2nd Quarter 2012

Highlights

- Once again financial markets became captive to the European debt crisis. U.S. treasuries outperformed as economic worries mounted. Our credit-oriented portfolios underperformed during the quarter;
- Like 2010 and 2011, this year began with optimistic expectations for the economy, but faded on deteriorating external conditions. We believe the U.S. economy will continue to grow, but at a sluggish pace through the end of the year.
- As investors search for yield, global markets become enticing. How should we think about global high yield?

Markets

		Returns (%)	
GIA*	Average Quality	Q2-12	12 Months
Global High Yield Composite	(BB-)	0.06	4.39
Core Plus Composite	(A)	1.74	6.81
Core Composite	(A+)	2.40	8.44
**Returns are net of fees*			
Benchmark Bonds			
Barclay's U.S. Aggregate Index	(AA+)	2.06	7.47
Treasury	(AAA)	2.83	9.04
Credit	(A)	2.46	9.54
Mortgage	(AAA)	1.10	5.04
Government/Credit	(AA+)	2.56	8.78
BoA Merrill U.S. Corps & Yankees	(A)	2.27	8.65
BoA Merrill Corporate Master	(A-)	2.37	9.15
BoA Merrill High Yield	(B+)	1.88	6.62
JPM Emerging Markets EMBI+	(BB+)	2.75	11.15
JPM CEMBI Broad	(BBB)	1.43	6.11
JPM GBI-EM Global Diversified	(BBB+)	-1.21	-1.69
Citi Non-U.S. World Govt. Bonds	(AA+)	0.20	0.44
Benchmark Equities			
S&P 500	NA	-3.29	3.14
Nasdaq Composite	NA	-5.06	5.82
Russell 2000	NA	-3.83	-3.50
MSCI EAFE	NA	-8.37	-16.67
Europe	NA	-9.11	-19.34
Japan	NA	-7.44	-9.31
MSCI Emerging Markets Equity	NA	-10.00	-18.22

Markets

During the second quarter financial markets remained gripped by European efforts to resolve the sovereign debt and banking crisis. Greece edged closer to exiting the Euro zone as the angry populace voted more anti-austerity candidates into power. Spain moved into the eye of the storm with renewed capital deficiency in the banking sector and growing pressure on regional government finances. Adding to investor concerns, China delivered lower than expected economic performance, and U.S. economic data softened following a strong fourth quarter and favorable employment data in the first quarter of 2012. Not surprisingly, financial markets displayed significant volatility. U.S. stocks ended the quarter on a positive note, but lost over 10% between March 31 and May 31. Treasuries hit new historical low yields, with the 10 year touching 1.45% during the quarter. Commodities fell as the prospects for Chinese growth faltered with oil dropping 19% and industrial commodities continuing a price erosion that commenced in early February.

Throughout this confusing quarter, credit spreads widened, but bonds ultimately performed reasonably well, a reflection of generally robust creditworthiness and drag-along benefit of lower treasury yields. The high yield bond market took a breather in May and early June, but ultimately delivered a strong performance in June and for the quarter. The Bank of America Merrill Lynch (BACML) High Yield Cash Pay Index (J0A0) was up 1.88% for the quarter and 7.02% year-to-date. Spreads widened by 45 basis points for the quarter, almost all a result of the decline in treasury rates, as the yield of the index went from 7.08% to 7.19%. Fund flows were negative $803 million for the quarter, reflecting strong outflows in May and the first week of June, offset by inflows the rest of the quarter. Year to date, flows remained strong at $19.8 billion. The default rate increased to 2.16% through June, although the volume of defaults in June was the lowest in the last ten months. New issuance totaled $54.7 billion for the quarter, a sharp drop from the first quarter, but still a robust pace of $161.7 billion year-to-date.

The Bank of America Merrill Lynch U.S. Corporate Index (C0A0) returned 2.37% for the quarter underperforming the U.S. treasury index which returned 3.0%. However, year-to-date investment grade corporate bonds handily outperformed treasuries 4.87% compared to 1.67%. The 10-year U.S. treasury rate declined from 2.21% to 1.65% during the quarter pulling up prices of most fixed income securities and furthering investors' search for yield. Spreads widened by 23 basis points to 215 basis points for the quarter and the yield of the index dropped from 3.47% to 3.35%. The pace of issuance slowed significantly after 1Q's frenzied pace of $344.5 billion. Still, $212.2 billion of new bonds were sold, bringing year-to-date issuance to $556.8 billion.

Emerging market debt experienced a volatile quarter as significant news affected many markets. Disappointing economic data from China affected Chinese borrowers and YPF's expropriation in Argentina hurt some Latin American borrowers. Other name specific events also affected emerging markets during the quarter. Despite volatility, the JPM Emerging Markets Bond Index Plus (EMBI+) returned 2.75%, the Corporate Emerging Markets Bond Index Broad (CEMBI Broad) returned 1.43%, and the GBI-EM Global Diversified (local currency markets) index returned -1.21%. Year-to-date performance was 6.91%, 6.78%, and 6.99% respectively. Corporate bond issuance remained buoyant for the year with $143.7 billion pricing across countries and currencies.

Portfolios

Our *Global High Yield Composite* consists of portfolios investing primarily in U.S. high yield, higher yielding investment grade credit, and emerging markets corporate bonds. The Composite underperformed the Bank of America Merrill High Yield Cash Pay Index by 182 basis points in the quarter, and was behind the index by 223 basis points over the last 12 months. During the second quarter the European debt crisis escalated, liquidity deteriorated, and some of our holdings suffered significant price declines. Emerging markets were negatively affected by the lower growth data, affecting many corporate borrowers. Approximately 111 basis points of underperformance are attributable to our emerging markets exposure and 60 to our high yield holdings. The remainder came from our allocations to investment grade credit and cash. Over the past twelve months our emerging markets accounted for 179 basis points of underperformance as a consequence of poor liquidity, growth fears in China, and significant price declines in some of our holdings in Brazil and Argentina. Our high yield holdings outperformed over the last twelve months, while our investment grade holdings and cash accounted for the remainder.

Our *Core Plus Composite* consists of portfolios that can hold up to 30% in securities rated below investment grade. The Composite underperformed the Barclays U.S. Aggregate Index by 32 basis points for the quarter, and was behind by 66 basis points over the last twelve months. U.S. treasuries outperformed credit markets during the quarter on the heels of weaker growth and expectations for further Federal Reserve easing. During the quarter our emerging markets exposure cost the portfolio 27 basis points and our high yield holdings cost 14. While our underweight in mortgages was favorable, it was offset by our underweight in treasuries. Over the last 12 months U.S. treasuries outperformed high yield, emerging market corporate bonds, and mortgages. While our investment grade and high yield holdings outperformed, they did not contribute enough to offset the portfolio's underweight in treasuries and the negative contribution from emerging markets..

Our *Core Composite* is an investment grade only composite managed against the Barclays Government/Credit Index. The Composite underperformed the benchmark by 16 basis points during the quarter, and was behind by 34 basis points over the last twelve months. U.S. treasuries outperformed credit markets during the quarter and the portfolio was overweight credit. While the negative contribution from credit was a modest 6 basis points, the underweight to treasuries cost the portfolio 10 basis points. Over the last 12 months the portfolio was overweight credit. An important influence on the core fixed income market during that period was the Fed's "Operation Twist" which lowered long-term interest rates more than short-term rates. While the credit index outperformed the treasury index, long treasuries significantly outperformed long credit. Since much of the portfolio's longer exposure was in credit, the portfolio underperformed over that period.

Economy

It's déjà vu all over again! For the third straight year the economy closed the prior year with a firm tone and expectations for a healthy recovery, only to be derailed mid-year by debilitating external factors. In 2010 Greece launched the European sovereign debt crisis, in 2011 the Japanese tsunami and Arab Spring provided the interruption, and in 2012 Europe's expanded debt crisis combined with a Chinese slow-down to zap U.S. economic momentum. The underlying problem is that the

U.S. recovery has been fragile all along. While the outlook has deteriorated in the second quarter of 2012, we think the economy should continue to muddle through at a reasonable, but not spectacular, pace because some important indicators have turned favorable.

Disappointing data releases on employment, consumer confidence, and manufacturing combined with election year rhetoric and a looming fiscal crisis to sour sentiment. However, housing data came in better than expected. Housing prices appear to have bottomed after 5 years of declines and mortgage finance availability, along with attractive borrowing rates, seems to be improving. In addition, personal consumption has held in well despite reduced confidence. While economists adjusted their forecasts for 2Q full year growth down, they continue to expect better performance in the second half of the year.

In reaction to contractionary measures from government authorities, the Chinese economy has slowed, by many measures, more than expected. China had become the marginal consumer of many commodities because of the country's rapid growth. One consequence of the Chinese economic slow-down has been a decline in oil and industrial commodity prices. Lower prices should help keep inflation in check and, as consumers benefit from lower gasoline and home fuel prices, they can augment their consumption of other goods. While these might not jump-start the economy, they should keep the economy growing, even if slowly.

A significant Chinese contraction is worrisome because China was the engine of global growth over the last two years. The economy has been transitioning from export-led growth to domestic consumption led growth. That transition will likely continue, but with Europe in recession and the U.S. muddling, the implications may include a slower global growth rate. At the same time, Europe will take years to shift from government driven economies to private sector led growth. Europe may experience at least two more years of sluggish activity.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing 2.0% to 2.5% in Q3 and Q4 2012. Once again, the U.S. economy was set back by external factors in the first half of the year. China's slowdown and Europe's recession affected manufacturing, which had been an important source of marginal growth and may now be less supportive. On the other hand, news on housing, oil prices, and personal finances remains encouraging. The Federal Reserve will likely remain accommodative and financing for consumers and small businesses seems to be flowing more readily. On balance, the economy should continue to muddle through at a reasonable, but not stellar pace. PROBABILITY 65%

2. A second scenario has the economy declining to 0.0% to 1.0% growth due to another flare-up of the European debt crisis and slower than expected growth in emerging economies. The fiscal cliff coming right after the presidential election may curtail investment and high unemployment could conspire to ruin consumer confidence and put the economy back into a stall. PROBABILITY 25%

3. The third scenario has the economy recovering to trend or even above-trend growth of 3.0 to 3.5% over the next six months. After years of headwinds for the economy, conditions have improved enough to envision tailwinds instead, and the second quarter may have been a temporary stall in an otherwise upward trajectory. After four years of restructuring and stimulus, some of the headwinds may be fading and favorable factors, like energy prices, could lead to surprises on the upside rather than the downside. Data at the end of the quarter suggest this scenario is highly unlikely over the next six months. PROBABILITY 10%

Market Outlook

Investor sentiment has suffered violent swings in 2012. U.S. stocks rallied over 10% in the first quarter only to lose all the gains by the end of May. Continued modest economic activity will likely keep interest rates in a narrow, but low, absolute range. Low interest rates should encourage the search for yield, which favors investment in higher return credit markets. With a stable economy, default rates should remain low and credit availability should enable companies to refinance or fund investments more easily. While the Fed will likely continue to be accommodative, any indication that the economy may perform better than expected will likely lead to higher rates, a risk that affects all fixed income markets. Credit spreads remain at higher than historical average levels, but fixed income returns may still be affected negatively by an increase in rates.

Commentary – What is Global High Yield?

Investing has become global. Vast pools of money from many regions of the world have long sought opportunities away from their countries of domicile and U.S. investors have long placed portions of their assets overseas. However, institutional investing in the U.S. has followed a relatively strict asset allocation methodology that has relied on categorizing investments into narrowly defined “asset classes”. Asset classes can generally be defined as groups of investments that share certain risk and return parameters that can be analyzed and relied upon for investment allocation purposes. As investors have pursued more opportunities, asset class designations have expanded from stocks, bonds, and their subsets to include alternatives, commodities, real estate, and others.

A key feature of an asset class is commonality of risk. While this is conceptually simple, in practice, few investments share a large group of risks. It can be argued that large cap and small cap stocks share a set of risks, like economic growth, consumer sentiment, and other macro factor risks, but small caps tend to display more volatility given the same set of economic outcomes. Analytical difficulties arise as new investment opportunities are added to "established" asset classes. The addition of non-U.S. investments to U.S. based portfolios is one example. Most institutional investors own U.S. government bonds. When going global by investing in foreign government bonds, those investors become exposed to changes in interest rates and currency values in each country in which they invest. While the addition contributes diversification, it is hard to argue non-

U.S. government bonds expose U.S. investors to similar risks as U.S. government bonds, even though at a high level both sets of investments are sensitive to changes in interest rates.

An area of significant interest to investors today is high yield and, in particular, global high yield. Here too, investors are faced with the question of what global high yield means and how the "asset class" should be defined for asset allocation purposes. The logical starting point is to define the possible component parts and find common risks.

The high yield market gained traction in the U.S. as investors became willing to step between banks and less creditworthy borrowers by lending money at higher yields. Borrowers were attracted to additional sources of capital and to the flexibility public markets offered compared to financing from banks. The high yields available from the sector were more similar to equity returns than bond returns, and so were the risks. As the high yield market gained "mainstream" status, investors recognized that the asset class had more similarities with equities than with traditional bonds, even though they shared more structural characteristics with bonds. The reason for this is that traditional bonds, treasuries and investment grade corporates, share a common risk that accounts for almost all the volatility in those sectors, interest rates. High yield bonds, on the other hand, are sensitive to "credit risk," a risk that is idiosyncratic rather than systemic.

Credit risk has similarities with stocks because corporations pay interest on their debt and dividends on their stock with the same cash flow. Events that affect corporate cash flow will affect both asset classes. Bonds are senior to stocks in the capital structure so they enjoy payment priority over stocks, but they do not enjoy much upside from improvements in cash flow that corporations enjoy when successful. This feature makes high yield bonds less volatile than stocks, but still different in risk from government bonds.

Logic suggests that the common risk attributable to global high yield is credit risk, so how should investors think about currency risk and investments in countries where interest rates are high? The indexes below could be representative of sectors that might be considered for inclusion in a global high yield strategy.

BAML U.S. High Yield Cash Pay Index (J0A0): Index of U.S. high yield issuers.
JPM Corporate Emerging Markets High Yield Index (CEMBI HY): Index of emerging market corporate issuers rated below investment grade.
JPM Global Bond Index –EM Global Diversified (GBI-EM): Index of emerging local market investments with results in U.S. dollars.
Barclays Global High Yield Index (BC GHY): Index of high yield issuers from U.S., Europe, UK, and emerging markets with results in U.S. dollars.
Barclays Global Pan-Euro High Yield Index (BC PEHY): Index of high yield issuers from Europe and U.K. with results in U.S. dollars.

Return and volatility over the period January 2003 through June 2012:

	Return	Volatility
J0A0	9.92%	10.60
CEMBI HY	11.64	16.45

GBI-EM	11.95	12.15
BC GHY	11.05	11.50
BC PEHY	12.90	18.92

Over the past 9.5 years each of these sectors has delivered comparable results even though their sources of risk have been quite different. The difference in volatility between the BC Pan-Euro high yield index and the BC Global High Yield Index can be attributable almost entirely to the effect of the currency. Approximately 20% of the BC Global High Yield index is made up of non-U.S. dollar denominated investments. Over that period, the Euro appreciated by 2.5% per annum versus the U.S. dollar, but contributed nearly all of the excess volatility. The JP Morgan Global Bond Emerging Markets Index (GBI-EM) consists primarily of government bonds of ten emerging market countries. Over the last 9.5 years the returns of that index came approximately 80% from the underlying assets and 20% from currency appreciation. Although "returns are returns," there is an important difference between asset returns and currency returns.

We do not believe investors should ascribe a "return" to currency investing as the return should be generated by the foreign assets that are selected. Making investments in foreign markets expecting a return from currency implies the investor's domestic currency will permanently devalue. Instead, investors should select investments abroad based on the expected returns and risk of those assets. Analytically, expected asset returns can be calculated by hedging currency exposures to determine if those returns provide a compelling alternative to domestic assets. Separately, investors can isolate currency management for gain or risk control, if appropriate.

Attaching risk sources to assets based on credit risk versus interest rate risk, i.e. high yield bonds due to creditworthiness rather than to high interest rates in a foreign jurisdiction, allows for an asset class distinction. Global high yield should refer to investments whose source of risk and return is credit, regardless of domicile. High interest rate markets should be attached to a global government bond asset class. How might investors deal with overlap, if, as often happens, certain borrowers in their own markets may qualify for both asset classes? We believe active managers should be given reasonable leeway, but it is generally the case that credit risk can be separated from interest rate risk. We believe an appropriate measure of the key source of risk for a global investor is the relative compensation for credit risk in each currency. In theory, the manager can select the jurisdiction with the most attractive compensation for credit, hedging the currency to pick the best investment. Alternatively, the global government bond investor can chose a creditworthy borrower to invest in a country with high rates. While these approaches may lead to overlap, each manager must reconcile in attribution the unintended risk that may come with that selection. It is often the case, however, that highly desirable borrowers in home jurisdiction do not pay higher credit spreads domestically than abroad, thereby making it unattractive for credit investors to select domestic currency bonds for those entities. Similarly, if the borrowers are truly creditworthy, the risks they pose to investors seeking high foreign interest rates, will likely be predominantly related to the volatility of rates rather than to changes in credit quality. Therefore, even if two portfolios hold exposure to the same borrower, it will likely be in different currencies and the risks to the investor would match up properly in asset allocation.

July 16, 2012

GIPS requires GIPS Disclosure Statement (please see attached disclosure)
GIPS requires GIA fee schedule disclosure "GIA's fees are (i) .35% annually for standard USA fixed income, (ii) .50% annually for enhanced fixed income and (iii) .75% annually for specialized products"

Important Information

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Management Fees, as well as account minimums and other important information are described in GIA's Form ADV - Part II. Since management fees are deducted quarterly, the compounding effect will be to increase the impact of such fees by an amount directly related to the account's performance. For example, an account with a 10% gross annual return and a 1% annualized management fee that is deducted quarterly will have a net annual return of about 8.9%.

*Important GIPS disclosures pertaining to composite performance may be found at the back of this letter.

Index Definitions

Barclays US Aggregate Index
The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Barclays US Treasury Index
This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Barclays US Government/Credit Index
The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Barclays US Credit Index

This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Barclays US Mortgage Backed Securities Index

This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bank of America Merrill Lynch US Corporate & Yankees Index

The Bank of America Merrill Lynch US Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

Bank of America Merrill Lynch US Corporate Index

The Bank of America Merrill Lynch US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

Bank of America Merrill Lynch US High Yield Master Cash Pay Only Index

The US High Yield Master Cash Pay Only Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

JP Morgan Corporate Emerging Markets Bond Index (CEMBI)

The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. Both indices are also available in Diversified versions.

JP Morgan EMBI+ Index

The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)

The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

Citigroup Non-US World Government Bond Index

The Index is comprised of foreign government bonds with maturities over one year.

S&P 500 Index

An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index

An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI EAFE- Europe Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe.

MSCI EAFE- Japan Index
The index is a capitalization weighted index that monitors the performance of stocks from Japan.

MSCI Emerging Markets Equity
The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.