

APRIL ECONOMIC REPORT

May 13, 2010

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President

Term of the Month: Le Tarp

Nickname given to Europe's nearly \$1 trillion bailout of Greece and the euro zone



Earnings, Greece and Goldman Sachs

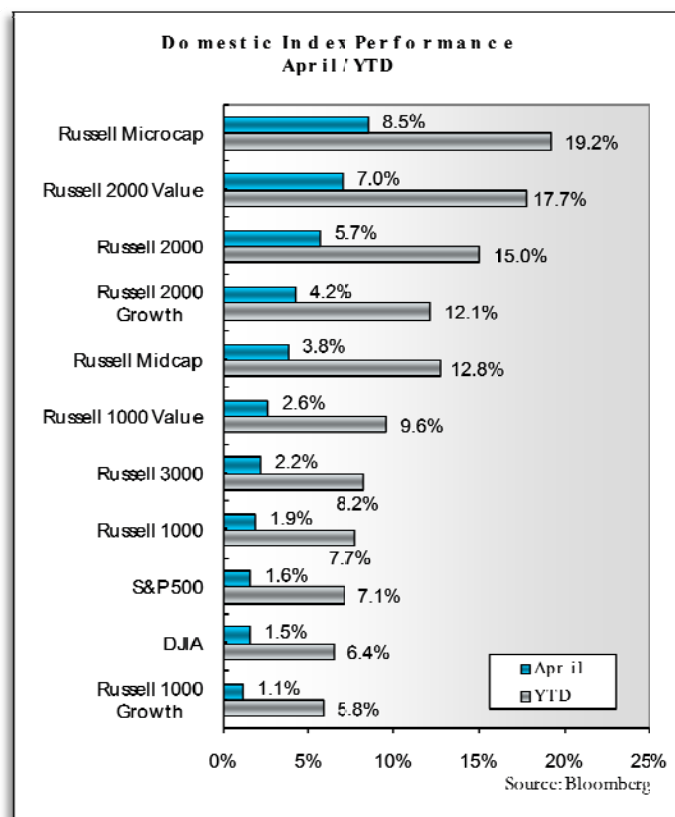
Equities continued to rally during the month, though not without a few bumps along the way. Through the first few weeks, earnings-driven optimism buoyed returns for the most cyclical sectors, with consumer discretionary leading the way, followed closely by energy and industrial. As was the case in Q1, the smallest capitalization stocks beat the largest in April, and value outperformed growth. Joining positive earnings were a set of optimistic macroeconomic releases: the first report of Q1 GDP yielded an encouraging +3.2% (3rd consecutive positive quarter); retail sales improved; unemployment held steady and applications for building permits rose.

Potholes materialized mid-month when the investment world finally acknowledged that Greek austerity provisions would not be enough to stave off bankruptcy. This, in turn, pushed “Club Med” country woes even further into the spotlight. The IMF’s updated GDP forecast exemplifies the associated strain – the US GDP forecast for 2010 was upgraded to 3.1%, while Europe’s estimate was held to a paltry 1%. Later in the month, a lawsuit against Goldman Sachs unearthed another pothole, spurring worry that hamstringing regulatory oversight was not far behind.

The good news:

- Despite increasing spreads abroad, US corporate spreads continued to narrow across the credit spectrum, highlighting the ample liquidity available to US firms.
- The number of M&A deals in Q1 2010 rose by more than 30% compared to the same period last year.
- Earnings surprised across sectors, with only energy disappointing (Exxon’s \$6.3 billion in profits was well below the \$10.9 billion expected); the 300+ S&P companies that reported so far, beat estimates by more than 13% (+7% if financials are excluded).
- Revenues also beat expectations, though by a smaller margin (+0.3%).

Earnings & Guidance: Companies that retrenched for much of last year are starting to express confidence in an economic recovery. This is best exemplified by the ratio of positive to negative earnings guidance revisions so far this year. Using the S&P 500 as the proxy and combining Q4 & Q1 guidance, yields revision ratio of nearly 9:1, which is a stark contrast to the same time last year when the ratio was an inverted 2:3. This change signals that management teams are finally starting to see the light at the end of the tunnel, which should result in increased production, capital spending and eventually hiring.



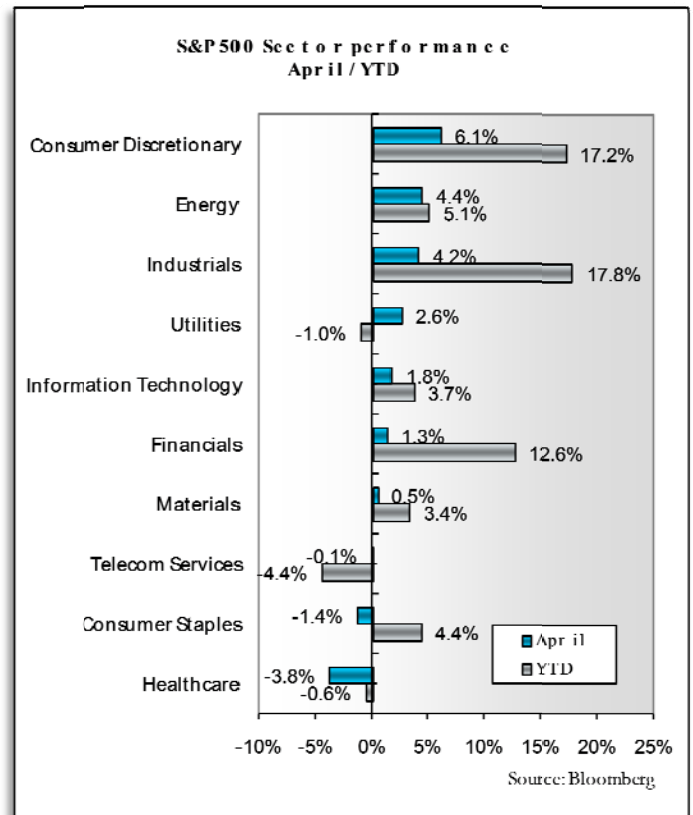


The not so good news:

- The majority of mutual fund flows continued to move into fixed income (the little that flowed into equity went into international and emerging market funds).
- Although inflation remained under control, commodity prices held an upward trend, prompting concern that corporate cost cutting, which resulted in greater operating leverage and margins, could soon be offset by rising input costs. Investors should note that current analyst expectations for S&P 500 earnings are predicated on near-peak margins.
- Despite showing the first YoY increase since 2006, S&P/Case-Shiller 10- and 20-city indices were broadly negative on a MoM basis (19 of 20 cities were lower). There could be further downward pressure due to the expiration of the homebuyer tax credit at the end of April.

Goldman Sachs provided arguably the biggest market headline during the month. On April 16, the SEC filed a civil lawsuit against the Wall Street giant (criminal allegations would require a stronger burden of proof) alleging fraud from the firm's collateralized debt obligation dealings (CDOs) during the financial panic. The lawsuit is predicated on the allegation that Goldman Sachs sold CDOs linked to faltering subprime mortgages without disclosing that a certain hedge fund was able to select and bet against the underlying securities. According to SEC enforcement director Robert Khuzami, "Goldman wrongly permitted a client that was betting against the mortgage market to heavily influence which mortgage securities to include in an investment portfolio, while telling other investors that the securities were selected by an independent, objective third party." What is interesting about the case is that it was the lack of disclosure, and not the securitization and selling of the toxic securities that was considered illegal.

In the subsequent weeks, (and since every year is an election year) instead of accepting some of the blame, lawmakers looked for villainy outside of their chambers to carry the PR burden. It should therefore be no surprise that for the remainder of the month, Goldman Sachs and its executives were dragged through the mud by Congressmen alleging that the firm partook in "dishonest" and in one Senator's opinion (Carl Levin), "sh--ty" deals. Surfacing email evidence pointing to Goldman top brass' blatant disregard for SEC rule 10b-5 (Employment of Manipulative and Deceptive Devices) did not ease the process. After rigorous neck-wrangling, it now appears more and more likely that Goldman will try to settle the lawsuit out of court. What may be more troubling for the firm is the recent criminal investigation by Federal Prosecutors, which is being conducted independently of the SEC case. If criminal chargers are brought, Goldman will have a much tougher and longer legal battle ahead. Such a case could also open the door for lawsuits involving other major Wall Street CDO players.





Regardless of the outcome, Washington's actions suggest that increased financial regulation is on the immediate horizon (expect legislation activity to pick up now that the GOP has ended their filibuster of Financial Regulatory Reform). Next, Congress will entertain floor discussions about how to curtail systemic risk in the future. And ultimately, rhetoric opposing "too big to fail" will be supported by law.

One potentially negative result of the proposed legislation is the elimination of certain derivatives (if not an outright ban, the regulation of some instruments could become so onerous that they will no longer be viable solutions). Derivatives provide additional liquidity to various markets, and their elimination may grind certain segments to a halt. Conversely, there are potential positives. One encouraging proposal requires the spin-off of Wall Street's proprietary trading desks from other operations (this should assuage debates over conflicts of interest). There is also a movement toward requiring all derivatives to be traded on an open exchange, which although initially painstaking, should provide the necessary transparency that was missing during the downfall of AIG, Bear Stearns and Lehman Brothers. We will continue to closely monitor the happenings in Washington, and report changes as they become available.

Sources: Wall Street Journal; Bloomberg; Morgan Stanley, Ritholtz.com; Thomson-Reuters; Seeking Alpha; FT.com; SEC



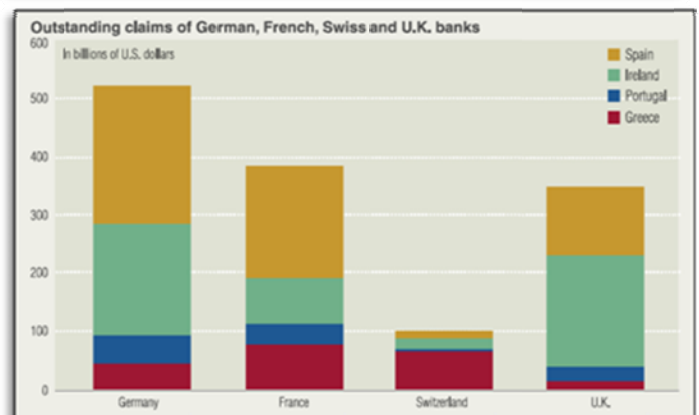
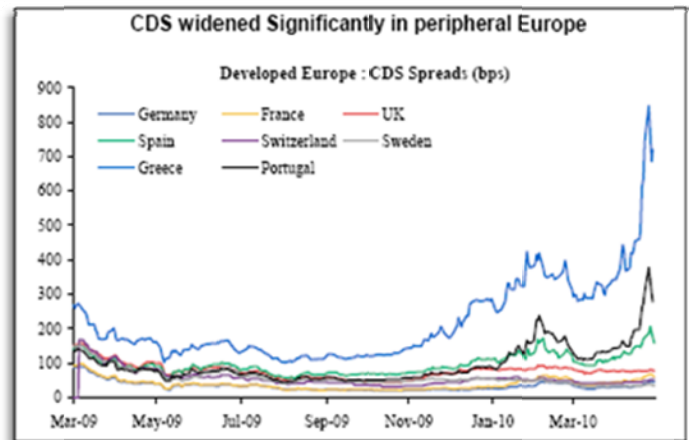
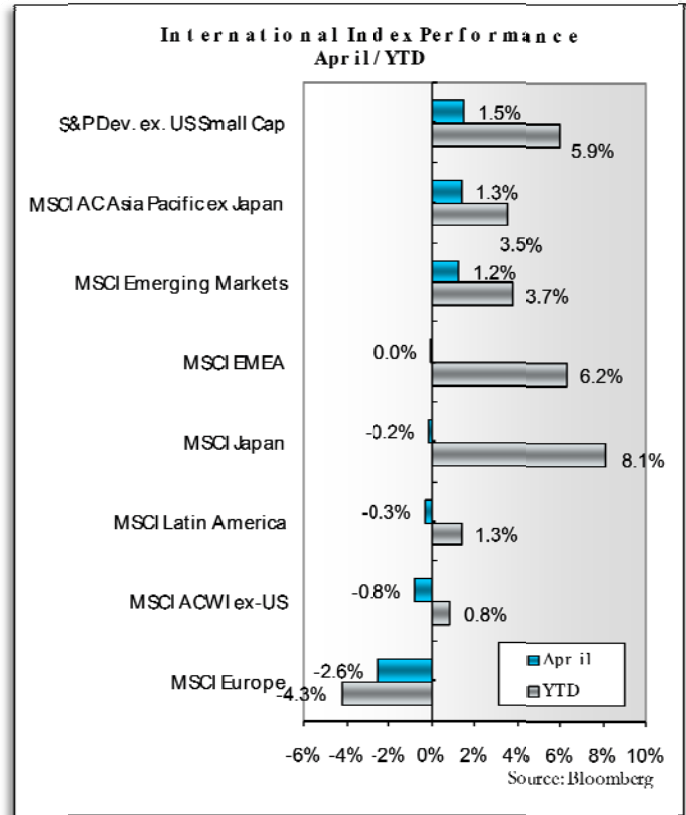


Greece Can't Hide Behind Ash Cloud

Between ash clouds and sovereign debt crises, international equities endured a volatile month in April, with the MSCI ACWI ex-US index ultimately finishing down 0.8%. Apparently subject to the whims of daily headlines coming out of Europe, 10 of the month's 22 trading days saw gains or losses at or above 1.0%. This seesawing was punctuated by a sharp selloff at the end of the month, following S&P's downgrade of Greece's sovereign credit rating to junk status on April 27th. Within a few days, the agency also downgraded Portugal and Spain's credit ratings, further amplifying investor concern about fiscal stability in the region. Accordingly, the cost of default protection surged for "Club Med" countries, with CDS spreads touching record highs for Greece (up 378 bps), Portugal (up 136 bps), and Spain (up 40 bps).

While the volcano ash cloud floating over Europe in mid-April proved disruptive to business travelers, its macroeconomic impact appears largely contained. In aggregate, earnings lost by airlines and related industries may have largely been made up in others such as bus, rental car, and rail companies. The urgency to provide relief to Greece, however, intensified following S&P's credit downgrade, culminating with a new bailout agreement between the EU and the IMF for Greece in the first few days of May. As part of the program, the ECB agreed to accept all Greek government debt as collateral when lending to banks – particularly important as any further downgrades in Greece's credit rating would have thrust the bonds below minimum standards required for such operations. The move provides implicit support for large Greek debt holders and props up Greek access to ECB funding, a key source of financing for the country's banks. As mentioned in recent flash reports, exposure to Greek and other Southern European debt among Europe's core countries is quite considerable (and apparently enough to outweigh moral hazard concerns for the remaining troubled sovereigns).

At mid-month, developed European equities actually sat in positive territory (+3.7%), before collapsing to an April return of -2.6%. This was the worst performance among major global regions. On a local basis, MSCI Europe was marginally better, declining 1.7%. European currencies did not fall against the dollar



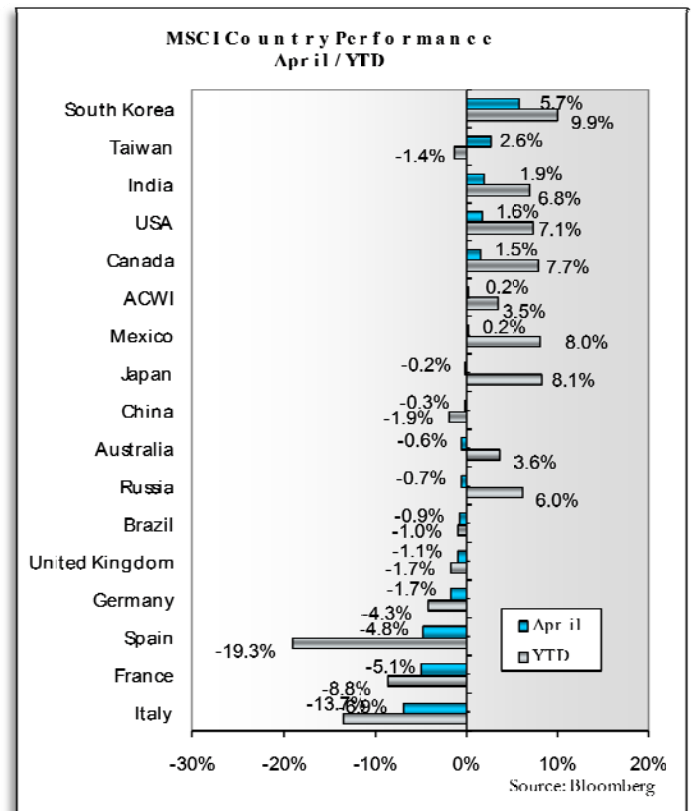
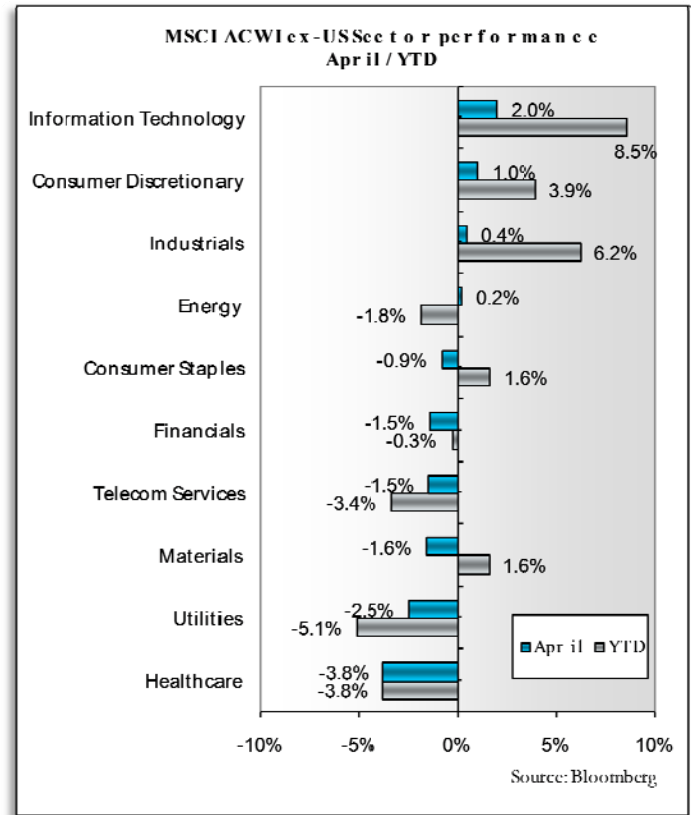


as much as one might have expected during April, with the Euro down only 0.82%, Sterling actually gaining 1.35%, and the Swiss Franc falling 0.98%. YTD, however, those currencies are all down significantly, with the Euro deteriorating by more than 7%.

Despite sovereign fears hanging over Europe, April economic data was generally encouraging, with industrial production and various economic confidence and sentiment surveys outpacing analyst expectations. Domestic demand remained weak, however, which was reflected in contracting retail sales data for the Eurozone during the month. European equities were led down in April by Greece (-11.5%), the worst performing country in the ACWI ex-US index. Predictably, Portugal (-8.7%), Italy (-6.9%), and Spain (-4.8%) also declined. Among the few in positive territory were several Nordic countries and Ireland (+8.1%). Europe has seemingly attractive trailing P/E and P/B multiples, but those valuations are likely warranted given the stagnant growth facing Europe in the near term.

Emerging markets (+1.2%) outperformed developed, though the MSCI EM index continued to face headwinds from BRIC heavyweights China and Brazil. From the BRIC group, only India (+1.9%) finished April in positive territory. Smaller export-driven economies led returns, particularly in the MSCI EMEA (Europe, Middle East & Africa) index. Three countries from the region were among the top 10 performers in April, including Egypt (+9.0% and top-spot holder), Turkey (+7.5%), and Morocco (+4.8%). Each country has provided double-digit returns YTD, but their impact has been minimal given that they comprise less than one percent of the MSCI ACWI's total market capitalization. With that said, Central and Eastern European countries cooled off in April after a strong March, with Poland and Russia turning slightly negative and Hungary posting a flat return. Emerging markets were aided by currency movements versus the dollar and euro during the month, as index returns were mostly flat on a local basis.

Japan took a breather in April, edging down slightly, but the country continues to lead major markets YTD at +8.1%. Loose monetary policy has been a tailwind for Japanese equities – the Bank of Japan left monetary policy unchanged at its April 7th meeting. Though economic data has generally been positive, the bank noted that the economy lacks “sufficient momentum to support a self-sustaining recovery in domestic private demand.” The Japanese economy continues to be an export story, with industrial production and durable goods shipments rising but private and public consumption exhibiting weakness. Valuations





remained mixed for Japan, with the market trading at a premium on a forward P/E basis (1.27x relative to developed MSCI World), but cheap on a P/B basis (0.68x relative).

Asia Pacific ex-Japan led global equities on a regional basis in April, returning 1.3%. Smaller export-oriented countries like Indonesia (+6.1%), Philippines (+5.1%), and Malaysia (+4.3%), all of which have double-digit YTD returns, continued to propel region. Among the larger components in the index, South Korea saw another strong month (+5.7%) despite reported declines in industrial production (though exports did grow 35.1% YoY in March, beating analyst estimates). Singapore gained 5.8% on a huge rebound in GDP (32.1%, fastest rate in 35 years) as manufacturing activity more than doubled. These bright spots were overshadowed by the index's largest components, however, as both Australia and China edged down. The MSCI China index now stands at -1.9% YTD, second only to beleaguered European countries in terms of the world's worst performers. Chinese export growth softened to 24.3% YoY in March, below expectations and trailing February's 45.7% increase. The country also squeezed liquidity again, with the central bank raising bank minimum reserve ratios by 50 basis points to 17% for large institutions (well above the 10% required for large US banks). The announcement came on the heels of several Chinese banks posting record profits in Q1. The \$381 billion in new lending by those banks during the first quarter was in line with 2009's torrid pace, furthering fears of a credit bubble in the overheating economy.

On a sector basis in the ACWI ex-US index, technology (+2.0%) led returns in April and remains the best performing sector YTD at +8.5%. Other cyclical areas, including consumer discretionary, industrials, and energy, also finished April in positive territory. Health care lagged as most European pharma fell alongside other stocks in the region. Materials also struggled in April, and in early May got more bad news when Australia announced it was imposing a 40% tax on its miners; the move is sure to squeeze margins for giants such as BHP Billiton and Rio Tinto. Uncertainty created by the measure (the so-called "resources super profits tax," or RSPT) may also inhibit M&A activity in the industry, hurting both domestic mid-cap miners and the foreign corporations looking to acquire them.

Looking ahead, all eyes will continue to be on Greece and Southern Europe. Greek parliament is expected to approve the conditions set forth by the bailout package sometime this week, and the country will face a severe test over the next 18 months as it attempts to rein in a budget deficit projected to be 8.1% of GDP this year (some analysts estimate Greece's costs exceed the bailout and additional financing will be necessary). The decisive step by the ECB has not appeared enough to assuage investor concerns in the first few days of May, as global markets continue to roil. Fundamentals are clearly not in play in the region right now, but skilled equity managers can use the volatility to pick up quality businesses at significant discounts. From a valuation perspective, price-to-cash earnings for Europe are seemingly cheaper at 8.5x versus the US (10.7x) and emerging markets (10.1x) as of month-end; many contrarian managers believe 2-3 year returns for high quality stocks could be significant. Given the high level of polarity in stock returns globally, we reiterate that active management is the best course of action to navigate this murky environment.

Sources: Bank of Japan, Financial Times, Bloomberg, WSJ, Morgan, Business Insider, Reuters, NYTimes



Fixed Income: "It's the economy, stupid."

Economics: Economic data continued to signal that a full-fledged recovery is underway. In early April, it was announced that March employment grew by 162,000, the first month of outsized job growth in 2 years. Consumer confidence also appeared to increase, which in turn led to solid gains in retail sales. Overall, it appears confidence is gradually pushing the economy onto more solid footing, but many outstanding concerns remain.

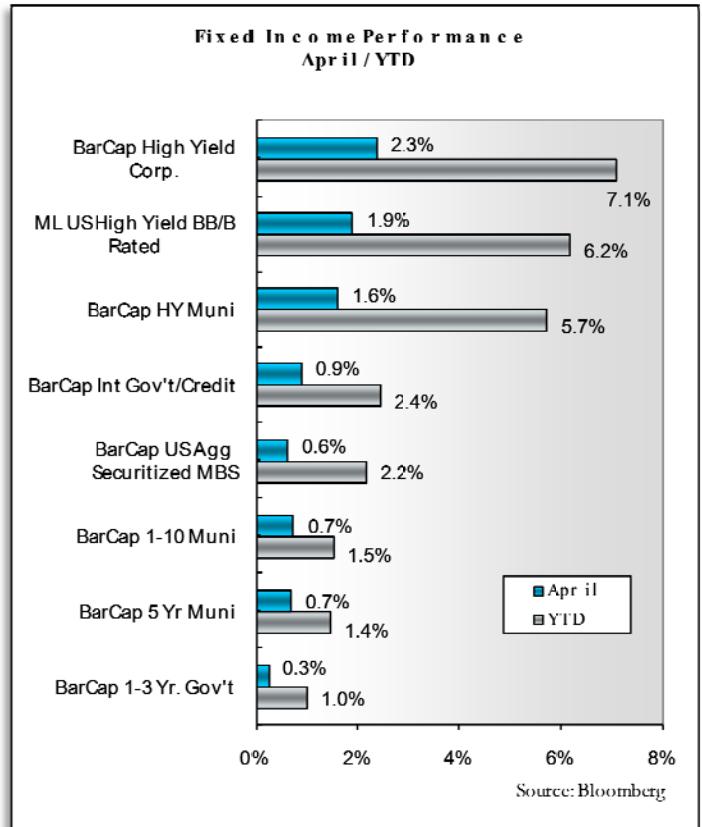
As we mentioned above, job growth reemerged at a relatively robust pace in the month of March. Average weekly hours increased slightly, but average hourly earnings fell for the first time since 2004, an indication that although the jobs market is healing, it remains far from recovered. The unemployment rate held steady at 9.7% while the underemployment rate increased to 16.9%, indicative of the number of people struggling to find more permanent or gainful employment.

Inflation figures offered a mixed picture in the month. The headline Consumer Price Index rose a tepid 0.1% and the core index, which excludes food and energy, was flat. It looks likely that consumer prices will enter a period of shallow deflation due to the weak employment picture. To the contrary, the Producer Price Index jumped 0.7% to post its strongest YoY gain in 18 months. Much of the gain was driven by stronger commodity prices, notably lumber, copper, aluminum and crude oil. Producers are currently unable to pass these higher costs on to the consumer level; something that may change quickly should the recovery prove sustainable. Conversely, higher input costs could act as a mechanism to keep growth in check no matter who foots the bill, producers or consumers.

The final area of improvement was seen in housing. The S&P/Case-Shiller Home Price Index, which measures prices in 20 metro areas, recorded a 0.7% YoY gain. Existing home sales jumped to a seasonally-adjusted annual rate of 5.35 million in March, up 6.8% over the previous month. The \$8,000 home buyer tax credit has obviously had a positive effect on home prices and sales, but its expiration at the end of April, combined with a small MoM decrease in prices, foreshadows a deceleration of positive trends.

The economy is clearly in a period of growth following a very deep recession in 2008 and the first half of 2009. The sustainability of this recovery has yet to be determined and there will be inevitable bumps along the way, as evidenced by the drama unfolding in Greece and the other periphery countries in Europe. Regardless, improvements in employment and a relatively benign inflation outlook should offer a certain degree of support to the recovery.

Federal Reserve: The regularly scheduled Federal Reserve meeting revealed little as the Fed held the Fed Funds rate between 0% and 0.25%. While the Fed indicated that economic activity "continued to strengthen," subdued inflation and additional slack in multiple industries are offsetting the improved outlook, allowing the Fed to react in a more deliberate manner.





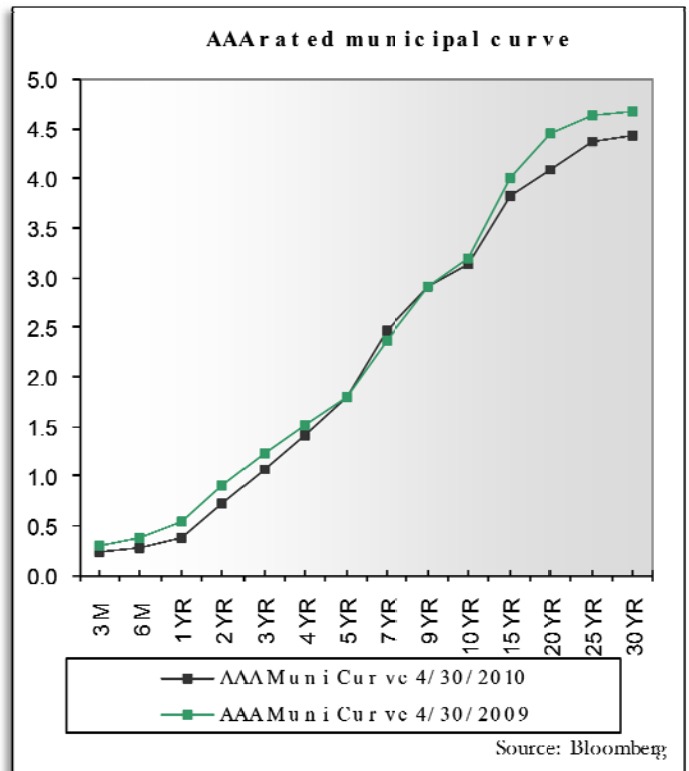
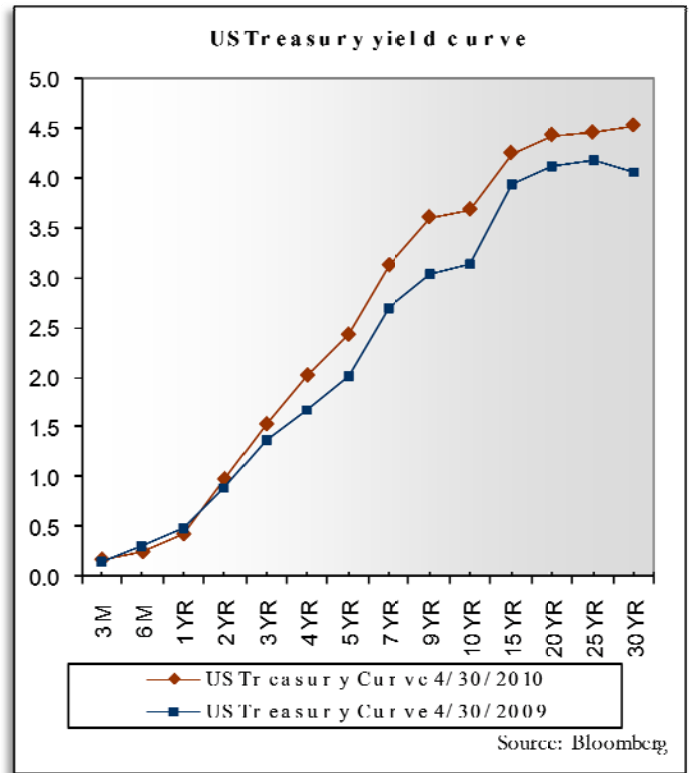
Kansas District President Hoenig remained the lone dissenter, believing that the Fed holding rates steady for an “extended period” would likely cause future inflationary pressure. Fed Funds Futures indicate that the Fed is now unlikely to raise interest rates prior to November of this year. Those expectations have been gradually pushed further into the future, so it would not be a surprise if those same futures were pushed into 2011 within the next several months.

Government Markets: Given the sovereign concerns dominating the headlines for the better part of the past month, it should come as no revelation that Treasury securities performed well in April. Registering their best return since January, the Barclay’s US Treasury index was up 1%. Yields on the 10-year Treasury opened the month at 3.83% and briefly made a run at the 4% threshold before declining for the remainder of the month and eventually closing at 3.66%. Looking across the entire term structure, the curve flattened a bit with yields falling 15-20 basis points across the curve, with the exception of 2 year bond which fell 10 basis points.

All of this is good news for the Treasury Department, which is expected to sell \$351bln of securities in the second quarter, based on a survey of primary Treasury dealers. In addition given the Treasury departments desire to extend the duration of its liabilities, lower yields across the curve are very helpful. The government will provide its borrowing expectations in the coming week, but regardless, it appears that the level of borrowing is in decline from the first quarter, when the Treasury tapped the markets for \$483bln.

In review of TIPs, performance was a bit more robust relative to nominal Treasuries, as the Barclay’s TIP index produced a total return of 2.4%. Longer dated TIPs produced the most interesting result, generating a return of 4.6%; this performance is expected given the benign inflation statics forcing the implied inflation rate down. Adding fuel to the fire were falling nominal yields. When both fall, one should expect the TIPs market to outperform – and given the power of duration, it’s no wonder the long bond performed well.

Municipal Market: For the month, yields in high quality AAA munis fell modestly and the curve flattened to some degree; the 10 year muni finished the month 15 basis points lower at 2.94% while three year munis dropped just 5 basis points to 1.72%. The Barclay’s 1-10 year index produced 0.8% of total return with price and coupon generating an equal





portion of this return. On a valuation basis, munis remain well priced relative to Treasuries but as we have mentioned on various occasions, the prospect of higher state and federal taxes sets a new standard for this measurement, and as such, the market may not be as overvalued as perceived.

In a repeat of the previous quarter, long duration and low quality bonds produced the best total return, as BBB rated bonds generated 2.6%, and bonds due beyond 22 years posted a 2.0% return. In retrospect, this performance is not surprising. The BAB (Build America Bond) program continues to deplete supply of longer duration, tax exempt bonds thus creating a supply demand mismatch for this area of the curve; this has been and will remain a natural tailwind in 2010. Regarding BBB bonds, as investors search for yield many continue to buy lower rated bonds, despite the gloom and doom prognostications for the muni market. In addition, the recalibration of muni ratings by Moody's and Fitch generated some spread tightening. Case in point, California GO jumped from a high BBB rating to high single A; as this change (as well as favorable revenue statistics for the state) was digested by the market, it drove spreads tighter. This favorably affected many of the BBB rated indices which have a delay in recognizing a change in issuer ratings.

Flows into the muni market have rebounded after briefly turning negative. In an annual ritual, investors liquidated holdings ahead of tax payments in March and early April. Cash has since returned to the market but is nowhere near the level seen in mid-2009. Managers seem content with new flow levels.

In a quick review of investor demand, it seems investor attention is bifurcated between a willingness to take on market risk (duration) and a willingness to take on rating risk (credit risk). In both categories investors tend to invest in extremes. In reality, those that prefer a moderate position may outperform over time given the steepness of the municipal yield curve and the valuation of A rated bonds.

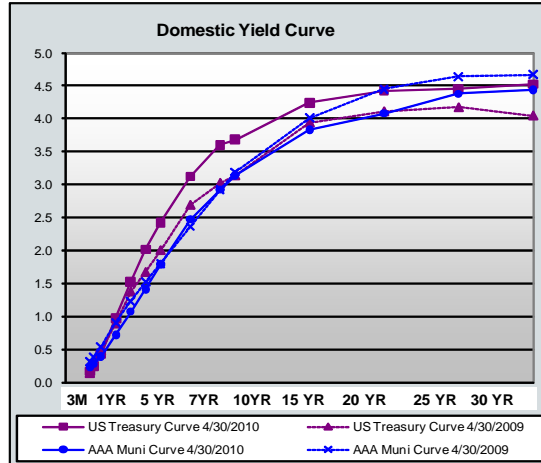
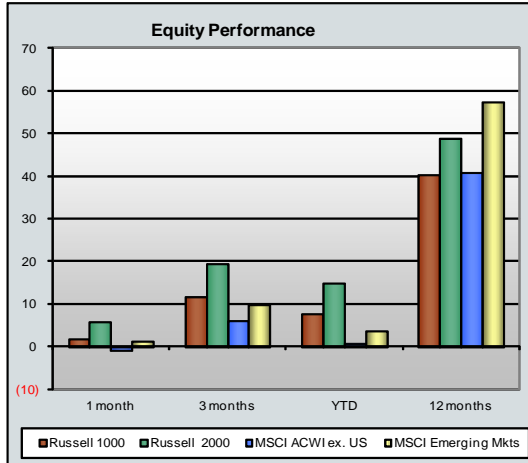
Corporate Market: Spreads continued to grind tighter and why shouldn't they? Corporate credit quality is improving, shareholder friendly activities are only just starting to pick up (share repurchases and M&A activity), cash flow remains robust, defaults are falling, and rating agencies are offering more upgrades than downgrades. In addition, yields on comparable assets are pretty paltry. The net result was a modest spread compression of 10 basis points for the Barclay's Investment Grade Corporate index to 143 basis point, and 10 basis points for the high yield index to 548 basis points. Relative to 10 year averages, these valuations appear high, but in the context of the market today, barring a sudden change in economic expectations, there is little reason to believe spreads will rise from here. From a total return perspective, the corporate credit markets generated their strongest monthly return of 2010 as Investment Grade bonds produced 1.8% and High Yield generated 2.3%

The leveraged loan market performed admirably although not nearly as well as the previous month or relative to their corporate bond cousins. Perhaps it was the result of tax season liquidation, or perhaps it was time for the market to take a breather, at any rate, the Barclay's loan index rose just 1% for the month.

Sources: Barclays, Bloomberg, Morgan Stanley, Municipal Market Advisors; Bill Clinton



MONTHLY PERFORMANCE FLASH REPORT
April 30, 2010



	1 month	3 months	YTD	12 months
Large Cap				
S&P 500	1.58	11.05	7.05	38.84
DJIA	1.53	10.08	6.42	38.69
Russell 1000	1.85	11.67	7.65	40.21
Russell 1000 Value	2.59	12.72	9.55	42.28
Russell 1000 Growth	1.12	10.64	5.81	38.16

	1 month	3 months	YTD	12 months
Small/Mid Cap				
Russell 2000	5.66	19.41	15.01	48.95
Russell 2000 Value	7.00	21.27	17.72	52.44
Russell 2000 Growth	4.20	17.38	12.13	45.20
Russell Microcap	8.49	22.89	19.17	54.47
Russell Midcap	3.76	16.65	12.76	50.84
Russell Midcap Value	4.50	17.76	14.55	54.39
Russell Midcap Growth	2.97	15.47	10.87	46.95

	1 month	3 months	YTD	12 months
International Markets				
MSCI EAFE	(1.73)	3.76	(0.80)	35.02
MSCI ACWI ex. US	(0.81)	6.00	0.83	40.97
MSCI Europe	(2.58)	1.75	(4.25)	34.10
MSCI Japan	(0.15)	6.07	8.08	25.72
MSCI AC Asia Pacific Ex - Japan	1.33	10.42	3.47	55.86
S&P Dev. ex. US Small Cap	1.46	8.11	5.94	48.25
MSCI Emerging Mkts	1.23	9.82	3.72	57.55
MSCI EMEA	(0.01)	6.92	6.24	60.80
MSCI Latin America	(0.33)	11.19	1.33	67.88
MSCI Frontier Markets	0.06	13.93	11.51	35.91

	1 month	3 months	YTD	12 months
Sectors (S&P 500 GICS)				
Consumer Discretionary	6.10	20.66	17.17	51.84
Consumer Staples	(1.38)	5.50	4.36	29.77
Energy	4.45	10.04	5.10	29.03
Financials	1.35	14.24	12.65	51.62
Healthcare	(3.83)	(1.05)	(0.56)	30.34
Industrials	4.15	19.16	17.77	52.73
Information Technology	1.79	13.28	3.73	43.49
Materials	0.47	13.10	3.36	36.12
Telecom Services	(0.11)	4.11	(4.42)	8.24
Utilities	2.63	4.14	(1.00)	23.42

	1 month	3 months	YTD	12 months
Fixed Income				
BarCap 5 Yr Muni	0.67	0.83	1.44	5.51
BarCap HY Muni	1.58	4.11	5.71	27.56
BarCap 1-10 Muni	0.72	0.94	1.50	4.91
BarCap US Treasury 1-3 mo.	0.01	0.02	0.03	0.11
BarCap 1-3 Yr. Govt	0.26	0.25	0.98	2.05
BarCap Int Govt/Credit	0.87	1.02	2.43	7.37
BarCap High Yield Corp.	2.34	5.74	7.07	42.58
Citigroup High-Yield	2.24	5.20	6.37	40.28
ML US High Yield BB/B Rated	1.87	4.80	6.16	33.74
BarCap US Agg Securitized MBS	0.60	0.81	2.15	5.54
JPM EMBI+ Composite	0.67	4.45	4.31	21.90

	Latest Month end (4/30/2010)	3 Months ago (1/31/2010)	Latest Year end (12/31/2009)	12 Months ago (4/30/2009)
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	Latest Month end (4/30/2010)	3 Months ago (1/31/2010)	Latest Year end (12/31/2009)	12 Months ago (4/30/2009)
Currency				
U.S. Dollar Index Value	81.87	79.46	77.86	84.61
USD vs. Yen	93.85	90.27	93.02	98.63
Euro vs. USD	1.33	1.39	1.43	1.32

	Latest Month end (4/30/2010)	3 Months ago (1/31/2010)	Latest Year end (12/31/2009)	12 Months ago (4/30/2009)
Commodities				
Gold (\$ per troy ounce)	1179.20	1080.85	1096.95	888.20
Crude Oil (\$ per barrel)	86.15	72.89	79.36	51.12

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