



Monthly COMMENTARY

June 30, 2010

DOW JONES INDUSTRIAL AVERAGE	9,774.02	90-DAY TREASURY BILL	0.18%
S&P 500	1,030.71	10-YEAR TREASURY NOTE	2.93%

The Economy

The month of June 2010 brought an end to a second quarter of turbulent equity markets and mixed economic numbers. Equities, as measured by standard benchmarks such as the Dow Jones Industrial Average (DJIA) and the S&P 500, were down approximately 10% in a very volatile quarter. To place the quarter in perspective, the S&P 500 Index was up 7.0% (year-to-date, total return on April 30th) at the end of the first month in the period. When the closing bell rang on June 30th, that standard benchmark was down 6.6% (year-to-date, total return). Investors will remember May 6th as a “day of infamy” when the DJIA slid nearly 1,000 points in 20 minutes before recovering two-thirds of its losses.

By way of contrast, fixed-income investors sought quality, and pushed U.S. Treasury prices higher, resulting in lower yields. At quarter’s end, yield on the 10-year Treasury Note was 2.93%.

What caused the dramatic change in risk-reward perception? In short, investors are worried. The overwhelming sense of anxiety stems from global economic conditions, domestic economics, and regulatory factors. These major issues have over-taken positive news such as corporate earnings and growth in selected overseas markets.

Investor concerns appear to be centered on the employment numbers, growth in the private-sector job market, the housing market, and the global financial system. The Conference Board’s Consumer Confidence Index fell from 62.7 in May to 52.9 in June. This was a reversal of gains made during the first five months of the year, and at odds with the University of Michigan Index, which has been moving sideways. The Conference Board’s Index is more sensitive to labor conditions.

The Labor Department reported a loss of 125,000 jobs in June; however, this was primarily due to loss of temporary Census workers. In fact, private industry added 83,000 workers. Although the unemployment rate fell to 9.5% - its lowest level in almost a year – the decline was due to an increase in people who have stopped looking for work and therefore no longer considered unemployed.

Housing is treading water, but this could signal stabilization. Gains made through April had the benefit of the stimulus tax credit for first-time buyers. With this tax credit program’s expiration, future gains will depend on financial variables such as lower prices, higher personal income, low interest rates, etc. According to Freddie Mac and Fannie Mae, the 30-year mortgage rate is now at 4.59%, a 40-year low. This will influence new buyers, and also spur re-financing.

Inflation is not worrisome today, but it may be at some point in the future. With the core CPI increasing at only 0.9% (year-over-year), and the 10-year Treasury Note yielding less than three percent, deflation is a persistent topic. We do not see these factors as indications of deflation, rather as examples of disinflation, with prices increasing, but the rate of increase slowing.



Looking to the second half of the year, we remain in the slow economic growth camp. Analyzing the numbers and dissecting the economic news, there appear to be two other camps: the double-dip recession, and the faster growth advocates. The “slow growth” case has support from the Fed. In its latest report, the Federal Open Market Committee has a GDP forecast of 3.4% - 4.5% in 2011. We feel that the U.S. will grow at the lower end of this range, and selected emerging markets at a faster rate.

Stock Market

What a difference a quarter makes. When we wrote our First Quarter commentary, the S&P 500 was up 5.4% and all sectors were positive. In the second quarter, however, the S&P 500 declined 11.4%, and the only positive sectors were gold mining, residential REITs, and brewers.

Russell Investments’ quarterly survey of investment professionals (*Investment News*, June 28, 2010) noted that the major threat to U.S. stocks is the European sovereign debt crisis. Investors are moving between taking on risk, and risk aversion – leading to greater market volatility – which heightens concern in the marketplace. Although we expect slow economic growth, job recovery will lag, creating another headwind for investors. Finally, the May 6 “flash crash” brought computerized stock trading, and its potentially negative impact on markets, to the forefront.

Please find equity total return performance below:

Equity Total Return Performance as of June 30, 2010

INDEX	JUNE 2010	Q2 2010	YEAR-TO-DATE
S&P 500	-5.2%	-11.4%	-6.6%
DJIA	-3.4%	-9.4%	-5.0%
NASDAQ	-6.5%	-11.8%	-6.6%

(Source: Bloomberg)
Past performance does not guarantee future results.

Corporate earnings are coming through better than expected. According to *USA Today* (May 6, 2010), three-quarters of the S&P 500 companies have reported, and first quarter operating earnings are up 82% from a year ago. Much of the gains are in the financial industry and reflect very low earnings of the March '09 quarter as well as the effect of the government stimulus. While these are temporary factors, it is encouraging to note that consumer demand –not merely cost cutting – is playing an important role in the earnings growth. We expect this growth to continue, and estimate earnings of \$90.00 for the S&P 500 this year.

Admittedly, we are in the “skepticism” phase of the market cycle. However, there is “cash on the sidelines;” corporate earnings are expected to grow, and the market correction of the second quarter brought valuations to reasonable levels. In addition to the cited economic fundamentals, mid-term election years provide favorable buying opportunities for stocks. An 80-year study by Ned Davis Research, Inc. shows that the DJIA gained an average of 56.8% from its low in the mid-term election year to its high two years later in the presidential election year.

Using a conservative estimate of \$90 per share for operating earnings of the S&P 500, and placing a slightly lower-than-average 14 times as a price-earnings valuation, we expect to see equity gains in the second half.

Fixed-Income Market

Treasury prices continued their ascent in June propelled by moderating domestic and global economic activity, renewed European banking woes, modest inflation, and the threat of greater austerity and reduced



stimulus by the global governments. Yields on two-year Treasury notes fell to all-time lows yielding 0.59% late in the month. The yield on the 10-year Treasury fell 20 basis points in June to end the first half of 2010 at 2.93%. The substantial gains in the Treasury market mark the most surprising event in the bond market YTD. At the beginning of the year, nearly every pundit and forecaster was warning investors that the Treasury market would either underperform or, worse, was the next “bubble.” Globally, while stocks fell 9.5%¹ in the first half of 2010, bonds performed very well, rising 4.5%². Bonds beat stocks by the widest margin since 2001. Treasury prices are exhibiting a negative correlation with daily movements in the equity market. The formula for bond market outperformance in the first half of 2010 was to be long duration and long the Treasury sector.

Please find sector performance in June and year-to-date below:

Fixed-Income Sector Performance as of June 30, 2010

	JUNE 2010	YEAR-TO-DATE
TREASURIES	1.86%	5.86%
AGENCIES	1.15%	3.76%
CORPORATES (INVESTMENT GRADE)	2.13%	5.79%
CORPORATES (HIGH YIELD)	1.24%	4.51%
MORTGAGE-BACKED SECURITIES	1.19%	5.06%

(Source: Bloomberg)

Past performance does not guarantee future results.

We recommended moving our taxable durations to 100% of benchmark in June from 95%. Going forward, we are comfortable with a slight underweight in Treasuries and a slight overweight in investment grade corporates.

Despite several prominent articles and interviews wary of municipal credits, the municipal market continues to exhibit decent price action. In our view, general obligation municipal credits are strong, accounting for less than 1% of municipal defaults over the last year. We recognize that municipal finances are under pressure, but believe that most municipalities have the wherewithal to close their deficits. Additionally, any degradation in municipal credits will be gradual and will not reach the dislocations observed in the corporate bond market over the last three years. We continue to advocate a longer-than-benchmark duration in the tax-exempt market.

¹ Merrill legend Global Broad Market Index 12/31/09 – 6/30/10

² MSCI World Index of 24 developed countries



Index performance is noted below:

Fixed-Income Total Return Performance as of June 30, 2010

	JUNE 2010	YEAR-TO-DATE
BARCLAYS CAPITAL AGGREGATE BOND INDEX	1.57%	5.33%
BARCLAYS CAPITAL GOV/CREDIT INDEX	1.80%	5.49%
BARCLAYS CAPITAL INTERMEDIATE GOV'T/CREDIT INDEX	1.36%	4.56%
BARCLAY'S MUNICIPAL BOND INDEX	0.06%	3.31%

(Source: Bloomberg)

Past performance does not guarantee future results.

Appendix

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Important Information

Past market performance is no guarantee of future results.

Index performance cited is for illustrative purposes only and is not indicative of the performance of any specific investment. An investment cannot be made directly into any index.

International investing involves special risks including currency risk, increased volatility of foreign securities, political risks, and differences in auditing and other financial standards.

Diversification does not assure a profit nor protect against loss.

Bond prices are sensitive to changes in interest rates and a rise in interest rates can cause a decline in their prices.

High yield, lower-rated securities generally entail greater market, credit and liquidity risks than investment grade securities, including higher volatility and higher risk of default.



Dow Jones Industrial Average (“DJIA”) is an unmanaged index, which represents share prices of selected blue chip industrial corporations as well as public utility and transportation companies.

The Consumer Price Index (“CPI”) is a measure of change in consumer prices as determined by a monthly survey of the U.S. Bureau of Labor Statistics.

Nasdaq Composite Index is an unmanaged index that measures all Nasdaq domestic and non U.S.-based common stocks listed on the Nasdaq Stock Market.

The S&P 500 Index is an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Barclays Capital Government/Credit Bond Index is an unmanaged index which includes non-convertible bonds publicly issued by the U.S. government or its agencies; corporate bonds guaranteed by the U.S. government and quasi-federal corporations; and publicly issued, fixed rate, non-convertible domestic bonds of companies in industry, public utilities, and finance.

The Barclays Capital Intermediate Government/Credit Bond Index is an unmanaged index which includes non-convertible bonds publicly issued by the U.S. government or its agencies; corporate bonds guaranteed by the U.S. government and quasi-federal corporations; and publicly issued, fixed rate, non-convertible domestic bonds of companies in industry, public utilities, and finance.

The Barclays Capital Aggregate Bond Index is an unmanaged index composed of securities from the Barclays Capital Government/Corporate Bond Index, Mortgage-Backed Securities Index, and the Asset-Backed Securities Index.

The Barclays Capital Municipal Bond Index is a market-value-weighted index for the long-term tax-exempt bond market. To be included in the index, bonds must have a minimum credit rating of Baa. They must have an outstanding par value of at least \$7 million and be issued as part of a transaction of at least \$75 million. The bonds must be fixed rate, have a dated-date after December 31, 1990, and must be at least one year from their maturity date.

The Federal Funds Rate is the interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight.

Duration is a measure of a security’s price sensitivity to changes in interest rates. Securities with longer durations are more sensitive to changes in interest rates than securities of shorter durations.

GDP-Gross Domestic Product, the output of goods and services of a country annually.

FOMC-Federal Open Market Committee creates monetary policy.

Freddie Mac– Federal Home Loan Mortgage Corporation, Freddie Mac, is a government-sponsored enterprise (GSE) chartered by Congress to stabilize the nation’s residential mortgage markets and expand opportunities for homeownership and affordable rental housing.

Fannie Mae- The Federal National Mortgage Association (FNMA) was set up as a stockholder-owned corporation chartered by Congress in 1968 as a government-sponsored enterprise (GSE).

REIT- Real Estate Investment Trust: an investment trust that owns and manages a pool of commercial properties and mortgages and other real estate assets.



Sovereign Debt Crisis- A sovereign default is a failure by the government of a sovereign state to pay back its debt in full.

Flash crash- unexplained market event causing the DJIA to slid nearly 1,000 points in 20 minutes before recovering two-thirds of its losses 5.6.10.

MSCI EAFE Index – Stock market index that is designed to measure the equity market performance of developed markets.

Agency Securities – Bonds issued by US government agencies

Mortgage-Backed Securities – A type of asset-backed security that is secured by a mortgage or collection of mortgages.

Weekly Treasury Auctions – Treasury securities are sold through weekly auctions.

Examples of bond issuers are cited for illustrative purposes only and are not representative of any particular investment portfolio.

The Conference Board's Consumer Confidence Index- is based on a monthly survey of representative sample of 5,000 U.S. households.

The University of Michigan Index- A survey of consumer confidence conducted by the University of Michigan. The Michigan Consumer Sentiment Index (MCSI) uses telephone surveys to gather information on consumer expectations regarding the overall economy

*The information contained in this **Monthly Commentary** was prepared from sources believed to be reliable, but we do not guarantee that the information is complete or accurate. Opinions and projections contained herein reflect our opinion as of the date of the analysis and are subject to change without notice. This report is distributed for information purposes only and in no way should be construed as advice on how to conduct an investment program. Before acting on any information, you should consult with your professional advisor.*

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MTB001649 09/10