MARKET UPDATE

Are We Just Six Months to Clarity?

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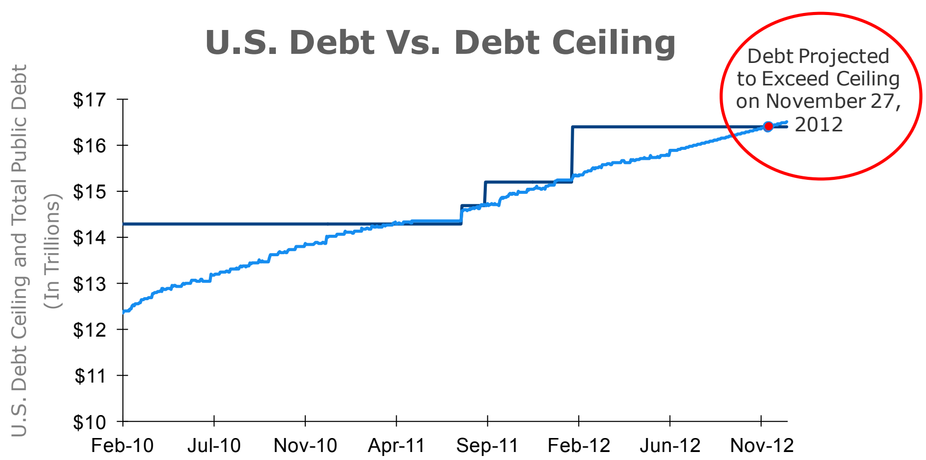
In a repeat performance of the past two summers, economic data has simply been weak. However, unlike the past two years, the second half of this year likely holds the resolution of a number of open global issues. Events transpiring in the coming months should remove some of the ambiguity investors have faced in recent quarters. In this Market Update, we discuss several unresolved issues on which we expect to gain more clarity within the next six months.

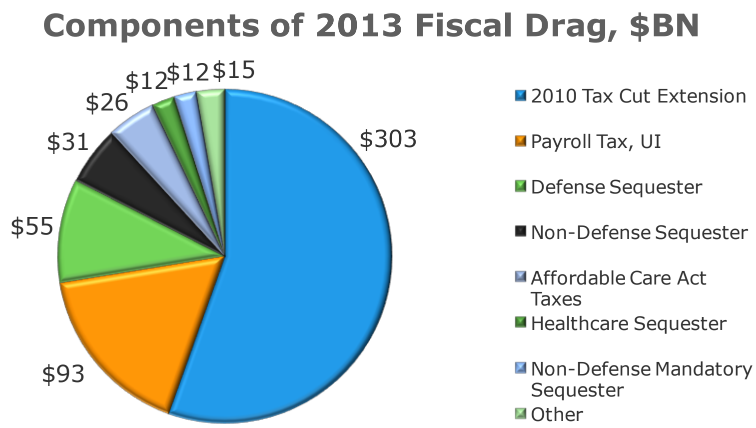
1) *U.S. Presidential Election*: The U.S. election is shaping up to be a close, brutal battle right up to election-day on November 6. Regardless of the outcome, we will know who holds the top U.S. leadership position within the next six months.

2) *The Debt Ceiling*: If federal spending continues at its current pace, we project that the U.S. will hit its debt ceiling limit in late November, requiring Congress to pass a new debt ceiling resolution during a lame duck legislative session.



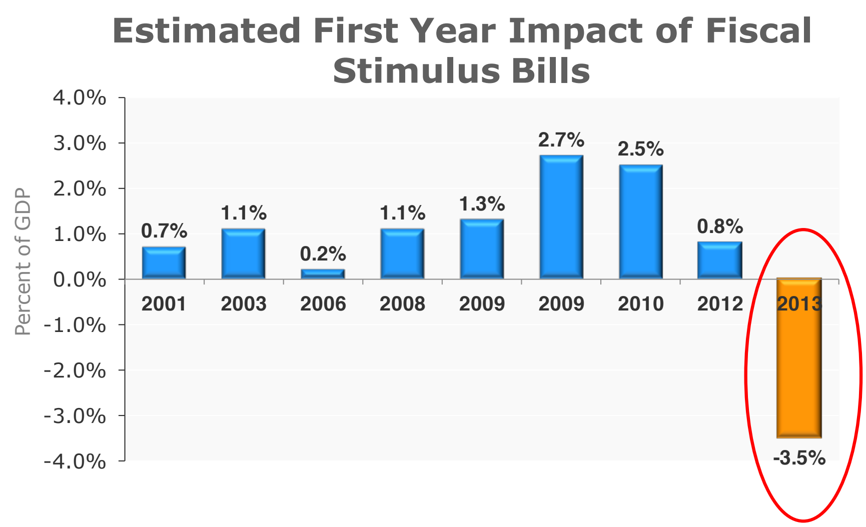
Source: U.S. Treasury Direct, 7/11/2012

3) *The Fiscal Cliff*: Unless a deal is struck by the end of this year, the Bush Tax cuts will expire on January 1, 2013, increasing the marginal tax rate for all Americans and raising the tax rates on capital gains and dividends back to their pre-Bush era levels. Taxes could also increase for some taxpayers to help fund the Affordable Care Act. At the same time, the Social Security Tax is scheduled to revert back to 6.2 percent from its current 4.2 percent and $100 billion in discretionary spending cuts take effect. Whatever the outcome, we will have more clarity on taxes and federal spending within the next six months.



Source: Strategas Research Partners, LLC, 5/2012

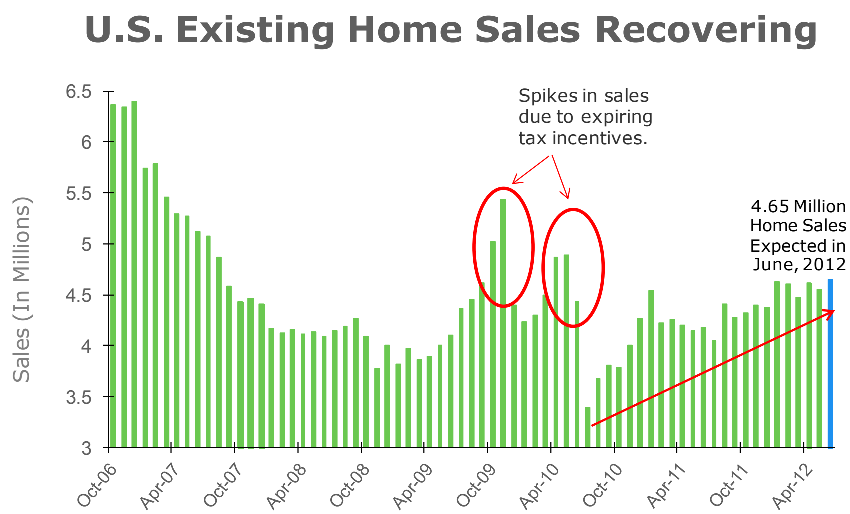
If legislation is not enacted to blunt the impact of this "Fiscal Cliff," then, collectively, these tax increases and spending cuts could erase approximately 3.5 percent from U.S. economic growth. A hit of that magnitude likely would push the U.S. economy back into recession. We likely will know the resolution plan by New Year's Day.



Source: Strategas Research Partners, LLC, 4/2012

4) *Operation Twist Will End*: The Federal Reserve recently extended its program of selling short-maturity Treasury Bills and Bonds and purchasing longer-term Treasury debt, an effort to reduce longer-term interest rates known as "Operation Twist." Unless the Federal Reserve takes additional action, the program which was originally scheduled to end in June, will run through year-end. We will know if it plans such an extension within the next six months.

5) *Housing Trends*: The U.S. housing market appears to be making a recovery. According to realtors, there are too few moderately-priced homes for sale and, in some regions, residential price wars have erupted. Within the next six months, we should have more clarity on whether this trend will result in the long-awaited turnaround for housing.



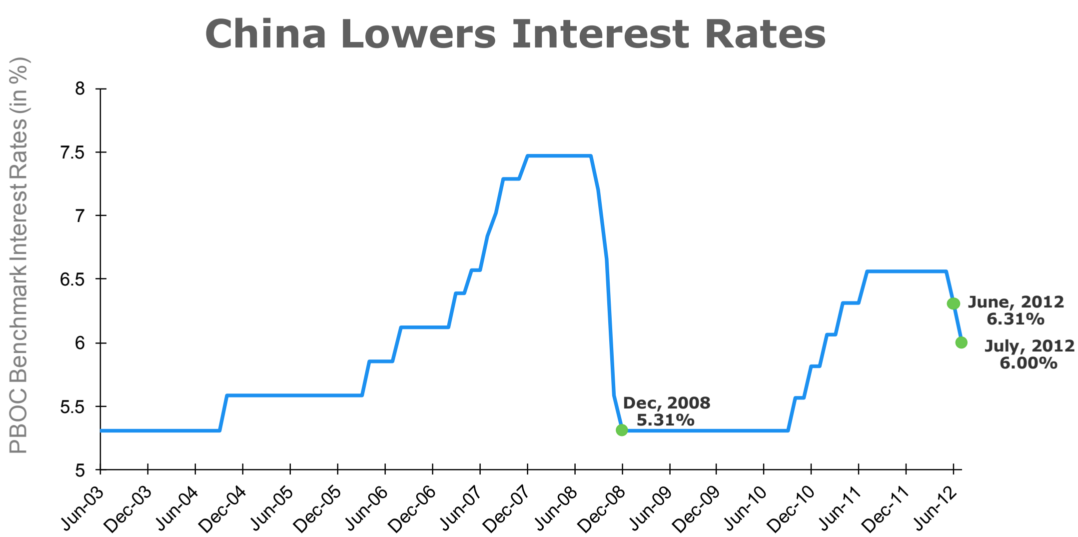
Source: Bloomberg Financial, LLP, 7/12

6) *Employment Trends*: The unemployment rate has dropped nearly a full percentage point over the past year, but job creation has begun to slow and the unemployment rate has stalled at 8.2 percent. The next six months should remove enough uncertainty to see a gradual improvement in hiring.

7) *Eurozone Bank Recapitalization*: The European Banking Authority announced that by the end of June, European banks had increased their capital reserves by €94.4 billion ($116 billion). Additionally, the European Financial Stability Fund (EFSF) will be used to assist in the recapitalization of the Eurozone's troubled banks. As a result, we expect to see healthier bank balance sheets within six months. European leaders also agreed to allow the European Central Bank (ECB) regulatory control of the region's banks within six months, although we believe this transition may take longer than projected.

8) *Greek Renegotiation or Exit*: The newly elected Greek Prime Minister, Antonis Samaras, is attempting to renegotiate the terms of his country's next loan installment from the troika (the ECB, the International Monetary Fund and European Commission). Renegotiation of lending terms is necessary because Greece has fallen behind agreed upon spending-reduction targets during two months of inactivity while the country prepared for elections. The need for the next loan installment is imminent, with Greece expected to run out of money within weeks. Mr. Samaras is pushing for a four-year fiscal adjustment plan rather than the two-year plan now in place. We expect the adjustment plan to be negotiated by year end.

9) *China Policy Effects*: Having successfully lowered its inflation rate, the People's Bank of China cut interest rates for the first time since 2009 this past May. Recently, the Chinese government also outlined specific policies to increase spending on direct investments by state-owned companies. Changes to monetary and fiscal policy tend to have a more immediate impact on emerging economies than developed economies. Therefore, we should expect to know if China has successfully arrested its economic slowdown by year end.



Source: Bloomberg Financial, LLP, 7/12

10) *Mayan Calendar End*: We are betting on the sun coming up on December 22, 2012!

Conclusion

Investors and capital markets prefer clarity over uncertainty. Recent weakness in the global economy is at least partially due to delayed economic activity in the face of so many unresolved matters. We have identified a number of issues on which we expect to receive more clarity within the next six months. Greater clarity in the economic and political environment could result in higher asset prices. As such, the months and days leading up to these important decisions may provide investors with attractive opportunities to bring their allocations in line with our current recommendations, including our suggested over-weights to emerging markets' debt and equity and high-yield debt. We believe that resolution of these issues may bring positive surprises to markets that have been weighed down by negative expectations for the better part of the year.

Data for this QMU was sourced from Bloomberg Finance, LLP, unless otherwise noted.

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