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Stocks closed out 2010 with a strong fourth quarter as investors gained confidence in the economy and cheered further monetary stimulus from the Federal Reserve. A primary beneficiary of this sentiment was the stock of smaller companies as evidenced by the 26% gain in the S&P 600 Small Cap Index. Larger stocks also posted attractive returns with the S&P 500 Index gaining 15% on the year. Returns for foreign stocks lagged the U.S. market with the MSCI EAFE Index gaining a bit more than 8%. Improving economic confidence, along with fears of rising inflation led commodities, and in particular precious metals, to strong gains in 2010. The DJ-UBS Commodity Index gained nearly 17%, but gold rose nearly 30% and silver rocketed up 84%. Bonds, meanwhile, ended the year on a weaker note, but the Barclays Aggregate Bond Index still managed to generate respectable gains of 6.5% on the year.

Our portfolios generated nice returns on the year, especially considering our increasingly conservative posture. Earlier in the year, as we began to doubt the economic recovery, we exited many of the winning investments purchased around the market bottom of 2009, including broad commodities, agricultural commodities, commodity-oriented stocks, emerging market stocks, and Treasury Inflation Protected Securities. These investments have continued to trend higher after our sales as investor optimism has been stoked by additional monetary easing. Our portfolios continue to be defensively positioned with equity allocations well below each investor's target allocation and with that minimal equity exposure concentrated in large, high-quality stocks. Conversely, our portfolios are maintaining bond allocations well above respective targets, and that exposure is investment-grade only and is increasingly moving to intermediate and long maturities. In taxable portfolios, we reduced our municipal bond risk exposure in the fall by shortening maturities and increasing credit quality. As such, our municipal bond portfolios have held up better than most during the recent downdraft. We are now taking advantage of the turmoil by once again lengthening our maturities.

We continue to believe strongly in our outlook for an economy that will fail to meet rising expectations. Much of the strength that the economy displayed last year can be attributed to temporary government stimulus. At its core the economy remains stagnant as evidenced by bleak employment figures. Furthermore, we do not believe that residential housing prices in this country have bottomed or that foreclosures have peaked. A further slide in housing prices will only dampen consumer confidence and accelerate the shift away from spending and towards saving and reducing debt. Additional headwinds to economic growth include higher interest rates than a year ago, surging fuel prices, and the proliferation of the sovereign debt crisis in Europe. Perhaps the one true bright spot in the global economy is the strong growth in emerging economies in Latin America and Asia. However, many of these countries are now tightening monetary policy in a concerted effort to slow this growth and stave off future inflation problems. Given these and other concerns, for the meantime, we will keep our portfolios in defensive postures (relative to each investor's investment policy) in order to better protect our sizeable gains from the previous two years.

Sincerely,

David B. Ackerman, CFA, CFP