



JOLLIFFE CAPITAL, INC.

"excellence through research" Registered Investment Advisor

www.jolliffecapital.com | www.happynestegg.com | 303.469.6273 | Toll-free: 877.524.3030

June 2010 Economic Update & Commentary

Overview: Financial market volatility has increased over the past several weeks amid growing investor concern over happenings in Europe, the prospect of increased financial market regulation in the United States and, more generally, worry that the economic recovery has hit a rough patch. While investors are unnerved by current events, we believe the economic recovery remains on track, as interest rates remain low and leading economic indicators continue to have a positive tone. That said, U.S. economic data has been somewhat less positive in recent weeks, with the decline in unemployment claims having stalled and with upward revisions to corporate earnings slowing down. Although overall data points to strong second quarter growth, an unimpressive jobs report did not send the signal that markets were hoping for – namely that the lagging labor market is fully on board with the recovery.

GDP: Positive momentum emerged in Q1. Real GDP was up 3.0% with gains in consumer spending, equipment investment, federal spending, and inventory building. Construction spending remains weak. The data reinforces what has been a V-shaped bounce in activity across broad sectors of the economy. Can this growth be sustained without the artificial supports provided by special federal programs, unusually low interest rates, and credit easing by the Federal Reserve? The pace of economic expansion seems likely to remain moderate—a little more than 3% over the four quarters of this year but picking up considerably next year as obstacles to growth recede.

Retail Sales: *The key to a stable recovery is a transfer of the drivers of growth from government stimulus to private demand.* Retail sales figures show signs that this transition is taking place. Retail sales, posting their seventh straight monthly gain, rose 0.4% in April, with strength in autos, gas and building materials. A strong 6.9% gain in building materials (which follows a near 8% gain in the prior month) is likely due to a modest revival of new home construction. Core sales which exclude the more volatile components of autos, gas and building materials showed weakness in April, declining 0.2%. However, core sales remain positive relative to a year ago.

The momentum in consumer spending into the second quarter is very strong. Even a modest improvement in employment hiring will put millions of Americans back on company payrolls by the end of this year, improving consumer confidence and spending. We expect consumer spending growth in the range of 2.5-3.5% through the year. This should continue to provide the equity and bond markets with a growing conviction about the sustainability of this economic expansion.

The Leading Economic Index fell in April. This was the first decline in 12 months. While such a drop is not a signal for panic, it does suggest that forward momentum in the economy may be moderating. There are two components of the indicators we find troubling. First, building permits fell sharply, which suggests a drop-off in residential construction post-first-time homebuyer credit. This brings into question the sustainability of the housing recovery and its new equilibrium pace of housing starts. Secondly, the rise in jobless claims suggests to us that private-sector job growth will continue to remain subpar.

Housing: Existing home sales jumped to a 5.8 million unit annualized pace in April while housing starts increased 5.8% as homebuyers and builders scrambled to get contracts signed prior to the April 30th deadline of the homebuyer tax credit. We expect home sales to slip in coming months as the effect of the tax credit fades. The inventory of existing homes for sale grew in April lifting the month's supply for all homes to about 8



months. Declining demand is evident in new mortgage applications, which fell about 34% in April. The drop comes even as conventional 30-year mortgage rates fell below 5% during the same period. With supply growing and demand expected to decline, it is bad news for home prices and it may have a short term negative effect on consumer sentiment.

The key to a housing recovery is a return to stable and positive job and income growth. The recent trend in private sector job growth is encouraging, although the latest data for May has been disappointing. This will underpin housing demand and help to pull up the pace of construction once we pass the near term challenges from the homebuyer tax credit expiration and distressed sales. However, we don't expect residential construction to be a major driver of economic activity over the next few quarters.

Labor: The U.S. payroll data came in below expectations, rising by 431,000 jobs in May. Almost all of the change was due to temporary Census hiring, which added 411,000 jobs to the total while the remainder came from private sector hiring. The unemployment rate fell to 9.7% on a fall in the participation rate, equivalent to 322,000 net-workers leaving the labor force.

The support from Census is a completely temporary phenomenon; we expect the government sector to reverse course over the June to September period. Therefore, the government sector will be a material drag on employment growth over the next four months, leaving the U.S. economy completely dependent on the private sector to drive employment growth. A slower than expected pace of job growth reveals the headwinds still facing the US recovery. The unemployment rate is likely to remain essentially flat this year, with progress in lowering that rate limited by a large number of workers sitting on the sidelines, ready to re-enter the civilian labor force as employment opportunities improve.

We expect the U.S. economy to add more than 2 million jobs over the course of this year and another 4 million in 2011 as the economy expands.

Inflation: Both the producer price and consumer price indices suggest that low inflation remains the hallmark of the outlook in the post-stimulus era. Producer prices for finished goods are flat over the past three months. The consumer price index declined 0.1% in April. Energy prices fell 1.4% while Food prices rose 0.2%. Core prices (which exclude Food and Energy) were unchanged, falling to their lowest year-over-year reading (+0.9%) in 4 decades. Excess housing supply should continue to pull core prices lower, but housing is not the only component showing declines. Vehicle, apparel, and personal computer prices also fell in April. Moreover, substantial slack in the economy, as measured by the unemployment rate, capacity utilization and the output gap should continue to put downward pressure on core prices.

With inflation trending so close to the zero-bound, the possibility of deflation is being discussed. However, disinflationary pressures should prove temporary, as should any dip into deflation territory. Up until now, markets, consumers and businesses all agreed that any down-leg in inflation will not be sustained, as 1-5 year inflation expectations are hovering in the 2-3% range.

We expect the core measure to trend back up by the end of 2010, rising to about 1.5% y/y by the end of 2011. As the economy continues to expand and adds back more than 6 million workers to payrolls by the end of 2011, diminishing slack should temper any downward pressure on CPI.

Federal Reserve: The risks and uncertainties stemming from the developments in Europe are certainly less supportive of domestic growth and also one more reason for the Federal Reserve to adhere to the current



course of monetary policy - keeping interest rates at exceptionally low levels and offering a conditional promise to keep them there for an extended period. Given continued high unemployment and extraordinarily low inflation for the next two years, if not longer, there is no change in sight on the monetary policy stance, and we expect the first move on the Fed Funds target rate will take place towards the end of 2010 or early 2011.

Equity: Given the magnitude of the recent currency and sovereign debt concerns, equity market performance may well be driven by the broad macro outlook rather than company-specific fundamentals. This is usually the sort of environment where volatility remains high in both directions. Markets remain under pressure as a result of the sovereign debt issues in Europe, policy tightening in China and elsewhere, and uncertainty surrounding pending regulations for the financial services sector. On a relative basis, U.S. markets have benefited from the uncertainty, as investors have continued to view the United States as a higher-quality haven for their assets. We expect that this trend will continue, which makes U.S. stocks more attractive than those of other developed markets.

U.S. Dollar: One of the spillover effects of the European sovereign debt crisis has been the appreciation of the U.S. dollar versus the euro. The rising dollar has been a source of concern for some investors, since a stronger dollar could have negative implications for U.S. corporate profits. While the trade-weighted value of the dollar is still below its average level of the past several years, the weaker euro could present a risk for U.S. corporate profits, as could weaker levels of European economic growth.

Trade: The nominal U.S. trade deficit for goods and services widened slightly in March to \$40.4 billion with broad-based increases in both exports and imports. Both increases reflect the economic recovery that is occurring in both the U.S. and the global economy. While trade data released this month continued to support an upward trend in exports, turmoil in Europe and dollar strength will likely lead slower growth in U.S. exports in the long run.

Outlook: Currently, the impact of short-run stimulus programs is ending and we remain uncertain about the sustainable path of growth going forward. One leading indicator, jobless claims, suggests that the sustainable pace of economic growth will be disappointing to many who are hoping for a jump in public revenues and jobs. Jobless claims remain in the 450,000 plus range and have not improved very much over the past three months. In recent weeks the persistent problems of limited credit availability and job gains suggest that we remain uncertain about the pace of sustainable growth for the next six quarters. Our outlook continues to call for sub-par economic growth and an above-average unemployment rate.

In the near term (i.e. the second quarter of this year) growth is likely to continue along its recent buoyant path slightly above 3.0%. However, the second half of the year is where the real test will be. By this time, the key factor to watch will be whether the recent upward trend in the job growth continues or begins to sputter.

As long as the U.S. economy can continue to add jobs and repair the deep hole in the workforce, real income growth should be able to continue to bridge the gap between stimulus and private demand. Fortunately, there are strong signs that this will continue, and the recent trends in private job creation over the past two months of data give us reason to be optimistic on this front. If, on the other hand, uncertainty around recent developments abroad (and at home) begins to undermine corporate confidence and forestalls the hiring process, the path will prove to be a much rockier one.



CAPITAL MARKET PERFORMANCE

Index Performance as of May 31, 2010	1 Month	QTD	YTD	1 Year	5 Year
Russell					
3000 Value	-7.55	-6.30	-1.74	22.26	1.60
3000	-7.90	-5.91	-0.32	23.20	0.84
3000 Growth	-8.24	-5.52	1.13	24.05	-0.08
1000 Value	-7.63	-6.60	-2.26	21.59	1.45
1000	-7.93	-6.22	-0.88	22.33	0.67
1000 Growth	-8.22	-5.84	0.54	22.98	-0.28
MidCap Value	-6.86	-4.10	3.26	30.14	3.09
MidCap	-7.35	-3.87	4.46	33.93	3.08
MidCap Growth	-7.80	-3.66	5.61	37.62	2.65
2000 Value	-6.61	-2.69	4.72	30.54	3.21
2000	-7.59	-2.36	6.29	33.62	2.77
2000 Growth	-8.45	-2.04	7.77	36.60	2.20
S&P 500					
Consumer Discretionary	-7.00	-1.33	8.97	42.59	1.11
Consumer Staples	-4.60	-5.91	-0.44	17.19	5.13
Energy	-11.38	-7.44	-6.87	3.31	5.97
Financials	-9.16	-7.94	2.33	21.58	-10.48
Health Care	-6.72	-10.30	-7.25	13.77	0.25
Industrials	-9.53	-5.77	6.55	34.05	0.56
Information Technology	-8.10	-6.46	-4.68	28.47	3.07
Materials	-9.46	-9.04	-6.42	16.46	4.09
Telecommunication Services	-3.90	-4.00	-8.15	5.37	1.31
Utilities	-5.61	-3.12	-6.55	12.31	2.85
Other U.S. Equity					
Dow Jones Industrial Avg.	-7.56	-6.15	-1.63	22.66	2.02
Wilshire 5000 (Full Cap)	-7.91	-5.89	0.01	23.67	1.28
International Equity					
MSCI EAFE	-11.37	-12.90	-12.08	6.84	1.83
MSCI Emerging Markets	-8.75	-7.63	-5.36	22.72	14.00
MSCI AC World	-9.39	-9.19	-6.25	15.23	2.53
MSCI AC World ex: US	-10.41	-11.14	-9.67	11.08	4.49
Fixed Income					
Barclays Aggregate Bond	0.84	1.89	3.71	8.42	5.33
Barclays 1-3 Month T-Bill	0.01	0.03	0.04	0.12	2.68
Barclays Government	1.53	2.50	3.63	4.53	5.13
Barclays Credit	-0.38	1.29	3.59	15.20	5.06
Barclays High Yield Corporate	-3.59	-1.33	3.23	28.79	7.32
Barclays Muni Bond	0.75	1.97	3.25	8.52	4.52
Barclays TIPS	0.00	2.36	2.94	8.48	4.77
Barclays Global Agg. Ex: US	-3.22	-3.87	-5.46	0.67	4.06
Barclays Emerging Markets	-2.53	-1.51	3.06	19.62	8.19
Alternatives					
HFRI Equity Hedge	-3.69	-2.37	0.84	13.99	5.09
HFRI Equity Market Neutral	0.23	0.79	2.68	4.69	2.98
NAREIT Equity REIT	-5.55	1.00	11.12	55.96	2.23
Dow Jones UBS Commodity	-6.92	-5.11	-9.89	0.47	-1.05



JCI's Investment Team - "excellence through research"



Patrick S. Jolliffe, CFP®, ChFC, Founder, President, CEO & Portfolio Manager. Pat began his career in the insurance and investment industry in 1994. Having earned a BSBA in Management from the University of Denver, he founded his first Investment Advisory firm in 1998 and most recently, founded and serves as President and CEO of Jolliffe Capital, Inc., a Registered Investment Advisor, registered with the Securities and Exchange Commission. The firm is responsible for roughly \$60 million in client assets, with Pat having counseled businesses and individuals alike on investment and estate planning matters throughout his career. As a fiduciary, Certified Financial Planner Practitioner® and Chartered Financial Consultant, Pat personally attests to all financial plans.

Shawn Mercer, Vice President and Safe Money Strategist. Shawn began his career in the insurance industry 15 years ago. A pioneer in safe strategies for senior clientele, Shawn has specialized in principally guaranteed safe income strategies utilizing guaranteed insurance contracts underwritten by some of our country's highest-rated insurance carriers. In the safe strategies he promotes, Shawn manages roughly \$40 million. He also recently passed the Series 65 examination, enabling him to complement his expertise with fee-based, customized investment management services. Shawn has been featured as an industry expert in various media, including television and radio in Colorado and Arizona, and is enrolled in curriculum for obtaining his CRPC® designation, offered through the College for Financial Planning. Mr. Mercer attended Oklahoma Baptist University majoring in business administration.



Abdur R. Chowdhury, Ph.D., Consulting Economist. Abdur was educated at the University of Dhaka in Bangladesh earning a B.A. (Honors) in 1976 and an M.A. in Economics in 1977. He earned an M.A. in 1981 and a Ph.D. in Economics from the University of Kentucky in 1983. Abdur is a Professor of Economics at Marquette University.

Barry K. Mendelson, CIMA, Senior Analyst Barry earned his Certified Investment Management Analysts designation (CIMA) from the Investment Management Consultants Association and the University of Pennsylvania's Wharton Business School in 1990. Barry earned a BS from Palmer College in Davenport, Iowa in 1976.



Richard Iwanski, CFA, Senior Investment Analyst. Rick is a Chartered Financial Analyst (CFA) charterholder, a member of the Investment Management Consultants Association (IMCA), the CFA Institute, and the CFA Society of Milwaukee. Rick attended the University of Wisconsin, Madison earning a Bachelor of Arts degree in Economics in 1992.

**Jolie Keller, CFA
Investment Analyst**



**Sam Vanden Heuvel
Nick Ihn
Heikki Luoma,
Research Associates**





Separate Account Management
Eric Barden, CFA, President,
Barden Capital Management, Inc.

2010 Forecast

The economic recovery continues to accelerate. The private sector finally stopped cutting jobs and started adding to payrolls. We are in the very early stages of an economic upswing. 2010 should see above average economic growth and above average performance for stocks.

Performance

For the three months ending May 31st, the growth accounts under the management of Barden Capital were down about 1%, lagging slightly behind the performance of the S&P 500, but outperforming the Morgan Stanley benchmark for global securities.

For 2010, the U.S. stock market is the best performing market out of the 15 developed country markets. International markets have lagged substantially as European markets are pre-occupied with the fate of the Greek debt crisis. Investments in emerging markets have also created a drag on performance in 2010.

For the last twelve months, the growth accounts are up about 20%. Since Barden Capital's inception in November, 2006, the growth accounts have outperformed the S&P 500 by more than 3% a year on average with lower volatility. In other words, after fees, an investor who employed us to manage for growth beginning in August of 2006 would have 10% more wealth than an investor who used low-cost S&P 500 index funds.

Corporate Profits

The market looks as far out as it can see. It's not the

change in expectation on near term earnings that drives stock prices, but it's the change in expectations on earnings 12 and 24 months out that has the most impact on stock prices. Over the last 22 years, investors have valued the market at 17.6 times forward earnings, on average. Valuation has ranged as high as 28 times forward earnings during the dot-com boom, and as low as 10.8 times during the credit crisis of 2008-9.

Today, investors value the market at 12.9 times earnings, quite low by historic standards, but these are obviously not ordinary times. Multiple expansions tend to coincide with increased investor confidence. As the market recovery matures, it's likely that the multiple will increase to at least 17 times earnings, likely peaking somewhere around 20 times earnings.

Regardless of how confidence plays out, the earnings component of the valuation equation continues to improve. At the end of 2009, analysts anticipated \$84 in 2011 earnings for the S&P 500. Now, just three months later, analysts are projecting S&P 500 earnings of \$95.60, an all time high. Valuing the market conservatively at 15 times earnings, the current estimate implies a year-end price target for the S&P 500 of 1434, 30% higher than today.

The high water mark for S&P 500 earnings was \$88 in 2006. If the S&P 500 sets a new high for earnings, stocks will likely set a new high as well. My guess is that the S&P 500 will exceed 1500 sometime within the next 18 months.

Market Strategy

Large, high-quality growth stocks continue to lag small low-quality stocks. This is typical coming out of a bear market, but what is unusual is the size of the performance disparity. Eventually, this disparity will reverse, and high quality stocks will outperform, but the timing of this shift is unknowable. It appeared that the Greek debt crisis might start a run to quality, but after a couple of false starts for blue-chips it's too soon to tell if the recent outperformance of high quality stocks will last.



I'm reluctant to chase low quality stocks that are outperforming. We have a portfolio of undervalued companies with strong quality characteristics like low debt and strong cash flows. This prevents us from matching the gains of the most aggressive strategies. But, we are pursuing a course that will yield stout gains through strong earnings growth while limiting our risk by owning high quality companies.

Economic Outlook

The stock market is a leading indicator of the overall economy. Now that the first year of the new bull market is behind us, we can get a sense of the potential of the impending economic recovery. From the low on March 9th, the S&P 500 was up 68% over the next year. That makes this the best first year of a bull market performance since the 1930s. Given the severity of the economic downturn, it's quite likely that we are setting up for the strongest economic expansion since the end of the Depression.

Inflation

Core inflation continues to gradually decline in spite of higher energy costs. High unemployment precludes any significant wage increases, which is a requirement for runaway inflation. A strengthening dollar also mitigates the risk of inflation. Even though many observers stress the risk of deficit spending, the nearly unprecedented increase in private savings has so far more than offset the increase in government spending.

Unemployment

The private sector finally stopped cutting jobs and started adding to payrolls. The most optimistic economists are forecasting as many as 300,000 new jobs a month for the rest of the year. But, the economy needs to add approximately 3,000,000 jobs just to reduce the rate of unemployment by 1%. To reach what economists consider full employment (5% unemployment) the economy needs to create about 15 million jobs. Assuming the optimists are right, it will still take the economy more than four years to get back to full employment levels. This is a simple estimate for the expected duration of the current economic recovery.

Currently, the U.S. is benefitting from Europe's problems as most investors believed Europe was in a stronger position coming out of the credit crisis of 2008. Portfolio managers who limited their investments in the U.S. are now racing to catch up. This is clearly a very fluid environment and we won't hesitate to change course as events dictate.