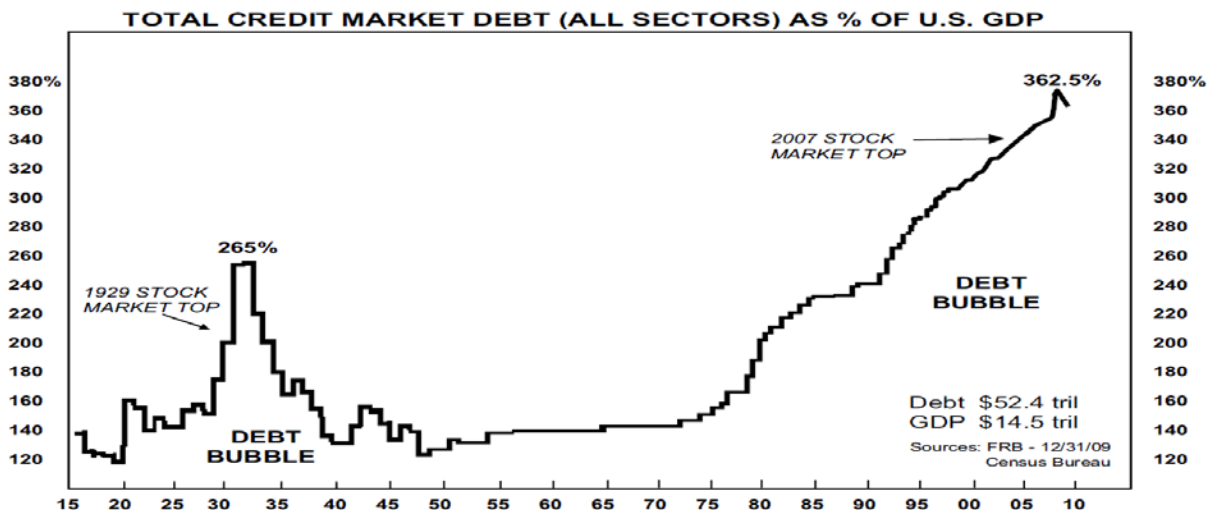


2nd Quarter 2010 Market Commentary and Outlook

Global macroeconomic realities once again reared their ugly head during the quarter. This time the viability of the world's second most important fiat currency, the Euro (the composite monetary unit that replaced national currencies in several European countries) and the European Union or EU (the economic block established in 1993 by the Treaty of Maastricht) were literally called into question. This challenge arose from a debt funding crisis in the "periphery" of Europe, specifically the sovereign debt of Portugal, Italy, Ireland, Greece and Spain. This incident publically tested the leadership of the EU to function as a cohesive economic block. Based upon the recent decline in equity prices, global markets gave the EU performance mixed reviews at best.

From our perspective, the dramatic market reaction to the social, political and potential economic uncertainty surrounding this funding crisis highlights just how far markets need to go before we can feel that we have returned to some kind of "normal" investment environment. With memories of the Bear Stearns and Lehman Brothers' 2008 collapses fresh in investor's minds, the initial response was swift. The Dow Jones Industrial Average declined over 800 points, finishing down 7.9% for the month of May. This was the weakest May since the 21.7% drop experienced in 1940. The initial bungling and finger pointing among the EU players in this pan-European drama actually made the U.S. political model look effective. The dollar rallied 8% relative to the Euro in the month of May after a previous 8% increase during the first four months of 2010. Unfortunately, this funding crisis came to a head during an active European political period, with significant elections being held in Germany and the U.K. Naturally, this only added to the grandstanding as politicians jockeyed to protect special interests and polish their respective conservative/liberal images. Several "doom and gloom" prognosticators straight-lined another worst case scenario in which this funding crisis morphed into another global banking crisis and economic meltdown. We do not believe that this European "periphery" funding challenge, by itself, will necessarily snowball into a global economic interruption on the scale of that experienced in 2008. However, we do believe that this is characteristic of the real issues that will continue to threaten global market stability for the foreseeable future. With this context, we continue to manage our client's asset allocation in a conservative manner with principle protection still an elevated priority.

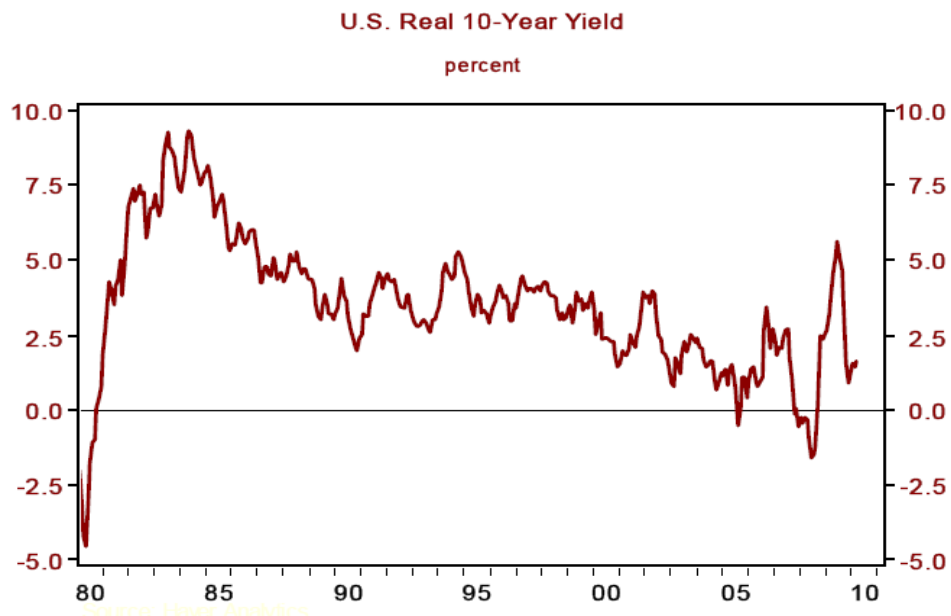
Too Much Leverage – Private and Public Balance Sheets Are Stretched!



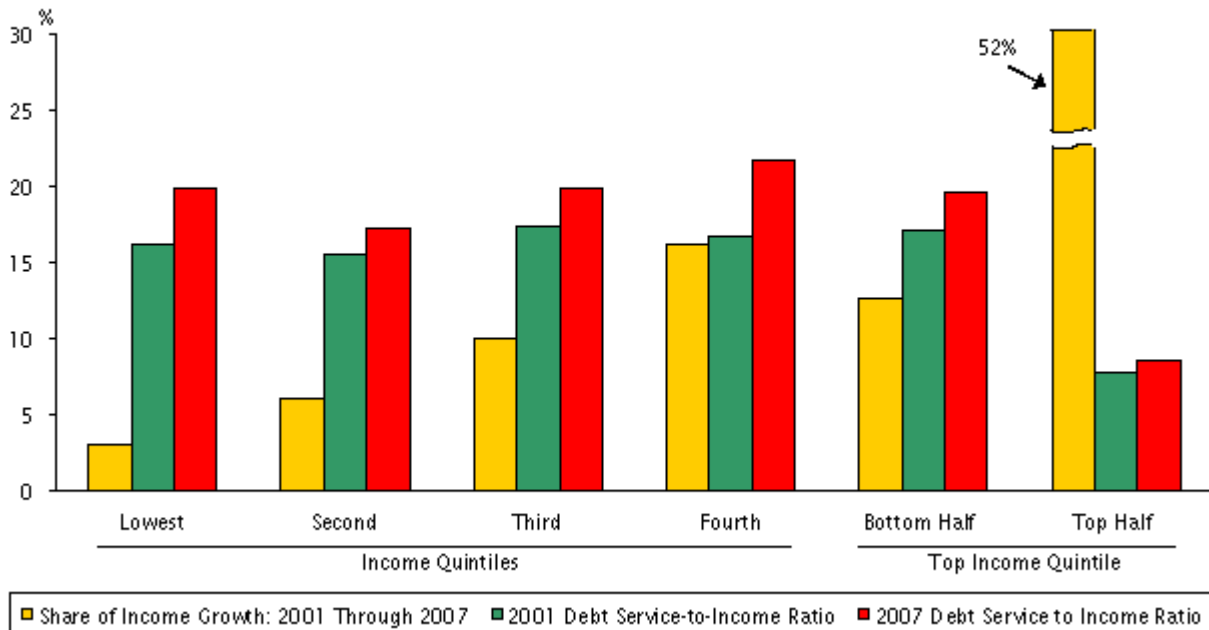
To better understand why we continue to prioritize principal protection, we need to drill deeper into the issue of global leverage. Simply put, too much leverage remains throughout the global financial system and continues to cause major economic uncertainty. Unfortunately, there is no silver bullet that will resolve this destabilizing situation. As we can see from the Federal Reserve Board (FRB) chart at the bottom of the previous page, total debt in the U.S. at year end 2009 was at an all time record high relative to GDP. Essentially, if we took every dollar of income (\$14.5 trillion) generated by our economy, it would take over 3.5 years to pay off the outstanding \$52.4 trillion of debt. This does not include the unfunded liabilities for Social Security and Medicare currently estimated to be \$107 trillion. Unfortunately, much like an individual, we obviously cannot pledge every dollar of our income to debt reduction. However, a significant correction of this income/leverage relationship is required to return markets to a more stable state. Reversing this leverage process will take time and a series of incremental steps, including increased taxes, greater austerity, and spending cuts. Shrinking your way to success is a very slow, painful way to go for any society. Knowing that, we continue to believe that eventually a politically less painful solution will be sought, resulting in an attempt by governments to inflate or print their way out of this common mess.

How did we get here? Credit (from the Latin term “Credo”, meaning “I believe”)

Interest rates have been coming down for almost 30 years. As one can see from the RDQ June 2010 chart below, real interest rates (the inflation adjusted cost of money), have essentially declined to near zero. In 2004/2005 and again in 2008, real rates actually went negative. When real rates go negative, the correct interpretation from an economic perspective is that capital is essentially free. The academically correct thing to do is to borrow as much as you can and repay it in the future with dollars that are inflated and worth less. The least logical thing to do is save, as savings essentially lose purchasing power. Unfortunately, in many developed economies that is exactly what happened. First, as noted above, the sheer volume of lending grew and second, the availability of credit became more pervasive as underwriting standards declined. As one can see from the March 2009 Empirical Research chart on the following page (top), during the period from 2001 to 2007, the bottom half of the income distribution in the U.S. dramatically increased their leverage (as measured by debt service to income ratio), to “keep up”. Unfortunately, they purchased highly appreciated assets and had little to no savings to back them up in the subsequent real estate bust. System wide this chain of events set the stage for the dramatic real estate / consumer credit bubble which burst in 2008 and continues to plague the U.S. banking system today. The prophetic Warren Buffet commented in July of 2007, **"when the tide goes out, we find out who's been swimming without a bathing suit."**



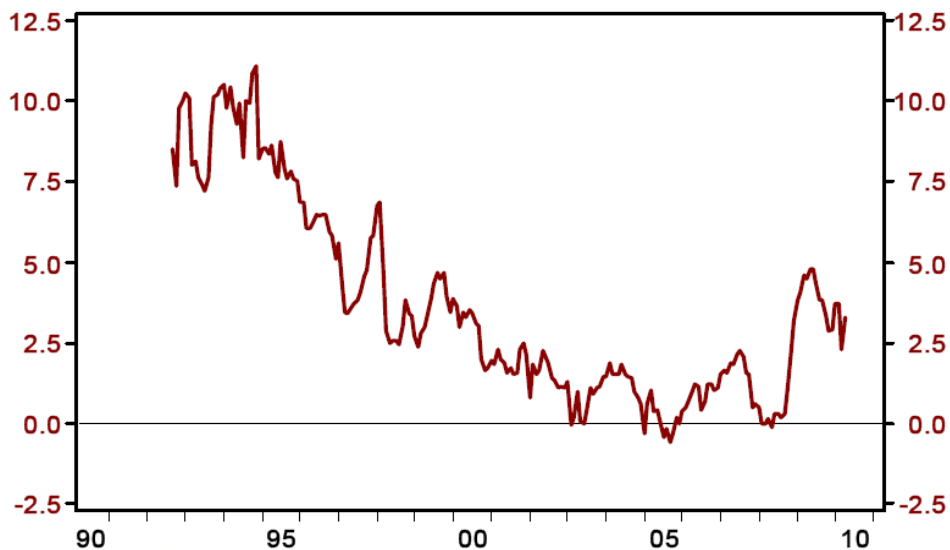
Share of Aggregate Income Growth and Debt Service-to-Income Ratios



Internationally the story is amazingly similar. The lowest income quintile in Europe, the “periphery” – (Portugal, Italy, Ireland, Greece and Spain) also utilized leverage to keep up. With the advent of the Euro, the laggards could no longer utilize traditional competitive devaluations to compensate for their lack of productivity. As one can see from the RDQ June 2010 chart below, very low, and in some cases, negative real rates were offered to fiscally dysfunctional countries like Greece. Their government continued to fund populist policies (increased entitlements including pensions) which drove fiscal deficits and debt to GDP ratios to unsustainable levels. In addition, as one can see from the RDQ June 2010 chart on the top of the following page, traditional credit metrics and perspectives evaporated as Greece was allowed to borrow funds at levels comparable to Germany, an economy several times its size.

Greece Real 10-Year Yield

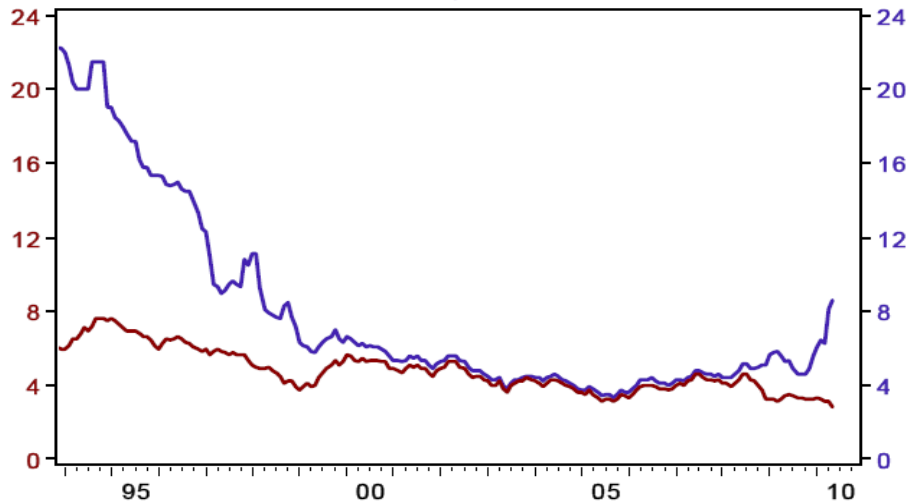
percent



Source: Haver Analytics

Germany: Fed Govt Securities w/ Residual Maturities of b/w 9-10 Yrs
AVG, %

Greece: 10-Year Government Bond Yield
Avg, %



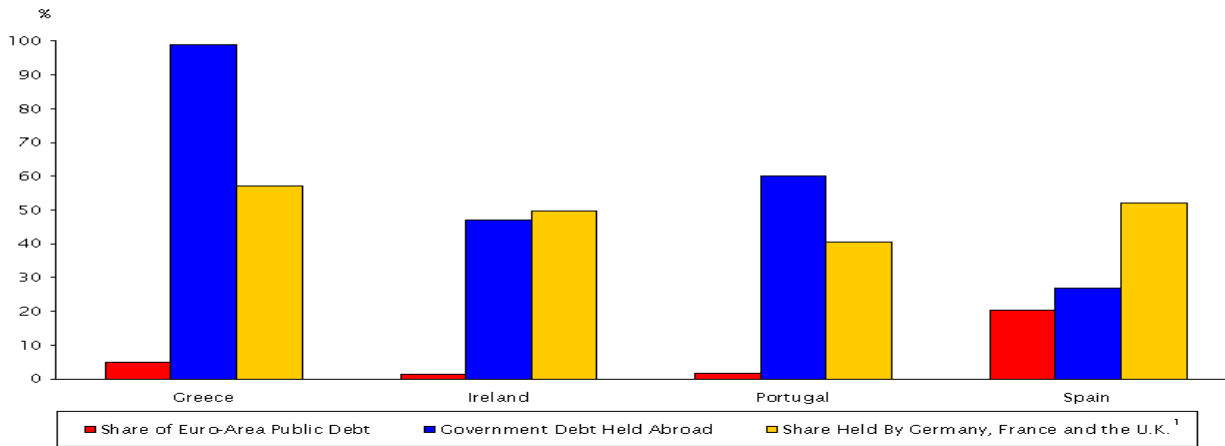
Bottom line - this global leverage issue took years to make and will take years to unwind. The policy actions taken in the U.S and now by the EU to deal with this crisis (issuing more debt to deal with inappropriate levels of debt) can best be characterized as delaying the inevitable.

Can The European Monetary Union Become a Fiscal and Political Union?

It appears that the 750 billion Euro aid package, hammered out by the European Union Finance ministers in early May, was sized correctly (77% of outstanding government debt for Greece, Spain and Portugal, according to Credit Suisse) to address the current debt crisis. Most importantly, this injection of liquidity should prevent this funding issue from morphing into a European banking crisis. As one can see from the Q1 2010 Empirical Research chart on the next page, the European “periphery” debt as a percent of EU public debt, while not massive (red bars) is held in large part abroad (blue bars) by Germany, French and the UK banks (yellow bars). This comingling of EU financial relationships is a good news - bad news story. Obviously, it is in the best interest of the German, French and UK legislatures to prevent defaults by these countries that would impact their banks. However, once again public funds are being utilized to support the private sector. This is a highly volatile strategy in which German taxpayers are essentially being asked to shoulder the burden of perceived Greek spendthrifts. European regulators have found themselves in a no-win situation, much the same as U.S. regulators did back in 2008.

While Credit Suisse notes that European banks generate substantial pre-provision profits of 320 billion (B) Euros per year, they are still highly leveraged. David Enrich notes in his June WSJ article that the European Central Bank – (ECB) warned in their semiannual financial stability report that EU banks face 195B Euros in write-downs this year due to continued economic uncertainty. He also details leverage ratios (ratio of assets to common equity less goodwill) for a group of major European banks which range from 21 to 49 times, versus a selection of major U.S. banks which are running at only 12 to 17 times. While we feel that this aid package does provide temporary relief, the final chapter has not been written on this funding crisis. The more politically challenging aspect of this situation (setting fiscal policy) is yet to be determined.

**Select Indebted European Economies
Share of Government Debt Held Abroad
2010**

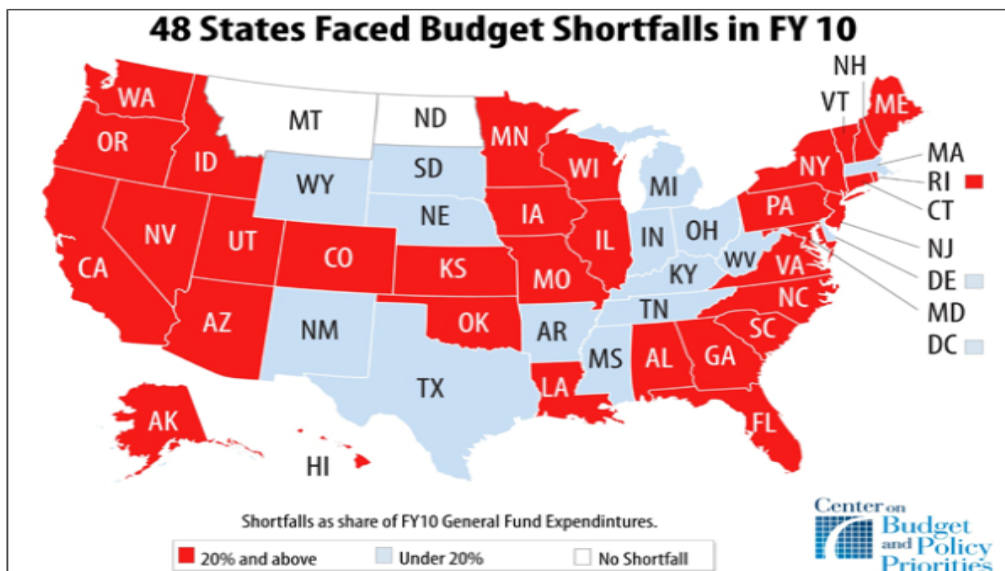


¹Combined share of both government and bank debt.

EU countries have long reserved the authority over taxing and spending for their national parliaments. However, with this recent crisis, the European Commission (the executive arm of the EU) realized that this may need to change. Although austerity plans have been announced by Greece, Ireland and Spain, they may not have the political will to shrink spending by the required 15%, 12% and 8% (respectively, as a percent of their GDP) to stabilize their leverage problem. Markets have started to discount the reality that Greece will probably not be able to shrink their way to financial health and, as a result, will have to restructure their outstanding debt. The timing of that announcement is uncertain, however, the headlines leading to it will continue to inject uncertainty and market volatility.

What About the U.S. “Periphery” - California, Illinois, Nevada

Data from the Center on Budget and Policy Priorities (CBPP) June, 2010 chart below, indicates that due to the current recession, budget shortfalls have developed in forty eight states. In more than half the states, the short fall has exceeded 20% (highlighted in red) of the total budget. Shortfalls for the current fiscal year ending June 30, 2010 and 2011, are estimated to exceed \$375B. Due to the timing of most states’ fiscal year end, this is a very topical issue. According to CBPP, tax receipts have declined at an historic pace, yet costs continue to climb. CBPP estimates that Medicaid enrollment increased 8% yr/yr in 2009 as those who lost their jobs have become eligible for publicly funded health care.



As a result, CBPP is projecting deficits that are significantly higher this time than during the last recession and expects them to continue over the next two fiscal years as tax receipts tend to lag an economic recovery. It would appear that the federal government may have to come to the rescue of many states, putting further pressure on the total U.S. deficit. Most states have passed budgets assuming that Congress would come through with additional funding for Medicaid. However, the aid has not been approved and its passage is uncertain during an election year due to growing voter angst surrounding the federal government's record budget deficit. Recently, Illinois comptroller Daniel Hyres said in his June WSJ interview that the state's backlog of overdue bills could hit \$5.5B by the end of June. Last month, the Illinois lawmakers adjourned after voting to give the governor more power to cut spending, yet not approving the borrowing necessary to fund a large \$4B pension contribution. Apparently, the deficit issue was too hot to handle prior to the fall mid-term elections.

Wall Street - "White Shoe" Goldman Sachs Faces Fraud Charges

We knew 2010 (a political year) was going to be pocketed with volatile headlines as the financial industry was made the whipping boy for the sins of the 2008 collapse. Never in our wildest dreams did we think Goldman Sachs would become the poster child for client neglect. During the financial meltdown, Goldman became a de facto extension of the Treasury Department. We now know Henry Paulson, then Secretary of the Treasury (an ex-Goldman partner), literally was on the phone with Goldman's Chairman and CEO Lloyd C. Blankfein on a daily basis. Administration critics note that Goldman had the most to gain (some estimate \$13B) by keeping wounded counter-parties like AIG alive and capable of funding payments to high profile clients including legendary hedge fund manager John Paulson (no relation), who had bet against the U.S. housing market. Forward to April 2010, the U.S. Securities and Exchange Commission (SEC) files suit against Goldman Sachs alleging fraud over a complex "synthetic collateralized debt obligation" called Abacus. In a day-long hearing on April 27th, Senators made the case that "Goldman repeatedly put their own interest and profits ahead of the interest of its clients". These hearings spurred the Obama administration and current Democratic effort to ramp up financial regulation including reigning in the trading of complex derivatives that, in their mind, led to the financial crisis.

Unintended consequences of the proposed U.S. financial reform legislation could present a potential threat to global markets. This legislation sets the stage for global debate surrounding the issues of "too big to fail" and appropriate bank capital requirements. We are watching this matter closely as it has the potential to impact the banking system's ability to lend and continue to support the fledgling global economic recovery.

The Flash Crash - High Frequency Trading – The Death of Long Term Investing?

We can provide you with the following statistics from Credit Suisse that describe the Flash Crash; however, we still cannot tell you why it happened.

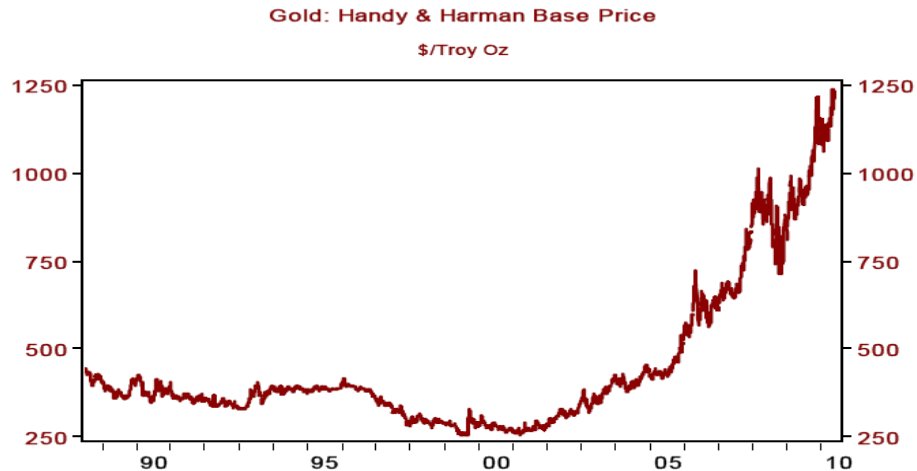
- One half of the stocks in the S&P 500 suffered an intraday loss of at least 10%*
- 1 in 25 had losses of more than 20%*
- Nearly \$700B of U.S. market value was erased before recovering*
- Several stocks and ETFs posted prints around zero*

On May 18th, the SEC issued a 151 page report that was inconclusive and has yet to issue an official statement about what they believe was behind the sudden drop. Unfortunately, the suspected computer driven aberration comes at a time when investors' confidence is already at a ten year low. Post the inter-day 1,000-point drop, the growing role of high-frequency traders has been drawing new scrutiny. The May 17th New York Times article "Speedy New Traders Make

Waves Far From Wall St” focused on these new market participants. According to the Times, “depending on whose estimates you believe, high frequency traders account for 40-70 percent of all daily trading on every market in the country”. These firms typically hold stocks for a few seconds, minutes or hours, and are significant contributors to the increasing daily volatility present in markets today. While the higher volatility does not spell the end of long term investing, it does pose a challenge to traditional fundamental investors.

Gold and Treasury Bonds an Unlikely Couple?

Over the past decade, physical gold was up 328% and the ten year Treasury bond was up 102%. Both investments dramatically outperformed most equity indices, which were down on a total return basis according to data provided by the Wall Street Journal Market Data Group. This outperformance pairing is rare in that Treasuries and gold typically move in opposite



Source: RDQ

directions depending upon investors’ expectations for inflation (or deflation). Recently, both gold and Treasury bonds have benefited from an increase in short-term risk aversion resulting from the worries surrounding the European debt crisis. According to Lipper FMI, individual investors have pumped \$10B into Treasury funds this year and according to State Street Advisors the inflows into their SPDR Gold Shares (GLD) exchange traded (ETF) fund totaled \$4.35B in May, the third highest on record after \$5.6B and \$4.6B in February and March of 2009. The critical investment question in this paradox is when and how will we see these assets paths diverge? We remain firmly in the “inflation long-term” camp and, as a result, continue to hold a meaningful allocation to gold in most client accounts. Near term, the deleveraging scenario that we outlined above will serve as an economic brake (mainly in the developed economies), pushing inflation further down the road. However, the massive amount of liquidity that has been and will continue to be injected in the form of fiscal and quantitative easing (printing money) to re-capitalize the banking system, will eventually gain traction, drive growth, and result in inflation. While inflation appears to be dead in developed economies, that is not the case in emerging markets. China’s productivity and labor force transition (rural to urban) has been a major deflationary force globally. In May, China reported a consumer price index increase of 3.1 % which was slightly above the government’s inflation target of 3%. Previously unheard of events including strikes have recently occurred at Honda Motor supplier plants and Hon Hai Precision Industries. Both were resolved with increases in wages running as high as 27%. Chinese wage inflation, coupled with their recent decision to allow their currency to appreciate, has both global cost push and demand pull implications. Either may cause an inflationary spiral.

SUMMARY

Global markets will likely continue to face uncertainty, volatility, and a very challenging political environment heading into the back half of 2010. As outlined above, the tremendous level of leverage in the global system will need to be reduced, before we can find our way back to a more normal investment environment. In the near term, governments will continue to supply liquidity to buy more time to sooth investor angst. However, during this muted growth recovery, investors will continue to have their confidence tested as they digest major macro economic, social and political challenges. In addition, investors' will continue to face smaller micro questions, foremost being where will top line sales growth come from? With fiscal deficits so high, where will funding come from? On a positive note, as we enter into Q2 reporting season, corporate profits will continue to feel tremendous support from the major cost cutting and business realignments implemented in early 2009. Tight cost controls combined with continued top line momentum will likely allow companies to generate consensus beating earnings. The market's reaction to positive earnings surprises and management's commentary on an improving outlook are rather unpredictable at this point.

Client portfolios are positioned for cautious optimism with principle protection a high priority. This positioning will allow us to continue to look opportunistically to take advantage of emotional overreactions on the up and down side to buy and sell positions. As stated before, 2010 will be marked by dramatic financial, social and political developments that will require rapid interpretation and potential adjustments to your portfolios. Beaumont looks forward to providing this guidance and, as always, we thank you for your trust and confidence. If you have not done so recently, please review your portfolios with your relationship manager. In the meantime, if you have any questions or comments please feel free to contact us at 781-237-7170 or email me at mstack@bfpartners.com.

Michael P. Stack, CFA

Disclosures:

Diversification does not ensure a profit or guarantee against loss.

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