INNOVEST MONTHLY MARKET COMMENTARY

December 2010

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Bond Rates	12/31/2010	12/31/2009
U.S. Federal Funds Target Rate	0.25%	0.25%
U.S. Two-Year Treasury Yield	0.60%	1.14%
U.S. Ten-Year Treasury Yield	3.30%	3.84%
U.S. Ten-Year Muni Yield	3.75%	3.69%
High Yield	7.51%	9.06%
Exchange Rates		
$ per €	1.34	1.43
$ per £	1.57	1.61
¥ per $	81.11	93.10

Latest Returns

EQUITIES Index	Dec-10	3 months	YTD	1 Year	3 Years	5 Years
S&P 500	6.68%	10.76%	15.06%	15.06%	-2.85%	2.29%
S&P 400 Midcap	6.55%	13.50%	26.64%	26.64%	3.52%	5.74%
S&P 600 Small Cap	7.66%	16.24%	26.31%	26.31%	3.02%	4.64%
MSCI EAFE	8.10%	6.61%	7.75%	7.75%	-7.02%	2.46%
MSCI Emerging Markets	7.14%	7.34%	18.88%	18.88%	-0.32%	12.78%
FIXED INCOME Index	**Dec-10**	**3 months**	**YTD**	**1 Year**	**3 Years**	**5 Years**
BC Aggregate Bond	-1.08%	-1.29%	6.56%	6.56%	5.91%	5.80%
BC Muni Bond 1-10 Yr	-0.98%	-1.91%	3.13%	3.13%	4.83%	4.60%
BC High Yield	1.81%	3.21%	15.11%	15.11%	10.38%	8.92%
BC Global Aggregate Bond	1.31%	-1.32%	5.86%	5.86%	5.86%	6.74%
CSFB Bank Loan Index	1.33%	3.30%	9.97%	9.97%	4.30%	4.41%
OTHER Index	**Dec-10**	**3 months**	**YTD**	**1 Year**	**3 Years**	**5 Years**
DJ UBS Commodity	10.69%	15.80%	16.82%	16.82%	-3.67%	1.18%
DJ Wilshire US REIT	4.74%	7.45%	28.08%	28.08%	0.01%	2.30%
S&P Developed World Property	6.87%	6.93%	21.50%	21.50%	-4.31%	2.65%
LPX 50 TR	8.61%	14.43%	31.81%	31.81%	-12.20%	-4.04%
HFRI Fund of Funds Index	1.97%	3.37%	5.45%	5.45%	-2.59%	2.38%
3 Month T-Bills	0.02%	0.04%	0.13%	0.13%	0.79%	2.43%

* Returns provided by outside vendor. Innovest not responsible for accuracy of numbers presented.

The Economy

The major headline during the month of December was the agreement reached between President Obama and the Republican leadership, allowing a two-year extension of the Bush-era tax cuts that were to expire on December 31, 2010. The compromise included a one-year reduction in Social Security employee contributions from 6.2% to 4.2%, a provision to allow businesses to fully expense investment spending in 2011, and an extension of unemployment benefits. While the market rallied on the legislative agreement, the Congressional Budget Office estimated the corresponding reduction in Federal revenue to be $857.8 billion. It now appears that the federal budget deficit will exceed $1 trillion for four straight fiscal years of 2009 through 2012.

Fourth quarter U.S. gross domestic product (GDP) is expected to recover all the output lost in the deep and lengthy recession, thereby transitioning the economy from recovery to a new expansionary phase. The ISM Manufacturing Index continued to indicate economic expansion within manufacturing businesses, holding above 50 for the seventeenth consecutive month. Early holiday shopping resulted in a 0.8% increase in November retail sales, beating expectations. On the employment front, the ADP jobs report on January 5 indicated that the private sector added 297,000 jobs in December, the largest increase since records began in 2001. This hiring helped to lower the nation's unemployment number to 9.4%. However, the recovery in employment thus far remains subpar compared to historical recoveries, and the actual unemployment rate is much higher when including discouraged and underemployed workers.

In other global news, the Irish government effectively nationalized Allied Irish Banks PLC after the nation's high court approved the finance ministry's request to inject an additional €3.7 billion ($5 billion) of capital into the troubled lender. The U.S. Treasury Department announced its intention to sell its remaining 2.4 billion shares in Citigroup, after partially monetizing its ownership in General Motors' during

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the automaker's November initial public offering.

The Market

During the month of December the Fed's second round of quantitative easing spurred a continued risk rally around the globe, by effectively depressing real yields through the purchase of $600 billion in Treasury notes. Domestic large cap equities returned 6.68% for the month, with the S&P 500 closing the year at 1258 and a 15.06% annualized return. Small and mid cap equities produced similar monthly results, up 7.66% and 6.55% respectively, and profited from a notable risk premium during the year as the U.S. economy evaded a double dip recession. International equity, as represented by the MSCI EAFE Index, outpaced domestic stocks for the month (+8.10%), benefiting from moderating fears of contagion among peripheral European countries. Emerging markets' performance was a positive 4.47% in local currency returns, as compared to 7.14% in dollar terms. China announced its intention to reduce accelerating inflation and fears of asset bubbles by raising reserve requirements for financial intermediaries and interest rates for borrowers.

Fixed income returns were pressured by rising rates. The 10-year Treasury note peaked over 3.5% intra-month, contributing to a -1.08% return for the Barclays U.S. Aggregate Bond Index. Municipal bonds also declined slightly (-0.98%) on concerns about state and local budgets and massive new bond issuance. Below-investment grade issues, such as floating rate corporate loans and high yield bonds, posted marginal gains during December on further contractions in credit spreads.

Modest gains for hedge fund of funds continue to provide strong diversification benefits and asymmetrical returns. Commodities were the strongest diversifying asset class during the month, with the Dow Jones-UBS Commodities Index returning 10.69%. Listed private equity exhibited strong return enhancing characteristics (+8.61%), outpacing global equity across all market capitalizations for the month and year.

Outlook

Nearly three and one-half years after the start of the residential housing collapse, we have begun to witness improving consumer balance sheets and a recovery of profits for financial intermediaries. The road to recovery is far from over, however, as the Fed continues to fight high unemployment and deflationary pressures in housing. Delinquencies in residential mortgages have steadily climbed, recently reaching 11%. The indiscriminate lending practices that led to the disaster in housing arguably masked a structural increase in unemployment between 2002 and 2007, as the real estate bubble artificially employed about one million additional workers. As a result, the unemployment rate has soared and the number of insured banks on the government's "problem list" has reached 3 ½ times 2008 levels. The fourth consecutive month of declines in the S&P/Case-Shiller US Home Price Index supports the concern that housing prices may continue to decline as financial intermediaries are forced to liquidate delinquent properties.

As noted in previous months corporate earnings remain the bright spot in the economy. Operating earnings for the S&P 500 are only 11.5% below the 2007 peak, as deep cost cutting has allowed incremental sales to flow to the bottom-line. Nearly $2 trillion of cash on corporate balance sheets, combined with strong free cash flow generation, has prompted companies to start buying back stock at depressed levels and increase dividend payouts. According to Goldman Sachs, approximately $275 billion of capital was used to repurchase stock in 2010, with an additional $243 billion for dividend payouts. Although analysts' estimates have largely underestimated the impact of operating leverage during the recovery, many companies are now starting to moderate expectations of future earnings growth. Sales growth may become an increasingly important part of companies' earnings prospects, as the effects of cost cutting begin to decay. Nonetheless, prospective earnings growth and moderately attractive valuations point to attractive long-term real returns for patient equity investors compared to the alternative in core fixed income.

As we enter into a new year, we remind our clients that a well diversified portfolio based on prudent investment assumptions is a key tenet of successful investing. We are in the final stages of updating our five-year outlook for the financial markets, and we look forward to discussing investment risks and opportunities with our clients in the coming weeks. As noted by renowned investor George Soros, "Markets are constantly in a state of uncertainty and flux and money is made by discounting the obvious and betting on the unexpected."

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