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Dear Client,

Below are brief notes about our investment plans and selected economic issues.

INVESTMENT PLANS

- On May 14th we put some cash to work in Mike's Picks through the purchase of Harris Corporation at $29.16. Harris is a global communications equipment maker, whose products include defense communications and electronics, and wireless transmission network solutions. We also sold our position in Terex on May 14th at $14.13.
- With the capacity utilization rate at a mere 68%, the unemployment rate at 9.4% (and climbing), and a rising savings rate, inflation doesn't seem to be a near-term threat to our economy. However, we believe that ultimately the amount of fiscal and monetary stimulus provided globally will result in economic growth and produce inflation. We also believe there is a good chance that the depth of government involvement in the financial and automobile industries (and possibly others) can't help but result in inefficiencies, unintended consequences, and inflationary pressures. With these thoughts in mind for the long-run, we will continue to maintain exposure to energy and other commodities.

OBSERVATIONS

Housing. Housing is not out of the woods yet and may not be for some time, but in the last few months we have seen both a leveling off in the rate of decline in some statistics and even marginal improvements. New home sales and existing home sales both reached their lows in January of this year and have improved since. Housing starts and permits reached their lows in April, but have been "bouncing along the bottom" since the beginning of the year. Additionally, pending new home sales showed surprising strength in April (+6.7%).

Light at the End of the Tunnel or the Train? Just the other day European Union leaders said they saw the first signs of a "sustainable economic recovery" and began discussing an "exit strategy" from their various fiscal and monetary stimulus programs. Also recently, John Lonsky, Deputy Managing Director of the International Monetary Fund, said he expected the IMF to raise its forecast for global growth "modestly upward". Additionally, some analysts have raised their expectations for Chinese growth from 5% upward to 7%. On the other side of the coin, the World Bank just lowered its estimate for the depth of the global recession this year to -2.9% from -1.7%. The debate continues.

Volatility. Since mid-May the VIX Index (S&P Volatility Index) has dropped to levels (30%) not seen since last summer prior to the Lehman Brothers collapse. In October and November it reached as high as 80% as the markets were in a tailspin. We view this substantial decline in volatility as an indication that some measure of confidence and optimism has returned to the equity markets. Contrary to the drop in volatility in the equity markets, price action in the US Treasury note and bond market has been violent. UST 10yr note yields rose from 2.54% on March 18th to 3.95% on June 10th! Surprisingly, that dramatic a move in rates over such a short period of time does not appear to have undermined the equity market gains since the early-March lows.

Pressure – But Not Crowding Out. The rise in US Treasury yields is putting some upward pressure on mortgage rates, but those rates have not risen as fast as the Treasury rates have. UST 5-year note and 10-year note yields rose as much as 0.96% and 0.86%, respectively, from their mid-May lows while 30-year mortgage rates rose about 0.73%. Nonetheless, it is not exactly what the housing market needs at this stage of a long-awaited recovery. The drop in corporate bond rates also seems to have paused for the time being.

Moving Averages. Although we do not trade based on technical chart formations and moving averages, many people do. Within days the 50-day moving average of the S&P 500 Index may cross above the 200-day moving average. For some investors this is a strong signal that the market is in very good shape and will continue a strong upward move. In the absence of any dramatic new economic information, this cross (should it occur) may bring fresh money into the market.

Michael A. Camp, Principal Joseph F. Hunt, Principal