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Revised

ECONOMIC UPDATE -- MODERATE EXPANSION CONTINUES

Despite disappointing employment growth, incoming economic data received since our February Outlook indicates the economy continues to expand, albeit moderately. Business added just 121,000 jobs in March, roughly half the net gains posted in each of the preceding three months. The unemployment rate, taken from a separate survey of households rather than employers, eased to 8.2% from 8.3% in February, as discouraged job seekers left the market leaving a smaller portion of the population looking for work. The reported slowdown in employment gains suggests employers remain cautious about hiring in the face of rising gas prices and uncertainties arising in part from policy-driven issues such as out-of-control health care costs, ballooning retirement plan funding obligations, and $500 billion of tax hikes and government spending cuts scheduled to take effect next year. The weak employment report, a coincident indicator, is consistent with a downtick to about 2.5% in overall GDP growth from the 3.0% pace of the fourth quarter of last year.

Clearly, when viewed in isolation, the March jobs data looked weak. However, it is worth noting that on average, over the past three months, the economy created a more respectable 200,000 jobs. Moreover, the soft March number may have been largely "pay-back" from typical spring hiring which came earlier this year due to the warm weather. In addition, last month's figures are subject to upward revision in the months ahead, as has been the pattern in recent months. And, a reported decline in 7,500 temporary positions may have come as businesses converted these to permanent jobs and companies that had postponed projects were beginning to revive them for later in the year. Stay tuned!

EURO ZONE STRESSES

Compounding our domestic uncertainties, developments in Europe, which for the past two years have had an important influence on the tenor of global financial markets and the global economy in general, continue to cloud the outlook. The combination of high debts, large deficits, and poor growth prospects in several of

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the peripheral countries using the euro has raised concerns about fiscal sustainability and, consequently, led to sharply higher sovereign borrowing costs--first for Greece, but subsequently for other euro-area countries as well. Pessimism about these countries' fiscal and economic situations, in turn, has undermined confidence in the strength of European financial institutions increasing the cost and difficulty those institutions have faced in obtaining funding and curbing their willingness to supply credit. The difficulties in the euro area have impacted the US economy. US exports to Europe over the past two years have underperformed our exports to the rest of the world. In addition, weaker demand from Europe has slowed growth in other economies, which has also lowered foreign demand for our products.

Until very recently financial stresses in Europe, appeared to have receded, contributing to the better tone of financial markets, including the US. The improvement reflects, in part, a number of actions taken by European policy-makers. Measures taken by the European Central Bank (ECB), including implementing two longer-term refinancing operations and easing collateral rules and reserve requirements, have allowed European banks to lock-in funding for up to three years, thereby alleviating concerns about near term liquidity. With the benefit of this support, European banks have in turn increased their holdings of sovereign debt, contributing to lower borrowing costs for some countries. Euro-area leaders, the Greek government, and private-sector holders of Greece debt are taking steps to put Greece on a more sustainable path by reducing its sovereign debt and intensifying their efforts to implement fiscal and structural reforms.

Nevertheless, the Greek economy remains in a deep recession and more needs to be done to achieve a full resolution to the crisis. Last week global financial markets grew skittish again as growing debt and a weak bond offering in Spain raised the specter of a deepening slump in Europe. We expect additional periodic bouts of disquieting financial market jitters. To diminish these, the European banking system must be strengthened; a significant expansion of financial back stops or "firewalls," to guard against contagion in sovereign debt markets needs to be erected; and, continued efforts to increase economic growth and competitiveness and to reduce external imbalances in troubled countries, must be made.

FORWARD LOOKING INDICATORS

Looking beyond the March job numbers and recent European financial market turmoil, other high frequency forward looking economic indicators we monitor confirm the moderate US expansion is sustainable:

- US factory orders, which account for about 12% of the US economy, climbed in February for the third month in the last four boosted by demand for business equipment. Orders excluding transportation gear increased by the most in five months and there is little reason to expect a manufacturing slowdown as inventories remain lean.

- Claims for US employment benefits dropped to the lowest level in four years. Companies are retaining workers and hiring amid robust retail sales and growing consumer confidence.

- The Institute for Supply Management's (ISM) manufacturing index rose to 53.4 in March from 52.4 a month earlier. Recall that 50 is the dividing line between growth and contraction in the manufacturing sector. Abroad, the manufacturing sector was mixed in March. Euro-region manufacturing contracted for the eighth consecutive month in March, adding to signs the 17-country economy continued to shrink in the first quarter. UK manufacturing growth unexpectedly accelerated in March to the fastest pace in 10 months and China's Purchasing Managers Index rose to a one-year high.

- The Institute for Supply Management Non-Manufacturing Index, which accounts for about 90% of US GDP, signaled continued expansion with a reading of 55.0. The employment sub index was strong at 56.7 compared with its 6 month average of 53.7.

- Both our firm's proprietary Economic Model and the Conference Board's Leading Economic Indicators (LEI) rose in February signaling the economy will continue to expand over the next six months.

- Open market indicators we track closely have, since year-end, pointed to continued economic expansion. For example, US stock prices, a highly reliable leading economic indicator, have risen about 9% this year. Among the strongest groups are those identified as being economically sensitive. Defensive sectors have underperformed.

-------------------------	S&P 500 Stock Sectors*	-------------------------	
Economically Sensitive **Outperformers**	**%** **Change**	**Defensive** **Underperformers**	**%** **Change**
Information Technology	+19.2	Utilities	-4.7
Financials	+16.8	Telecom	-1.6
Consumer Discretionary	+12.9	Energy	-1.6
Industrials	+6.5	Consumer Staples	+3.2
Materials	+6.1	Healthcare	+5.8

*12/31/11 through 4/11/12

- Though volatile, the yield on the 10 year US Treasury bond has drifted up from 1.87% to 2.02% since year end. A steepening yield curve has been a reliable precursor to an expanding economy.

CHINA IN TRANSITION

China remains in a policy-driven transition from an export and infrastructure development-driven country to a consumer spending-driven nation. This transition will take time and there are risks of a policy misstep or two along the way derailing the process. A return to GDP growth of 10% + is highly unlikely in the near to immediate term. But China will grow and it will emerge ultimately as the world's largest consumer. China's current problems, including the undercapitalization of its banks, higher than desired inflation, and empty apartments and retail spaces in some cities, are very solvable in a nation expected to grow at a 7% or better rate for the foreseeable future.

China's GDP grew by 8.1% in the last quarter down from 8.9% year-over-year in the fourth quarter of 2011. This was the slowest growth since the first quarter of 2009 when trade was reeling in the midst of the global financial crisis. The slowdown is attributable to weaker domestic and external demand, as investment and consumption both slowed and the contribution of net exports to growth turned negative. The slowdown was triggered by tightening fiscal, monetary and property policies last year to combat rising inflation and to cool the home building sector. Recently released data shows that retail sales improved slightly in March -- up 15.2% year-over-year in March, up from 14.7% in January-February. In response to the slowdown in the last quarter, policies were eased last month which included more fiscal spending, increased credit to support projects already under construction, and targeted easing in the hard hit low-end property market. In our view, a protracted slowdown would be politically intolerable. Easing steps are, therefore, likely to be taken soon to avoid a further slowdown in the third quarter when the top party leadership is scheduled to be reshuffled. We expect a rebound in growth, possibly in the late part of the 2nd quarter or in the 3rd quarter at the

latest. Further easing, either explicit (e.g. bank reserve cuts) or implicit (e.g. more projects launched and funded) will likely be added in the current quarter. A sign of additional implicit and/or explicit easing are likely to ignite a recovery in the Chinese stock market which has been one of the world's worst performing bourses over the last two years.

FORECAST

While major issues remain, such as the $500 billion domestic fiscal "cliff" at year end and European government austerity pressures, there is growing evidence that businesses are hiring, beginning to spend a portion of their $2.0 trillion cash hoard. These outlays support the view the US is unlikely to slip back into recession as some have feared. Capital spending intentions are actually accelerating, not slowing. Recent surveys of businesses and checks made by our firm's research analysts confirm that business has stepped up spending. Indeed, capital spending intentions are now up almost 11% for 2012 versus 2011, as compared with only a 6% increase planned as recently as January. All 10 business sectors are showing stronger spending growth plans than in January. For example, consumer discretionary and tech hardware have shown a near tripling in the pace of planned investment growth while semiconductors are likely to be down only moderately now as compared with almost 25% decline previously planned.

Hiring intentions, which have also been gaining strength, have a high degree of correlation with declining future unemployment rates. Looking at the most recent National Federation of Independent Business Survey on hiring intentions we find that as businesses begin to look for workers, as is the case now, they actually hire with a proven impact over the subsequent year. In fact, we may now be on the verge of the long awaited *virtuous cycle* where employment boosts income and consumption. In turn, production and inventories are increased to meet growing demand which further adds to income available for both consumption and business investment.

Overall, then, the US economy continues to expand at a moderate pace. Manufacturing is underpinning US growth despite a slowdown in exports, rising petroleum and input prices, as well as the difficulty businesses are having finding highly-skilled workers. Capital spending is rising and factory capacity utilization has drifted upward. GDP rose at an annual rate of 3% in the last three months of 2011 – the largest increase in more than a year. Hiring has exceeded muted expectations. Consumer confidence has risen for seven straight months – reaching

the highest level in 11 months in March and consumption was strong in the first quarter providing momentum to the economy as it entered the current quarter. Retail sales grew 0.8% in March, the third consecutive month of robust sales, despite a 27 cent increase in gasoline prices. Headwinds to more rapid expansion continue to be the depressed housing market, difficult borrowing conditions for consumers with low credit scores, and the sluggish pace of incomes growth.

Specifically, we expect GDP to rise at a 2.25% to 2.5% rate this year unchanged from our February forecast. Core inflation, elevated temporarily by high gasoline prices, is forecast to drift down toward the upper end of the Federal Reserve's target of 2.0% rate as wage growth remains muted and resources remain underutilized. Housing, depressed by the overhang of unsold homes on the market and difficult borrowing conditions for many home buyers, is in the process of bottoming. Some local markets have turned up while others (e.g. Phoenix, Las Vegas, central Florida) remain distressed. Given the unacceptably high unemployment rate, the Fed is likely to remain on course with its highly accommodative monetary policy, keeping short term rates near zero for an extended period. Intermediate and longer term bond rates have seen their lows for the current cycle and are expected to drift higher as investors shift their preference from risk aversion toward demanding higher bond returns to offset future inflation risks. We continue to expect the unemployment rate to drift down toward 7.8% by year-end.

EQUITY INVESTMENT STRATEGY

Despite the fact equities have risen sharply from uniquely depressed levels during the past two quarters, we believe stock valuations, now at about 12.5 times forecast S &P 500 earnings, remain attractive from a longer term standpoint -- well below the 15 times mean multiple of the past 20 years. Other measures of valuation we monitor confirm stocks to be statistically undervalued. When compared with bond yields, expected returns from stocks are significantly higher.

Looking ahead to potential sources of demand for US stocks, surveys of institutional investors show their stock ratios at generational lows. Individual investors with over $6 trillion of cash on their balance sheets, have been net sellers of US equities for the past 4 years, liquidating about $500 billion of securities in that time. Corporations, by far the largest single source of demand for equities over the past few years, have nearly $2.0 trillion of cash on hand. Despite the stock market's rise, flow of funds data provides little evidence of a shift in

investors' preferences from bonds to stocks indicating there remain substantial potential sources of demand for equities as earnings rise and conditions brighten.

Notwithstanding the likelihood of a 5% to 10% correction at some point, clients' portfolios are fully invested in equities relative to their target maximum positions. The mix of stocks in clients' portfolios remains tilted toward *growth* shares where we have emphasized companies likely to benefit from the modest economic growth we forecast including technology, diversified industrials, transports and energy. Investments in financials represent the largest exposure within the *value* portion of clients' stock holdings. Beyond the US, our equity investment platform includes both developed and emerging market equities, now weighted toward the more rapidly growing emerging market segment.

FIXED INCOME STRATEGY

The fixed income portion of clients' portfolios remains in high quality bonds laddered out to 3 years, invested with duration of about 1.8 -- well below the benchmark. The proceeds of maturing bonds are being reinvested in other high quality corporate bonds maturing in 3 years or less. The obligations of financial companies are currently viewed as most attractive. US Treasury and agencies are overvalued, in our opinion, and are largely absent from portfolios. TIPS (US Treasury Inflation Protected Securities) were eliminated last year reflecting their unattractive prospective returns.

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