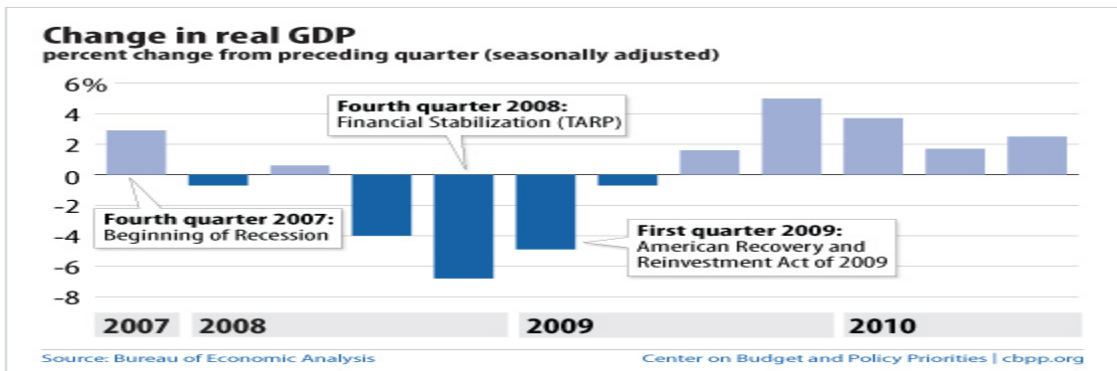


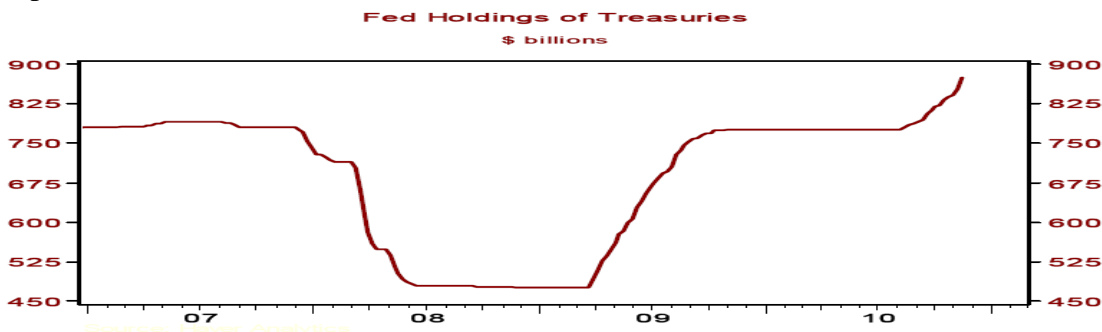
4th Quarter 2010 Market Commentary and Outlook

The S&P 500 rallied 10.8% during the 4th quarter as corporate and consumer confidence improved after the mid-summer fears of a double dip and a European currency crisis. The market's 4th quarter burst brought the S&P 500 full year performance to 15.1%. Almost half of this year's gain came in the final month of the year. December's +6.7% performance was the best December performance since 1991. Impressively, this rally took place in the face of continued muted 2-3% economic growth (see Bureau of Economic Analysis, December chart below) and elevated unemployment (see Bureau of Labor Statistics, December chart below). Despite these and other challenges (i.e. Germany's growing resistance to further bailouts in Europe and China's accelerating rate tightening measures), market sentiment ended the year's rollercoaster ride decisively on a global growth trend.



Quantitative Easing (QE2) – “Don’t Fight The Fed”

During the quarter, the Federal Reserve launched a follow up liquidity program dubbed QE2 . With this program, the Fed signaled its intentions to purchase an additional \$600B of treasury securities. The timing of the announcement during this summer's slow down scare was critical, resulting in lower interest rates and forcing equity markets to assume a positive “don't fight the Fed” posture (see RDQ Economics December chart below).



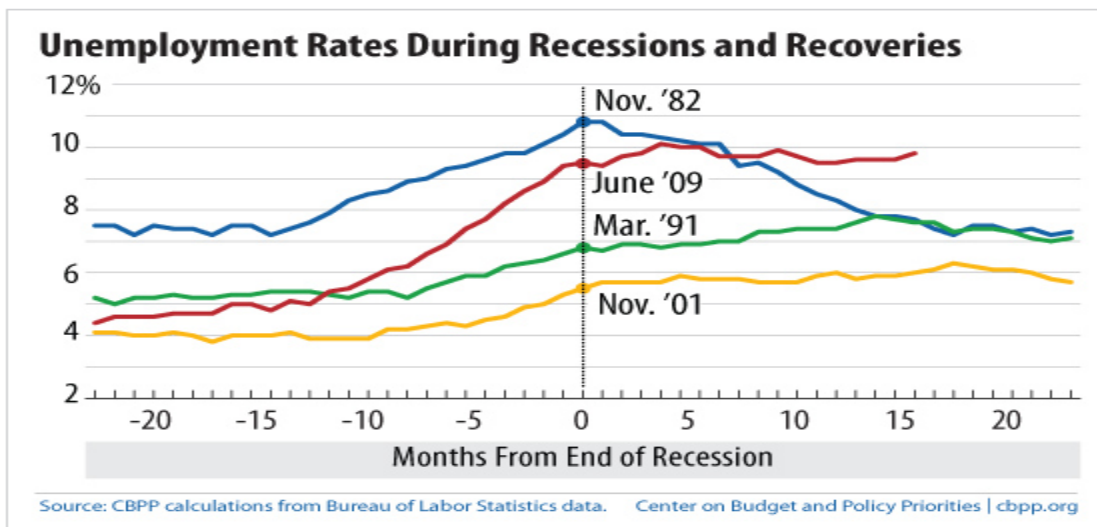
Source: RDQ Economics

The Fed's monetary injection was quickly supplemented by the dramatic U.S. mid-term election results providing signs that the political log jam in Washington may have finally broken. Negotiations between President Obama and Republican leaders produced a \$900B tax cut-unemployment insurance deal. Critics of these monetary and fiscal actions minimize them as, at best, "kicking the can down the road". These realist views were quickly silenced however, by the short-term gratification provided by the continued rally in the equity market. Corporations, consumers and investors had been looking for tangible evidence that gridlock in Washington would not derail this fledgling recovery. For the time being, these actions seemed to have turned the psychological tide as several Wall Street firms have revised their 4th quarter gross domestic product (GDP) expectations higher. Barclays Capital economist Dean Maki commented in mid December that recent data suggests GDP is growing at least at a 3.5% annual rate in the fourth quarter, stronger than his current forecast of 3%.

We continue to look for opportunities to add to holdings with higher growth potential and improving fundamentals, taking advantage of volatility caused by varying macroeconomic headlines. While slow growth and volatility will continue to dominate the investment landscape in 2011, we do believe that passing through last summer's double dip slow down scare was a key turning point for market psychology. We expect macroeconomic issues, including monetary tightening in emerging markets, political infighting around the fiscally challenged in Europe and further deterioration in the U.S. housing market to present periods of angst in 2011. Post the December euphoria, the market seems a bit ahead of itself and will need additional positive signals such as accelerating corporate spending and real job growth to support a continuation of the current market rally.

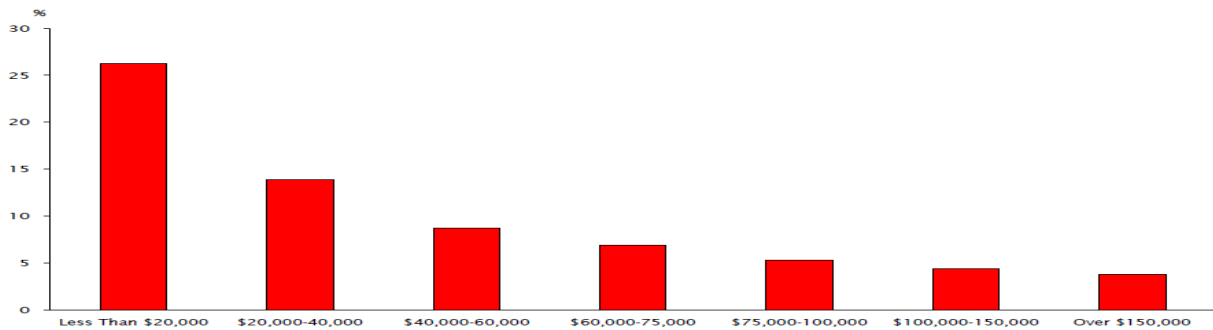
U.S. Mid-Term Election – An Ideologist Wakeup Call – It's All About Jobs!

As we noted in our 3rd quarter letter, despite significantly improved corporate profits, the unemployment rate has stayed stubbornly high (see Center on Budget and Policy Priorities (CBPP) December chart below - note red line). While private employers have added a total of 1.2 million jobs this year, this is only a fraction of the 7.4 million jobs lost since the recession began in December of 2007 according to the CBPP.



Structural arguments have been put forth to explain the uncharacteristically slow employment recovery, one being the development of a long running skills mismatch. An analysis of the widely varied rate of unemployment across various income levels (see Empirical Research Partners (ERP) September chart - top following page) would seem to support this argument.

Unemployment Rates by Income Level ¹
2010 Through August



¹Income levels determined over the preceding twelve months.

Source: ERP

Jurrien Timmer, Director of Global Macro Strategy at Fidelity Investments explains the issue well in the following quote from a recent Market Perspectives research briefing:

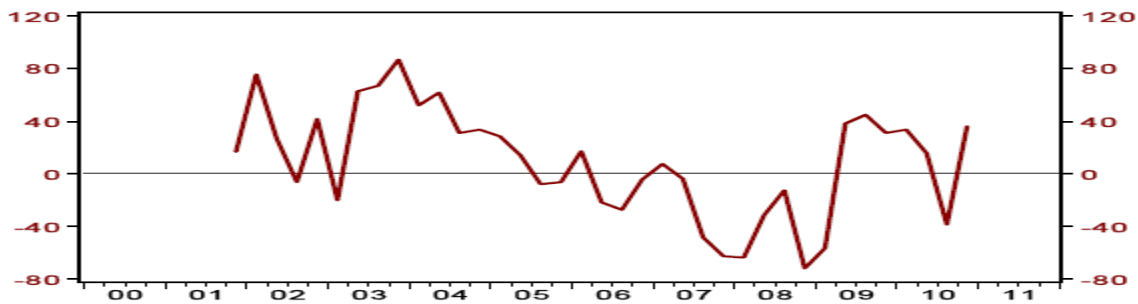
“Over the past two decades, the U.S. has essentially traded manufacturing jobs to China in exchange for cheap goods (labor arbitrage). This apparently worked well for a time because the loss of jobs in the U.S. was masked by a (false) sense of prosperity generated by the U.S. housing and credit bubble. Then the bubble burst and the structural imbalances were revealed.”

While we agree that a portion of the U.S. unemployment problem is structural, and will continue to delay improving employment trends in the auto and housing industries, we also believe that there is a cyclical component that can be reversed. In our 3rd quarter letter we identified a corporate “hiring strike”, with hiring hesitation based on fears of higher taxes and a growing anti-business agenda in Washington. The dramatic message provided by the mid-term election positioned the administration to negotiate the December tax and employment package which provided billions in payroll tax and business investment incentives. We, along with many investors, interpreted this as a constructive first step toward eliminating the anti-business perception and resolving the cyclical component of the U.S. employment conundrum.

Signs of Leadership in Washington or Just More “Kicking the Can Down the Road”

Early in the 4th quarter U.S. markets started to discount the positive impact the Fed’s monetary actions would have on corporate confidence (see RDQ Economics December chart below). Capital spending, historically a solid leading indicator, has been flashing green signals over

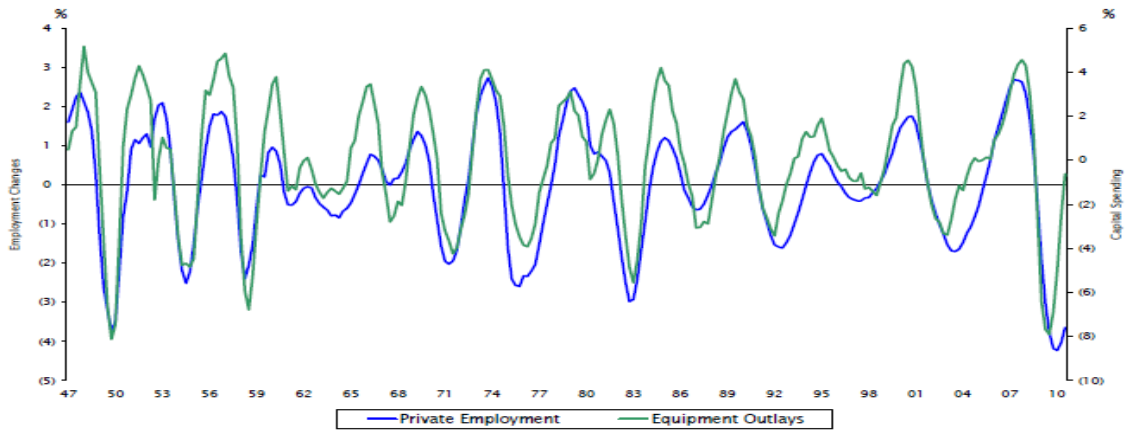
Duke/CFO: Net Optimism about the Economy versus Last Quarter
more optimistic minus less optimistic



Source: RDQ Economics

the past few months (see ERP December chart top following page – note green line). However, the historic tight correlation and expected coincidence behavior for private employment (blue line) has been missing. While there may be a lag and a less robust employment recovery this time due to the secular issues discussed above, we believe this historic relationship will persist. The positive follow through in private employment will be a critical variable supporting a continued rally in equity markets. If private payrolls do not start to ramp up or if further layoffs from the public sector (financially troubled states like Illinois and California) more than offset private sector growth, the market upside may be capped.

Cyclical Changes in Private Employment and Domestic Equipment Outlays ¹
1947 Through Q3 2010



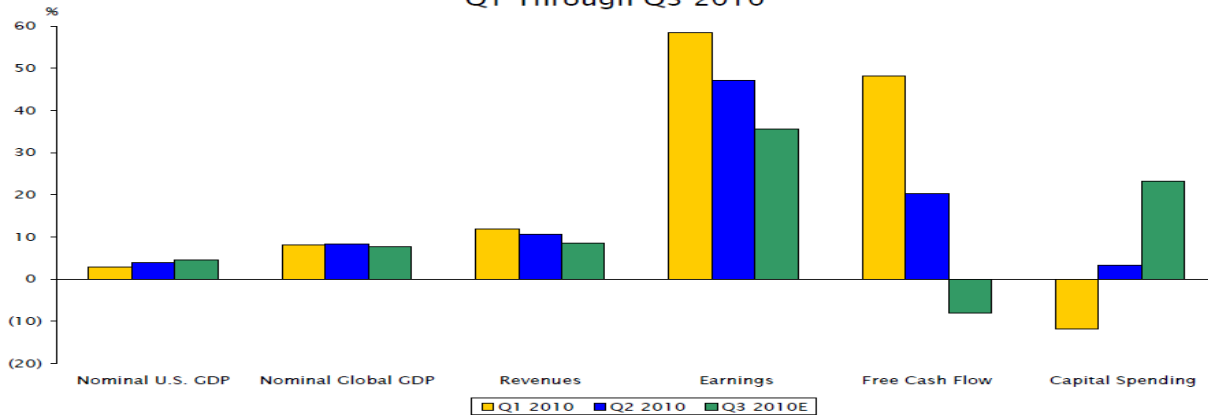
¹ Detrended using an unobserved components model.

Source: ERP

Excellent Operating Leverage Continues – 2011 Expectations Not Outsized

Corporate profits in the third quarter continued to demonstrate dramatic operating leverage (see ERP December chart below). As can be seen from the green bars, earnings up over 30% in the third quarter came in at three times the growth of revenues, and ten times the growth of nominal U.S. GDP. Looking into next year, consensus expectations of mid-single digit top line

S&P 500¹
Revenues, Earnings, Free Cash Flow and Capital Spending
Year-Over-Year Growth Rates
Q1 Through Q3 2010

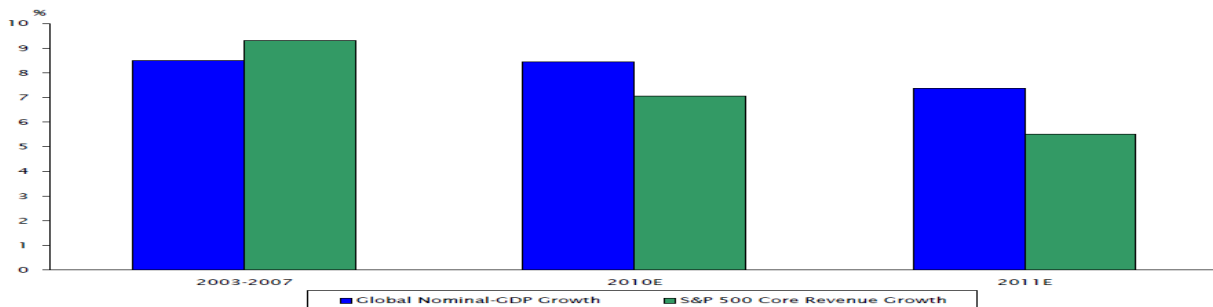


¹ Revenue, free cash flow and capital spending data exclude financials.

Source: ERP

growth are not outsized relative to expected global economic growth of mid to high single digits (see ERP December chart below).

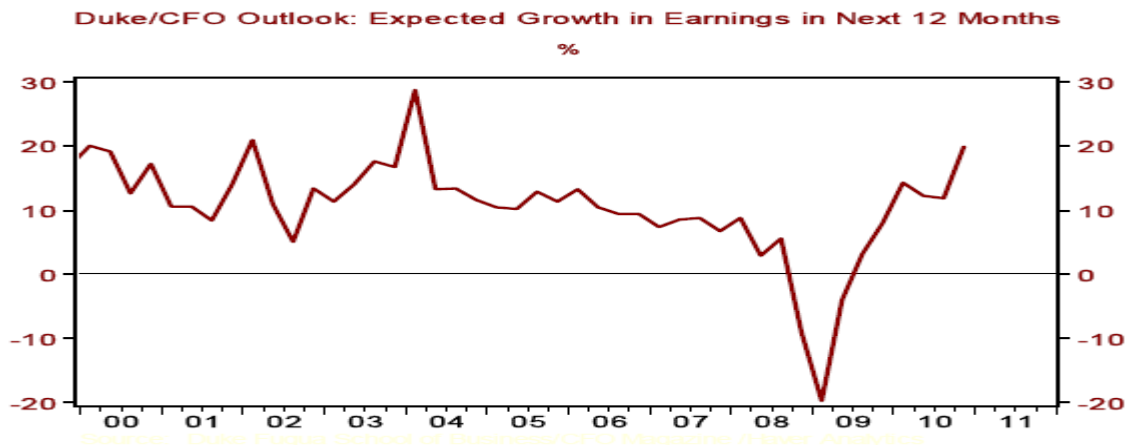
Global Nominal-GDP and S&P 500 Core Revenues¹
Year-Over-Year Changes
2003 Through 2011E



¹ Core revenues exclude financials, energy and industrial commodities.

Source: ERP

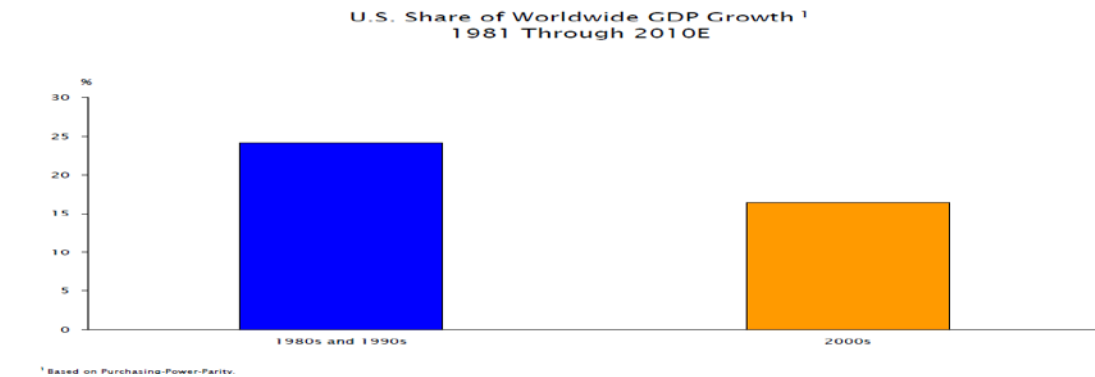
CFO expectations, (see RDQ Economics December chart below) are critical as CFO's control the corporate purse. CFO's growing confidence is a reflection of their ability to regain control over earnings through aggressive 2009 cost cutting measures combined with the stabilization and re-opening of the corporate credit markets. After the mid-term elections, positive corporate commentary during quarterly investor calls acknowledges a shift away from the unproductive stalemate and anti-business agenda that seemed to dominate Washington previously.



Source: RDQ Economics

Changing of the Guard – With Emerging Market Growth Comes Volatility

The mature, highly leveraged US economy is no longer the dominant force determining global GDP growth rates. The transition that has taken place over the past three decades can be seen in the ERP December chart below. During the 1980's and 1990's, the US economy accounted for 25% of global GDP growth. That share has declined to 15% during the last decade. This declining influence will likely continue into the foreseeable future as a deleveraging U.S. consumer and government shrink investment and hence capital formation.

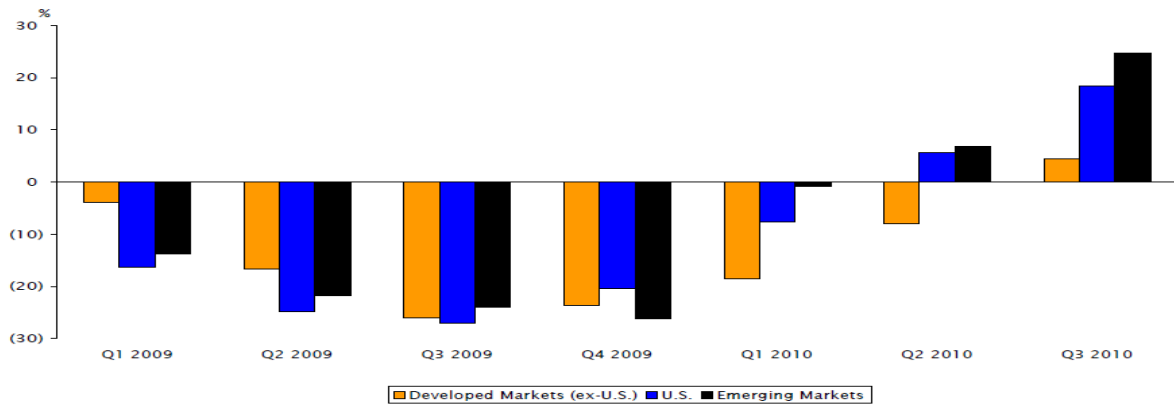


Source: ERP

The ongoing recovery from the “Great Recession” provides a telling snapshot of what we expect the future to look like (see ERP December chart - top following page). Emerging market's capital spending (black bars) declined the least in percentage terms in all but the 4th quarter of 2009, and quickly turned and led the recovery out in 2010. We believe this leadership role will persist for industrializing economies like China.

As discussed above, capital investment and private employment have historically been closely linked. The following mechanism (capital investment ⇒ jobs ⇒ wealth/standard of living ⇒ GDP growth) is alive and well in emerging markets economies like China. Hong Kong-based

**Developed and Emerging Markets
Year-Over-Year Changes in Capital Spending
Q1 2009 Through Q3 2010¹**



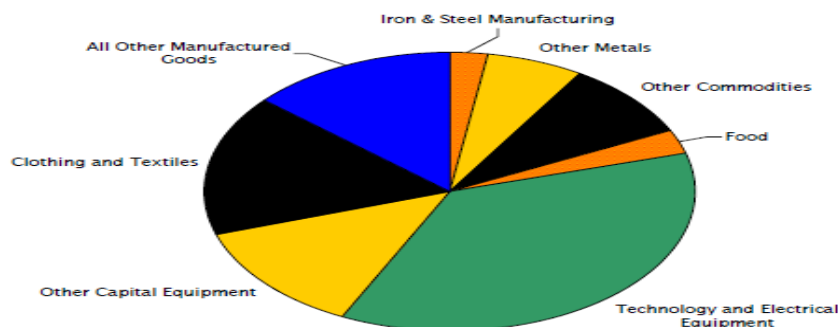
¹ Excluding financials and utilities and stocks that report on a semi-annual basis. Data are based on the median value for each universe.

Source: ERP

Kevin Yip, Managing Director for Bosera Funds, sees a very long runway ahead for Chinese economic development. He commented in a recent call that “China is still very early in its industrialization and urbanization process”. We agree with Kevin regarding the incredible growth opportunity provided by China, however acknowledge the potential for extreme volatility. China is early in its own economic life cycle and has a heavy exposure to capital intense exports including technology, capital equipment and manufactured goods (See ERP October chart below). Combined these two factors supports China’s excellent growth profile, however, also highlights the economy’s cyclical nature which lends itself to volatility. In the case of emerging markets we look to utilize this volatility as a buying opportunity when appropriate.

With emerging markets (specifically China) replacing the developed economies (i.e. U.S. and Europe) as the global growth driver, this creates a good news-bad news story for all investments. Going forward the potential for growth is solid; however, this growth will be accompanied by additional volatility. As investors, we feel the best way to address this volatility is to extend your investment time horizon and manage risk via diversification and proper asset allocation.

**China
Composition of Exports By Value
Year Ending October 2010**



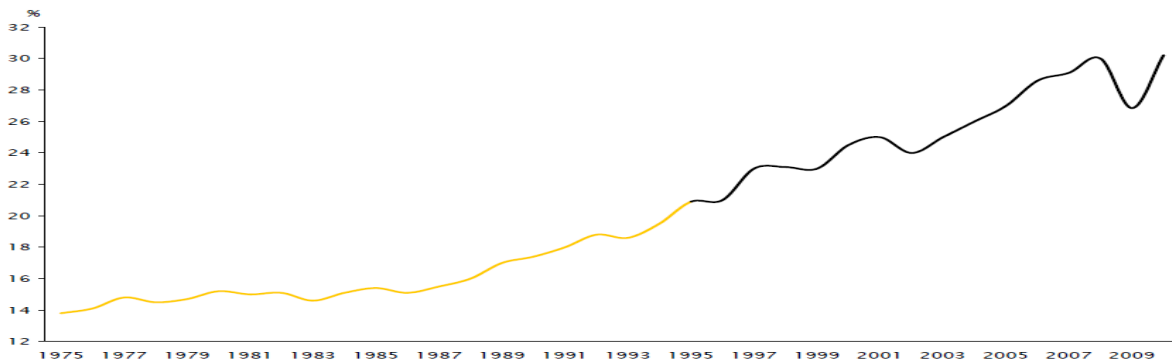
Source: ERP

Globalization’s Downside and Stress That Comes With Diverging Paths

The multi-decade process known as globalization has resulted in an optimization of global resources and produced a classic economic win-win. Competitive advantage driven productivity has created global deflation, generated jobs and a better standard of living for millions. As a result, global trade has essentially doubled as a percentage of global GDP over the past two

decades (see ERP December chart below). Unfortunately, all these pluses do have a downside, in that we now live in a highly correlated and interdependent global economy that still has

World Trade as a Share of GDP
1975 Through 2010E



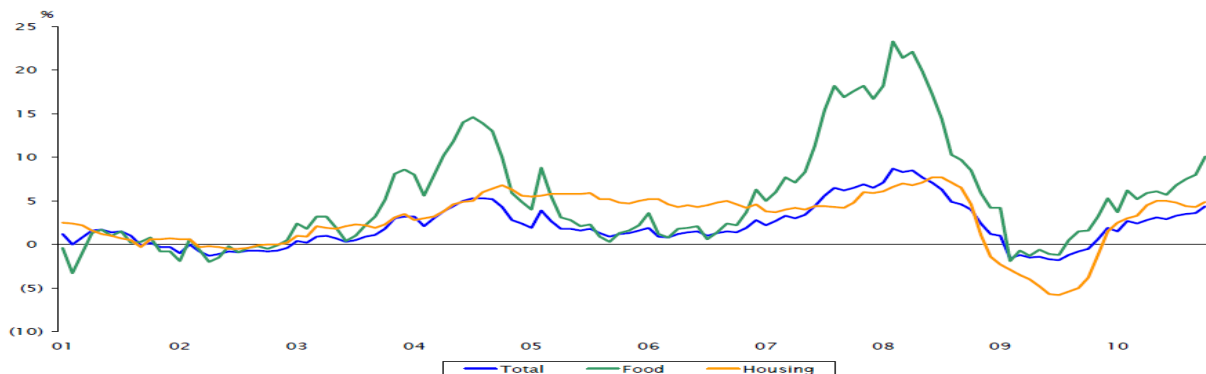
Source: ERP

significant social and political divisions. Recently these political divisions have come to the fore as domestic leaders struggle to resolve internal agendas. Labeling structural imbalances as roadblocks to domestic solutions has become the easy populist option. Fidelity's Jurrien Timmer discussed the structural imbalances between China and the U.S., as China is expected to report a \$190B global trade surplus this year. Unfortunately, Timmer's comments could easily be applied across other major trade partnerships, including the Euro Zone. In the coming quarters we will witness attempts to renegotiate these imbalances between the economic superpowers. The resulting headlines will have disruptive effects on the market as central banks and politicians maneuver to minimize damage to their local economies. The current battle developing between the U.S. and Chinese central banks around deflation versus inflation will become a very public test of this conundrum in early 2011. The Chinese and U.S. economies are at two very different points in their economic life cycle, yet they are inextricably linked as the value of the Yuan is tied to the U.S. dollar which essentially results in a common monetary policy. As these major trade partner's economic paths, and hence policy needs diverge, we can anticipate significant friction to develop.

Peoples Bank of China vs. the U.S. Fed

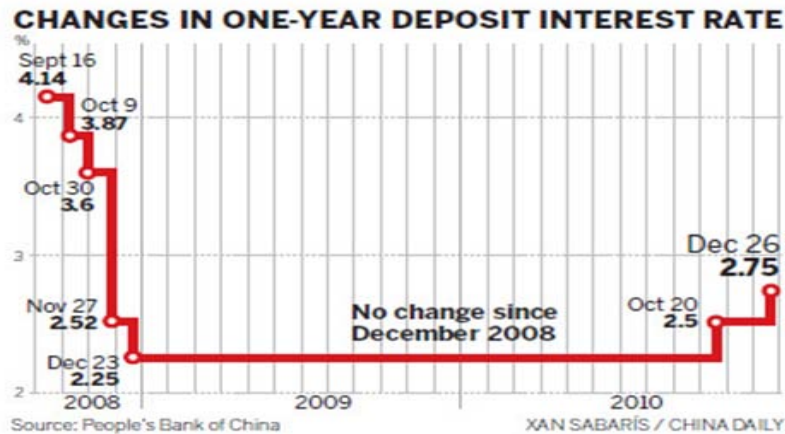
China's November CPI came in at 5.1%, the fastest growth rate since July 2008 (see ERP December chart below). These results forced China's government to raise its inflation target for 2011 to 4% from this year's 3% target and acknowledge upward momentum, especially in consumer prices. Despite a series of recent tightening measures (six consecutive bank reserve increases), the People's Bank of China raised its one year Yuan lending rate 0.25% points

Chinese Inflation
2001 Through October 2010



Source: ERP

to 5.81%. One year Yuan deposit rates (see People's Bank of China - December chart below) reflect this move, the second rate increase in less than two months. This increase signaled Beijing lost patience with less direct measures and felt a more aggressive response to the Fed's QE2 liquidity injection combined with an improving U.S. economy was necessary.



As one of the largest U.S. bond holders, China has objected to the Fed's recent liquidity injection, as it threatens the value of their U.S. dollar holdings. However, of greater concern for the Chinese Central Bank is their need to stay ahead of domestic inflation and credit proliferation. If inflation fueled by credit growth gets out of hand in China, the Central Bank will be forced to further lift interest rates, which could threaten the current economic recovery. In contrast, Fed Chairman Bernanke has labeled deflation the major threat in the U.S., as inflation is checked by limited bank lending (banks still have worthless consumer and real estate loans on the books that need to be recognized) and the lack of labor's political/economic power. Unfortunately from an inflation perspective, the Chinese economy is more like the U.S. economy of the 1970's when labor had political and economic leverage and turned a price/wage spiral into a serious problem. U.S. inflation peaked at 13.5% in 1981, only after then Federal Reserve Chairman Paul Volker raised the federal funds rate to 20%. China would like to proactively avoid such extreme measures. Hence this current deflation – inflation paradox demonstrates the extent to which these trading partners face significant potential for conflict.

Breaking the Yuan Peg

We believe the resolution to this growing economic conflict may be the eventual de-pegging of the Yuan. China has already taken gradual steps to “internationalize” the Yuan including the establishment of a Hong Kong-based deposit program to facilitate trade settlement. We anticipate more steps will be taken to expand and liberalize Yuan exchangeability. The timing and pace of the peg break is hard to judge and will depend upon China's faith in U.S. fiscal and monetary policy. As China loses confidence, they may be encouraged to accelerate the Yuan's conversion, reducing their need to accumulate more dollars. China currently holds \$2.6 trillion in foreign exchange reserves, much of which is U.S. dollars. As China allows the Yuan to float and reduces their dollar holdings, bad things could happen in the U.S. including a decline in the dollar (drives inflation) and higher interest rates (slows economic growth and puts pressure on U.S. real estate and equity markets). We will be watching this critical macroeconomic issue over the next few years as it has the potential to spin out of control. At this point we see this deflation – inflation conflict as a macro headline that will provide buying opportunities in the real asset and emerging market sectors in 2011, assuming China's braking actions do not morph into an actual economic hard landing.

SUMMARY

As we have outlined above, microeconomic fundamentals are heading in the right direction as we distance from the psychologically important mid-year 2010 economic double dip and Euro crisis fears. Encouraging signs including government stimulus and consumer and corporate spending have lifted expectations for a continued economic recovery into 2011. Fortunately consensus top and bottom line expectations are not overly optimistic, thereby reducing the potential for a major fundamentals-based disappointment. Macro uncertainty will continue to emerge as trading partners struggle to unravel the structural imbalances discussed above. These structural shifts are now identified as impediments to domestic issues in highly leveraged, mature economies. On this front, populist rhetoric and actions will increase as politicians play to the home crowd. Along those lines, global macro actions, including interest rate increases in China, a possible QE3 in the U.S., and growing resistance from Germany to further bailouts in Europe may provide market volatility which we will monitor and take advantage of when appropriate. We will continue to implement your individualized asset allocations with portfolios positioned for cautious optimism. We look forward to guiding you through these challenging times 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 e-mail me at mstack@bfpartners.com.

Michael P. Stack, CFA

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