total Returns			Annualized Returns		
Category	Third Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
Municipal Bond (inter.)	2.44	6.32	2.79	6.53	4.17	4.14
Short Taxable Bond	-0.44	0.98	0.90	4.51	3.54	3.41
Intermed. Taxable Bond	1.53	4.44	3.52	8.56	5.63	5.10
Long Taxable Bond	4.35	8.92	6.21	13.14	6.84	7.47
High Yield Bond	-6.66	-2.65	0.75	9.71	4.75	6.93
World Bond	-1.19	2.50	1.45	8.13	6.32	6.63
Small-Cap Stock	-21.77	-16.81	-3.70	0.62	-1.11	6.19
Mid-Cap Stock	-20.27	-14.42	-3.27	1.91	-0.41	6.11
Large-Cap Stock	-15.85	-11.24	-1.78	0.29	-1.81	2.56
World Stock	-17.70	-13.77	-6.36	1.12	1.54	4.74
Foreign Stock	-20.92	-17.60	-11.64	-1.79	-3.66	4.41
Natural Resources	-23.90	-22.52	-8.19	-1.55	1.69	12.50
Real Estate	-14.94	-6.61	-0.12	-1.34	-3.21	8.22

Source: Morningstar, Inc.