

## Review and Outlook

### Fourth Quarter 2010

#### Market Overview

Two thousand and ten was a strong year for financial markets in general. According to Bloomberg, this was the first year since 2005 that stocks, bonds, commodities and the U.S. dollar each achieved positive returns. The U.S. equity markets proved their resiliency posting a double digit gain for the second year in a row, while shrugging off multiple headwinds such as the oil well leak in the Gulf of Mexico, the sovereign debt crisis in Europe and the Flash Crash in early May.

With a gain of 15.1% in 2010 and 26.5% in 2009, the S&P 500 posted its largest two-year advance since the technology boom in 1998-1999. Appreciating 6.5% in December, the index rose above the 1,251 mark for the first time since September 12, 2008, the last trading day before Lehman Brothers filed for bankruptcy. Through year-end the index had risen 93.1% (including dividends) since dropping to the bear market low in March 2009 (source: BTN Research).

All ten sectors of the S&P 500 had positive returns with growth-oriented sectors outperforming more defensive sectors. Consumer Discretionary stocks led the way with a 27.8% gain, followed by Industrial and Material stocks with 26.7% and 22.3% gains respectively. Utilities (+5.5%) and Healthcare (+2.9%) were the only two sectors not to reach double-digit gains on a total return basis.

Among equity styles, small and mid-cap were the best performers in 2010 as the Russell 2000, a proxy for small-cap stocks, posted a gain of 26.9% and the S&P 400 Mid-cap index rose 26.6%. On an international basis, sovereign debt concerns continued to hamper growth in Europe offsetting strength in Asian markets and limiting the MSCI EAFE to a gain of 8.4%. Emerging market stocks enjoyed another strong year with a 19.0% return despite Chinese government efforts to slow growth in that country due to the fear of higher inflation.

Investors regained some confidence in equities in the second half of 2010 as prospects for bond returns became paltry and corporate earnings continued to rise. According to Bloomberg data, more than 70% of companies reported profits that beat analyst estimates in the third quarter. This was the sixth period in a row that a majority of U.S. companies beat projections and the longest streak since at least 1993.

Strong equity performances in Broadway portfolios for 2010 included: Consumer Discretionary sector – Target Corp +26.3%, Nike Inc +31.2% and McDonald's Corp +26.9%. Industrials sector – Caterpillar Inc +68.7%, Emerson Electric Co +38.0% and Ingersoll-Rand Plc +32.8%. Materials sector – Du Pont +54.5% and PPG Industries Inc +48.4%.

#### Economic Review

At the beginning of 2010, economic pundits couldn't agree on what the biggest risk was to the global economic recovery. Some feared the looming threat of significantly higher inflation from heavy monetary stimulus and consistently high government deficits, while others promoted fears of deflation and faltering growth as they referenced the sovereign debt woes in Europe. In the end, economic growth was just hot enough to keep the recovery on track while at the same time moderate enough to keep inflation at bay.

In the U.S., the main topic was continued economic growth but at a slower pace. GDP growth had slowed from 5% in the 4th quarter of 2009 to a median estimate of 2.5% for the 4th quarter of 2010. After a policy meeting on December 14th, Federal Reserve officials stated that "The economic recovery is continuing, though at a rate that has been insufficient to bring down unemployment". High unemployment was the determining factor for the Federal Reserve following through with a plan beginning in November to purchase \$600 billion in Treasury securities to help further stimulate the economy.

While it is still too early to declare the Fed's plan a success with an unemployment rate of 9.4%, there is evidence the employment outlook may have turned the corner. Claims for jobless benefits in the U.S. dropped in the week ended December 25th to the lowest level in two years and applications for unemployment assistance fell below 400,000 for the first time since July 2008. Private sector payrolls rose 113,000 in December marking the 12th consecutive monthly gain. In total, approximately 1.1 million jobs were created in 2010, which was the most since 2006.

The manufacturing sector and consumer spending provided two more areas of optimism in the 4th quarter indicating the economy may be moving from recovery to expansion. The



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Institute for Supply Management's manufacturing index expanded to 57 (a level above 50 indicates expansion) in December at its fastest pace in seven months. The institute's survey noted faster rates of new orders and production at U.S. factories due to a higher level of exports and increased holiday spending in the U.S.

MasterCard Advisors Spending Pulse reported a 5.5% rise in holiday purchases over the prior year. According to the report, this was the best holiday season since 2005. Some evidence of an improving labor market and a 4.6% increase in total cash earnings for U.S. workers this year has given consumers confidence to spend at a healthier rate.

Realizing that unemployment remains a serious headwind to sustainable economic growth, we believe the president's compromise with Congress to extend the Bush-era tax cuts in conjunction with the Fed's accommodative monetary policy should be sufficient stimulus to keep the economic recovery on track.

### Portfolio Spotlight: Commodities

Commodity returns in 2010 outpaced gains in stocks, bonds and the dollar with a return of 16.8% as measured by the Dow Jones-UBS Commodity Total Return Index. While commodities offer potential for large returns, investors must be aware that individually they are also much more volatile than equities. However, when added to a well diversified portfolio in an appropriate allocation, they may reduce the risk of the total portfolio.

Broad commodity funds have become a regular ingredient of diversified investment portfolios at Broadway. Commodity funds invest in five groups of commodities including agriculture, precious metals, industrial metals, energy and livestock. The benefits of investing in commodities are 1) a low correlation to traditional asset classes such as stocks and bonds and 2) they can serve as a hedge against inflation.

Correlation is used to describe how the prices of different assets move in relation to one another over a specified time period. Correlation values range between +1 and -1. Assets that move in tandem will have a correlation near +1, whereas assets that move in opposite directions will have a correlation near -1.

A value of zero implies there is no relationship. The table below provides a list of the correlations of major asset classes to commodities over the last 30 years.

Asset Class	Correlation
Large Stocks	0.15
Small Stocks	0.16
20-yr U.S. Gov't Bond	-0.07
Treasury Bills	-0.1
REITs	0.17
Inflation	1.00

Source: Morningstar data 1980 – 2009

From the table we can see that almost all of the values are just above zero or negative indicating that movements in commodity prices are most often different from movements of traditional asset classes. The one exception is inflation with a value of +1 indicating it is perfectly positively correlated with commodities.

Rising prices are usually considered a negative scenario for financial assets in that they can reduce the ultimate purchasing power of the assets in a portfolio. Commodities provide a hedge against inflation because they typically rise when inflation begins to rise.

When appropriate, based upon individual client objectives, Broadway is investing in broad commodity funds to reduce the volatility of portfolio returns and hedge against the negative effects of inflation.

Index	YTD	1 Year	3 Years
Dow Jones	14.1%	14.1%	-1.6%
S&P 500 Index	15.1%	15.1%	-2.8%
MSCI EAFE*	8.4%	8.4%	-6.5%

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

2 Year Treasury Bond Yield as of 12/31/10	0.60%
2 Year Muni Bond (AAA) Yield as of 12/31/10	0.62%



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