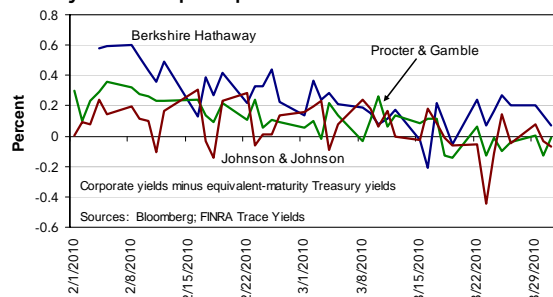


Economic Review

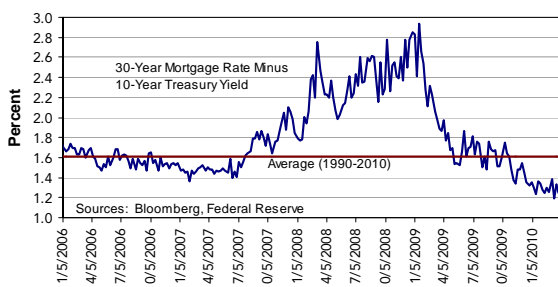
After months of public debate and falling public support, President Obama and Congress passed healthcare reform legislation in March. The bill represents a milestone in federal government involvement in healthcare. The bill includes mandatory insurance provisions for individuals, federal oversight of health insurance coverage and costs, limits on insurance coverage termination, and creates public high-risk insurance pools. The bill initially aims to raise revenues by eliminating flexible-spending account coverage for over-the-counter medicines, invoking taxes on medical device and drug companies, and raising taxes on dividends, capital gains, and other investment income for individuals and couples earning over \$200,000 and \$250,000 annually, respectively. As the bill's future costs are widely expected to rise beyond initial projections, Congress will likely pursue additional tax hikes, including an already proposed value-added tax. Companies such as AT&T, Verizon, and Caterpillar reported first quarter charges totaling over \$1 billion, as the bill ends a subsidy they had received to provide prescription drug coverage to retirees.

Treasury Yields Top Corporates



As the burden of healthcare costs weigh heavily on future budgets, Moody's and S&P issued warnings about potential downgrades to U.S. Treasury debt. With debt levels rising faster than GDP, and interest costs soon rising to over 15% of the federal budget, investors have become uneasy regarding the trajectory of borrowing and spending. Long-term Treasury yields rose to historic spreads over shorter-term issues, while bond yields on Berkshire Hathaway, Procter & Gamble, Johnson & Johnson, and Lowe's all fell below equivalent maturity Treasury bonds. Spreads between short and long-term Treasury bonds reached record levels, as the market predicted that interest rates will rise sharply in the future, due to a stronger economy and the exceptional issuance of debt. Bank profits are likely to remain strong due to the steepness of the yield curve, which allows them to borrow cheaply and buy higher yielding instruments.

30-Year Mortgages and 10-Year Treasury Yields



Interest on the federal debt will cost around \$400 billion in 2010. A one basis point increase in the financing rate for the debt will cost an additional \$1.3 billion annually in interest. A recent rise in 10-year Treasury yields pushed mortgage rates to their highest levels since August 2009. As the Federal Reserve ends its mortgage purchase plan, mortgage rates are likely to rise, given that the average spread between 30-year mortgage rates and the 10-year Treasury bond is 161 basis points. Since the Fed began purchasing mortgage bonds, that spread has fallen to 136 basis points.

States Sue Over Healthcare Mandates

- | | |
|-----------|----------------|
| ALABAMA | PENNSYLVANIA |
| COLORADO | SOUTH CAROLINA |
| FLORIDA | SOUTH DAKOTA |
| IDAHO | TEXAS |
| INDIANA | UTAH |
| LOUISIANA | VIRGINIA |
| MICHIGAN | WASHINGTON |
| NEBRASKA | |

Several states filed suit against the federal government over objections to the personal insurance coverage mandate, alleged 10th amendment violations, and abuse of the Commerce clause. The courts, rarely, if ever, overturn Congressional spending bills.

Retiring Senator Chris Dodd presented his financial industry reform package. The measure aims to increase regulation on hedge funds, derivatives, and CDOs, and creates a consumer financial oversight agency. Absent from the bill was a meaningful overhaul of Fannie Mae and Freddie Mac, which continue to add liabilities to their portfolios. Credit card reforms took effect early in the month, and included reforms to interest charges and rate changes, as well as limitations for applicants under 21 years of age. Credit card companies raced to convert fixed rate cards into variable rate cards in advance of the rules, while they also planned to introduce annual fees on a more widespread basis.

Market Returns

	As of March 31, 2010		
	March	3 Months	1 Year
S&P 500	6.0%	5.4%	49.8%
Russell 1000 Value	6.5%	6.8%	53.6%
Russell 1000 Growth	5.8%	4.7%	49.8%
Russell 2000	8.1%	8.9%	62.8%
MSCI EAFE	6.2%	0.9%	54.4%
Emerging Markets	8.1%	2.5%	81.6%
Barclays Agg	-0.1%	1.8%	7.7%
3-Month T-Bills	0.0%	0.0%	0.2%

The Federal Reserve gained a temporary reprieve from raising interest rates as the Euro continued to stagnate amidst debt troubles in Greece and Portugal. European leaders tentatively agreed to support new Greek debt, in conjunction with IMF backing. The stronger dollar provides a slowing effect on inflationary pressures. However, as the dollar's move was not predicated by positive action, the dollar still remains vulnerable to losses due to the massive increase in the Fed's balance sheet and bank reserves.

Job growth posted its strongest gains since May 2007, though the unemployment rate remained unchanged at 9.7%. The true condition of the labor market will become evident in the summer. Accounting for the census hiring, an unemployment rate around 9.3% indicates a neutral hiring environment.