

SEPTEMBER ECONOMIC REPORT

OCTOBER 6, 2010

Barry Glassman, CFP®, CFS
President

Term of the Month: Pushing a String

A metaphor coined by Economist John Maynard Keynes. While the Fed can use monetary policy to cool down economic growth (pulling on a string), there is only so much it can do to stimulate growth (pushing on a string).



US Equities: Volatility Continues

Volatile is probably the best way to define a quarter in which domestic equities enjoyed their 5th strongest July on record, up 7% followed by their worst August since 2001, down 5% only to rebound in one of the strongest September months in more than 70 years up 9%. However, a closer look at the nearby fund flows chart shows that the number of investors able to stomach the volatility motion sickness diminished during the quarter. U.S. stock fund flows were again negative, with much of the money going into fixed income funds.

Flash Crash Explained: The SEC finally came out with the results of an investigation into the May 6th flash crash. The release cited that a single trade involving 75,000 e-mini future contracts on the S&P 500 worth approximately \$4.1 billion sparked the market decline – e-mini futures allow for the purchase of every stock within the S&P 500 with little margin. The report did not comment on new regulation surrounding such derivative activity, but a follow-up response is surely in the cards.

Looking Ahead: The weakening of the US Dollar could favor large cap companies, defined as those with over \$5 billion capitalization. According to Bespoke, since the dollar's peak on June 7th, companies with more than 50% of their sales outside of the US are up 13.9% compared to +8.0% for domestically-oriented firms. Since large cap companies tend to have more overseas exposure relative to small caps, a cheaper dollar becomes an advantage for large cap multinationals.

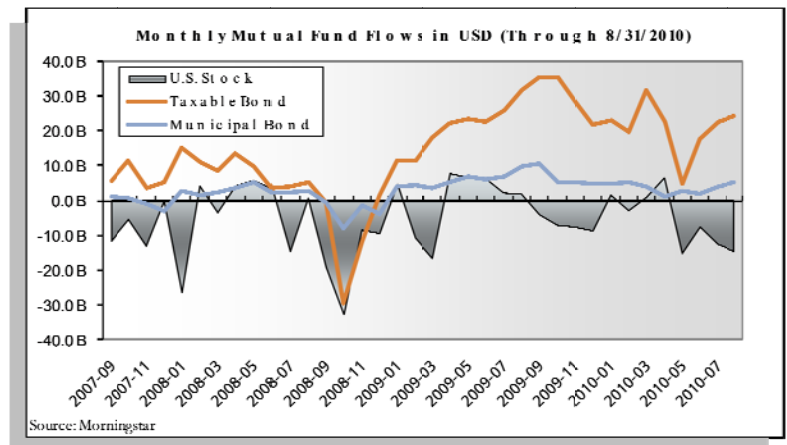
US Sectors:

Telecom: Telecom stocks, which make up a small portion of the US investment universe (<5%), were the biggest winners in third quarter. The 5%+ dividend yield (highest of any S&P sector) also makes the sector attractive to yield hungry investors. With the proliferation of Smartphones, new releases by iPhone, BlackBerry and Droid and increased data usage, telecom companies are enjoying stronger profit margins.

Materials: The materials sector also enjoyed a strong quarter, primarily due to increased merger and acquisition activity like BHP's bid for Potash Corp, continued demand for basic materials from China and a falling US Dollar. The commodities sector, as defined by the DJ UBS Commodities Index, rose 11.6% in the third quarter. Basic materials were large drivers with Copper and Aluminum up 23% and 18% respectively.

Every other sector, with the exception of healthcare and financials, finished the quarter in line or ahead of the broad index.

Healthcare: Healthcare stocks were affected by falling consumption of healthcare goods and services in the third quarter. The reasons for the decline are multifold, but at least part of the blame falls on sustained unemployment and rising deductibles, both of

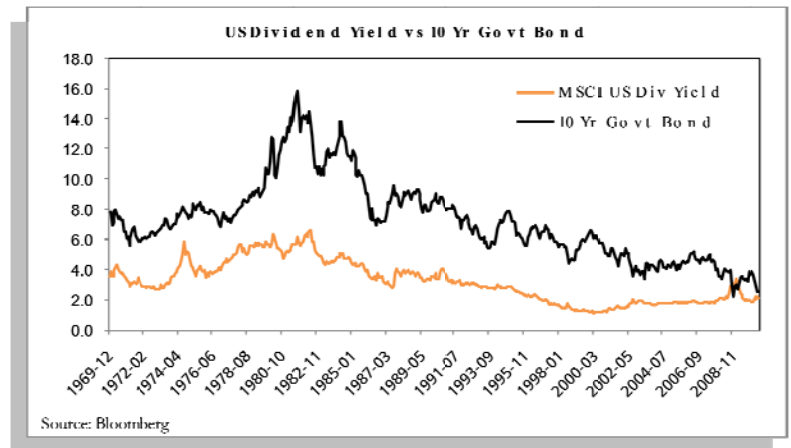




which have resulted in less frequent doctor visits. According to the Bureau of Economic Analysis, healthcare spending is down through the first two quarters of 2010, and is on pace for its slowest growth since the 1950s.

Financials: Much of the relative weakness in financial stocks is due to regulatory uncertainty. The passage of financial reform created new bureaus, councils and committees whose aim is to protect consumers, end “too big to fail”, and increase the powers of the Commodities Future Trading Commission (CFTC) and SEC. For example, the SEC will now take over monitoring responsibility for hedge funds, as well as credit rating agencies. As a result, many fear that additional bureaucratic requirements will squeeze the profit margins of financial companies.

Looking Ahead: With dividend payouts rising and fixed income yields at generational lows, investors can now purchase equities with comparable yields to bonds but with the benefit of potential price appreciation. If we should see the flow of funds reverse course and move from bonds back into stocks, we can expect stock prices to rise.



Sources: Standard & Poors, JP Morgan, Bespoke, Morningstar, ICI; SeekingAlpha; Bloomberg; NAREIT; MSCI

Fixed Income: Fear of a Bubble?

Economy on the Mend: Economic data during the third quarter showed indications of gradual improvement, with the exception of areas such as housing. Despite fears earlier in the year that the economy would enter into a second recession in short succession to the first, the reality for the moment is that while yes, growth is slowing, a double-dip is unlikely for the time being.

Housing Hurdles: The story of the quarter was obviously housing. With consumers unwilling or unable to relocate to a new home, housing markets will continue their stagnant pace, requiring government support. Existing home sales fell to all-time lows in July after a 27% month-over-month decline. Sales subsequently recovered 8% in August, but the decline in median home prices accelerated, falling to \$178,600. Those price declines are occurring despite the fact that prices are already 25% below the 2007 peak.

There is little reason to be optimistic about the future of housing for two reasons in particular. First, only 1.9% of the individuals surveyed by the Conference Board consumer confidence survey anticipate purchasing a home over the next six months. That is near levels last seen in 1970. Second, the amount of housing inventory flooding the market is on the rise given weaker sales. In August, the month's supply of housing spiked to 11.6 months based on current sales rates.

It will take a considerable amount of time, and a combination of lower prices and higher activity for inventory to decline. Lower prices are realistic, but higher activity will be more difficult to encourage.



Federal Reserve: The Federal Reserve held two notable meetings during the quarter. On August 10th, the Fed announced that it would reinvest cash flows from agency and mortgage-backed debt into Treasury securities with a maturity between 2 and 10 years. This is not considered to be a direct form of quantitative easing, but is an indication by the Fed that it is more than willing to intervene in the event that the economy experiences a second downturn.

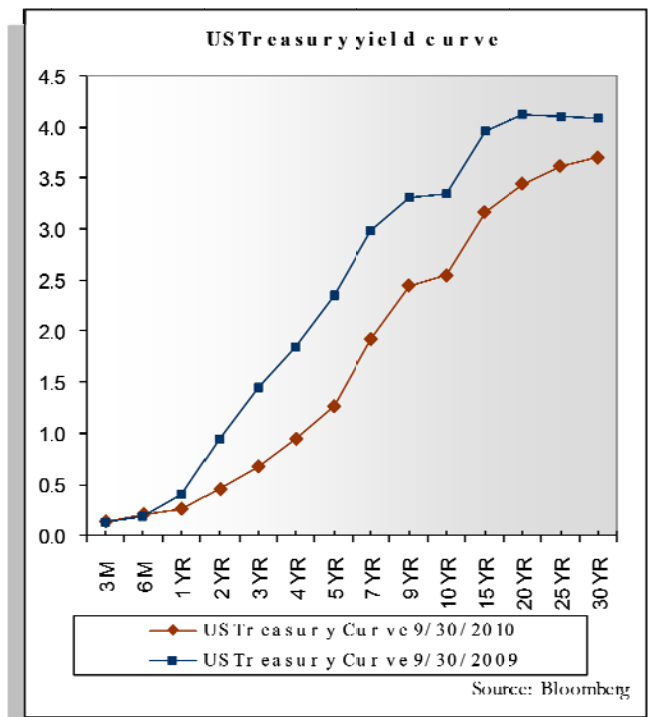
However, by the September 21st meeting, the Fed turned slightly more negative on the economic outlook, noting the “recovery in output and employment has slowed in recent months.” The Fed’s greatest concern at the moment seems to be the possibility of deflation, a fate they are extremely keen on avoiding. Investors should anticipate that the Fed will engage in additional asset purchases also known as quantitative easing within the next several months.

Demand for Treasuries Still High: In recent weeks, the popular business media latched onto the idea that the bond market is in a bubble, and the hard facts certainly lend support to the notion. The market is very well bought with \$375 billion placed into bond funds last year and another \$210 billion invested in 2010. Foreign investors continue to invest in the US bond markets placing \$373 billion into Treasuries in 2010. The Fed is also heating up demand by promising to maintain the size of its balance sheet through principal re-investment, and its readiness to step up quantitative easing should the US economy further deteriorate. This continued demand, whether actual or expected has caused a drop in the 10-year Treasury yield to 2.5%, resulting in a half of a percent decrease since the end of the second quarter and a full 1.35% lower than at the beginning of the year. In terms of returns, it seems those that invested early in 2010 were the smart money with the Barclay’s US Treasury index up 7.2% for the first nine months of the year and 2.7% for the most recent quarter; an impressive performance, particularly year-to-date.

Bond Bubble?: At this point, should investors expect a sharp increase in rates? Is the market in a bubble? This is up for debate. Certainly the Treasury market is prone to sharp moves – case in point, take a look at 2009, 1994 and 1987. As we look ahead, rates could rise as economic stability sets in. However, unless we experience a severe economic adjustment, sharp moves seem unlikely. So what could be an impetus for a sharp change?

- A sudden end to the implication of quantitative easing which forces investors to reevaluate demand (not likely in the near term).
- A sharp rise in short rates allowing investors to sell long term holdings in favor of money funds (again not likely).
- A change in the perceived position of the US in the global economy (who knows when and if this occurs).

Until a shock of this type hits the rates market, expect more of the same with perhaps some gradual moves towards higher interest rates. Should rates increase gradually; this will lead to only minor losses - or perhaps breakeven type performance - for those invested in short to intermediate bonds. Meanwhile, the bubble talk is more headline noise and a grab for reader’s attention.





Municipal Market: For the quarter, the Muni market followed Treasuries with falling rates. Remember that when rates decline prices rise. This led to solid performance in the quarter with the Barclay's 1-10 year index up 2.4% for the quarter. Year-to-date the Muni market is up 5%.

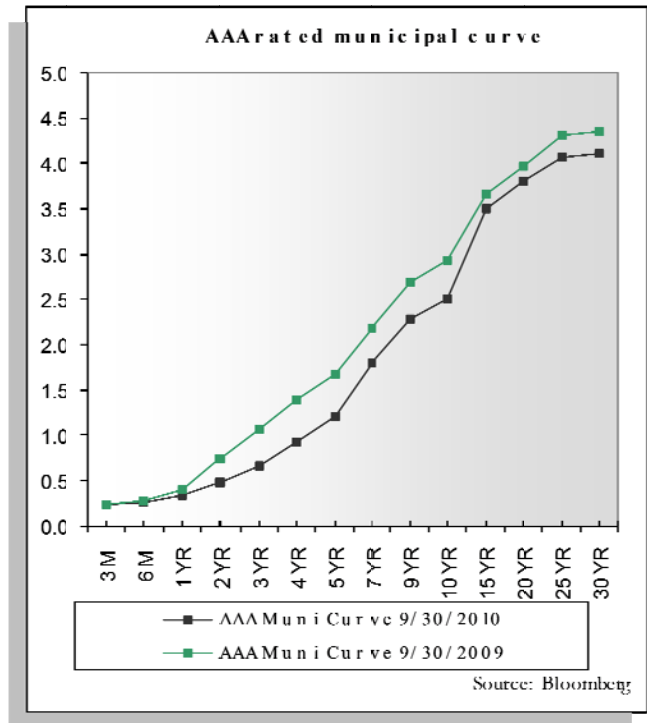
The Woes of California and Illinois: The main story in the past quarter was credit: California bumped through its yearly budgetary process, while Moody's placed a negative outlook on Illinois as it continues to struggle to pass its budget. These difficulties have driven all types of press and headlines, but the market did not show much worry. In fact despite the gloom and doom headlines regarding public pensions, stressed revenue sources and impending defaults in the municipal universe, it was lower quality Munis that continued to outperform – BBB and High Yield Munis were up 4.2% and 4.5% respectively in the quarter.

While defaults are elevated, high quality investors are mostly insulated from these difficulties.

Corporate Bonds:

The quarter was busy in the corporate markets. Demand for corporate debt remained strong as investors searched for yield, and credit metrics suggest that corporate issuers are the healthiest they have been in some time. Corporations took advantage of the "low yield" environment issuing \$612 billion in investment grade and \$190 billion in high yield bonds. The one 'chink in the armor' is that some of the uses of these recently-raised funds are being applied to less bond -friendly activities such as share buy backs or dividend payouts. While these activities reward the shareholder, they do not produce revenue for companies.

Sources: Barclay's, Bloomberg, Cumberland Advisors and Municipal Market Advisors





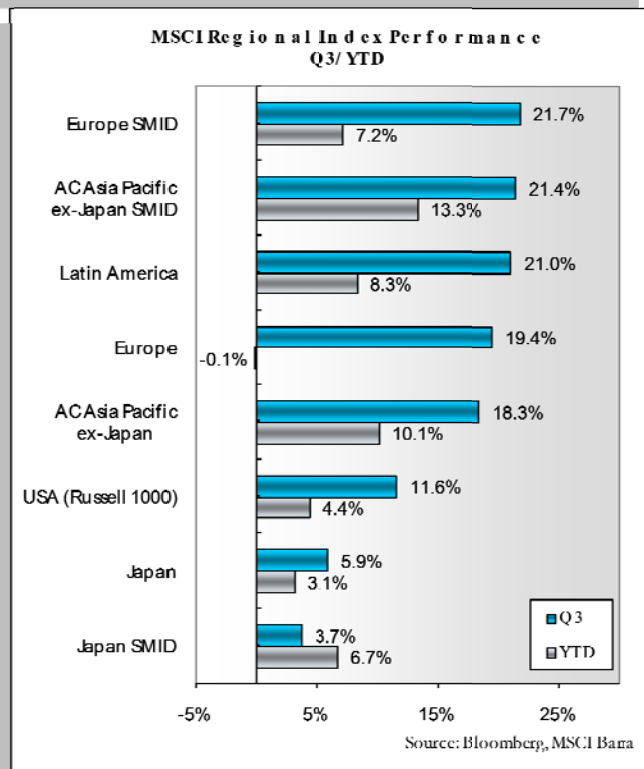
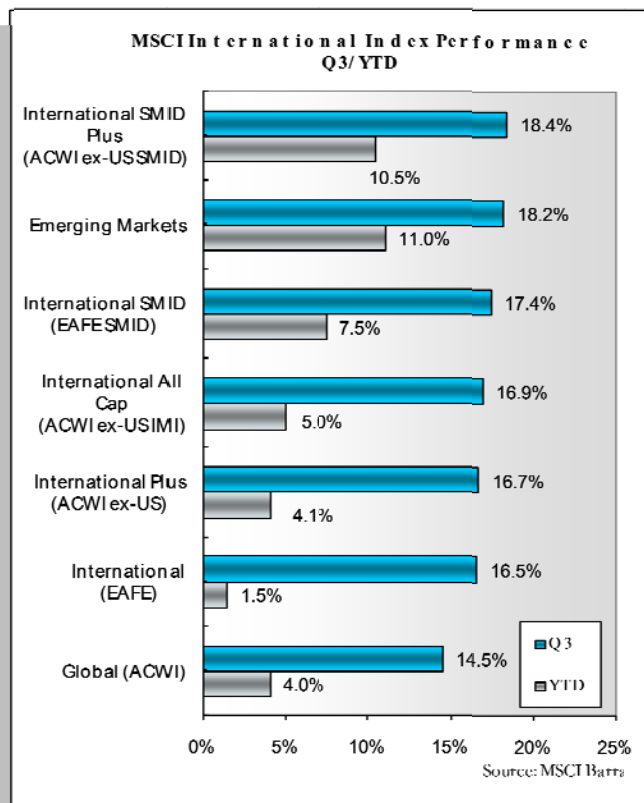
International Equities: European Stocks Bounce Back, Japan struggles

International equities outpaced US stocks in the third quarter, with the broad MSCI ACWI (All Country World Index) ex-US returning 16.7% for the quarter versus 11.3% for the S&P 500. Developed Europe (+19.4%, reflecting a +10% currency rebound) and Emerging Markets (+18.2%) drove performance, while Japan (+5.9%) was a relative drag on the broad index. Ireland (-3.4%), plagued by renewed concerns surrounding an undercapitalized banking system, was the only country to underperform Japan for the quarter. Overall, investors had reason to be euphoric during the quarter – every country but Japan, Ireland, and Morocco (+8.4%) delivered double digit returns within the ACWI index. Through the first nine months of 2010, international and US equity returns are fairly close, with the ACWI ex US up 4.1% and the S&P 500 up 3.9%, while developed non-US equities are lagging behind at +1.6%.

Ireland: On September 30, the Irish government acknowledged its largest banks needed nearly double the initial amount of estimated capital roughly €6.8 billion or \$74 billion (some of which will be underwritten by the country's pension reserve fund). As a result, and compounded by the large size of the Irish banking system relative to its economy, Ireland's budget deficit will increase to 32% of GDP (instead of an earlier 12% target) and public debt to GDP will rise to 98.6%.

PIIGS and Club Med: Investors have been more encouraged by banking conditions in the rest of the "PIIGS" group, particularly in Spain where liquidity has improved in short-term repurchase markets; many of the country's larger banks joined international clearinghouses, reducing counterparty risk inherent with such transactions. The four "Club Med" countries (Portugal, Italy, Greece, and Spain) each posted returns better than +18.9% for the quarter. No doubt currency effects benefited US-based investors, as the developed European index saw a 9.1% return in local terms improve to 19.4% after conversion to US dollars.

Economically speaking, indicators for the region were mixed during the quarter. Consensus 2010 GDP estimates for the Eurozone did increase throughout the period, rising from 1.1% in July to 1.6% most recently (in contrast to the US, which has seen declining 2010 GDP estimates over the last few months). While economic sentiment remained well above its long term average, an array of manufacturing



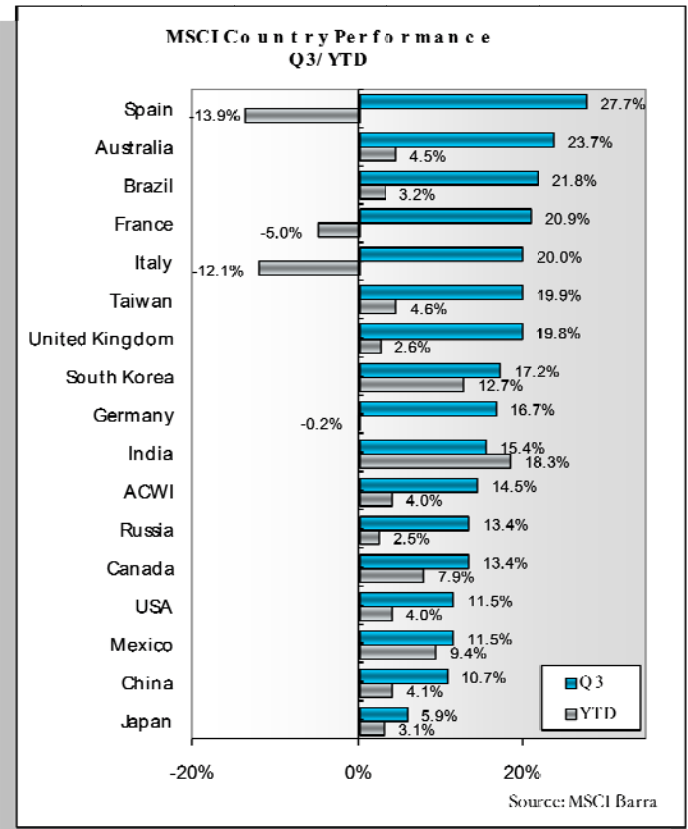


and services indexes indicate economic expansion is slowing for the region's biggest countries.

Japan's Monetary Policy: Japan was the primary laggard during the quarter, largely a result of yield-starved investors being driven to riskier assets. In September, Japanese exporters also continued to suffer as a result of an extremely strong yen, which hit a fifteen year high against the US Dollar making their exports more expensive. In a surprise move, Japan's government intervened in the currency markets on September 15th, unilaterally pouring 2 trillion yen into the system in a matter of hours. As a result, the yen shot up to ¥85.8 per USD from ¥83.1, but has since drifted back down to previous valuations. The move underscored the futility of the Japanese government to stem the rise of the country's currency. In response, the Bank of Japan is being implored by local politicians to abandon its ceiling on purchases of government bonds, which many believe has allowed deflation to persist in the country now for more than a decade (amplifying the attractiveness of the yen to global investors because of its continued rise in purchasing power). Critics of the BOJ argue that violating the bank's current limitation on government bond purchases would be seen as an act of debt monetization (i.e. "printing money" to pay off debt) which could elevate inflation expectations and provide some relief to Japan's currency. There is little sign the country's central bank is willing to undertake such actions, but if legislators are able to successfully challenge the BOJ's independence (which certain factions are currently attempting), the country's monetary policy could change dramatically in the future.

On October 6, Japan's Central Bank announced a new program that the Bank of Japan's Gov. Masaaki Shirakawa called "comprehensive easing." This \$60 billion program in asset purchases will include corporate bonds and for the first time, real estate investment trusts (REITs) and stock funds. Japan's foray into experimental monetary policies may be the first step of something bigger and we will be watching this in the months ahead.

After leading most major global regions through the first half of the year, Japan's sluggish performance over the last few months has allowed it fall back to the bottom of the ACWI universe in terms of relative YTD performance. Only the MSCI Europe index has posted a lower YTD return. At 3.3%, Japan's GDP growth is actually expected to outpace both the US (2.7%) and Europe (1.6%) for 2010, but the consensus for 2011 is a growth rate of just 1.6%.



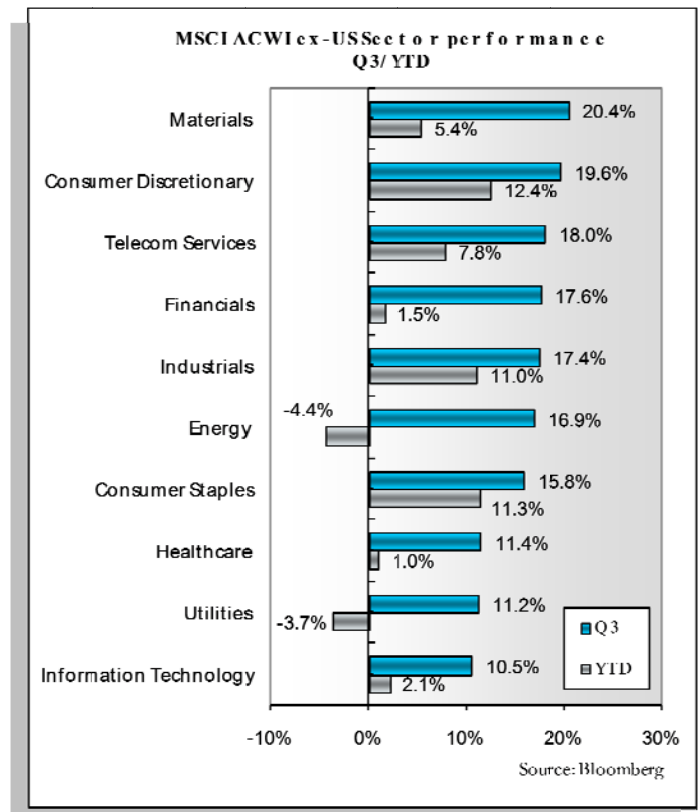


Emerging Markets Continue To Shine: In the third quarter, emerging markets raked in 18.2% for US investors and lead all major regions at +11.0% YTD. Regionally speaking, this relative outperformance has been broad based, though the strongest returns in the third quarter were in the index's smallest countries.

Sector performance among international equities was mixed with materials (+20.3%), consumer discretionary (+19.6%), and telecom (18.0%) posting the top returns within the ACWI ex US index. Technology (10.7%) and utilities (11.2%) were among the quarter's laggards. Sector performance was similar for emerging market equities, though telecom did not play as prominent role as in the developed world.

Looking Forward: We expect international equities (including emerging markets) to continue their upward momentum, though we expect that volatility will remain elevated. Country specific shocks or additional surprises like the recent Irish banking system drama may also continue to adversely impact stocks. We believe that quality stocks and stocks with favorable secular growth profiles will perform

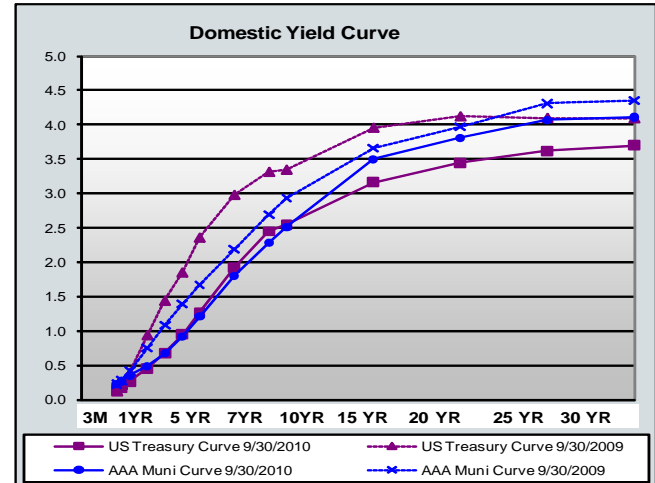
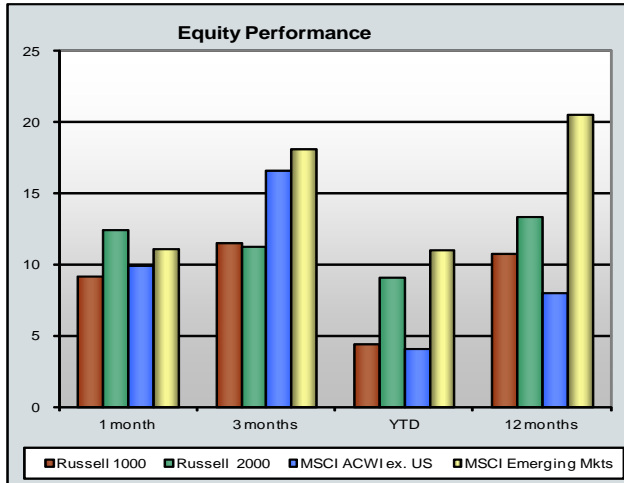
better than industrial cyclical or commodity oriented stocks in this type of environment. We are more bearish on the broad Japanese equity indices due to low domestic growth (e.g., low consumer spending/high savings rates) and continued political and monetary policy uncertainty. European financials also remain a concern due to exposure to sovereign debt from troubled countries and bad mortgages. We recommend avoiding passive index vehicles for international large cap at this time due to their higher exposure to European banks.



Sources: MSCI Barra, The Economist, Bloomberg, FactSet, Financial Times, Wall Street Journal, European Commission Economic and Financial Affairs



MONTHLY PERFORMANCE
September 30, 2010



	1 month	3 months	YTD	12 months
Large Cap				
S&P 500	8.92	11.29	3.89	10.16
DJIA	7.85	11.13	5.57	14.12
Russell 1000	9.19	11.55	4.41	10.75
Russell 1000 Value	7.76	10.13	4.49	8.90
Russell 1000 Growth	10.65	13.00	4.36	12.65

	1 month	3 months	YTD	12 months
Small/Mid Cap				
Russell 2000	12.46	11.29	9.12	13.35
Russell 2000 Value	10.74	9.72	7.92	11.84
Russell 2000 Growth	14.15	12.83	10.23	14.79
Russell Microcap	11.90	7.81	7.94	7.43
Russell Midcap	10.58	13.31	10.97	17.54
Russell Midcap Value	9.26	12.13	11.15	16.93
Russell Midcap Growth	12.09	14.65	10.85	18.27

	1 month	3 months	YTD	12 months
International Markets				
MSCI EAFE	9.82	16.53	1.46	3.71
MSCI ACWI ex. US	9.97	16.66	4.06	8.00
MSCI Europe	11.00	19.40	(0.07)	3.23
MSCI Japan	4.64	5.89	3.09	0.25
MSCI AC Asia Pacific Ex - Japan	11.94	18.34	10.14	16.86
MSCI EAFE SMID	11.34	17.38	7.45	7.06
MSCI ACWI ex. US SMID	11.38	18.36	10.47	13.90
MSCI Emerging Mkts	11.13	18.16	11.02	20.54
MSCI EMEA	11.45	21.82	12.27	22.70
MSCI Latin America	10.51	20.99	8.32	21.89
MSCI Frontier Markets	7.49	14.28	15.03	3.96

	1 month	3 months	YTD	12 months
Sectors (S&P 500 GICS)				
Consumer Discretionary	11.10	15.17	13.34	23.63
Consumer Staples	5.86	10.63	7.54	12.94
Energy	9.20	12.95	(0.84)	4.70
Financials	6.08	4.33	0.50	(2.84)
Healthcare	9.03	8.86	(0.71)	8.31
Industrials	11.40	14.31	13.34	19.44
Information Technology	12.14	11.78	(0.04)	10.66
Materials	7.75	17.84	2.66	10.22
Telecom Services	8.15	20.96	10.83	19.07
Utilities	2.93	12.35	4.32	11.90

	1 month	3 months	YTD	12 months
Fixed Income				
BarCap 5 Yr Muni	(0.33)	2.53	5.05	5.62
BarCap HY Muni	0.64	4.54	12.16	12.14
BarCap 1-10 Muni	(0.39)	2.18	4.70	4.81
BarCap US Treasury 1-3 mo.	0.01	0.04	0.10	0.11
BarCap 1-3 Yr. Govt	0.18	0.62	2.53	2.62
BarCap Int Govt/Credit	0.47	2.76	7.44	7.77
BarCap High Yield Corp.	3.01	6.71	11.53	18.44
Citigroup High-Yield	2.97	6.34	10.72	17.49
ML US High Yield BB/B Rated	2.69	6.74	11.58	16.78
BarCap US Agg Securitized MBS	(0.38)	0.63	5.11	5.71
JPM EMBI+ Composite	1.80	8.90	14.46	16.02

	Latest Month end (9/30/2010)	3 Months ago (6/30/2010)	Latest Year end (12/31/2009)	12 Months ago (9/30/2009)
Currency				
U.S. Dollar Index Value	78.72	86.02	77.86	76.65
USD vs. Yen	83.53	88.43	93.02	89.70
Euro vs. USD	1.36	1.22	1.43	1.46

	Latest Month end (9/30/2010)	3 Months ago (6/30/2010)	Latest Year end (12/31/2009)	12 Months ago (9/30/2009)
Commodities				
Gold (\$ per troy ounce)	1308.35	1242.25	1096.95	1007.70
Crude Oil (\$ per barrel)	79.97	75.63	79.36	70.61



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