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ECONOMIC & INVESTMENT SUMMARY
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During the third quarter, the stock market corrected sharply in reaction to the S&P downgrade of America's credit rating, the escalating European sovereign debt problems and a marked slowdown in economic activity. From the April highs to the September lows, the S&P 500 declined -21% and -14% for the third quarter. Intermediate-term corrections occur periodically as investors focus on "what can go wrong" rather than upside reward and these provide excellent buying opportunities. For example, last year the S&P 500 corrected -17% during the summer and subsequently rallied to finish the year with a +15% return. Although the economic expansion is more fragile than previously thought with uncertainties concerning the European debt situation, the stock market's rewards may outweigh the risks due to ongoing strength in corporate earnings and low valuations. In this review, we discuss the risks and our rationale for finding stocks attractive at this time. A summary of index returns through September 30, 2011 is as follows:

Dow Jones Industrials	-3.9%	Russell 2000	-17.0%
MSCI EAFE	-15.0%	S&P 500	-8.7%
NASDAQ Composite	-8.3%	Wilshire 5000	-11.4%

THE GLOBAL ECONOMY

The deterioration in the economic and financial situation in Europe is leading to a downgrade of global growth forecasts. The odds favor a period of sub-par growth rather than a full-scale recession. The largest developed economies – U.S., the Euro area and Japan – are expected to grow +1.5% in 2011 and somewhat less in 2012. The emerging markets remain the fastest growing economies at +6.4%, but are decelerating due to slowing exports and the lagged effects of recent tightening measures. China is leading the way with +8% - 9% growth. Overall, global GDP growth is projected to be +3.8% in 2011 and +4% in 2012.

Expectations for U.S. growth have moderated recently to the +1.5 to +2.0% range for 2011 and 2012. This slowdown reflects temporary weakness in manufacturing due to the Japanese earthquake, high oil prices in the first half of the year, a slowdown in hiring due to economic uncertainty, continued weakness in the housing market and less government stimulus. But the consumer's resilience has been impressive with +2.2% spending growth projected for this year despite low consumer confidence and high gasoline prices. In fact, the 13.1 million annualized pace of vehicle sales in September increased +11% from last year and may accelerate into the fourth quarter. Additionally, retail sales are projected to improve in the coming months. Business equipment spending should grow +9% this year and remains a key driver of economic growth. Higher corporate profits and the desire for further productivity gains have led to a capital equipment spending cycle that should last for several years. Positively, the ISM manufacturing data for September came in above expectations and eases concern that the economy is slipping into recession. In addition, there will be a pick-up in vehicle production to make-up for the previous cutbacks due to the Japanese-related supply shortages. The slow pace of job growth is causing concern, but recent reports have been "better than feared" indicating a firming of job growth at 1%. This pace is consistent with subdued growth, but it does not portray an economy falling into recession. Uncertainty regarding U.S. tax policy and regulation is hampering business confidence, but there is pent-up demand within businesses to add labor and capital to support future growth. A factor likely to slow our recovery is the increasing drag of the government sector with state and local governments reducing spending because of budgetary pressures. On balance, the underlying fundamental trends in the U.S. point to slow growth and partly hinge on successful resolution of the European sovereign debt crisis.

EUROPEAN SOVEREIGN DEBT CRISIS

European debt problems have been simmering with periodic flare-ups for over two years. Now, these issues are boiling into a crisis that requires immediate resolution to save the Euro and avoid a global credit crunch. The crisis stems from the inability of several fiscally imprudent countries, like Greece and Portugal, to finance their fiscal deficits and refinance their maturing debt obligations. The reluctance of the markets to provide capital to these peripheral nations is creating the need for a "bail out" at the expense of the stronger core countries. Additionally, the capital base of European banks is deteriorating because they own too many low quality sovereign bonds which is reducing the availability of credit. The slow response of European leaders to develop a workable long-term solution is jeopardizing investor confidence and this may, in turn, create a global recession and liquidity crisis. In late October, European leaders agreed to a substantial write-off of Greek debt, a recapitalization of the major European banks and a large stabilization fund to guarantee the debt offerings of Euro zone countries. These more explicit measures are calming fears and bolstering confidence that a workable solution is becoming the most likely outcome.

As a liquidity boosting measure, the ECB recently announced short-term lending facilities to provide the banks with ample access to liquidity through 2012. The ECB also announced a €40 billion bond purchase program to support the medium-term funding requirements for the banks. However, the ECB decided to leave short-term interest rates unchanged citing concern about inflation running near 3%. This may be a tactic to keep the pressure on the political leaders to create a workable long-term solution to restructure Greek debt and recapitalize the banks. At present, it appears that a mild recession may develop in Europe accompanied by lower inflation and interest rates. Separately, the Bank of England recently expanded their quantitative easing program by £75 billion to £275 billion to provide further stimulus.

FISCAL & MONETARY POLICIES

The future direction of fiscal policy remains uncertain despite the S&P downgrade of U.S. debt. Essentially, this downgrade was a message to Congress to attack the deficit problem. Clearly, the U.S. is not facing a liquidity crisis as long-term interest rates are at their lowest levels in 50 years. However, America needs a finely tuned fiscal approach that balances the call for greater stimulus in the near-term with the objective of reducing the projected long-term structural deficit. For each of the last two federal fiscal years, the budget deficit was $1.3 trillion, or approximately 8.8% of GDP. For perspective, the annual deficits for the last three years have been the largest since WWII. The cumulative impact of a series of deficits has pushed up America's government net-debt-to-GDP ratio to 73% from 43% in 2007. As a result of the debt-ceiling pact in August, a bi-partisan Super Committee will recommend spending cuts worth $1.5 trillion over 10 years. If the proposal is not approved, automatic spending cuts worth $1.2 trillion will impact discretionary programs in 2013. These potential automatic spending cuts combined with the possible expiration of the Bush tax cuts may create a significant fiscal drag on the economy in 2013 – a motive for both parties to get a constructive deal done. Fed Chairman Bernanke recently addressed the need for appropriate Congressional action by noting the risks associated with near-team austerity and the lack of a long-term deficit reduction plan. He further advised a thorough review of the tax code to promote long-term growth and an improved budget decision-making process to provide greater clarity and avoid financial market disruptions.

In terms of monetary policy, the Federal Reserve is easing incrementally in response to slow economic growth and the fragile recovery. The Fed recently initiated "Operation Twist" aimed at holding down long-term interest rates by selling short-term Treasuries from their portfolio and purchasing bonds with substantially longer maturities. This action influences long-term interest rates without expanding the size of the Fed's balance sheet as would occur with a quantitative easing program. On quantitative easing, the Fed suggested that round three (QE3) is possible, but the likelihood remains dependant on the re-emergence of deflationary risks. Today, inflation is a greater concern than deflation, with the consumer price index (CPI) up +3.9% and core inflation (ex. food and energy) increasing +2.0% over the past year. However, inflation should moderate later this year due to stabilizing commodity costs. Importantly, long-term inflation expectations remain subdued around +2.5% which partly explains the recent downward drift of 10-year Treasury yields to 2.1% from 3.6% earlier in the year. The Fed also specified that short-term interest rates will remain "exceptionally low" at least through mid-2013, which suggests an easy money policy and a positively sloped yield curve for the foreseeable future.

INVESTMENT OUTLOOK

The market's performance and events of the last few months have shaken investor confidence. It is understandable that the turbulent experience of 2008 raises concerns that another financial crisis may unfold. However, U.S. banks have significantly improved their financial condition since the collapse of Lehman Brothers, and the world's central banks are coordinating to offer European banks short-term loans to alleviate any funding pressures. There are risks that the European situation could spill over into the U.S., but this is not the most likely outcome at present. Furthermore, credit spreads have widened, but not as dramatically as in 2008-2009. At this time, the key questions are: Is the stock market attractive at this level? And are the risks to the outlook sufficiently discounted?

Given the recent -15% decline in stocks, we believe the stock market is attractive based upon an evaluation of individual company fundamentals, technical factors and investor sentiment. Corporate fundamentals remain favorable as we expect S&P 500 operating earnings to increase +14% to $96 per share in 2011, a record level, and +7% to $103 per share in 2012. Positively, cash flow growth has been stronger than earnings growth and S&P 500 companies have the largest cash balances in over 60 years. Unlike 2008, mergers and acquisitions continue in response to attractive pricing, lower interest rates and healthy cash levels. We are also encouraged by the high level of insider buying that some executives are demonstrating. The stock market is attractive at 12x 2012 earnings considering the outlook for earnings, inflation and long-term interest rates. This lower than average earnings multiple reflects many concerns, especially the "perceived risk" that earnings may decline in 2012. As a reminder, the stock market has never had a down year during both the third year of a presidential term and economic expansion -- a fourth quarter rally may put us in positive territory and keep the streak alive. We are pleased to note that the market has already experienced a meaningful recovery through late October.

On the technical side, several indicators suggest oversold and improving conditions. The market experienced panic selling in August which has been successfully tested, suggesting that the lows are established. From the April highs to the September lows, the S&P 500 corrected -21% -- a powerful correction but historically normal in the context of a recession scare -- implying that the worst of the correction has likely passed. In fact, the S&P 500 has rallied +18% since the early October lows. The

VIX option volatility index, a popular gauge of risk and fear, has declined to 26 from 45 in early August. For perspective, the VIX hit 85 in October 2008 and 55 during the market lows of March 2009, so the recent improvement is clearly a positive sign. Sentiment continues to focus on risk rather than reward as The Investors Intelligence survey hit the most bearish reading since March 2009. This bearish sentiment does not preclude further sell offs, but it does show significant skepticism that can be viewed positively as a contrary indicator. Also, the percentage of stocks above their 200 day moving average is at the same level as in early 2009 -- approximately 10% -- another contrary positive sign of oversold conditions.

The primary risks to our outlook include European sovereign debt troubles, a contagious spill over of liquidity risks from Europe, a U.S. double dip, a hard landing in China and higher than expected global inflation. Additional risks include the collapse of the euro, extreme fiscal austerity by the world's largest economies, geo-political conflicts, sharp increases in taxation and terrorism. These risks may threaten the expansion's sustainability, but we take comfort knowing that American companies may attract greater attention in a "flight to quality" trade if conditions become more difficult. America is a bargain for foreign investors considering the -25% decline in the value of the dollar over the last 10 years. We believe many fears are overly-discounted by investors and expect the stock market to strengthen in future quarters. Longer term, earnings growth is the predominant factor in stock price appreciation and we believe the factors supporting favorable earnings growth are evident for both the economy and the quality small and medium-sized growth companies of our investment focus.