A Brief Tour of Our Portfolios

Stembrook Investment Commentary – June 2011

After dramatic outperformance of high yield bonds over the past few years, we are closing our positions and taking profits

Financial Markets

2011 began with moderately positive economic and corporate news combined with a bit less pessimism. Both drove markets higher. Then, we encountered two macro events that brought uncertainty and risk aversion to the fore. An earthquake, tsunami and nuclear accident in Japan raised fears of nuclear contamination to food and air along with interruptions to the delicate global supply chain. The Arab Spring taking place in Tunisia, Egypt, Libya, Yemen, Bahrain and Syria unleashed tremendous pent up human energies and has thrown the political landscape of many Arab (read oil-producing) countries into an uncertain state.

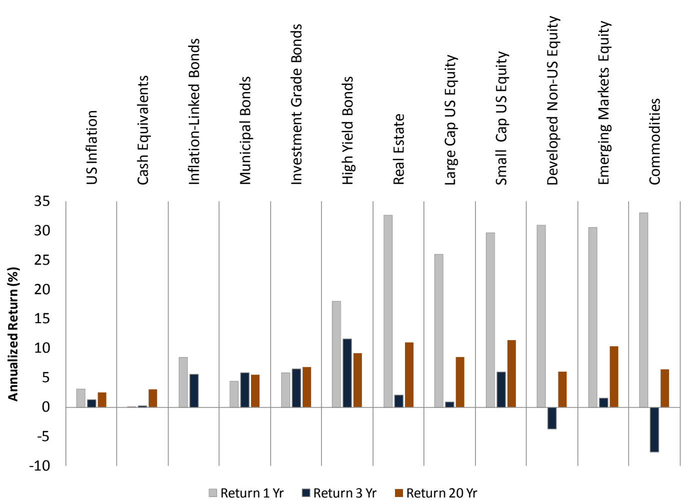
The recovery has not been smooth, but it is progressing. Through the end of May, the total return on the S&P 500 index is 26% for one year and is slightly positive for the past three years. If you purchased $100 of municipal bonds three years ago you would have roughly $119 today. The same $100 invested in high yield bonds would be worth roughly $139 today. Over the same period, the US economy has added 1.8 million non-farm jobs, exports of goods and services have risen by 12%, manufacturing has grown by 10% and aggregate private payrolls are actually above their peak in 2008. More recently, corporate profits have grown by 24% since March of 2010.

Reading recent headlines, you wouldn't get the sense that we've covered so much ground. Bear in mind that the media gets paid to sell papers and air time, not necessarily to give you a balanced opinion.

We still have a long way to go. Unemployment stubbornly remains at an unacceptable 9.1%, the glut of houses that have yet to find their natural price level is daunting and we've recently seen at least a short-term pullback in many economic indicators. All of this, against a backdrop of enormous sovereign debt concerns in Europe, creates significant short and long-term uncertainty.

As we've negotiated the many events of the past few years, we have been fortunate to have a strong investment process, objective valuation models and

Chart 1 – Global Market Returns as of 5/31/2011



Source: Thomson Reuters, Stembrook Research.

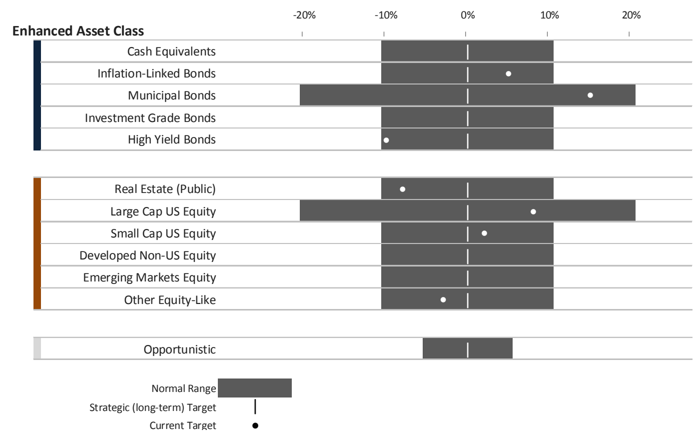
Indices: Consumer Price Index – US, U.S. 30-Day Treasury Bills, Citigroup Inflation-Linked Index, Barclays Capital Munis 5-Yr Index, Barclays Capital Aggregate Bond Index, Merrill Lynch U.S. High Yield Cash Pay, Dow Jones Wilshire REIT Index, S&P 500 Composite Total Return, S&P SmallCap 600 Total Return, MSCI EAFE Index, MSCI EM (Emerging Markets) a strong investment committee to keep us on course.

I believe that our portfolios are well positioned for the choppy waters ahead. We hold positions designed to capitalize on a continued recovery, protect against rising interest rates, hedge against future inflation and provide long-term growth.

The following is a view of how our portfolios are positioned today to tackle the challenges of the next three years and beyond and how we intend to capitalize on current anomalies to enhance our clients' returns.

Chart 2 – Portfolio Allocations vs. Strategic Targets

Tax-Deferred Portfolios



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As we walk through each position, note that our best ideas are used to inform the trading in each client's portfolio, but portfolios are also customized to best accommodate clients' specific situations.

Inflation-linked bonds

We continue to hold an overweight position in inflation-linked bonds in our tax-deferred portfolios. These bonds are issued by the United States Treasury and provide a stated yield plus an adjustment for future inflation. The benefits of these bonds include relatively low volatility, very low default risk as well as inflation protection. Inflation-linked bonds have been one of the best performing fixed income asset class over the past year. This, combined with an increasing implied inflation rate, leads us to keep an eye out for a time to reduce this exposure.

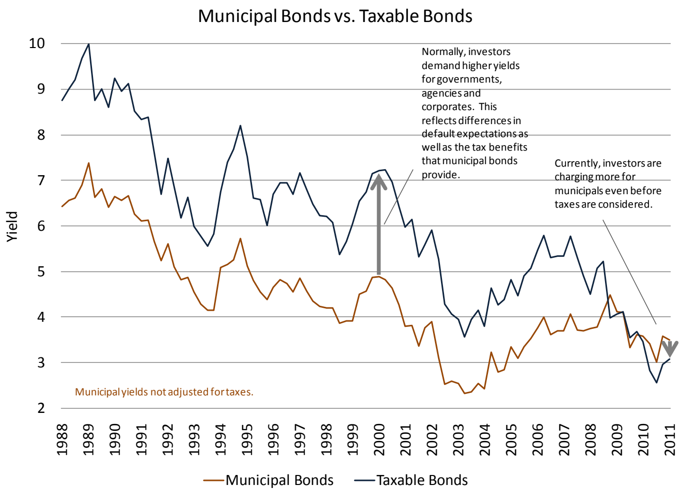
Municipal Bonds

We have increased our existing exposure to municipal bonds in our taxable portfolios and have added municipal bonds to our tax-deferred portfolios, given relatively high yields (extremely high in historical terms), and low odds of default.

An improving economy has strengthened state and local tax revenues. Revenues should continue to grow as the economy establishes positive momentum. Personal income tax revenues were up 22% on average from January 2010 to March 2011. During the same time period, corporate income tax revenues were up 41%. Revenues from sales tax have been increasing, but at a slower pace. Moreover, states have been adapting to budget shortfalls by cutting expenditures. For example, 86% of states have cut the size of their workforce and 61% have cut public health programs.

The municipal market experienced a strong selloff since November 2010; this can be largely attributed to headline risk, which has caused many investors to flee the market; hence, raising yields and lowering the prices of bonds. Net outflows from municipal bond mutual funds from November 2010 through the first week of May were more than $44 billion. We have recently begun to see investors reentering the market, with inflows of $512 million since the second week in May. These inflows are a drop in the proverbial ocean in this $2.9 trillion market, but could indicate a slowing or reversal of the recent trend. A weak supply of new bond issuance has also been instrumental in helping the market to rebound. The market has recovered nicely so far this year with the Barclays Capital 5 Year Municipal Index up 3.1%

Chart 3 – Municipal Bond Yields



through the end of May.

After a careful analysis of state and local government fiscal conditions, we concluded earlier this year that the market was undervalued. Today, the market continues to present us with a buying opportunity, so much so that we have added municipal bonds to our tax-deferred portfolios and increased our allocation in taxable portfolios. It is important to stress that our municipal bond investments are focused on high quality issuers. Investing in bonds that fund essential services and issuers that maintain a healthy credit profile is especially important given current market conditions. A small fraction of municipalities remain in fiscal peril and present a risk to lenders; this will likely be the case for years to come.

High Yield
We have closed out our positions in high yield bonds and taken profits. Over the past three years, high yield bonds have outperformed the Barclays Aggregate Bond Index - an index of investment grade taxable bonds - by 5% per year. Additionally, spreads, or extra yield provided for taking additional risk, have fallen below their historical average. Given these factors and the relative attractiveness of adjustable rate bank loans, discussed next, we have closed out our high yield holdings.

Floating Rate Bank Loans
As we described in our last commentary, floating rate bank loans provide high current yields and reduced risk from rising interest rates. Additionally, bank loans sit very high in the capital structure which means that in the event of default, holders of bank loans will be repaid ahead of other creditors. We continue to hold and monitor this position.

Publicly Traded Real Estate
Publicly traded real estate investments accessed through Real Estate Investment Trusts or REITs have performed very well in the past three years. REITs have rebounded from deeply depressed levels. These investments have historically offered higher current yields than other equity investments, but today's yields are very low by historical measures. Currently, those relatively high yields have drawn many investors to the market. Our research indicates that this market does not offer attractive relative value at this time and we have reduced our exposure.

Small/Mid-Cap Equities
We continue to hold an overweight position in small and mid-cap equities. While they have outperformed large cap stocks by more than 6% per year over the past three years, their valuation relationship to larger cap stocks is still attractive on a historical basis. However, these valuations have moved upwards and we are looking for opportunities to trim our positions in the future.

US Large Cap Equities
US large cap equities have endured 10 years of very poor absolute and relative performance. Given their relatively low valuations, a weaker dollar which helps exporting companies, strong balance sheets and stimulative monetary policy, we hold an overweight position in our portfolios. We maintain a focus on companies with lower valuations and strong businesses.

International Equities

We have added to our position in international equities bringing us back to a neutral position of roughly half of our total developed market equity investments. Given the economic, political and weather related incidents across Europe and Japan, these companies are valued at discounts to the US market.

Emerging Markets

We have moved from an overweight to a neutral allocation in emerging markets. Over the past ten years, emerging market equities have outperformed developed markets by more than 10 percent per year. It is difficult to know if this is a cyclical swing or a true secular shift. However, valuations of emerging markets have moved higher and while our models still find them attractive, the degree of that attractiveness has diminished in our most recent research update. This view is confirmed by increasing risks posed by rising wages and price inflation in these growing economies.

Commodities

We trimmed our gains in April, but maintained our neutral allocation. Commodities continue to provide an inflation hedge as well as exposure to global growth.

Boring, but Important

We took advantage of lower fees offered in selected fund investments by shifting to newly available share classes. If your statements reflect these transactions, please disregard them. These were costless transfers having no impact on market exposure or taxes. This shift offers a small improvement, but every basis point counts.

Investment Planning

The foundation of every client's investment strategy is their *Stembrook Strategic Investment Plan*. This plan takes into consideration your current portfolio, your expected saving and spending, and various scenarios for market returns given your high-level asset allocation. Please contact me if something has changed significantly with your unique state of affairs so that we may adjust your plan accordingly.

As always, I welcome your comments and questions, and appreciate your continued confidence in our investment management and advice.

Sincerely,

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Important note regarding Stembrook's capital market expectations.
The capital market expectations developed by Stembrook Asset Management are estimates of both a central tendency of asset class behavior and a probable range of asset class behavior over a long-term horizon. These estimates are one of many inputs used in the portfolio construction process, and should not be used independently. These expectations should not be construed as the returns that will be achieved, but merely those that may be achieved if certain assumptions hold true. Also note that each client's portfolio may differ given specific goals and constraints applied to the portfolio construction process.

Additional information is available upon request.