

April 29, 2010

Dear Client,

First Quarter 2010 Market Summary

Stock prices around the world continued their yearlong rebound during the first quarter, although at a more sedate pace than during previous quarters. And although equities remained well below their 2007 peaks, by the end of March, the S&P 500 Index had reached a significant milestone, recouping its losses since September 2008. Though progress is slow, the damage to both market sentiment and individual portfolios is gradually being repaired.

The U.S. Stock Market

After the market's ebullient advance from March 2009 through the end of the year, further progress came grudgingly during the first quarter. Stock prices dipped lower in January, only to recover their upward momentum during the remainder of the quarter. Still, investors found relative bargains in the market as interest rates remained low and signs of sustainable economic growth continued to accumulate.

The Dow Jones Industrial Average edged up another 4.82% during the quarter. The Standard & Poor's 500 Index gained 5.39%, while the technology-rich but dividend-poor NASDAQ Composite kept up the pace with a 5.91% gain.

Looking for deals after the markets' steep climb, investors turned their attention to traditionally value-oriented stocks. Smaller companies also gained favor, as they often have when the business cycle matures from tentative recovery to full-fledged expansion. The small-cap Russell 2000 Value Index fared best, gaining 10.02% during the quarter, while the Russell 2000 Growth Index, stocked with emerging technology companies, added 7.61%. The large-cap Russell 1000 Value Index also advanced, pushing ahead 6.78%, while the Russell 1000 Growth Index gained 4.65%.

Fourth quarter 2009 operating earnings reported by S&P 500 companies in early 2010 roughly doubled year over year compared to the final quarter of 2008. As profits improved, many U.S. corporations loosened their tight grips on cash and announced a net increase in dividends for the first time in two years; only two S&P 500 constituents reduced their quarterly payouts. Still, after the deep cuts made during the past two years, aggregate dividends remained 16.6% below their first quarter 2008 level. Wall Street now expects first quarter 2010 earnings, to be reported later this spring, to improve more than 30% from the same period last year.

International Equities

As the U.S. equity market slowed, demand for foreign shares also faltered. Investors were concerned that the long recession had left smaller European economies vulnerable to soaring borrowing costs or credit downgrades. This worry fueled selling and weighed down otherwise lively stock prices throughout the continent. And while the MSCI EAFE Index, which represents the world's most developed markets of Western Europe, Australia, and the Far East, ended the quarter with significant gains in local currency terms, the advance translated to just 0.94% for U.S. investors, whose profits were diminished by a resurgent dollar. Asian shares fared better than their European counterparts.

Credit and currency concerns also left U.S. investors more cautious about emerging markets. Compared with previously stratospheric gains, the MSCI Emerging Markets Index rose a relatively mild 2.11% during the quarter.

Chinese and Brazilian stocks actually posted small retreats in dollar terms, while the technology-rich Indian and oil-heavy Russian markets continued to advance, although at a substantially slower pace. The quarter's biggest winners came from well off the beaten track: Hungary (up 12.62% in dollar terms), Thailand (up 13.26%), and the thinly traded stocks of Egypt (up 11.87%).

Currency and Commodities

Despite speculation to the contrary, the deteriorating fiscal health of Greece and other European countries failed to provoke an outright crisis within the European Union. Still, the euro suffered, and the U.S. dollar gained 6.12% against the European currency during the quarter. Other currencies also lost ground against the dollar, as investors bet that the United States would emerge from the recession more quickly than many other highly-developed economies. The greenback ended the quarter at a three-month high against the Japanese yen, and in a much stronger position versus the British pound and other global currencies.

The strengthening dollar also helped the prices of oil, steel, and other industrial commodities, which are traded in dollars around the world. The cost of a barrel of crude oil edged up 4.7% during the quarter to close at \$83.76, roughly where it stood in late 2008 when world financial markets started unraveling. Likewise, copper, a proxy for global demand for finished goods, cost 5% more at the end of the quarter than it did when the year began. However, gold—a traditional hedge against inflation—cooled considerably after prices soared 26% in 2009. During the first quarter, gold bullion prices inched up just 1.41%, to \$1,115 an ounce in U.S. dollars.

The Bond Market

Although U.S. government bond investors avoided outright losses in 2009, soaring supply and slowing demand are beginning to shake up the relatively calm Treasury market. Over the past year, the federal government has sold \$601 billion in new Treasury securities to fund continuing stimulus programs, representing a roughly one-third increase in Treasury borrowing. By late March, U.S. investors were greeting Treasury auctions with a distinct lack of enthusiasm. For much of the quarter, however, Treasury bonds continued to serve as a safe haven for capital fleeing risks elsewhere, such as from the prospect that Greece or another European country might default on its credit obligations.

The Federal Reserve continued its virtually-zero interest rate policy throughout the quarter, voting twice to keep its short-term lending targets near 0% in order to nourish the economic recovery. Unless an unexpected inflationary shock requires a change in course, the Fed is likely to maintain this policy for some time to come. Still, the Fed has already started scaling back some of its extraordinary efforts to inject liquidity into financial markets throughout the credit crisis. Several lending and debt-buying programs expired during the quarter and were not extended.

With yields still very low, a representative portfolio of Treasury bonds delivered a total return of 0.91% during the quarter—well within long-term historical norms, but meager enough to discourage some investors. Short-term yields remained close to zero amid ongoing demand for fast-maturing Treasury bills. But the threat of inflation and the likelihood that the government would increase its borrowing still drove some investors further away from long-term bonds, allowing prices to sink and pushing yields upward. (Bond prices and yields move in opposite directions.) As a result, throughout the quarter, the gap or “spread” between two- and 10-year Treasury yields remained at a record 2.8 percentage points.

Corporate bonds, riskier than Treasuries, also offered higher yields, though after a yearlong rally, the advantage of owning even speculative or “junk” debt had been reduced substantially. The spread between high-grade corporate debt and Treasury securities of equivalent duration narrowed to 1.5 percentage points by quarter's end—the narrowest gap since late 2007 and an indication that investors have few concerns about corporate defaults. Meanwhile, lower-grade borrowers managed to issue bonds at relatively low effective interest rates. Globally, a record \$42 billion in high-yield bonds sold on the open market, even though about 11.6% of such debt went into default last year. Bond rating agencies now expect only 2.9% of all “junk” borrowers to default through the end of this year.

The municipal bond market, as represented by Barclays Capital Municipal 3-Year Bond Index, finished the first quarter up 0.3%, despite negative returns during March. Over the past 12 months, the municipal yield curve grew

dramatically steeper, as short-term rates neared 0%. Over the six-month period ended March 31, municipal interest rates dropped close to their all-time lows across the curve, driven in part by supply and demand. The issuance of government-subsidized taxable Build American Bonds (BABs) has reduced the volume of tax-exempt municipal issues, while at the same time demand for tax-exempt income has grown. With the end of the Bush tax cuts—and an almost 4% jump in the highest tax bracket—looming, higher-income investors are clamoring for tax-free investment options. BABs are expected to take up an even larger share of the municipal bond market in 2010, before the program concludes at the end of the year, so rates on tax-exempt municipal bonds may fall further.

The Economy

Although economists are still not sure that the long recession that began in December 2007 ended sometime during 2009, Federal Reserve Chairman Ben Bernanke and his colleagues observed that economic activity “continued to strengthen” throughout the first quarter of 2010. Yet they also warned of significant headwinds to full-fledged recovery. Notably, housing and labor markets remained “depressed” throughout the quarter, and though the Fed made vast amounts of money available to credit markets to encourage borrowing, bank lending continued to contract.

Gross domestic product (GDP), the widest gauge of U.S. economic activity, expanded at an annualized rate of 5.6% during the fourth quarter, as businesses worked to replenish depleted inventories. While the headline number was surprisingly high—economists had predicted growth of only 3.5% to 4.0%—few expected the trend to be sustainable unless consumer spending also improves. As a result, forecasts for first-quarter GDP growth are only in the 2.3% to 3.0% range.

Personal consumption accounts for 70% of the economy, and while consumers have tiptoed back into stores, they remain significantly less eager to spend than they were two years ago. Retail activity edged up very slowly during the first months of 2010, with household spending still constrained by high unemployment, tight credit, and a stagnant housing market. Sales continued to erode for furniture, electronics, and home improvement stores; however, rising gasoline prices pushed spending at filling stations up 24% during the 12 months ended in February.

American families remained profoundly wary about the state of the economy. Data from the Conference Board revealed that in February, consumers’ sentiment about their current financial state reached its lowest level in a generation, and while confidence rebounded somewhat by quarter’s end, it remained extraordinarily depressed.

With more than eight million jobs having been lost during the recession, job seekers are justified in saying that work is hard to find. Although U.S. businesses finally increased their payrolls significantly in March, it was neither in line with economists’ expectations nor enough to budge the aggregate unemployment rate from an elevated 9.7%. And while the number of people employed in manufacturing and health care edged higher, as did the count of those working for the government and temporary services firms, employment in financial services and technology continued to decline.

Inflation remained dormant throughout the quarter as businesses running at reduced capacity competed aggressively to make sales. Consumer prices increased 2.1% during the 12 months that ended in February. Prices for gasoline and used cars surged, but housing costs actually declined for both renters and homeowners.

Near the end of the quarter, government bankers said they believe inflation will remain subdued “for some time.” That could give the Federal Reserve leeway to keep interest rates low for an extended period as it looks to increase the pace of the still-tentative recovery. Real estate markets are still struggling in many regions and hiring is sluggish at best. Meanwhile, state and federal budgets have swelled amid worries that new government responsibilities, mandated by health care reform and other changes, may only compound the problem at a delicate time.

Given the depth of credit concerns in Greece and elsewhere, there is speculation that even the U.S. government’s credit rating could be downgraded as it struggles to finance surging budget deficits. That would increase borrowing costs for the Treasury, and if inflation returns, the situation could become even more dire. Yet for today, the economy is growing again, and for many investors, that appears to be enough.

Your Portfolio

As we previewed in our last letter, during this first quarter we made, or are in the process of making, several tactical changes to client portfolios. In the domestic equity segment, we replaced Laudus Rosenberg U.S. Discovery Fund with T. Rowe Small Cap Value and added a new position in Columbia Dividend Income, a large-cap value fund. In the international equity segment, we exchanged a portion of dollar-hedged Tweedy Browne Global Value Fund for Tweedy Browne Global Value Unhedged, a move intended to increase client exposure to non-dollar currencies.

Because we expect interest rates to start moving up again later this year, we liquidated long-term corporate bonds in taxable accounts, reduced high-yield bond exposure from 7% of fixed income to 3% of fixed income in all accounts, and shortened average duration by up to 17%, depending on client tax strategy. We also slightly reduced TIPS exposure for clients with TIPS, as we believe that TIPS are no longer cheap.

For clients with taxable fixed income we substituted PIMCO Low Duration Bond Fund for the Vanguard Long-Term Corporate Fund. In tax-exempt fixed income portfolios, we added Columbia Short-Term Municipal Fund and T. Rowe Price Short/Intermediate Term Municipal Fund for greater diversification.

In most client accounts, we reallocated 5% of the portfolio to a new asset class: hard assets. Currently, clients with hard assets exposure are invested in a mix of gold and silver ETFs, although we may incorporate exposure to real estate and/or soft commodities, such as oil, at some point in the future. As we explained in our special report last quarter on gold, we feel that a small position in gold and silver aids portfolio diversity by hedging against fast rising or hyper-inflation and falling currency values.

In the process of making these tactical changes, we fully rebalanced almost all client portfolios. The trading for clients that already had hard assets exposure took place in January and February. We rebalanced almost all other client portfolios at the end of the quarter. As of mid-April, your portfolio managers were still in the process of rebalancing portfolios for a handful of clients with special situations, but we expect trading to have been completed in those portfolios by the time you receive this letter.



If you haven't done so lately, please take some time to review your current financial situation and call us *immediately* if your health, family situation or career outlook has changed, or may be changing in the near future. It may be time to adjust your portfolio allocation to better position you for what lies ahead.

Best regards,

Tracy Kuntz, MBA, CFP®
President

Enclosures

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GLOBAL EXCHANGE TRADED FUND STRATEGIES
1st Quarter 2010 Performance Review

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Global Balanced Strategy

Our Global Balanced Strategy, which allocates among bonds, stocks, and hard assets around the world, gained 2% in the first quarter of 2010 and 34% over the past 12 months.

The year began with a bit of uncertainty, as global investors awaited news of definitive action on the debt crisis in Greece. While more cautious investors quickly sold assets to escape anticipated price slumps, those who stayed the course benefited from a V-rebound in equities, higher-risk bonds and industrial commodities as soon as plans to rescue Greece started to unfold. The first quarter asset price rally and increasingly positive economic reports gave investors hope that the global economy is finally healing.

Led by the U.S. stock market, global stocks advanced 3.4% during the first quarter. The S&P 500 rose 5.4%, outperforming both developed and emerging market equities. With credit market recovery less pronounced than economic recovery in many countries, global bond investors remained cautious during the first quarter. By quarter's end, global bonds had returned 0.3%, reflecting U.S. bonds' 1.8% return offset by foreign bonds' 1.5% loss. Currency gains and losses largely accounted for the return difference.

The increasingly popular dollar carry trade—the practice of borrowing cheap U.S. dollars and investing them in higher-yielding currencies—kept the value of the dollar low for most of 2009. Last December's Dubai World debt crisis, however, gave the dollar a much-needed boost as dollar carry trade investors fled to safety. A week later, Greece's fiscal crisis bogged down the euro. These back-to-back sovereign debt crises escalated default risk on government debt and gave rise to speculation about which highly-leveraged country might be next. By quarter's end, the dollar had gained more than 5% against the euro and little against the yen, despite Japan's serious debt problem.

Among G7 countries, Australia and Canada are the least debt-laden, and both avoid low rate policies. With their higher yields, both the Australian and Canadian dollars are popular plays against the U.S. dollar and the yen, and both have risen in value relative to the U.S. dollar during the past three months.

Since December 2008, the prices of copper and gold have surged. By the end of March, copper prices were approaching their July 2008 peak, and the price of gold bullion hovered around \$1,100 per ounce, only 10% below its all-time high. The price of crude oil remained 40% below its last peak of \$145 per barrel, despite jumping 50% since last March. Overall, industrial commodities gained ground during the first quarter, while soft commodities, like corn, wheat, and soy beans, foundered. The CRB Commodity Index, which tracks the prices of up to 19 commodities, finished the quarter down 3.5%.

Throughout the quarter, we maintained our equity portion target at roughly 45% of strategy assets. At quarter's end, 45% of the strategy was invested in equities, 44% in fixed income and 11% in hard assets. The overall allocation was 16% in U.S. bonds, 28% in foreign bonds, 26% in U.S. equities, 19% in foreign equities, and 11% in hard assets.

Developed Markets Strategy

Our Developed Markets Strategy, which invests in equities and fixed income securities of industrialized countries, declined 0.5% for the first quarter of 2010, but gained 51.4% over the past 12 months.

Dragged down by the slumping euro, developed markets had a poor first quarter. For the first time in its 10-year history, the euro experienced a crisis of confidence, challenging the notion that a common currency can survive when some member nations are less frugal than others.

The weaker euro hurt our equity portion, which finished up a mere 0.2% for the quarter, compared to 0.9% earned by the MSCI EAFE Index. The equity portion underperformed the index due to our greater weighting in European stocks vs. Japanese stocks compared to the index. In a surprising surge, Japanese equities gained 8.3% during the quarter after lagging the index by more than 20% last year. Japan's stock market rally came close on the heels of its economy's resurgence. Whether Japan's momentum can continue, however, is uncertain. Japan's debt is almost twice the size of its GDP. And the Japanese government may have to borrow heavily from international markets this year to cover a shortfall in tax revenue. Japanese stocks are not cheap compared to their European peers; both stock markets are trading at 18 times trailing earnings, on average, although Japanese stocks pay a lower dividend yield, on average.

The one-two-punch of the euro slump and Greece debt crises hit European stocks hard, causing them to lag the index by 3% in U.S. dollars. In local terms, European shares actually finished up over 3%, tracking the economic performance of larger constituents such as France and Germany. Smaller euro zone nations Portugal, Italy, Greece and Spain, however, lost ground during the quarter.

At quarter's end, the strategy was invested 51% in equities, with 7% in Asia, 39% in Europe and 5% in North America.

Emerging Markets Strategy

Our Emerging Markets Strategy, which invests in less-developed economies, finished the first quarter up 4.1%, bringing its latest 12-month return to 60%.

The bond portion, which is invested in a mix of foreign sovereign bonds to reduce portfolio risk, gained 2.2% in the first quarter, but lagged the JP Morgan Emerging Markets Debt Index by 2% due to the index's exposure to dollar-denominated securities. Greece's debt crisis created an immediate opportunity for emerging market bonds, as vigilant bond holders wondered whether certain advanced economies like Japan, the U.K. or the U.S. might follow suit. In comparison, emerging market countries appeared safer and fiscally sounder given their low ratio of debt to GDP and faster-growing production output.

In January, credit rating agencies elevated ratings on some emerging market bonds from junk to investment grade, a move which served to tighten the spread between emerging market debt yields and yields of U.S. Treasuries of similar maturity, and to boost investor confidence in emerging market bonds. Recent new issues of emerging market debt drew overwhelming demand, with bids exceeding offers.

Investors' enthusiasm also kept emerging market equities afloat. After gaining more than 74% in 2009, the MSCI Emerging Market Index struggled to earn 2.1% during the quarter. Many smaller economies were up more than 5%. In comparison, the stock portion of the strategy advanced 6% during the quarter due to our smaller weighting in Asian and Latin America stocks compared to the index. The stock markets of the two largest emerging economies, China and Brazil, both finished the quarter in the red.

Since last November, Chinese stocks have lagged other emerging market stocks by a large margin. Statistically, China's economic indicators still look very robust. Driven primarily by infrastructure spending, China's GDP grew 11.9% in the first quarter—its fastest pace since late 2007. At the same time, the Chinese government unexpectedly tightened bank lending, possibly in an attempt to slow the growth engine. However, this move may also have the unintended result of laying the groundwork for a property bubble. Major urban areas in China are plagued with new real estate developments with high vacancy rates, while in remote areas newly-built villages stand empty. The threat of an economic slowdown may cool China's demand for raw materials from Brazil and elsewhere which, in turn, could account for Brazil's poor first quarter performance.

At the end of the first quarter, 48% of the strategy was invested in bonds, and 52% in equities. The equity portion of the strategy was allocated as follows: 17% in Asia, 10% in Latin America, 15% in Eastern Europe, and 10% in the Middle East and South Africa.