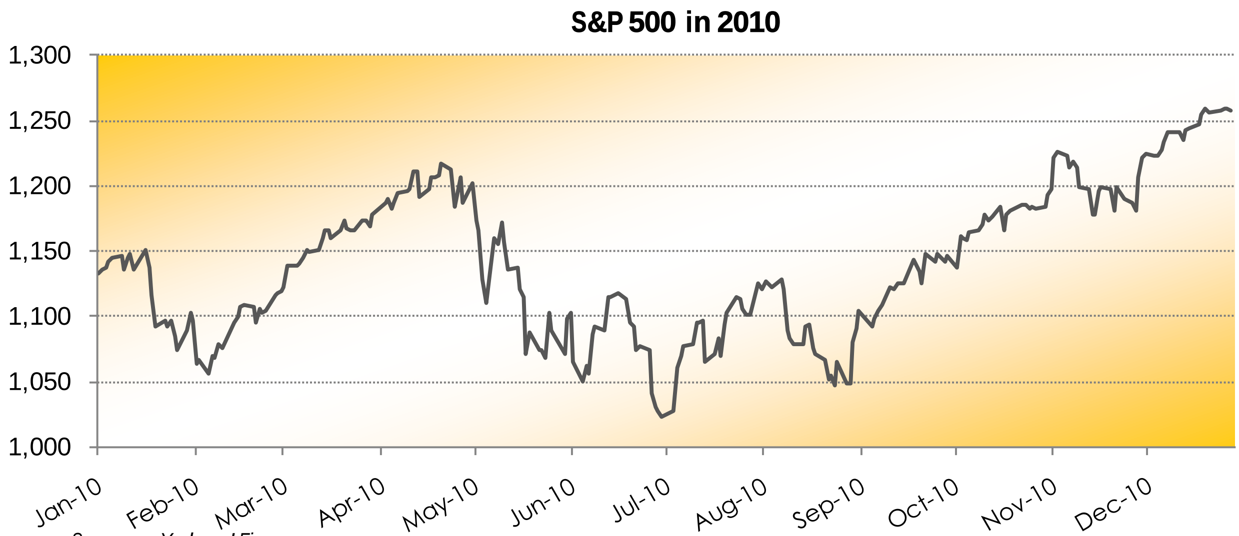
The story of the U.S. equity market in 2010 was several tales woven together. A January freeze was followed by a spring thaw as the S&P 500 hit a post-recession high in April, and longer-term Treasury yields crept upward. Then, the summertime blues came early with the May "flash crash" and renewed fiscal troubles in Europe weighing on equities throughout the middle of the year. The equity market did not regain solid footing until late August when the Federal Reserve signaled that another round of quantitative easing would materialize before year-end. Since then, we have seen domestic stocks climb steadily northward to post a roughly 15% year-to-date gain.

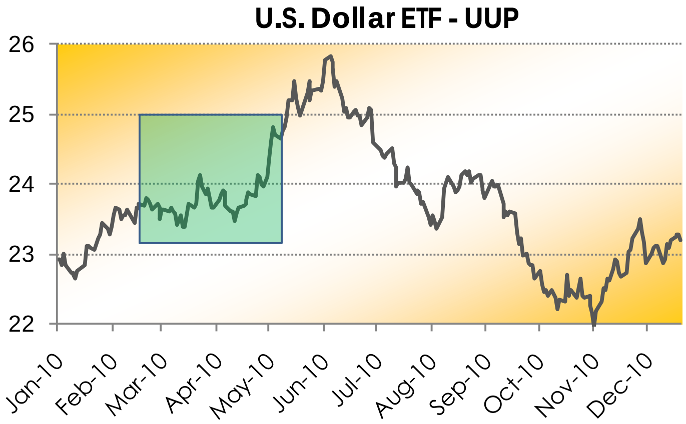


Source: Yahoo! Finance

Our investment view throughout the year could be summed up as a combination of *"The economy is not the market,"* and *"Don't fight the Fed."* Despite the ups and downs, as long as the government was supporting the markets – both through words and actions – we were not about to take the short side of that bet. This stance proved beneficial for our portfolios. Below we look back at the major trends in the markets during 2010, and how we invested to reap the rewards for our clients.

Greek Tragedy

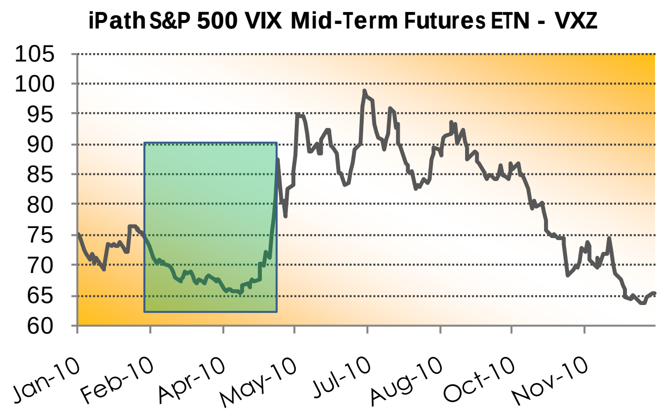
As 2010 began, one of the major themes unfolding was the fiscal upheaval in Europe. Greece was on the precipice of disaster with deficits at multiples of the limits allowed by European Union criteria, and they were not alone. Ireland, Portugal and Spain were considered dominos in line to fall. At MMA, we were fairly certain that a member of the European Union would not be allowed to "fail"; however, we also believed that the euro would pay the price for the fiscal burdens of these countries. Although the U.S. has its own debt mountain to conquer, investing is a relative game and we believed that the dollar would emerge as the safe haven alternative. In early February, we began to position the Opportunistic portion of our portfolios to take



Source: Yahoo! Finance
UUP is the PowerShares DB US Dollar Index Bullish Fund

advantage of this crisis. We sold our previous Opportunistic holdings in Brazil, China and India – countries which had risen 128%, 62% and 103% in 2009, respectively. We then purchased an ETF tracking the movements of the U.S. dollar – PowerShares DB U.S. Dollar Bullish ETF (UUP). The period over which we held UUP is shown by the green box in the graph at left. We closed out this Opportunistic holding with a nearly 5% gain over 3 months.

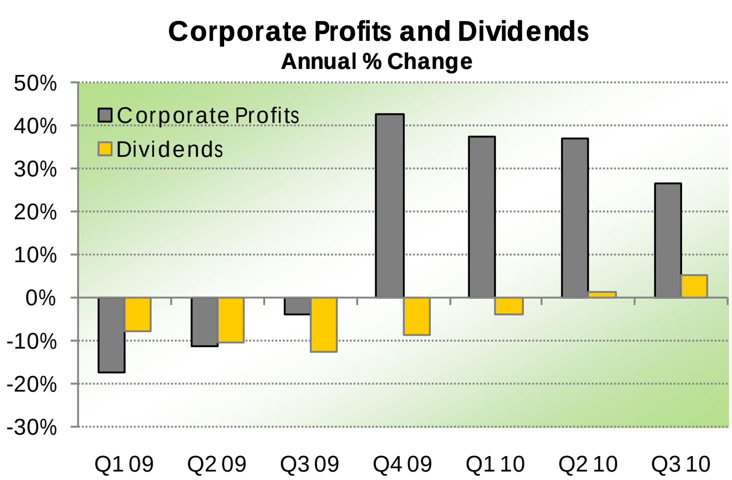
We also believed that the fiscal situation in Europe would increase the perception of global risk, which in turn could cause a spike in the VIX volatility index. Accordingly, we bought an Exchange Traded Note tracking the VIX volatility index – the iPath S&P 500 VIX Mid-Term Futures ETN (VXZ). Although the increase in volatility did not materialize immediately, after the "flash crash" in early May volatility spiked, and we were able to close out this position for about a 9% gain over 3 months.



Source: Yahoo! Finance

Clipping Coupons

The mixture of an uncertain economic recovery and rock-bottom interest rates was the recipe for dividend paying equities to shine in 2010. Yields on bonds remained near historical lows due to subdued growth expectations, few signs of inflation and the Fed's zero interest rate policy. Meanwhile, many investors were wary of jumping head first into the stock market with the consumer economy still on shaky ground, but the opportunity cost of remaining in cash and bonds was extraordinarily high. In order to compensate for some of the risk associated with equities, investors sought out high dividend paying

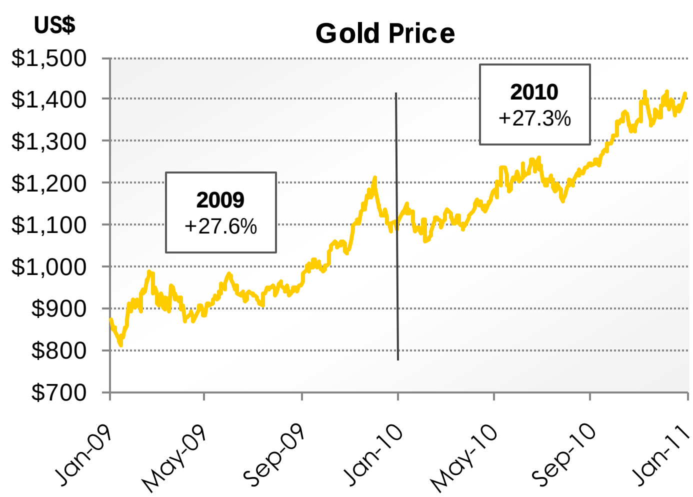


Source: BEA
Profits with Inventory Valuation & Capital Consump. Adjusts.

investments. This was a way to stay invested and potentially reap some gains, yet have a cushion against capital depreciation. Furthermore, cash-rich companies had the balance sheet leeway to pay out these dividends with corporate profits growing steadily every quarter.

We also seized the opportunity to own dividend paying equities in our portfolios. After selling our VIX and U.S. Dollar positions (VXZ and UUP) in May, we looked to capture more income for our clients as well as protect against weakness in the equity market. We bought two U.S. equity sector ETFs that were both defensively positioned (counter-cyclical) and offered high dividend yields: the Spider Select Sector Consumer Staples (XLP) and Utilities (XLU) ETFs. These ETFs yielded 4.2% and 2.6%, respectively, at time of purchase – significantly more than the broad S&P 500 index which was yielding only 1.8%. We recently sold these positions for gains of roughly 7% (XLP) and 6% (XLU). We replaced these holdings with two ETFs we believe will benefit from the bullish macro/commodity trends unfolding in the markets – MOO (Market Vectors Agribusiness ETF) and EWC (iShares MSCI Canada ETF).

All That Glitters

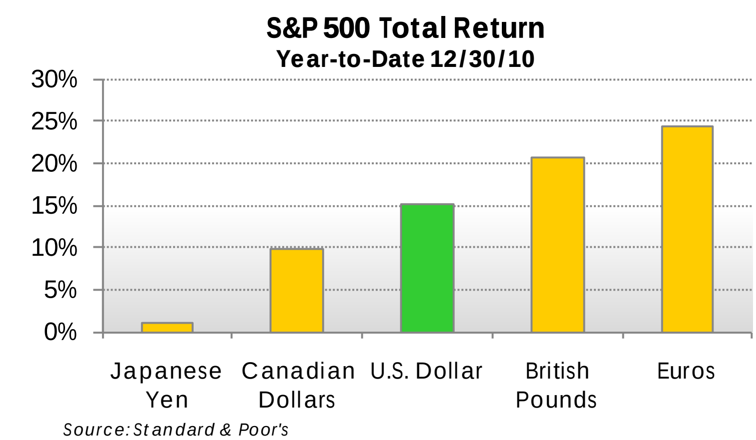


Source: London Bullion Market Association

Speaking of commodities, gold turned in yet another stellar year of performance. The metal has risen over 27% this year, closely matching last year's gain. Traditionally an inflation hedge, in this environment of ballooning deficits gold has become an alternative currency of sorts – a haven for those fearing devaluation of the dollar and euro. While we continue to own a small position in our portfolios, we hesitate to let our gold position grow too large. We believe in the "gold as alternative currency" theme, however, it is a difficult asset to properly value. Unlike owning shares of a company (equities) or a revenue stream from loaning money to a government or corporation (bonds), gold has no intrinsic value and is worth only what the next buyer is willing to pay – sometimes known as the "greater fool" theory of investing. The metal could have further upside in 2011, especially with fiscal concerns in Europe and the U.S. still on the front burner. From today's price of over $1400/ounce, gold would still have to appreciate another 63% to reach the all-time, inflation-adjusted high of $2287 hit in 1980. While this is a possibility, we believe that a reversal could come fast and furious when it finally arrives and would view any significant pull back as a sign of danger.

Returns are in the Currency of the (Be)Holder

Currency movements have been a major player in many investment themes of the year, and we expect this trend will continue. For the Fed, the dollar has become the "stimulus of last resort" as policy rates languish near zero. When the latest round of quantitative easing was announced in August, the U.S. dollar began to weaken as investors priced in the coming liquidity boost. We wrote about the pros and cons of this policy last month in *"Consumption Junction, We Need it to Function."* Although a weaker dollar is good for our export economy, it could damage the consumer in terms of inflation, particularly in the commodity space. A weaker dollar translates into higher oil prices globally, and higher gasoline prices locally, among other goods. Europeans experienced this in 2010. As Europe's debt woes took a toll on its currency, the price of goods rose more quickly in euros than in dollars. This was not good news for European consumers buying oil. The price of crude has risen about 13% in dollar terms, but more than 22% when converted to euros. On the other hand, a weaker currency was good news for European investors; for example, gold gained 38% in euros versus "only" 27% in dollars.



As global investors, we must also watch currency movements to gauge market perception in various regions. In the U.S. we consider the year-to-date 15% gain in the S&P 500 to be a pretty good year. The same investment reaped very different rewards, however, depending on home currency. An investor repatriating this year's gains back into yen would earn only a 1.1% return since the Japanese currency has risen over 14% against the dollar. A euro based investor benefitted from the currency's slide to the tune of a 25% gain in an investment in the S&P 500. These investors' perceptions of U.S. equity performance in 2010 might be quite different.

The Year Ahead

The year 2010 turned out to be much better for the markets than many had hoped a year ago. We would characterize our view throughout the year as "cautiously optimistic," and at this point we anticipate the same for the year ahead. As always, however, there are potential speed bumps ahead. We do not underestimate the positive impact that a government safety net has had for the past several years. We will continue to look for signs that this influence is fading, which could introduce more uncertainty into the markets. We may be nearing the turning point when further quantitative easing becomes more of a weight than a life raft. Fiscal problems and the *stimulus vs. austerity* tug of war will remain front and center, particularly in Europe, but also potentially in the U.S. as the new Congress takes office.

Perhaps the issue most important to our client base, though, is the health of the municipal debt market. Yields have backed up significantly in the past six weeks. A surge in issuance before the end of the Build America Bond program flooded the market with new bonds, a general increase in rates on the back of rising Treasury yields, and end of year portfolio window dressing (selling) have all contributed to higher yields. Without a doubt, states and municipalities face severe budget crises. We are firm in our beliefs, however, that most of these governments will do whatever it takes to continue servicing their debts. The punishment of being locked out of the debt financing markets in the future is far too great to risk. We have carefully selected our clients' individual municipal bonds for high credit quality and lower-than-index duration, and thus our individual portfolios have outperformed the broader muni indices. These bonds remain an important source of income and diversification for our clients.

We thank you for another year of your time, trust and attention. We hope that you and your family have had a very happy holiday season, and we wish you continued success in the New Year!

December 30, 2010

Katherine Krantz | Brock E. Moseley

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