

2011 Market Review & Outlook



Economic Outlook

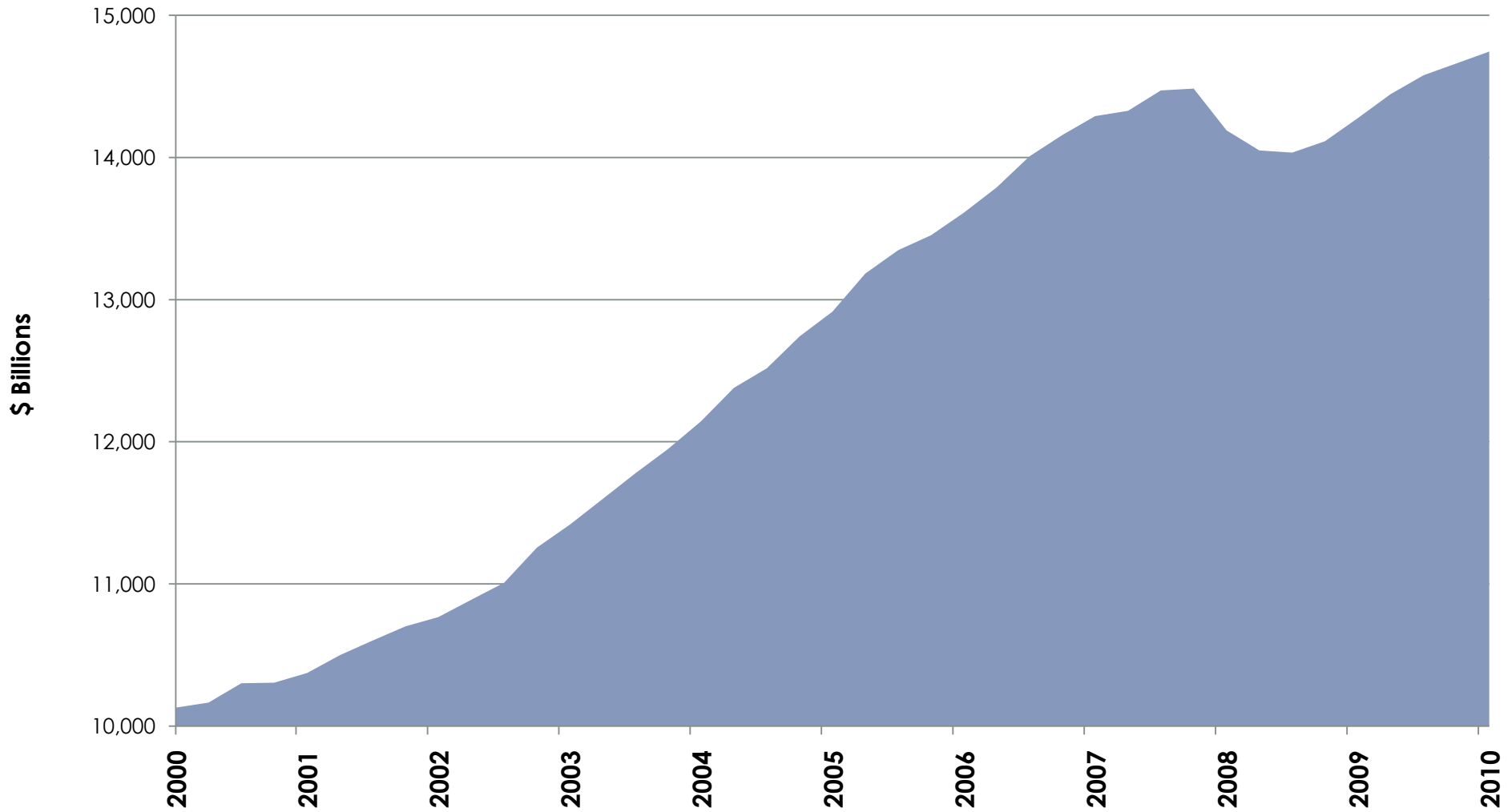
Jason O. Jackman, CFA

Economic Strategist



Economic Recovery Gaining Momentum

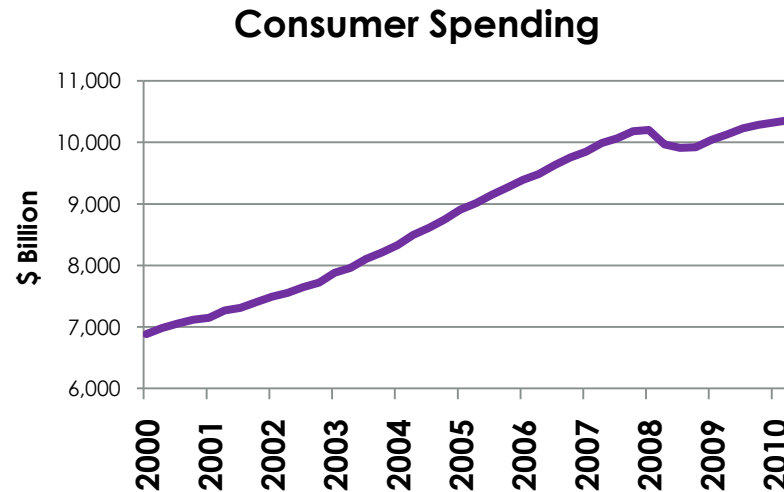
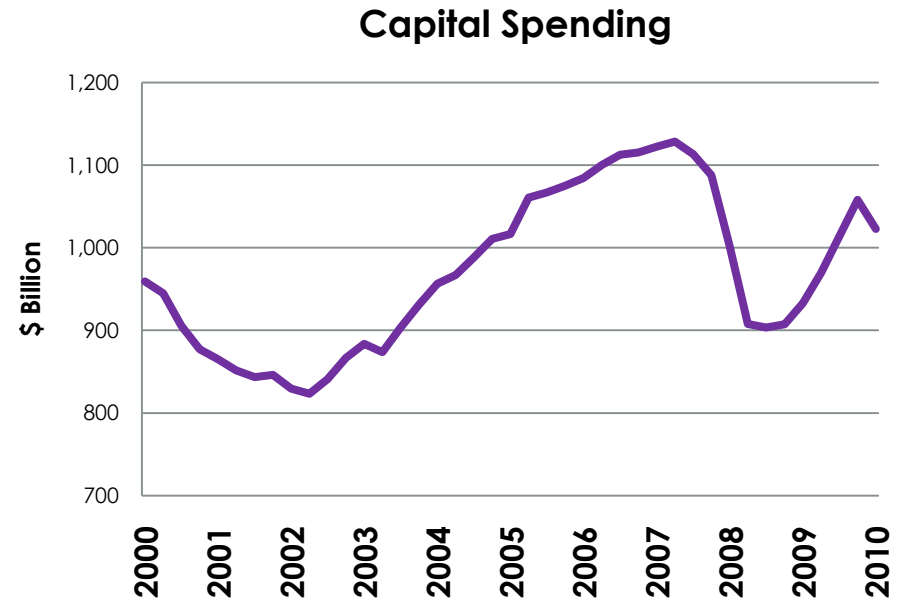
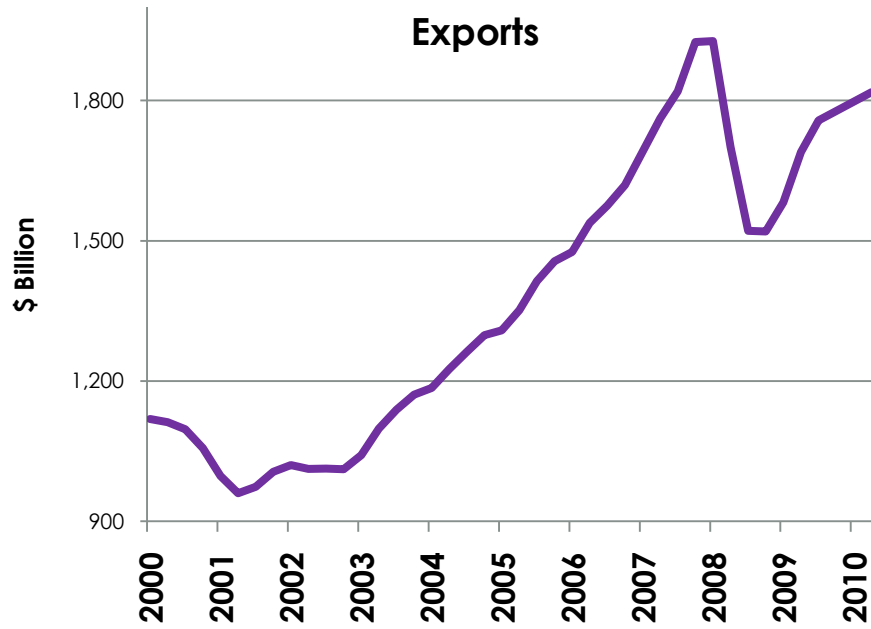
Gross Domestic Product



Source: Bureau of Economic Analysis



Improvement in Multiple Areas



Source: Bureau of Economic Analysis



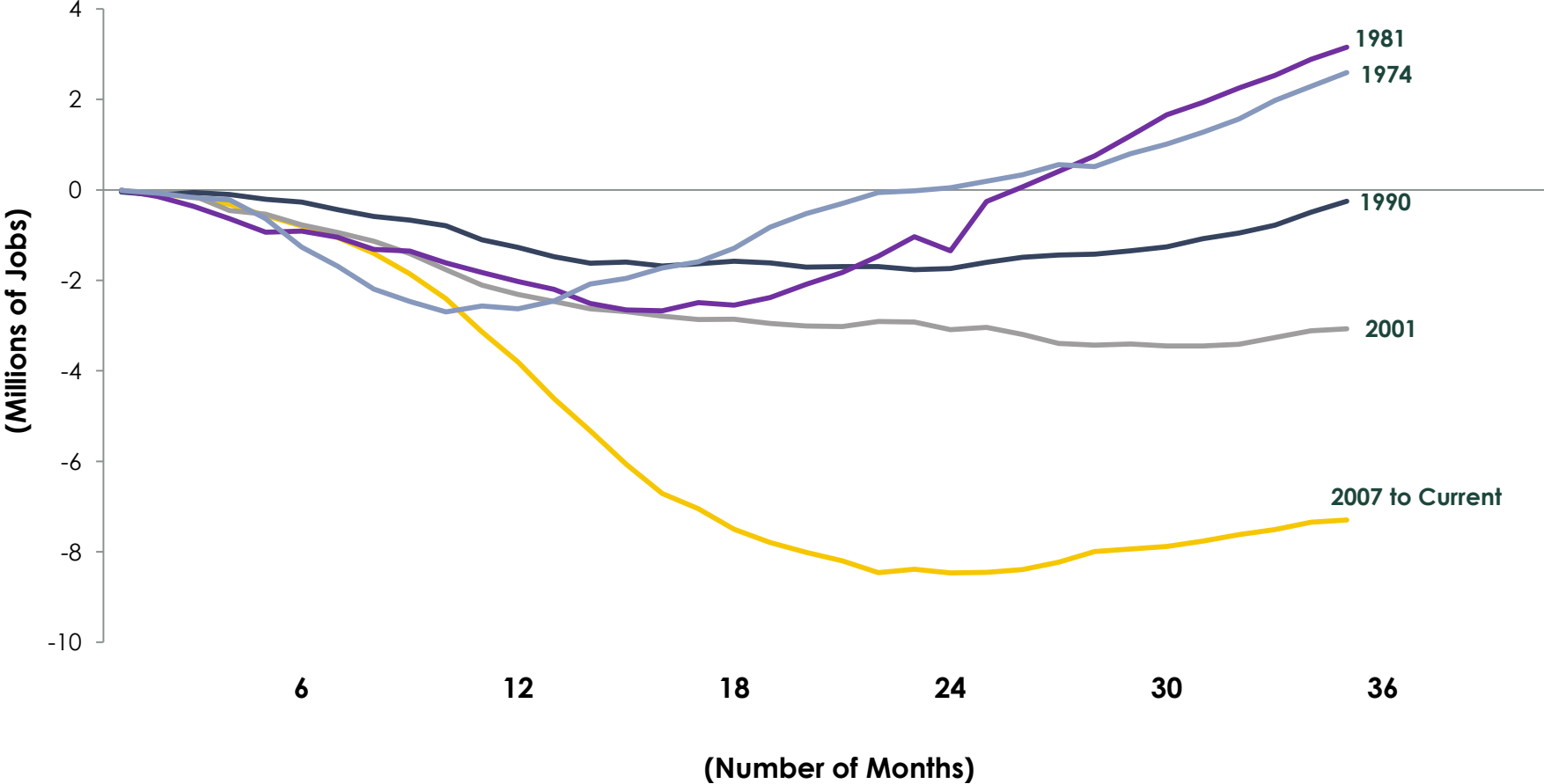
Lingering Economic Concerns

- **Labor Market**
- **Europe**
- **Government Debt**
- **Federal Reserve Policy**
- **Inflation**
- **Interest Rates**



Slow Improvement Ahead for Labor Market

Private Payroll Employment from Pre-Recession Peak



Source: Bureau of Labor Statistics



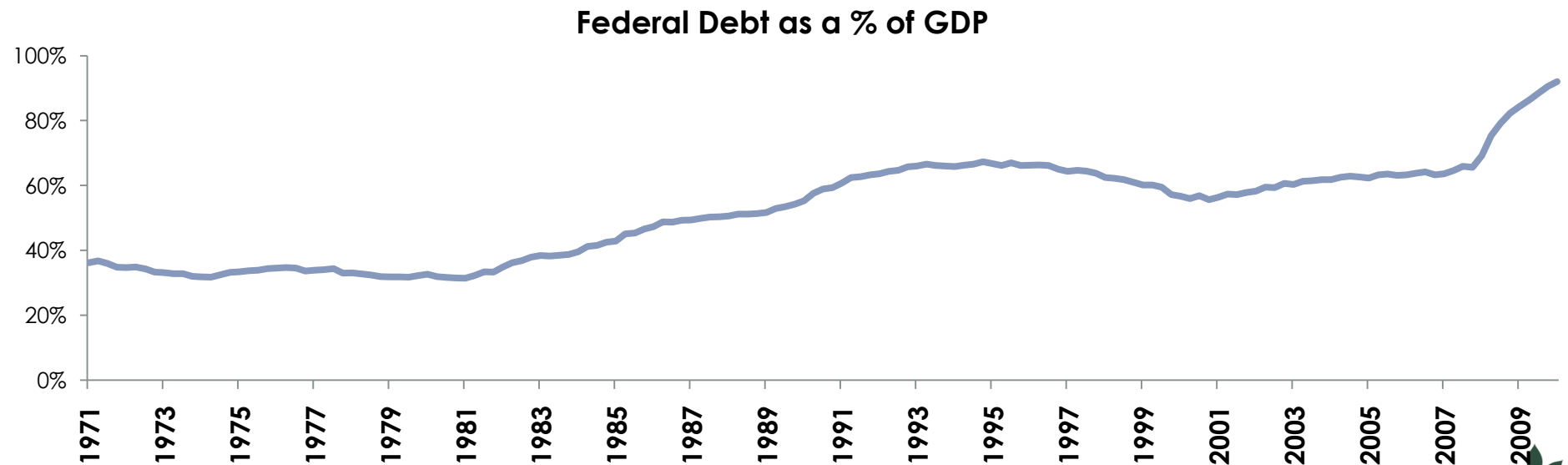
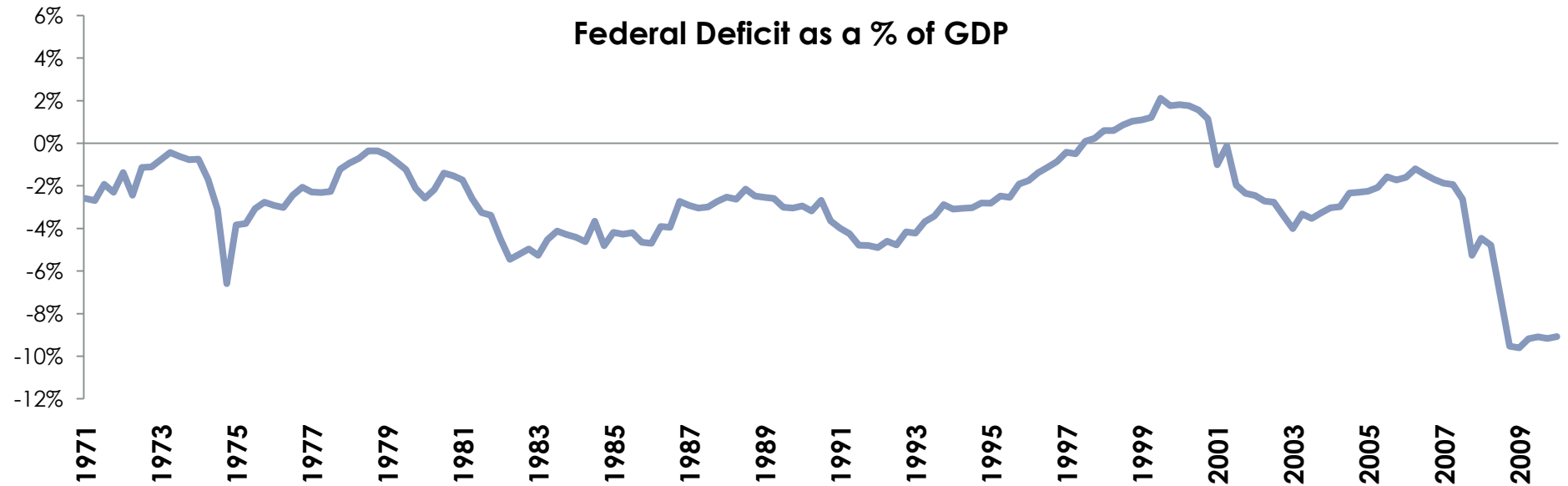
Mixed Global Outlook

| | % of World Economy | 2009 | 2010 | 2011 E | 2015 E |
|-----------------------------|--------------------|--------------|-------------|-------------|-------------|
| Total World Economy | 100% | -0.6% | 4.8% | 4.2% | 4.6% |
| Advanced Economies | 53.8% | -3.2% | 2.7% | 2.2% | 2.4% |
| Developing Economies | 46.2% | 2.5% | 7.1% | 6.4% | 6.7% |
| Euro Area | 15.1% | -4.1% | 1.7% | 1.5% | 1.7% |
| Developing Asia | 22.6% | 6.9% | 9.4% | 8.4% | 8.5% |

Source: International Monetary Fund



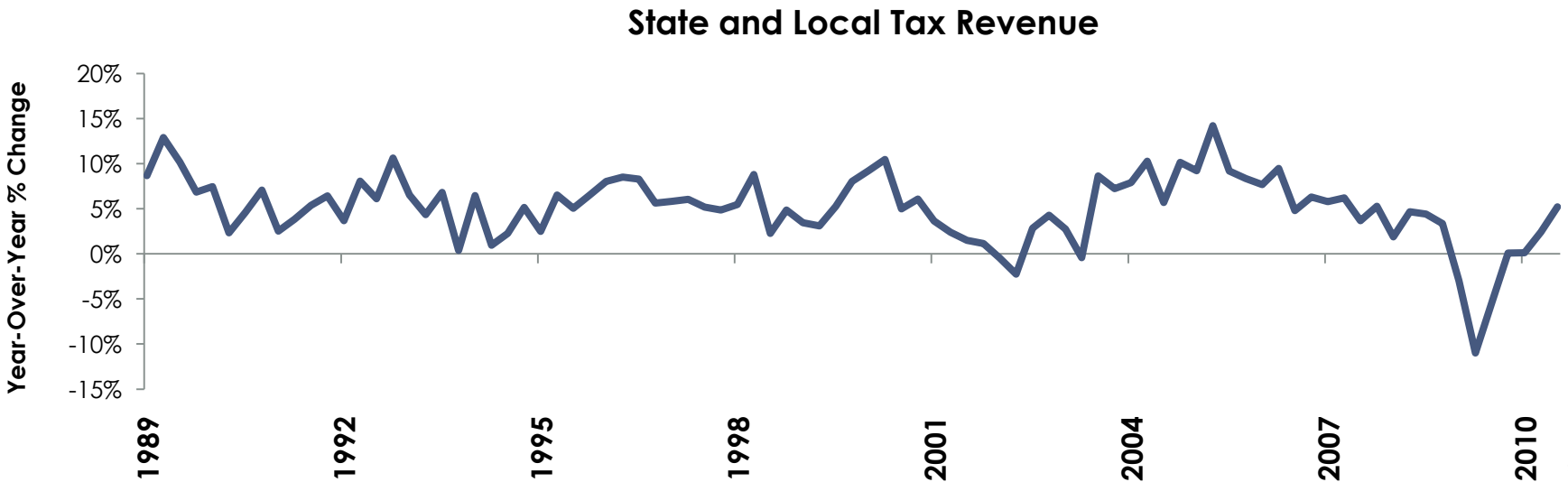
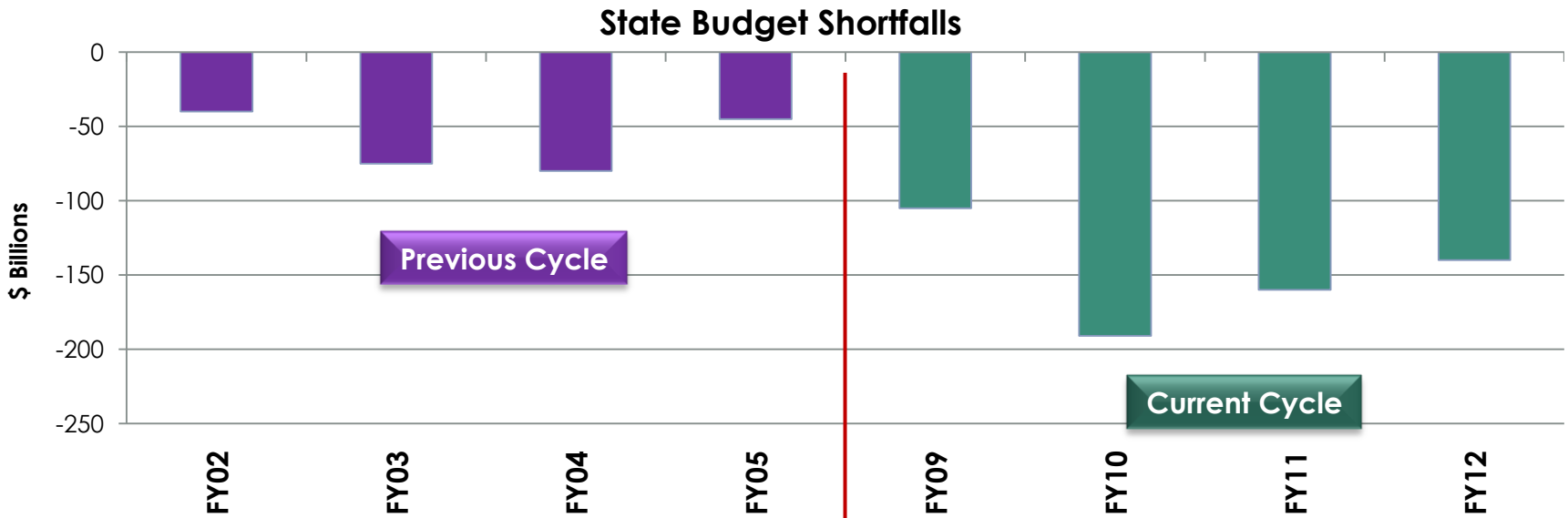
Federal Government Providing Additional Stimulus



Source: Ned Davis Research



Municipal Budgets Improving

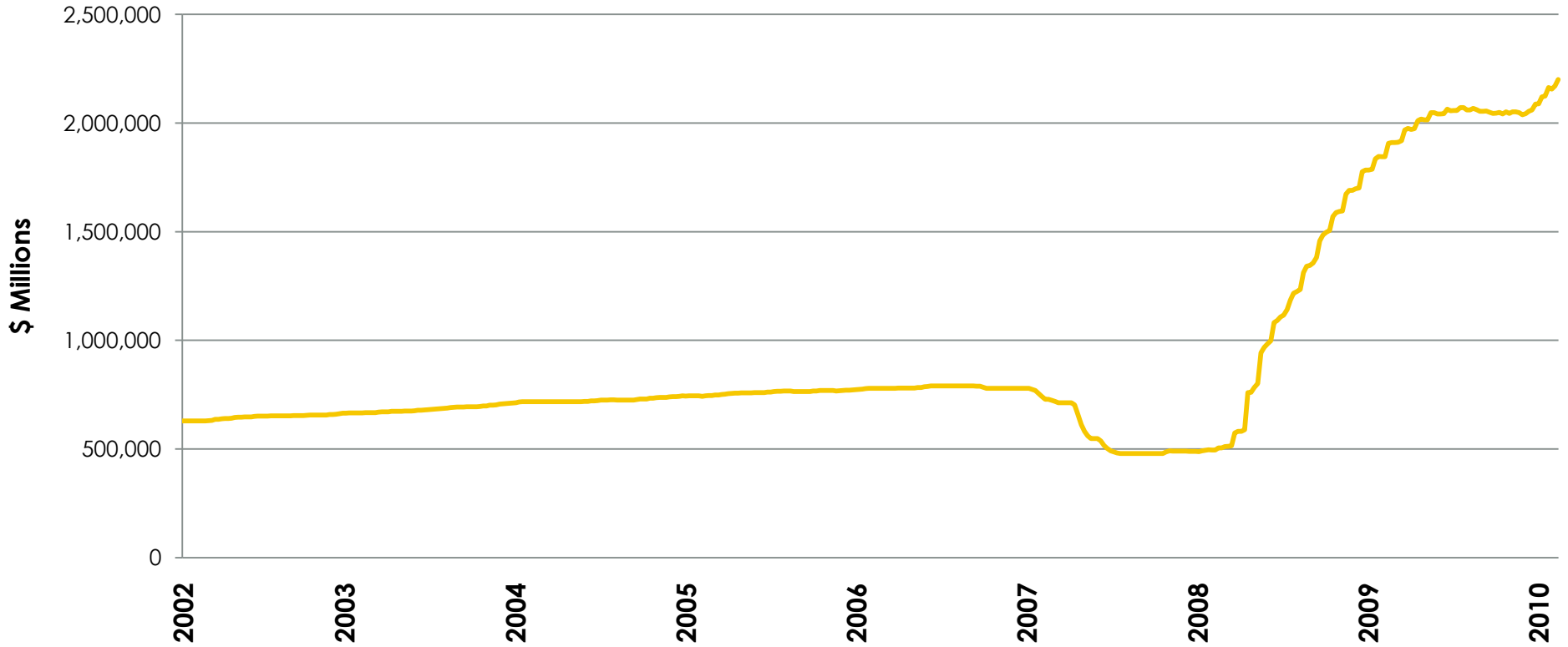


Source: U.S. Census Bureau



Federal Reserve: Quantitative Easing

Federal Reserve Asset Purchases

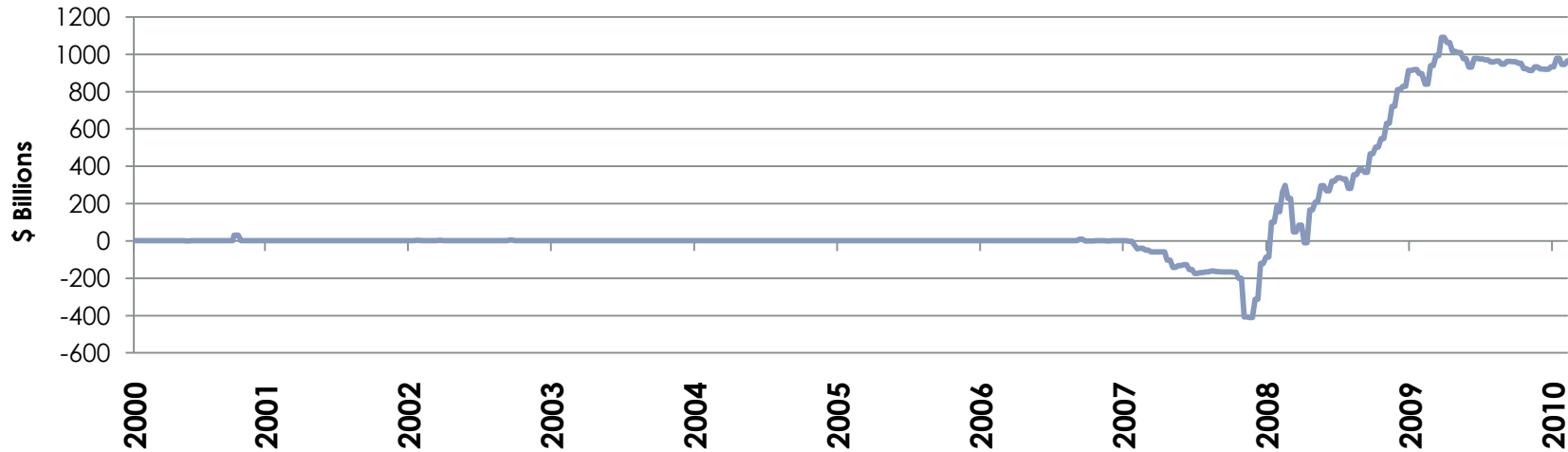


Source: Securities Held Outright; Board of Governors of the Federal Reserve System

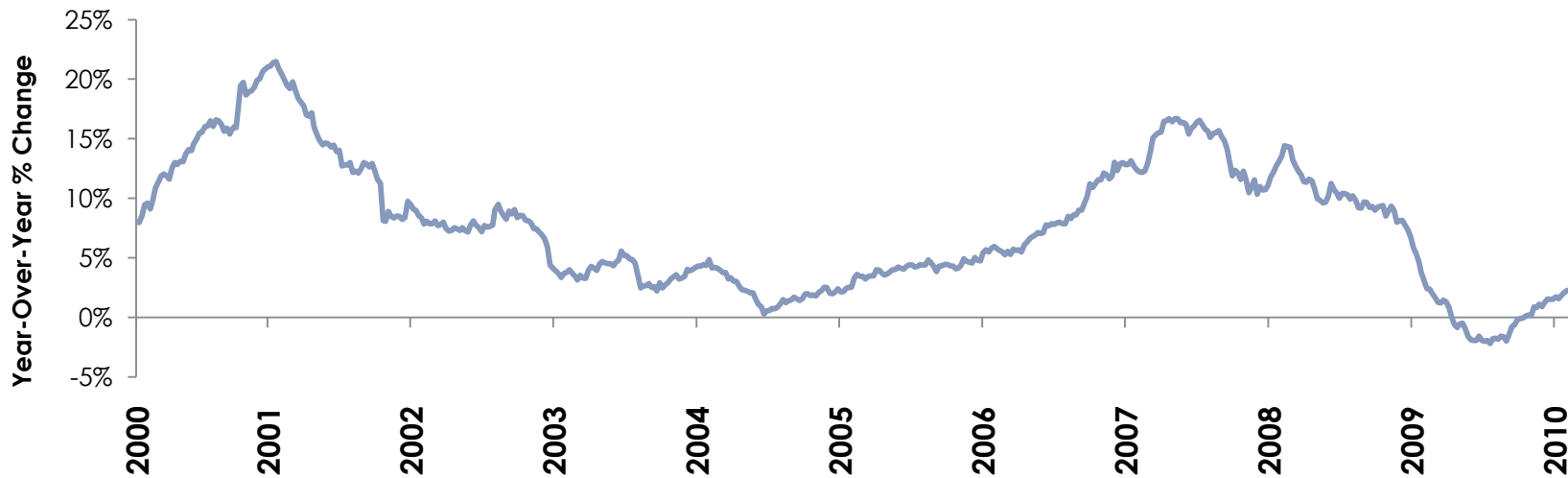


Fed Policy Tempered by Banks

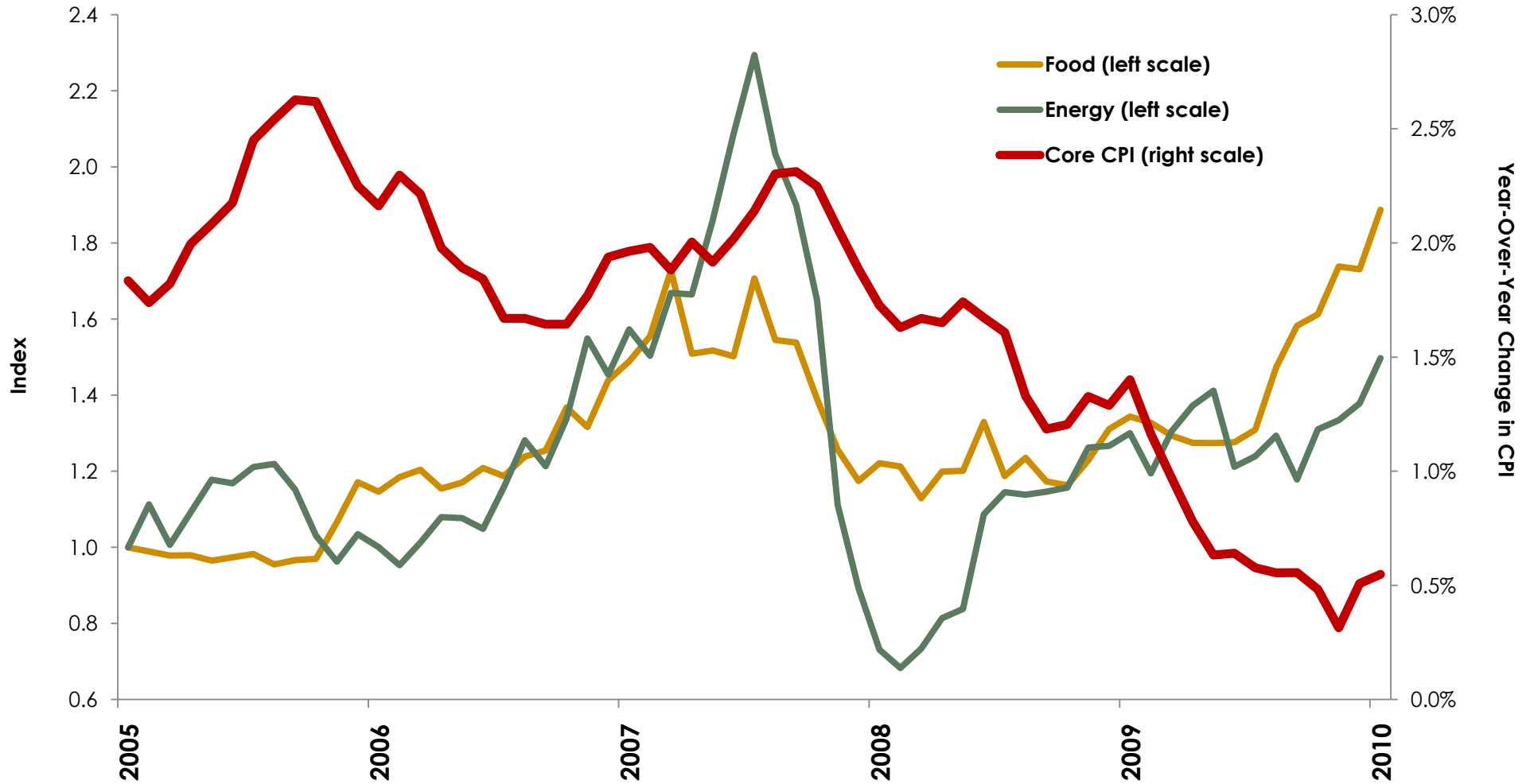
Bank Excess Reserves



Money Supply



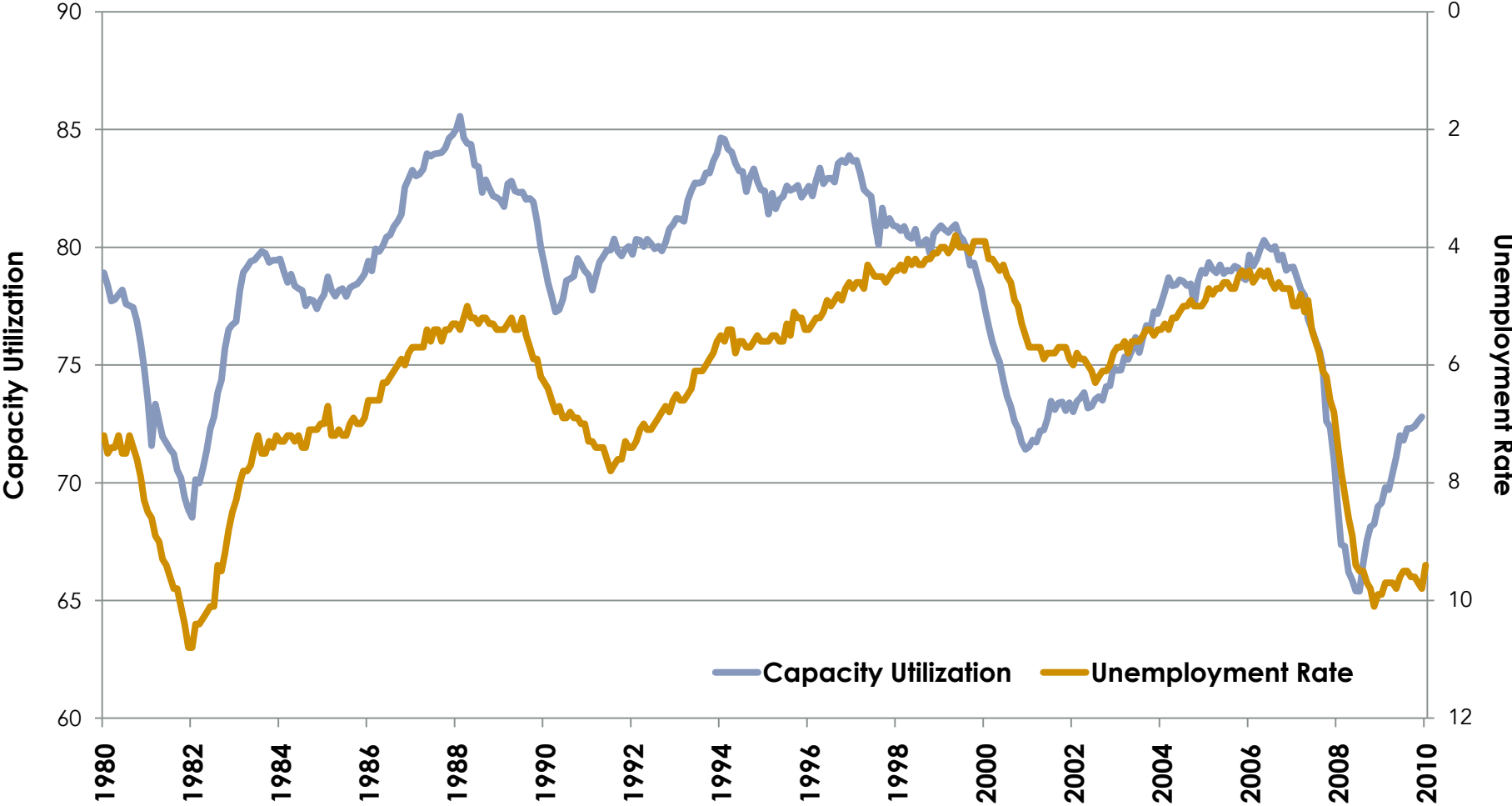
Inflation Subdued for Now



Source: Baseline



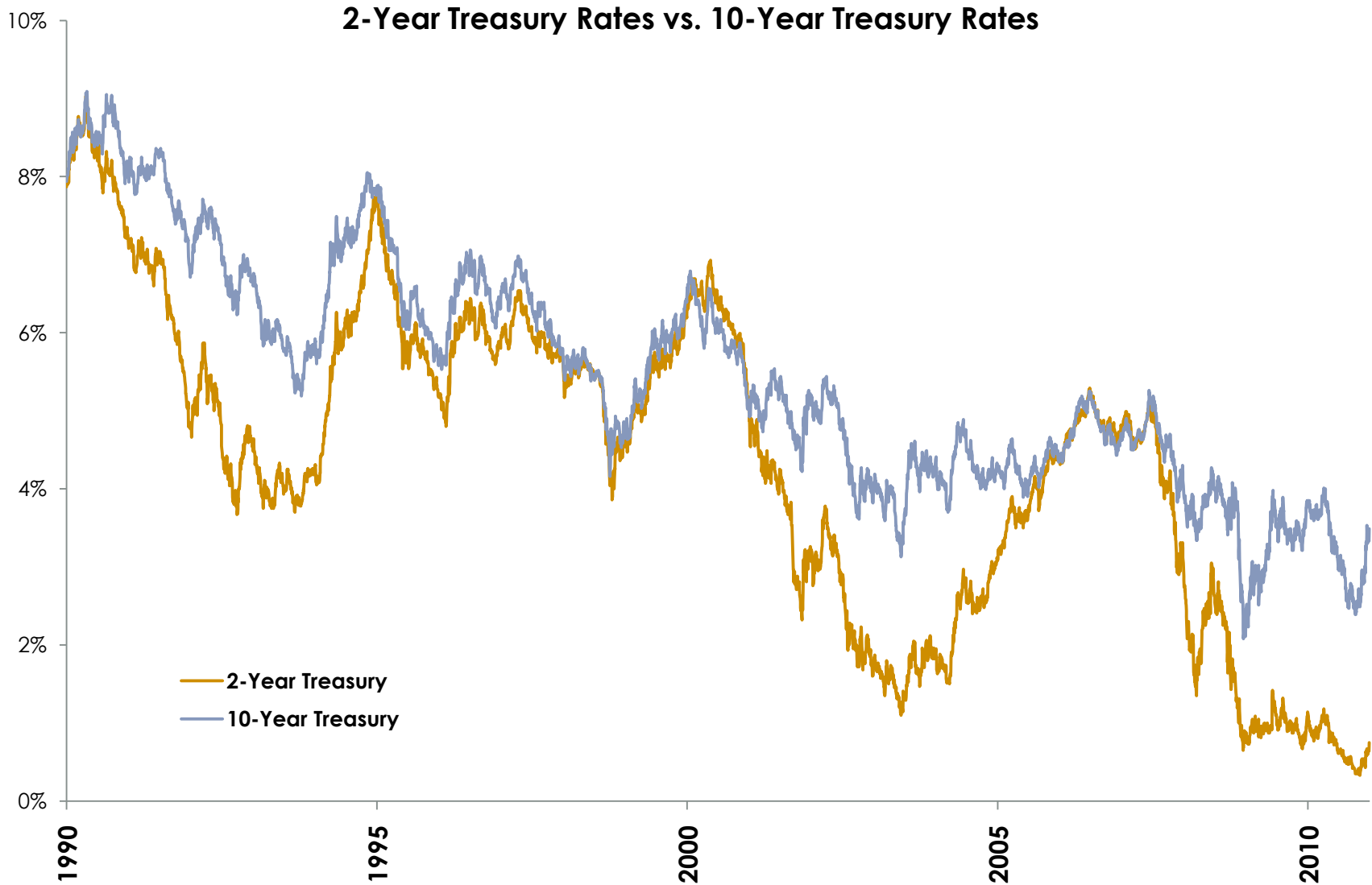
Excess Capacity Still Exists



Source: Ned Davis Research



Interest Rates Remain Anchored



Source: Bloomberg



Conclusions

- **Economic recovery gaining momentum**
- **Labor markets will slowly improve**
- **Global economy is both a risk and an opportunity**
- **Government debt – credible and substantive measures needed**
- **Inflation is currently contained**
- **Interest rates anchored in the near term**



Market Outlook

Jeffrey P. Cornell, CFA

Portfolio Manager – Core Equity Strategy



Major Equity Market Returns

Stocks Have Seen a Big Recovery

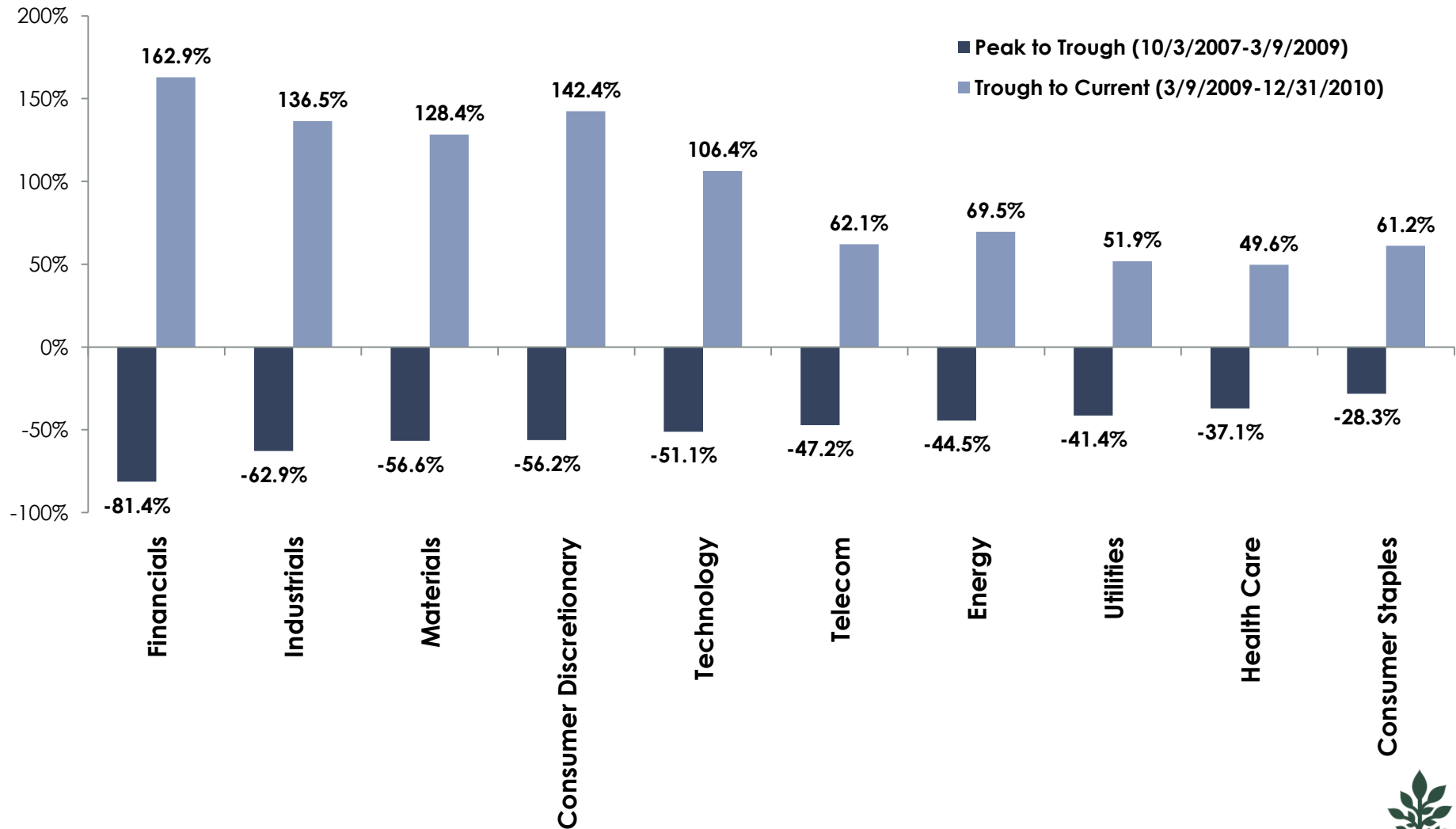
| Index | 2010 Returns | % From the Bottom | % From the Peak |
|---|--------------|-------------------|-----------------|
| Standard & Poor's 500 Index (Large Cap – U.S.) | 15% | 93% | 19% |
| Russell 2000 Index (Small Cap – U.S.) | 27% | 134% | 9% |
| International Developed | 8% | 94% | 32% |
| International Emerging | 17% | 137% | 16% |

Source: Baseline



S&P 500 Sector Performance Since Market Trough

March 9, 2009 through December 31, 2010



Source: Baseline



Tailwinds for Stocks

- Improving economy = better revenues/earnings
- Favorable valuations
- Quantitative Easing II
- Washington moving to the center
- Lower volatility
- Record levels of cash on balance sheets
- Asset flows – bonds to stocks?



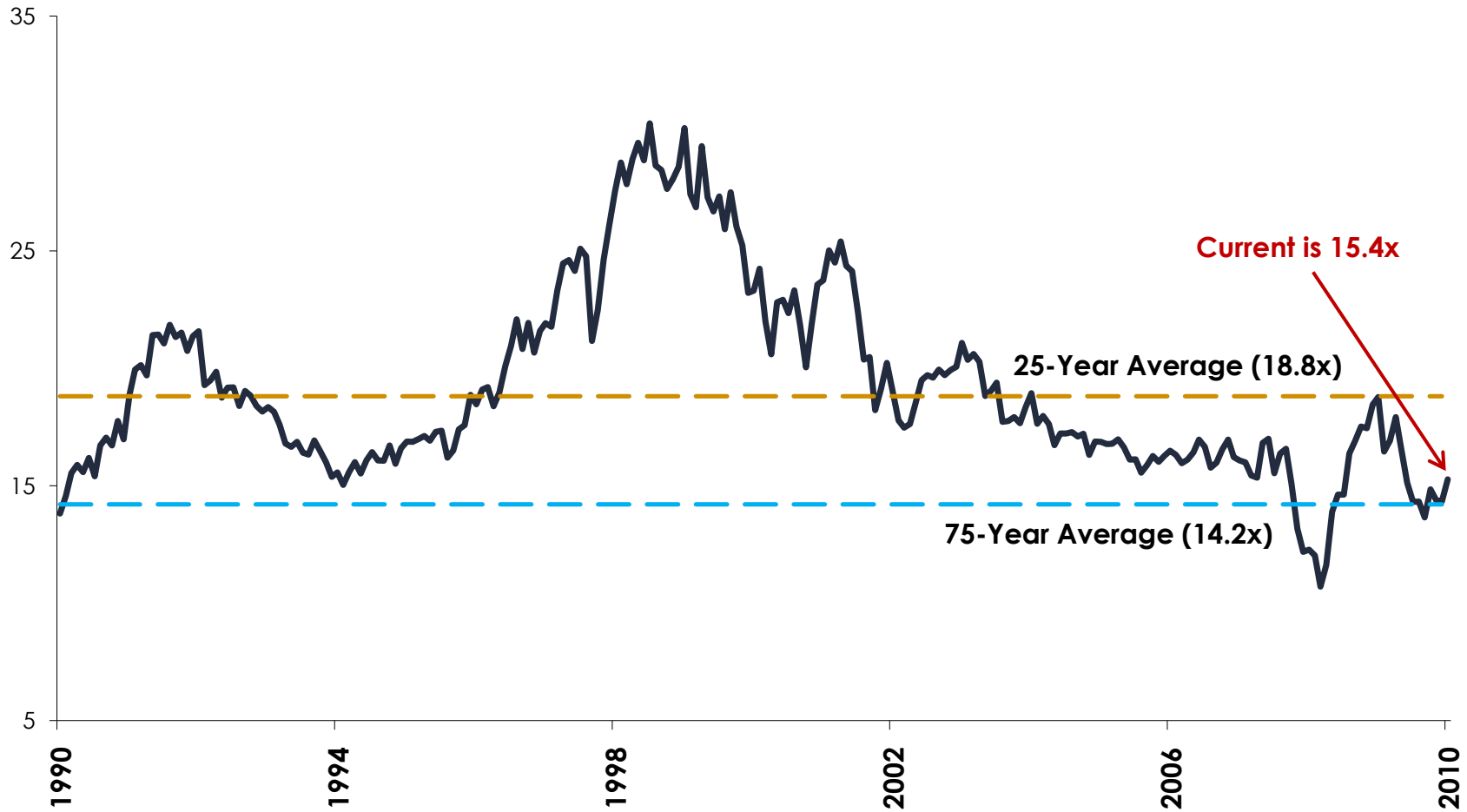
Our Thoughts for 2011

Equity markets should move higher



Valuations Remain Attractive

S&P 500 Index Trailing P/E Ratio (Operating Earnings)



Source: Baseline



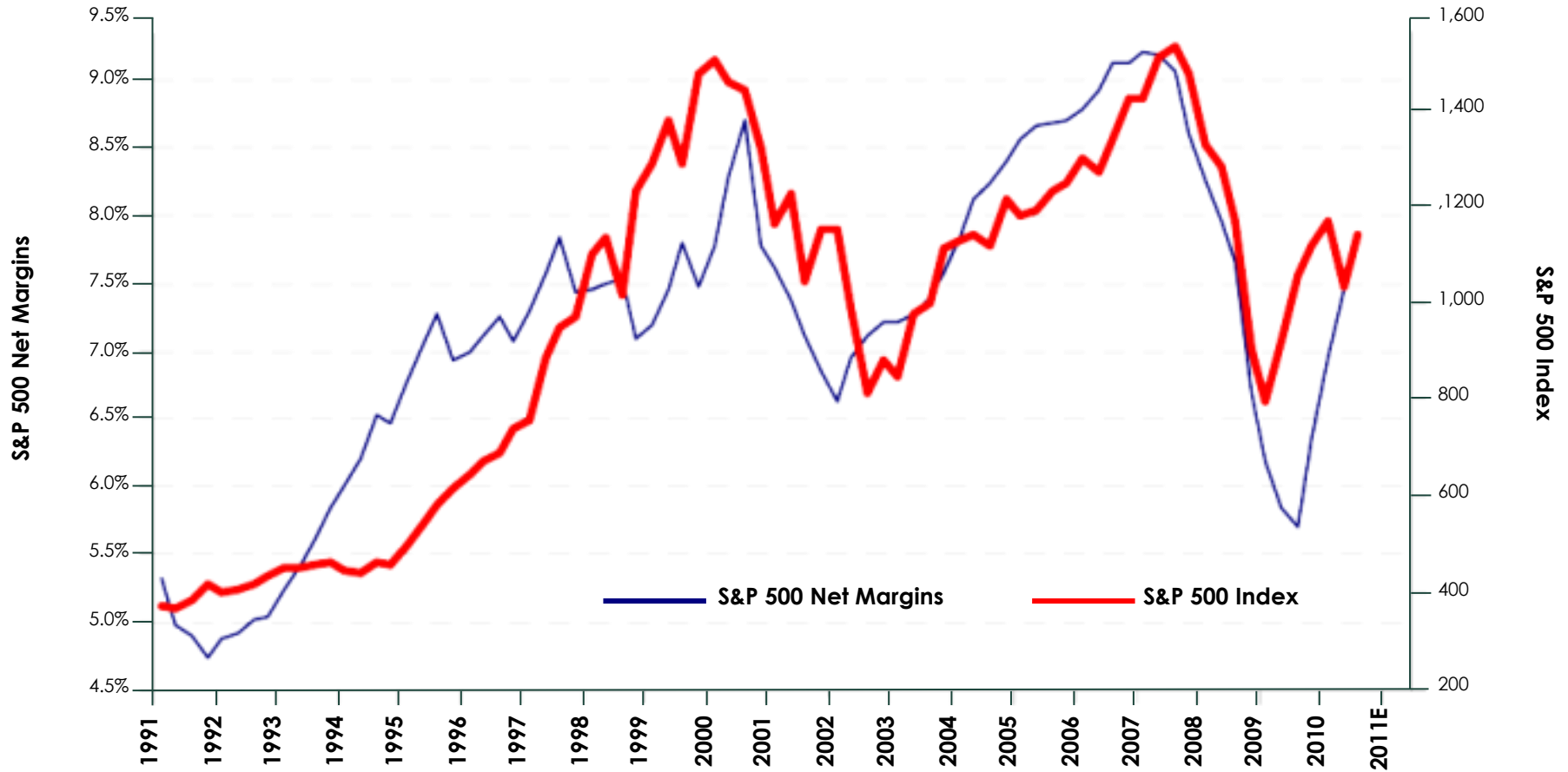
Earnings Growth has Soared

Forecast for Percentage Change in S&P 500 Index Operating Earnings



Profit Margins and Stock Prices are Correlated

S&P 500 Index vs. S&P 500 Net Margins

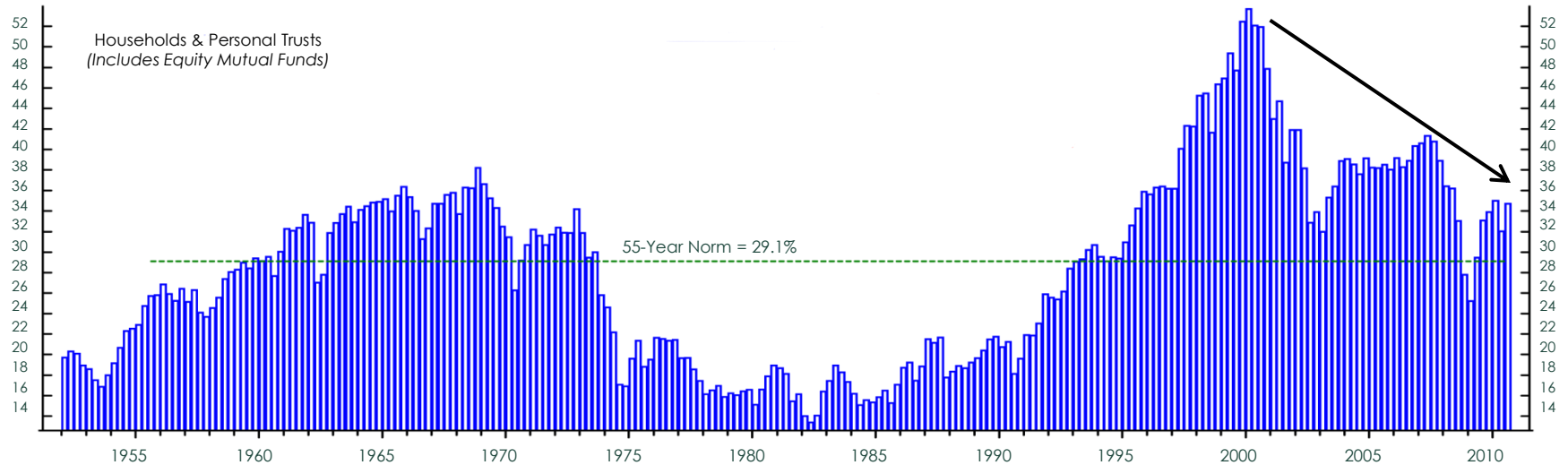


Source: Haver Analytics and CIRA

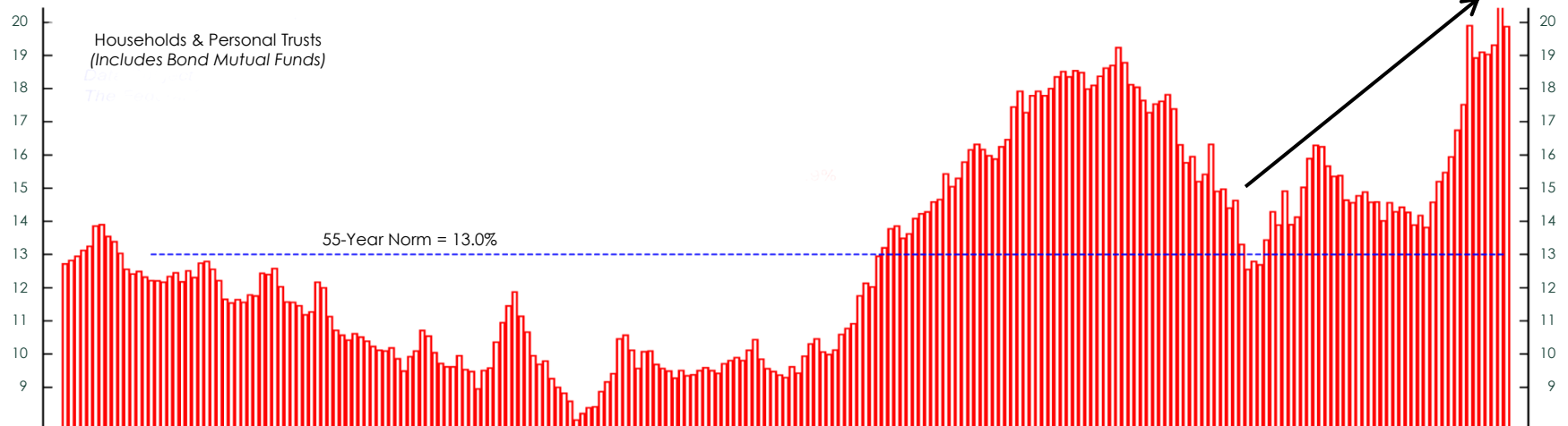


Investors Have Fled Stocks in Favor of Bonds

Stocks as a Percentage of Household Financial Assets (Adjusted for Pension Funds)



Bonds as a Percentage of Household Financial Assets (Adjusted for Pension Funds)



Our Thoughts for 2011

Larger cap stocks should start to outperform



Large Cap Stocks Look Attractive

| | S&P 500 Index | Russell 2000 Index |
|-----------------------------|---------------|--------------------|
| Trailing P/E | 15.7 | 31.7 |
| Forward P/E | 14.4 | 21.7 |
| Yield | 1.8% | 0.9% |
| Long-Term EPS Growth | 11.0% | 13.0% |
| Standard Deviation | 17.4% | 24.2% |

As economic growth broadens, risk aversion tends to increase, benefiting larger cap stocks



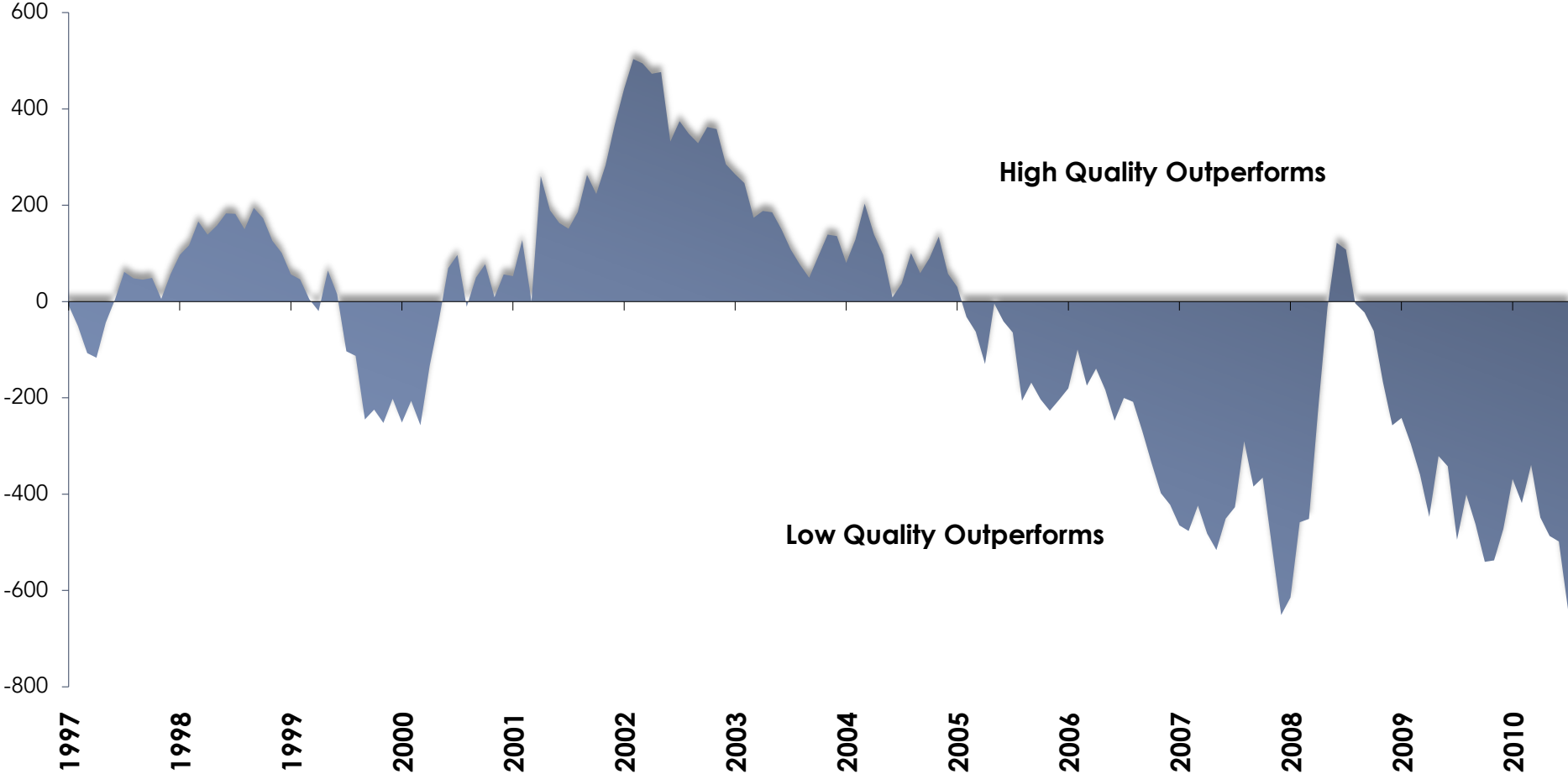
Our Thoughts for 2011

**Less cyclical, higher quality stocks
should perform better**



Higher Quality Stocks Should Perform Better

S&P 500 High Quality vs. Low Quality Stocks



Higher Quality Stocks Should Perform Better

- Data points below the line indicate periods when low quality outperforms high quality stocks.
- The quality ratings, as defined by Standard and Poors, are based primarily upon a company's consistency of earnings growth.
- Except for 2008, lower quality stocks have outperformed their higher quality counterparts since 2005. The sharpest period of low quality outperformance occurred in 2010. Given our belief in reversion to the mean, it points to better performance for higher quality companies in the near term.

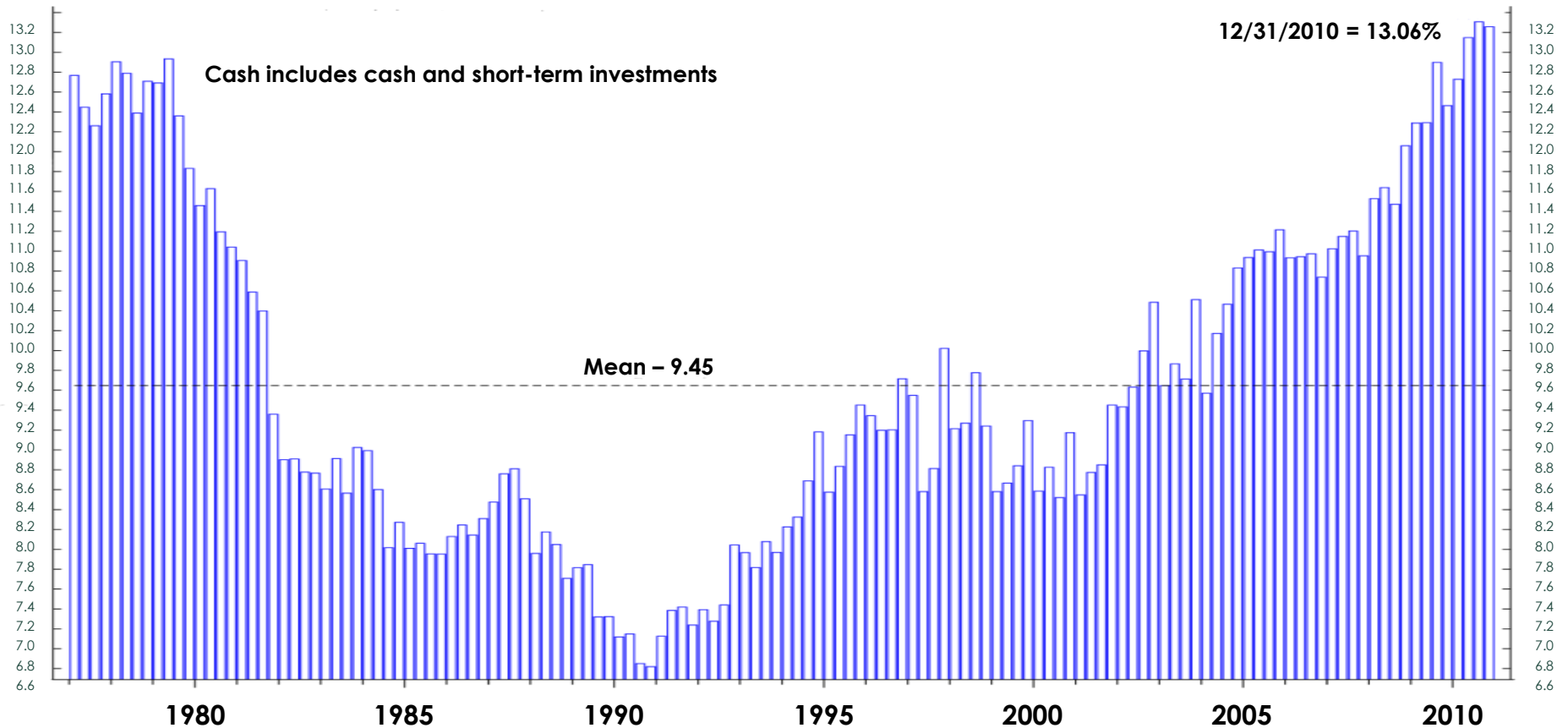


**High cash flow and cash levels
create opportunity**



Corporations are Flush With Cash

S&P 500 Index Total Cash as % of Total Assets



Options for Cash on Balance Sheet

- Increase Dividends
- Mergers/Acquisitions
- Hire Workers
- Share Repurchases
- Capital Expenditures
- "Keep" It



Dividends DO Matter

Returns of S&P 500 Stocks by Dividend Policy

| | |
|------------------------|-------|
| Growers & Initiators | 9.6% |
| All Dividend Payers | 8.8% |
| Cutters or Eliminators | -0.5% |
| Non-Dividend Payers | 1.7% |
| S&P 500 Index | 7.3% |

Monthly data 1972 through 2010



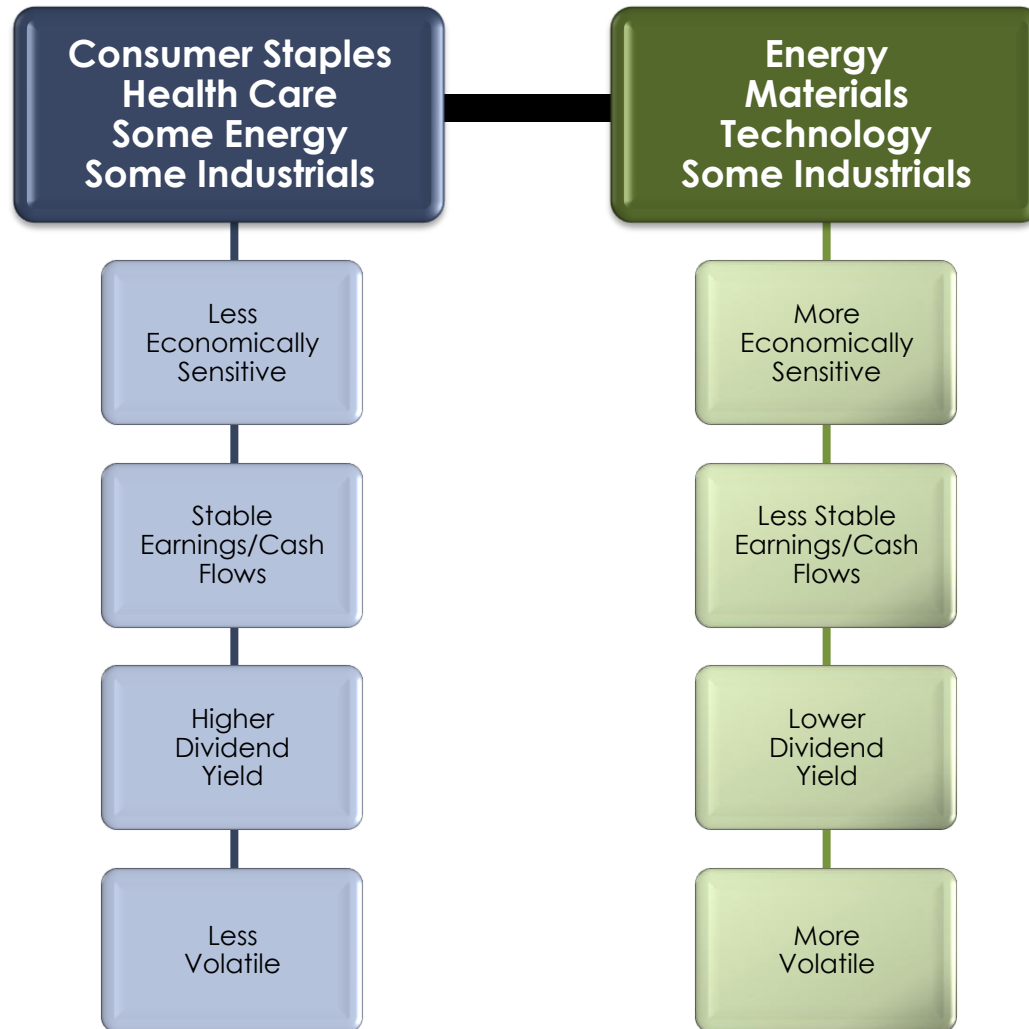
Our Thoughts for 2011

Barbelled portfolio still makes sense



Strategy: Own Both Cyclical and Non-Cyclical Stocks

Barbelled Portfolio



Anticipate a shift to more weight on left side as economic growth broadens



Conclusions

- **Stocks should continue to move higher**
- **Gains should be more modest**
- **Attractive opportunities exist in larger cap, higher quality companies**
- **High cash levels on balance sheets should create many opportunities for investors**
- **Continue to own both cyclical stocks that benefit from a economic rebound and non-cyclical stocks that have more stable revenue/earnings outlooks**



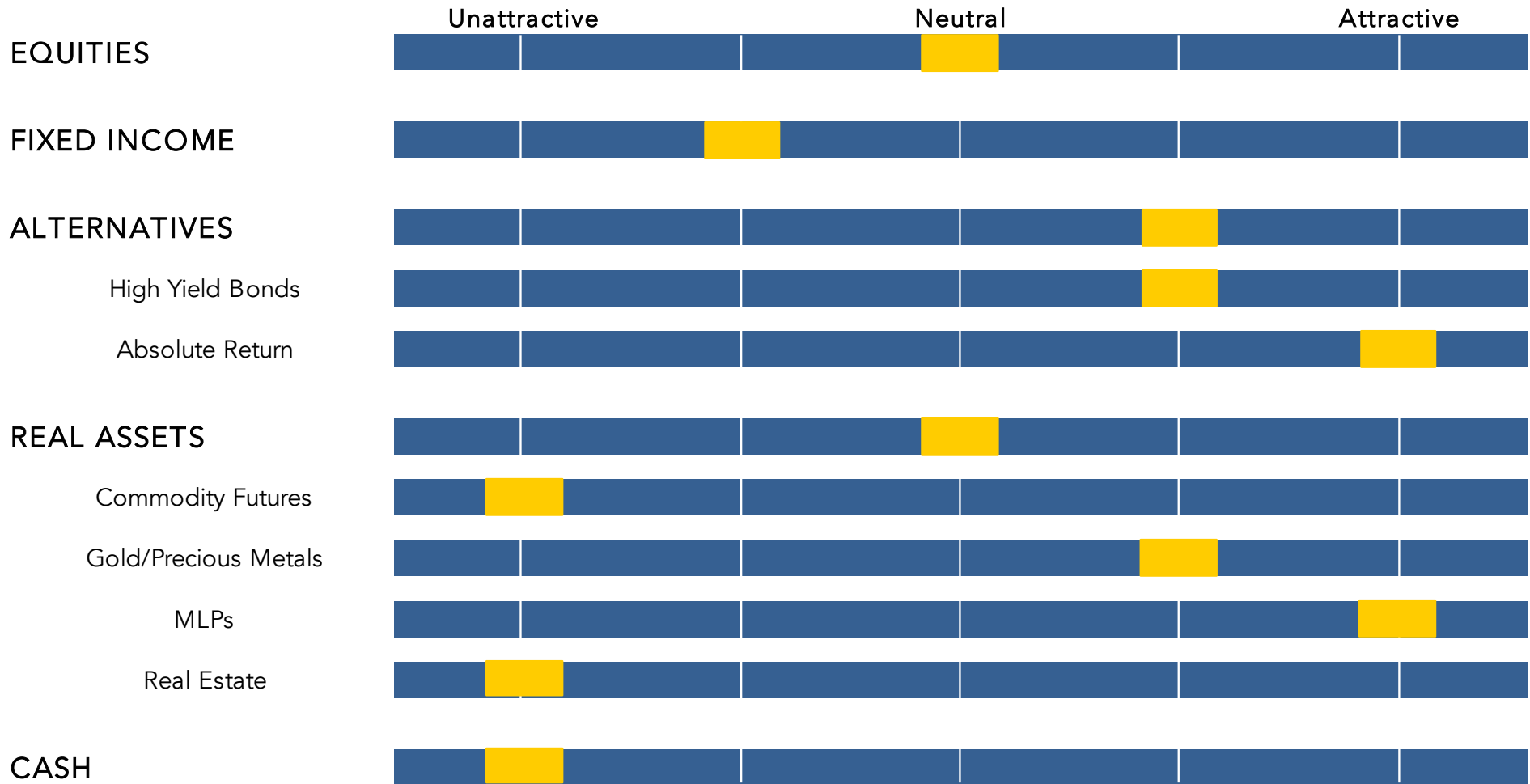
Asset Allocation

Bret H. Parrish, CFA

Director of Johnson Trust Family Office Services

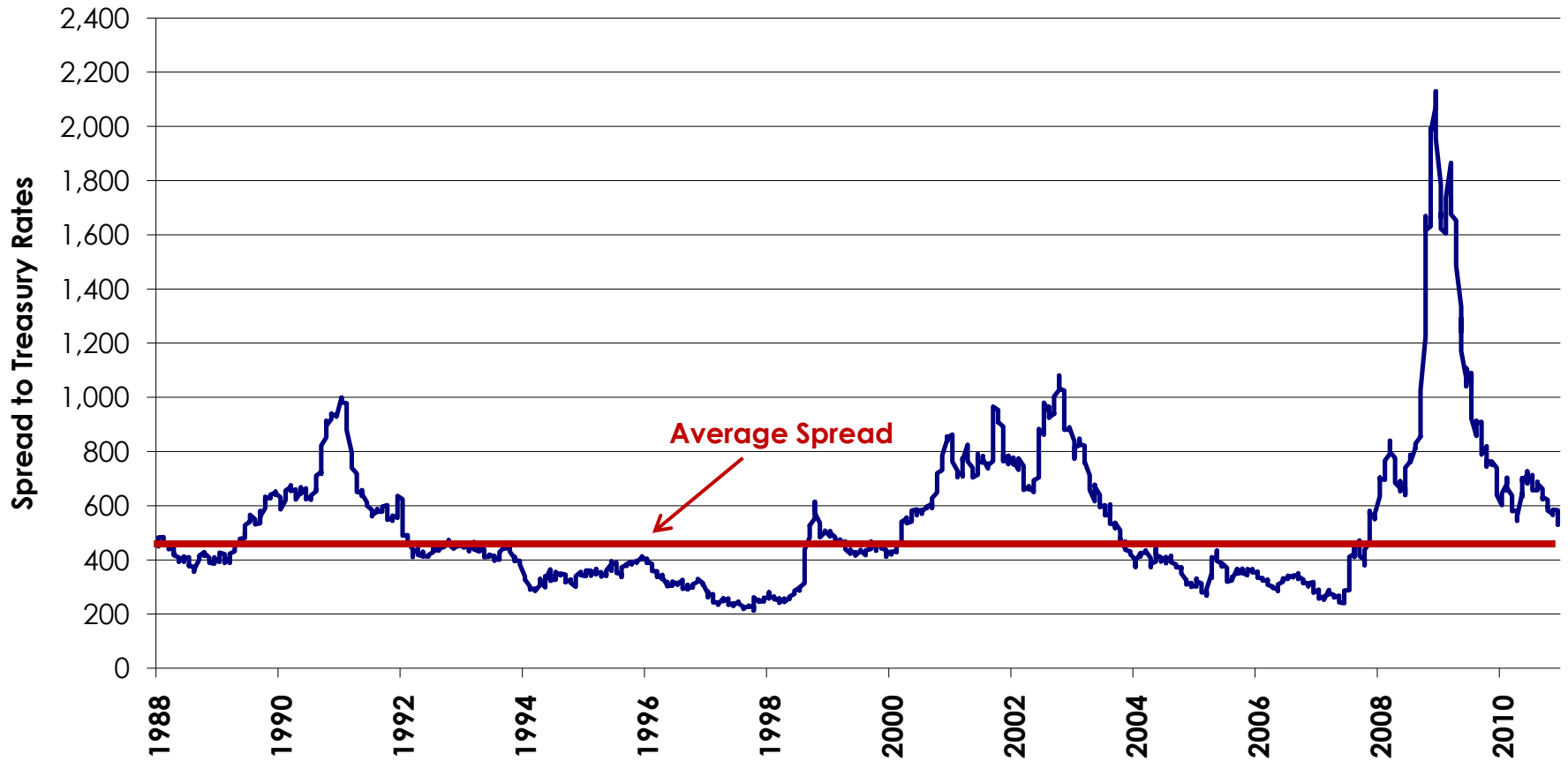


Asset Allocation Market Barometer



High Yield Spreads Remain Attractive

Bank of America/Merrill Lynch High Yield Index



High Yield Spreads Remain Attractive

- This chart looks at the spread, or premium, that investors pay high yield bonds versus treasury bonds. The spread is measured in basis points. 100 basis points equals 1%.
- These spreads are higher when the perceived risk of owning high yield bonds is greater. In late 2008 and early 2009, the credit crisis sent these spreads soaring to historically high levels.
- As the prices of these bonds have rebounded, the spread has contracted significantly.
- However, compared to history, the current spread still looks relatively attractive.

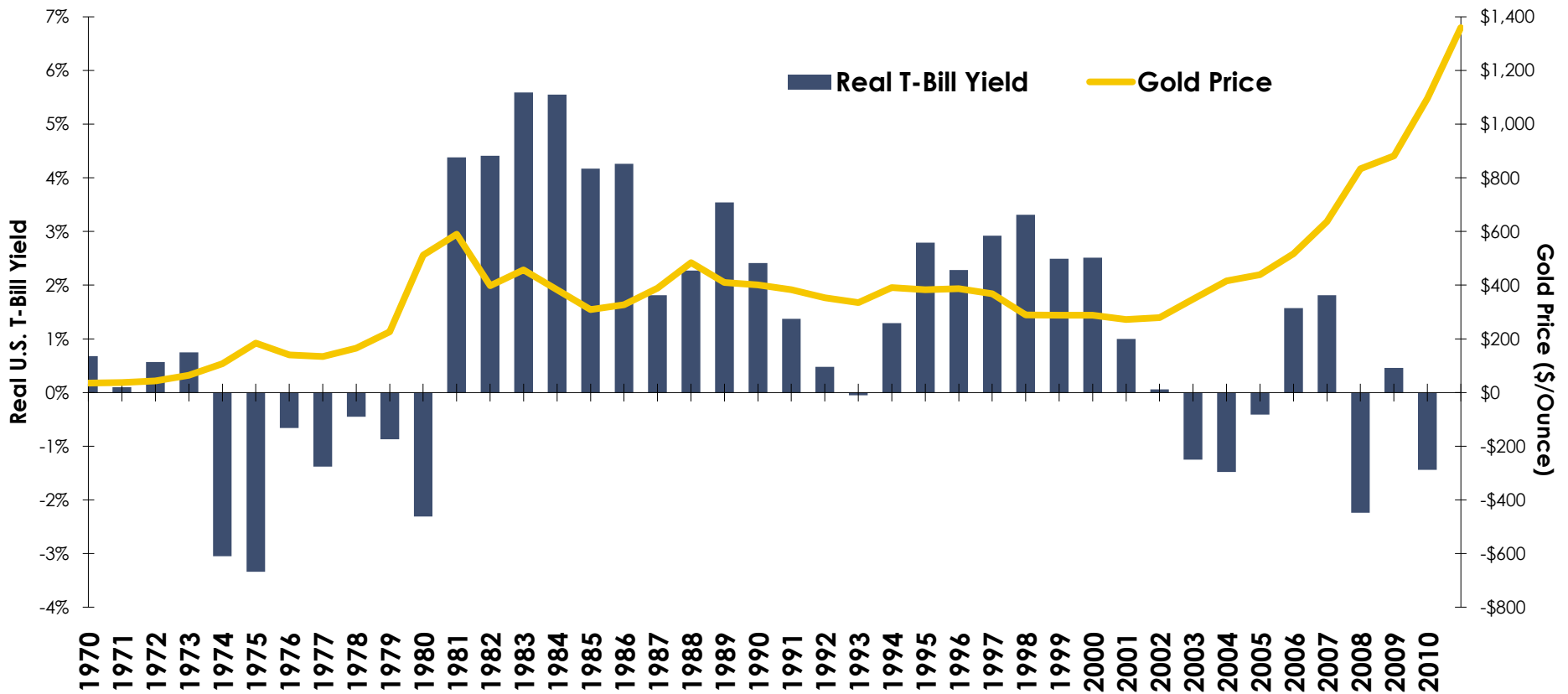


Goals of an Absolute Return Strategy

- Provide low correlation to traditional stocks and bonds
- Reduce volatility and focus on risk-adjusted returns
- Deliver positive returns by avoiding large drawdowns
- Exhibits risk metrics similar to many fixed income investments
- Limiting interest rate risk within a traditional portfolio
- Expect absolute strategies to achieve higher real returns than bonds



Gold Performs Well When Real T-Bill Yields are Low



| Gold Gain/Annum When: | | |
|-----------------------|------------|-----------|
| Real T-Bill Yield Is | Gain/Annum | % of Time |
| 1.2 and Above | -2.0% | 48.8% |
| Between 0.2 and 1.2 | 19.1% | 14.6% |
| 0.2 and Below | 26.1% | 36.6% |

Source: Ned Davis Research/Bloomberg



Master Limited Partnerships (MLPs) Offer Appealing Yields

■ Toll Road Business Model

- MLPs typically do not own the energy commodity
- Revenue stream acts as a toll road

■ Free Cash Flow

- History of stable and predictable cash flows, paid out to investors
- High dividends provide protection in uncertain markets
- Growing dividends provide an inflation hedge

■ Growth Opportunity

- Potential to grow cash flow through the build-out of U.S. energy infrastructure

■ Tax Advantages

- No corporate tax if at least 90% of income comes from qualifying sources
- Historically, over 90% of MLP distributions have been treated as return of capital; not subject to current income tax

