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Tactical Allocation: Third Quarter 2011

Fed Sees Weaker, But Continued Growth

In a recent press conference, Federal Reserve Chairman, Ben Bernanke acknowledged the weak pace of recovery. He reduced the central bank's official growth forecasts for a second time this year. The Fed now expects the economy to grow by 2.7-2.9% compared to their earlier forecast of 3.1-3.3%. Next year's expectation was similarly cut. One implication is that exceptionally accommodative monetary policy will remain into 2012 with further quantitative easing called upon as needed. What is leading the Fed to conclude that growth is slowing?

First, employment gains are weaker and job losses are higher. Weekly initial jobless claims remain over 400,000 and job gains have been lackluster. Average payroll gains have also slipped. During the second quarter, monthly payrolls grew at an average rate of 86,000. This pace is below the six month average of 126,000.

Second, housing continues to disappoint. The S&P/Case-Shiller Composite-20 City Home Price Index is down 4% since last year and new construction remains 60% below historic norms. Unsold supply of homes and condominiums is near 4 million units, excluding banks "shadow inventory" (2.5-3 million units would be more normal).

Third, several indicators relating to global manufacturing have sharply weakened. A surge in commodity prices, higher fuel costs, and a renewed focus on cutting inventory, appear to be contributing to some of this recent slowdown. We expect the second half to show some improvement as inventories and input costs stabilize.

Finally, domestic loan growth still remains very weak despite low borrowing costs and easing loan standards. In the past several decades, aggregate net borrowing tended to increase by 6-8% per year. Currently, total net U.S. borrowing is up 1.5% versus last year, despite large borrowings by the Federal government. Slow aggregate credit growth implies need for continued reflationary Fed policy.

Portfolio Posture

Portfolios have been allocated closer to the middle of prescribed ranges for stock and bond exposure as we await additional data on the pace of growth. In May, bond allocations were modestly raised, defensive sectors were added, and domestic large-cap value was re-introduced into portfolios.

STIFEL NICOLAUS

European Sovereign "Watch List" Data

10-Year Bond Yields

	2007	Current	Change
	=====	=====	=====
Ireland	4.5%	11.9%	+7.9%
Portugal	4.5%	12.4%	+8.5%
Greece	4.6%	15.9%	+12.2%
Spain	4.4%	5.5%	+1.2%
Italy	4.0%	5.1%	+0.4%

Deficit / (-Surplus) % GDP

	2007	2010	Change
	=====	=====	=====
Ireland	0.0%	32.0%	+32.0%
Portugal	3.1%	9.1%	+6.0%
Greece	6.4%	10.5%	+4.1%
Spain	-1.9%	9.2%	+11.1%
Italy	1.5%	4.6%	+3.1%

Debt % GDP

	2007	2010	Change
	=====	=====	=====
Ireland	25%	96%	+71%
Portugal	64%	83%	+19%
Greece	105%	142%	+37%
Spain	36%	63%	+27%
Italy	104%	119%	+15%

Moody's Rating

	2007	Current
	=====	=====
Ireland	Aaa	Baa3
Portugal	Aa2	Ba2
Greece	A1	Caa1
Spain	Aaa	Aa2
Italy	Aa2	Aa2

Unemployment Rate

	2007	2010	Change
	=====	=====	=====
Ireland	4.8%	14.2%	+9.4%
Portugal	7.8%	12.4%	+4.6%
Greece	4.8%	14.2%	+9.4%
Spain	8.6%	21.3%	+12.7%
Italy	6.3%	8.2%	+1.9%

Source: Bloomberg / OECD

A Matter of Faith

Fixing Europe's Fiscal Mess

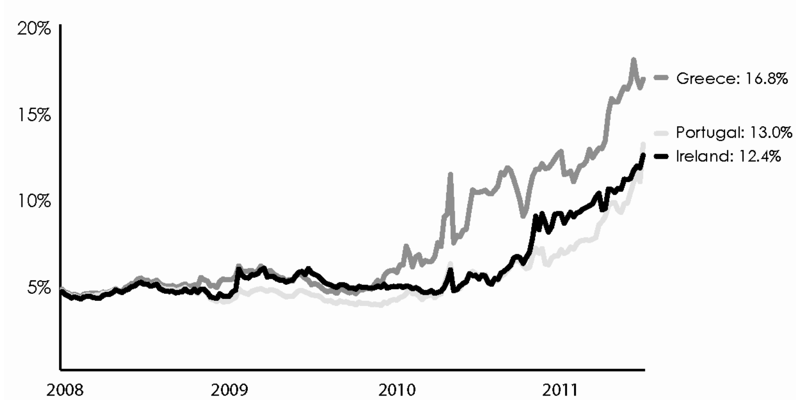
Markets continue to grapple with the potential for a default by one or more of Europe's highly indebted, peripheral countries. A growing patchwork of loans has failed to stave off ratings downgrades, lower the cost of insuring against sovereign defaults, or materially reduce the cost of issuing sovereign debt by Europe's most indebted countries (see chart).

So far, no European country has defaulted on its debt, but markets remain concerned one might. Ireland, Portugal, and Greece's bonds carry yields ranging between 12-16% compared with yields of 4-4.5% in 2007. Higher yields mean a higher cost of issuing and servicing a growing mountain of debt. Credit ratings have also been cut. Both Portugal and Greece are now rated below investment grade and Ireland sits just one notch above junk status, based on Moody's ratings. Spain and Italy remain in the investment grade category, but ratings may well be cut should their economies worsen or budget targets slip.

The impact of each country's crisis can be seen in the economic data. In 2010, deficits as a percent of GDP were 30% in Ireland versus 0% in 2007; 9.1% in Portugal versus 3.1% in 2007; and 10.5% in Greece versus 6.4% in 2007. In 2010, debt as a percent of GDP rose to 96% in Ireland versus 25% in 2007; 83% in Portugal versus 64% in 2007; and 142% in Greece versus 105% in 2007. Unemployment is now 14.2% in Ireland versus 4.8% in 2007; 12.4% in Portugal versus 7.8% in 2007; and 15.9% in Greece versus 8.1% in 2007.

The combination of rapidly rising debts, stagnating growth, and higher borrowing costs are a trap that countries must avoid in order to remain solvent under the Euro. The best possible outcome would be a restoration of faith in creditworthiness, accompanied by deficit and debt reductions, and a return to growth. So far, markets are unconvinced that existing loans and austerity are sufficient to accomplish these goals.

Europe's Sovereign Debt Markets Not Yet Convinced
Yield on Irish, Portuguese, and Greek 10-Year Government Bonds Remain Near Records



Source: Bloomberg

Finding a Fix is Not Easy

There is no easy fix for Europe's debt crisis. Thus far, issuance of EU and IMF loans, coupled with pledges of austerity, have been the primary tool to prevent debtor nations from defaulting. This approach is easier to implement than longer-run structural reform, but tends to have a short-sighted focus on providing stop-gap liquidity rather than providing a permanent solution to high cost debt and other imbalances. Additionally, some argue that austerity measures including tax hikes and spending cuts will have potentially deflationary short-run consequences when imposed on already weakened and indebted countries. Such an outcome would obviously prove counterproductive.

A second, longer-term approach involves the creation of a single authority responsible for coordinating tax policy and government spending among EU member countries. This would streamline the process of getting funds to countries in need of liquidity. Because this entity would have significant authority for imposing restrictions on sovereign countries, the establishment of such a body will be a long and politically difficult task to undertake.

Lastly, there is a suggestion that additional currencies be adopted within the euro zone. It is argued that this would provide Europe with improved flexibility to deal with debts and trade imbalances. This option has been vigorously opposed by most European officials because it is seen as diluting the benefits of a common currency.

Surpluses in the Euro zone

While a final fix is not easy to come by, it should be noted that not all of Europe is suffering the same fate as Ireland, Greece, Portugal, Spain, and Italy. Significant surpluses are being created in countries such as Germany, Netherlands, Finland, Denmark, and Austria. These countries are growing GDP by at least 4%, can borrow long-term money at below 3%, and boast a combined current account surplus of approximately $120 billion dollars, based on OECD 2010 data. By contrast, Ireland, Greece, Spain, Portugal, and Italy are experiencing growth near or below 0%, have borrowing costs above 10%, and are generating a combined current account deficit of approximately $40 billion. In short, the whole of Europe looks a good deal healthier than some of the individual members which should provide some element of flexibility in seeking an eventual compromise.

Implications for Portfolios

We continue to tilt portfolio exposure away from European equities at this time. Portfolio allocations remain near the midpoint of their strategic ranges as we assess the impact of this and other issues on fundamental conditions. As discussed earlier, those conditions continue to point toward market liquidity and economic growth, but the rate of improvement in conditions appears slower.

A Barometer for Assessing Changing Conditions

We regularly assess changes in fundamental conditions to help guide near-term asset allocation decisions.

Analysis incorporates approximately 30 forward-looking indicators in categories ranging from **Credit and Capital Markets** to **U.S. Economic Conditions** to **Foreign Conditions.**

From each category of data, we create 3 diffusion-style sub-indices that measure the trends in the underlying data. Sustained improvement that is spread across a wide variety of observations will produce index readings above 50 (potentially favoring stocks); while readings below 50 would indicate potential deterioration (potentially favoring bonds).

The WCA Fundamental Conditions Index™ combines the 3 underlying categories of into a single summary measure. This measure can be thought of as a "barometer" for changes in fundamental conditions.

Update on Fundamental Conditions

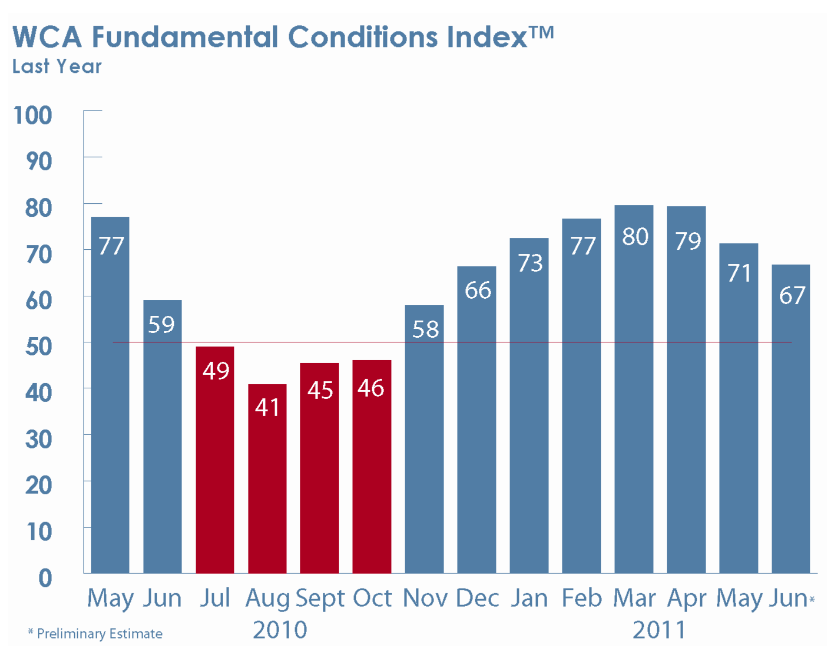
The fundamental backdrop continues to improve, albeit at a somewhat slower pace through the second quarter. The following is a quantitative assessment of 30 indicators measuring the strength of trends within credit and capital markets, the domestic economy, and foreign markets.

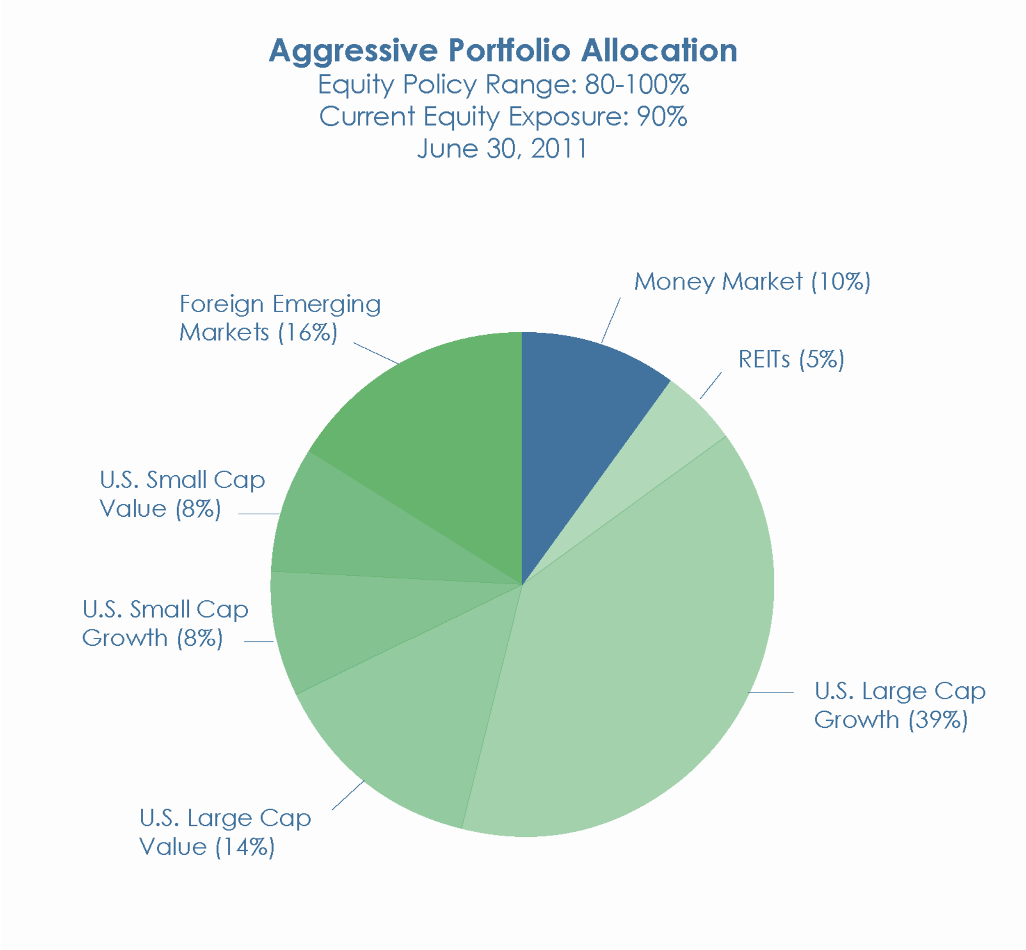
All three sub-indices (Credit & Capital Markets, U.S. Economic Conditions, and Foreign Conditions) remain above 50, indicative of generally improving trends. The rate of improvement has slowed in the second quarter.

WCA Diffusion Indices

>50 = Favors Stocks / <50 Favors Bonds

	Last	Current	Change	Summary
Credit & Capital Markets	85	60	-	Expanding, Slower rate
U.S. Economic Conditions	90	75	-	Expanding, Slower rate
Foreign Conditions	65	65		Expanding, Same rate
Fundamental Conditions	80	67	-	Expanding, Slower rate





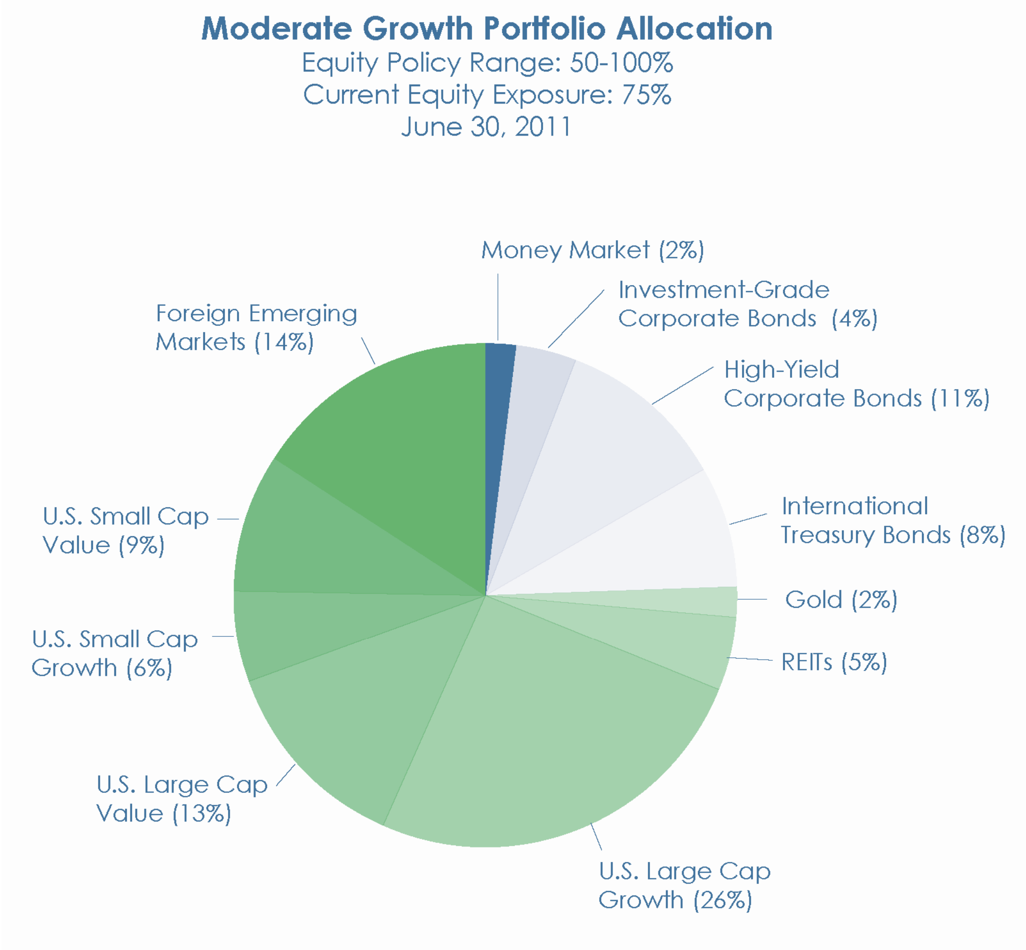
Investment Posture

The AGGRESSIVE PORTFOLIO invests between 80-100% in equities based on fundamental market and economic conditions. The strategy seeks to provide a risk adjusted return, over time, better than that of a fixed portfolio comprised of 90% stocks and 10% bonds. Because of the high degree of exposure to stocks, investors in this portfolio should have an investing time horizon of at least 20 years or be able to accept greater variability of returns associated with stock market investing.

- In the last quarter, the aggressive portfolio saw large capitalization value increased relative to large cap growth. Cash was also increased to 10% from 7%.

- Although economic and earnings growth may slow, high levels of domestic profitability, reasonable valuations, and more robust growth in emerging markets create opportunities.

- Cash is near the mid-point of the portfolio's mandated range. Foreign exposure remains focused on emerging markets which currently offer better growth prospects.



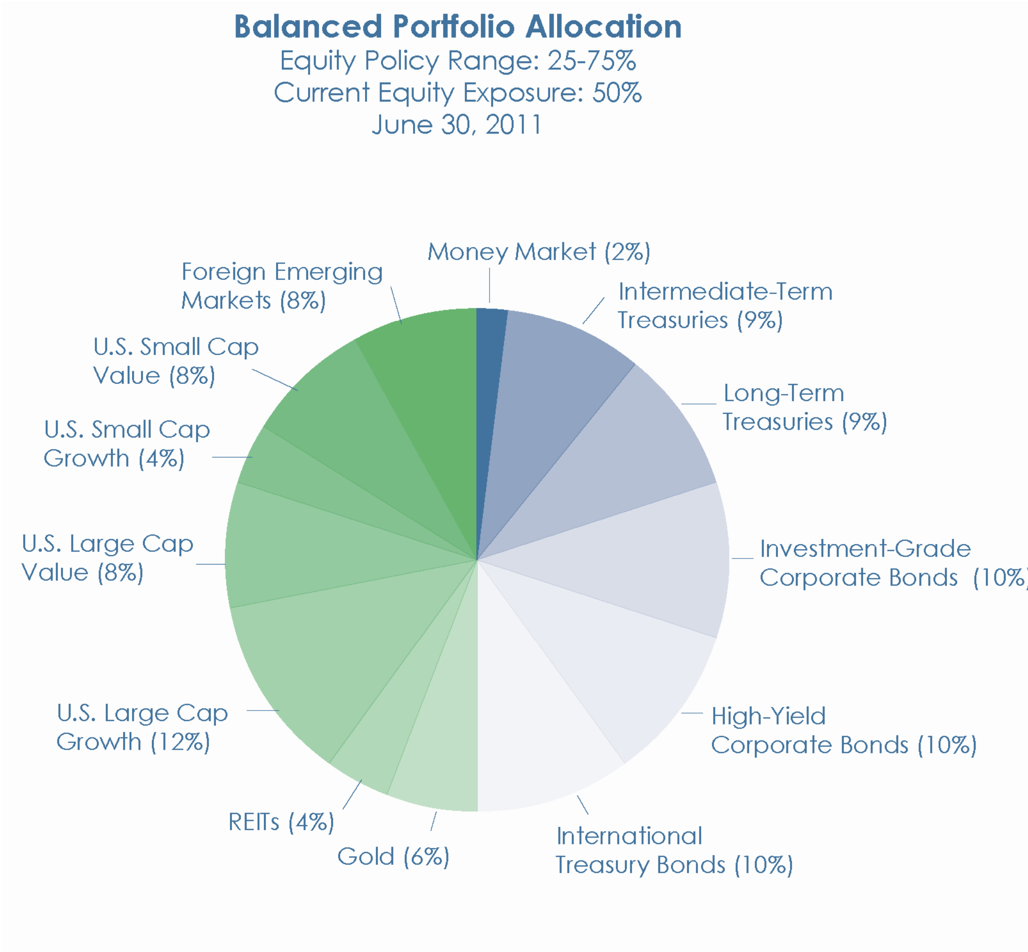
Investment Posture

The MODERATE GROWTH portfolio invests between 50-100% in equities based on fundamental market and economic conditions. The strategy seeks to provide a risk adjusted return, over time, better than that of a fixed portfolio comprised of 75% stocks and 25% bonds. Because the portfolio invests primarily in stocks, and secondarily in bonds, the portfolio may be appropriate for investors with a time horizon of at least 15 years or those who seek principal growth with a moderate amount income.

- Large capitalization value has been added to the portfolio in the most recent quarter. After a long period of underperformance, that margin of underperformance seems to be moderating and valuations appear relatively attractive (price-to-earnings ratio of 13X is about 15% below the S&P 500's earnings multiple).

- High yield corporate bonds and REITs provide a flow of income into the portfolio at rates significantly above that provided by Treasuries.

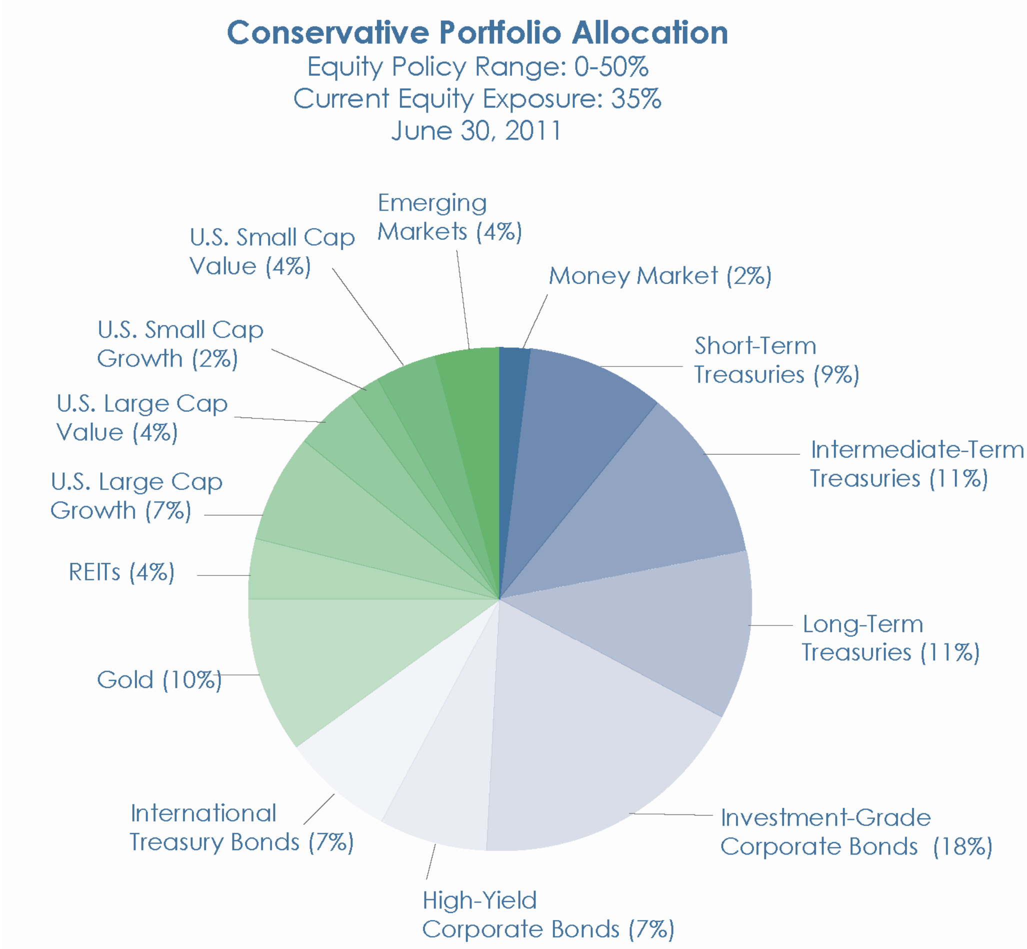
- Foreign emerging markets, international Treasuries, and gold provide non-dollar denominated exposure to the portfolio.



Investment Posture

The BALANCED PORTFOLIO invests between 25-75% in equities based on fundamental market and economic conditions. The strategy seeks to provide a risk adjusted return, over time, better than that of a fixed portfolio comprised of 50% stocks and 50% bonds. The portfolio provides a mix of stocks and bonds without a bias toward either. It may be appropriate for investors with a time horizon of at least 10 years with a moderate risk tolerance.

- This portfolio is broadly diversified across stock and bond markets. Exposure to non-dollar denominated assets are seen in emerging equities, gold, and international Treasuries.
- During the second quarter, the portfolio's stock / bond allocation was moved to a more neutral posture within the 25-75% strategic range for equity exposure as signs of slower growth were picked up in the data.
- High yield corporate bonds and REITs provide a higher yield, while Treasuries offer some counterbalance to the higher credit risk in the corporate bond and REIT positions.



Investment Posture

The CONSERVATIVE PORTFOLIO invests between 0-50% in equities based on fundamental market and economic conditions. The strategy seeks to provide a risk adjusted return, over time, better than that of a fixed portfolio comprised of 25% stocks and 75% bonds. This portfolio offers the most conservative mix of stocks and bonds relative to the other portfolios mentioned herein. Investors with a short-to-medium investment horizon of at least 5 years or lower risk tolerance who desire modest growth may prefer this option over a portfolio with greater exposure to stocks.

- This portfolio has most of its exposure focused on bonds for income, while a smaller portion is allocated to equities for longer-run principal growth.

- Given low overall levels of interest rates, areas that produce higher current income (corporate bonds or REITs, for example) are attractive within a diversified portfolio. Gold and international Treasuries provide some diversification benefit away from a weak dollar.

- During the last quarter, equity exposure and high yield corporate exposure was trimmed as data demonstrated slowing improvement of fundamental conditions

Sector Allocation
(Sector-Enhanced Portfolios Only)

	Portfolio Weight	S&P 500 Weight	Relative Weight
Energy	11.3%	12.6%	-1.3%
Technology	0.0%	17.9%	-17.9%
Materials	9.4%	3.6%	+5.8%
Industrials	11.3%	11.3%	0.0%
Consumer Discretionary	17.0%	10.7%	+6.3%
Cyclical Sectors	49.1%	56.1%	-7.1%
Health Care	11.3%	11.7%	-0.4%
Utilities	0.0%	3.3%	-3.3%
Consumer Staples	11.3%	10.6%	-0.4%
Telecommunications	17.0%	3.1%	+13.9%
Financials	11.3%	15.2%	-3.9%
Non-Cyclical Sectors	50.9%	43.9%	+7.1%
Total	100.0%	100.0%	0.0%

In the second quarter, we broadened sector allocations to include more consistent non-cyclical sectors alongside sectors with more variable earnings as the trend in our fundamental conditions index turned lower. At this time, portfolios are approximately evenly split between those sectors that tend to exhibit a strong correlation between earnings growth and global GDP growth (energy, materials, industrials, and consumer discretionary) and less correlated sectors (health care, staples, telecommunications, and financials).

Portfolio Changes
Second Quarter, 2011

	Conservative		Balanced		Moderate Growth		Aggressive Growth	
	Current	Change	Current	Change	Current	Change	Current	Change
Aggregate Bond Market	0%	-	0%	-	0%	-	0%	-
Cash & Short-Term Treasuries	11%	-11%	2%	-18%	2%	-12%	10%	3%
Intermediate-Term Treasuries	11%	11%	9%	9%	0%	-	0%	-
Long-Term Treasuries	11%	11%	9%	9%	0%	-	0%	-
Investment-Grade Corp Bonds	18%	-	10%	-	4%	-	0%	-
High-Yield Corporate Bonds	7%	-11%	10%	-	11%	7%	0%	-
International Treasury Bonds	7%	7%	10%	10%	8%	8%	0%	-
S&P 500	0%	-	0%	-	0%	-	0%	-
Large Cap Growth	7%	-11%	12%	-18%	26%	-16%	39%	-17%
Large Cap Value	4%	4%	8%	8%	13%	13%	14%	14%
Small Cap Growth	2%	-	4%	-	6%	-	8%	-
Small Cap Value	4%	-	8%	-	9%	-	8%	-
Developed Markets	0%	-	0%	-	0%	-	0%	-
Emerging Markets	4%	-	8%	-	14%	-	16%	-
Gold	10%	-	6%	-	2%	-	0%	-
REITs	4%	-	4%	-	5%	-	5%	-
Subtotal Bonds & Cash	65%	7%	50%	10%	25%	3%	10%	3%
Subtotal Equities & Other	35%	-7%	50%	-10%	75%	-3%	90%	-3%
Total	100%	0%	100%	0%	100%	0%	100%	0%

Index Definitions

Barclays U.S. Government Inflation-Linked Bond Index measures the performance of the U.S. Treasury Inflation-Protected Securities (“TIPS”) market. Used as a proxy for “inflation-protected bonds.”

Bloomberg/EFFAS Bond Indices U.S. Government 1-3 Year Total Return Index is a transparent benchmark for government bond markets. Indices are grouped by country and maturity sectors. Bloomberg computes daily returns and index characteristics for each sector. Used as a proxy for “short-term Treasuries.”

Bloomberg/EFFAS Bond U.S. Government 10+Year Total Return Index is a transparent benchmark for the total return of the 10+ year U.S. Government bond market. Used as a proxy for “long-term Treasuries.”

FINRA-Bloomberg Active Investment Grade U.S. Corporate Bond Index and FINRA-Bloomberg Active High Yield U.S. Corporate Bond Index are comprised of the most frequently traded investment-grade and high yield U.S. corporate fixed coupon bonds represented by the Financial Industry Regulatory Authority (FINRA) transaction reporting facility. Used as proxy for “high-yield bonds.”

FTSE NAREIT Equity REIT Total Return Index is a total return performance index of all equity REITs tracked by NARIET. Used as a proxy for REITs.

MSCI EAFE International Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets excluding the U.S. and Canada. As of June 2007, the MSCI EAFE Index consisted of 21 developed market country indices. Used as a proxy for “developed foreign.”

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. Used as a proxy for “emerging markets.”

Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 index. The Russell 3000 Index measures the performance of the 3,000 largest US Companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. Used as proxy for domestic “large cap stocks.”

Russell 2000 Index measures the performance of the 2,000 smallest companies in the broader Russell 3000 index. Used as proxy for “small cap domestic stocks.”

Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. Used as proxy for “domestic growth stocks.”

Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios. Used as proxy for “domestic value stocks.”

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Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. High-yield bonds have greater credit risk than higher quality bonds. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains.