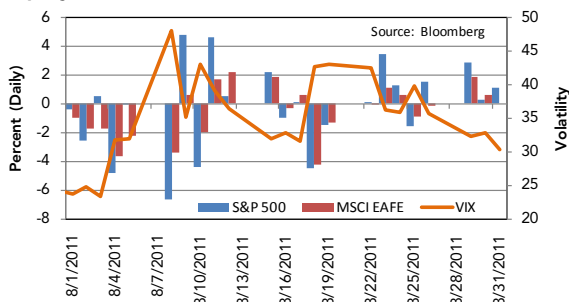


Economic Review

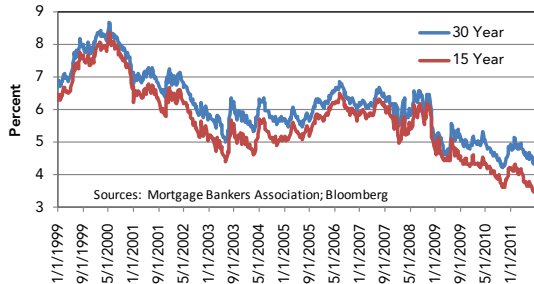
Equity markets worldwide oscillated wildly in August as the US waited until the last day to extend its borrowing capability. A contentious debate produced an agreement to raise the debt ceiling in two steps. The total ceiling will rise by \$2.4 trillion, which is expected to be sufficient until early 2013. A panel of twelve legislators was selected to develop \$1.5 trillion in spending cuts over the next decade and present their plan by Thanksgiving. Absent an agreement from the panel, cuts totaling \$1.2 trillion would automatically be enacted, drawing funds heavily from defense and from non-specific non-defense programs. The debt ceiling increase, under this clause, would also shrink by \$300 billion, to \$2.1 trillion. After the legislation passed, Standard & Poor's issued an unprecedented downgrade to US government debt, lowering its rating from AAA to AA+. Other rating agencies held firm on their top ratings. The downgrade was seen more as a commentary on legislative inability to produce meaningful budget restraint than a risk of technical default. Because the US can print money to pay its debt, default remains unlikely. However, since the debt is so large, the long term risk of devaluing the dollar to pay the debt remains a concern. Fannie Mae and Freddie Mac were also downgraded one notch by S&P, as their debt is guaranteed by the US government.

Equity Markets Become Volatile



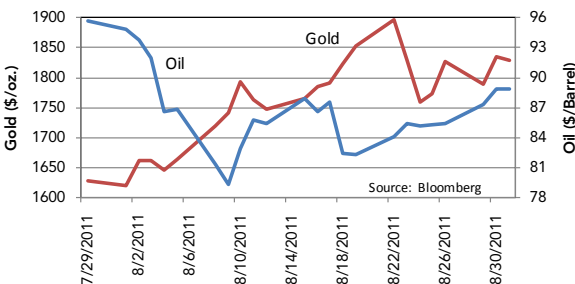
Although a downgrade to a debt rating usually results in rising bond yields, US Treasury yields sank to record lows in mid August. The 10-year Treasury yield hit an intra-day low of 1.97%, as investors sought cover from volatile stock markets in the perceived safety of Treasury bonds. The US dollar was not spared, however, as money flowed into the Swiss and Japanese currencies. Both countries intervened to stem the rising value of their currencies. In response to the currency movements and equity volatility, gold prices soared to nearly \$1900/oz.

Mortgage Rates Move Lower



Ultra-low Treasury yields had a positive effect on mortgage rates. 30-year mortgage rates fell to 4.3%, and 15-year mortgage rates dropped to 3.5%. In an environment of average unemployment levels, these rates would likely have produced a surge of home purchase and refinance activity. However, because of lingering high unemployment, consumers remained hesitant to commit to large purchases. Even with rents rising quickly, and in many areas surpassing the cost of a mortgage (excluding property taxes), buyers remained noncommittal. Adding to reduced mortgage activity is the high number of borrowers underwater in their current mortgages. Although government plans allow for refinance loans up to 125% of current home values, certain aspects of those plans limit the availability of options. To qualify for 125% financing under HAMP, the loan must be refinanced through the current lender, and most borrowers with second mortgages are immediately disqualified.

Gold Reaches Record; Oil Rebounds



The Federal Reserve stated that it will keep an ultra-easy monetary policy in place through mid-2013. While a low rate keeps borrowing costs low, an extended period removes the impetus for borrowers to act upon the low rates in a quick manner. Because borrowers now have another year and a half to consider borrowing, it will likely curtail any significant rise in asset prices, such as homes, until borrowers are given an imminent deadline for the end of ultra-low interest rates.

Market Returns

	As of August 31, 2011		
	August	3 Months	YTD
S&P 500	-5.4%	-8.9%	-1.8%
Russell 1000 Value	-6.2%	-11.2%	-4.0%
Russell 1000 Growth	-5.3%	-7.6%	0.2%
Russell 2000	-8.7%	-14.0%	-6.5%
MSCI EAFE	-9.0%	-11.6%	-6.0%
Emerging Markets	-8.9%	-10.6%	-8.3%
Barclays Agg	1.5%	2.8%	5.9%
3-Month T-Bills	0.0%	0.0%	0.1%

Europe's sovereign debt issues continued to cause concern amongst central bankers and investors. To calm fears, the European Central Bank purchased Italian and Spanish government bonds. Because the majority of European sovereign bonds are held by European banks, and the values of certain bonds have fluctuated greatly, investors viewed the situation as analogous to the US subprime mortgage bond market, which caused banks in the US and Europe to raise capital levels significantly.

The eastern US assessed damages from Hurricane Irene and a rare earthquake. Massive flooding across the region is expected to bring damage totals to well over \$10 billion.