

Review and Outlook

Second Quarter 2010

Market Overview

Spill, flash and austerity are three words to best describe the events that affected the performance of the financial markets in the second quarter of 2010. The S&P 500 declined 11.4% for the quarter, ending a streak of four consecutive quarterly gains for the U.S. equity markets. The rally looked as if it would continue as the S&P 500 posted a respectable 1.6% gain for the month of April, only to be followed by losses in May (-7.9%) and June (-5.2%).

Spill. On April 20th, BP PLC's Deepwater Horizon oil rig exploded causing an oil well leak that created an oil slick in the Gulf of Mexico spanning an estimated 2,500 square miles. While this incident was not a financial market event, it will have far reaching economic effects on communities in the Gulf which depend on tourism and the fishing industry for their livelihood. In addition, companies in the energy sector will be affected by the potential for increased industry regulation and moratoriums on deepwater drilling. The S&P 500 Energy Index underperformed the broad market declining 12.7% for the quarter.

Flash. A second event leading to reduced investor confidence was the Flash Crash that occurred on May 6th when the Dow Jones Industrial Average experienced its largest intraday point decline in history (998.50 points). The index dropped over 9% before recovering the majority of its decline, including a 7% drop in 15 minutes and a temporary loss of \$1 trillion in market value.

Congress and the SEC have launched investigations to learn the cause of the crash which is believed to be tied to electronic trades that were triggered as the index dropped to a specific level. In an effort to keep this type of crash from occurring again, the SEC has implemented new rules called "circuit breakers" that will briefly halt trading of S&P 500 stocks that rise or fall in value by 10% or more in any one day.

Austerity. The third and probably the most influential event affecting the markets during the second quarter was the sovereign debt crisis in southern Europe. Several countries in the European Union watched their credit ratings fall as spending on social benefits, pensions and salaries for public employees over the past decade ballooned out of control. In several cases government deficits had grown to more than 100% of gross domestic product.

In order to stave off concerns of contagion in the region and stabilize the European bond markets, the European Union with the backing of the International Monetary Fund arranged a 750 billion rescue fund called the European Financial Stability Facility. Approval of the fund required strict austerity measures from each member country and has threatened global economic growth. Eurozone policy makers will have to make the difficult decision between adopting fiscal austerity to calm the bond markets and continued deficit spending to bolster economic recovery.

While these events led to negative equity performance in the first half of the year, companies that 1) demonstrated financial stability; 2) appealed to the consumer; 3) saved on healthcare costs; 4) participated in global growth; or 5) improved operating efficiencies, performed well. In our portfolio we saw positive contributions from a number of stocks including: Berkshire Hathaway (+21.3%); Apple Inc (+19.4%); Express Scripts (+8.8%); Caterpillar Inc (+6.8%); and EMC Corp (+4.8%).

Economic Review

Economic news was a mixed bag in the second quarter as we received positive data about corporate earnings, consumer spending and personal incomes, but the housing market and unemployment continued their strangle hold on growth. In June, the Commerce Department released

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their final report on GDP for the first quarter indicating the U.S. economy grew at a 2.7% pace from January – March. The U.S. has now experienced growth for three quarters in a row after declining for the previous six. Growth was driven by consumer spending, which rose 3%, and business investments in inventory and technology.

Despite the debt crisis in Europe and sustained levels of unemployment, consumers continued to shop. Personal consumption was up 0.2% in May, beating consensus estimates. The growth in spending can be attributed to rising wages and salaries. Personal incomes increased 0.4% in both April and May.

Another driver of growth over the first half of the year was corporate profits. Profits have risen 8% this year and are up 34% from this time a year ago. This was the largest year-over-year gain in corporate profits since 1984. A major contributor to growth in profits at U.S. companies was sales to emerging market countries. In a speech on June 25th, the CEO of Caterpillar Inc. said his company sees the global recovery coming to fruition and is anticipating a 25% rise in revenue this year due to surging demand for equipment in developing nations.

As we mentioned earlier, there are reasons to be optimistic about the economy going forward, although unemployment and a stagnant housing market continued to thwart a return to pre-recession levels. Payrolls rose in April and May, but declined for the first time this year in June. While the unemployment rate declined from 9.9% to 9.5% during the second quarter, it was primarily due to temporary census hiring and people dropping out of the workforce rather than the creation of new jobs.

The housing sector was strong in April as both new and existing home sales rose for the month, but it appears the strength was due to the expiring home-buyer tax credit rather than the beginning of a trend. May's housing numbers were dismal as new home sales fell 32.7% to an

annual rate of 300,000, which was a record low dating back to 1963. The average price of a new home declined 4.1% versus a year ago indicating the amount of supply in the market may still be too high-compared to the number of willing and able buyers.

Broadway Portfolios

In light of the volatility brought on by the events of the last three months, we remain steadfast in our goal to invest in high quality assets with appropriate risk/reward characteristics and monitor our client portfolios for ways to reduce volatility, whenever possible.

We are achieving our goal by: 1) staying broadly diversified across all equity styles (large, mid, small-cap and international). Mid and small-cap stocks have outperformed large-cap year-to-date; 2) scanning our stock and bond portfolios for companies affected by the oil spill, European debt crisis or other significant events and making changes if risk/reward scenarios become undesirable; and 3) adding alternative assets including hedge funds, commodities and gold that have low correlation to stocks and bonds in order to reduce the volatility of returns over time.

Index	YTD	1 Year	3 Years
Dow Jones Industrials	-5.0%	18.9%	-7.4%
S&P 500 Index	-6.7%	14.4%	-9.8%
EAFE*	-12.8%	6.6%	-12.8%

*EAFE = Europe, Australia, & Far East International Index

2 Year Treasury Bond Yield as of 6/30/10	0.61%
2 Year Muni Bond (AAA) Yield as of 6/30/10	0.50%

