MURRAY
INVESTMENT MANAGEMENT

2nd Quarter 2011 Update

Economic Review

The U.S. economy hit somewhat of a soft patch during the first half of 2011. 1Q11 GDP growth was reported at 1.9% (down from 3.1% in 4Q10) while estimates for 2Q11 GDP have been falling. Greece's fiscal crisis, elevated energy prices and high unemployment (9.1% in May) were some of the primary economic concerns during the quarter.

The U.S. Federal Reserve left interest rates unchanged (0%-.25% target) during the quarter and allowed the QE2 program (Quantitative Easing) to expire at the end of June. In addition, the Fed also forecast less positive GDP growth but views the slowdown as temporary.

The Standard & Poor's rating agency cut the outlook for U.S. Treasuries but did not change the AAA credit rating. This downgrade was a warning to the U.S. Government that excessive borrowing and spending cannot go on forever without negative consequences.

Partially influenced by a release from the Strategic Petroleum Reserve, oil prices came down from elevated levels during the quarter to around $95 per barrel, which should help promote increased consumer spending. In addition, the economic data towards the end of the quarter and during the first part of June was marginally better and somewhat brightened the outlook for the 2nd half of the year.

Equity Market Performance

	2Q11	YTD
S&P 500	0.10%	6.02%
MSCI EAFE (International index net return)	1.56%	4.98%

Domestic equity markets were extremely volatile during the 2nd quarter as investors seemed to move back and forth between a "risk on / risk off" trade. The debt crisis in Greece and a slowing U.S. economy dominated headlines, but markets rallied at the end of June as Greece released an austerity plan and some economic data turned more positive. The Energy and Financial sectors were two of the weaker areas of the market during the quarter while the Healthcare sector rallied significantly to be among the best performing sectors year-to-date.

The broad International markets have generally lagged domestic markets during the year but outperformed during the quarter.

Bond Market Performance

	3 Months	YTD
BarCap US Aggregate Bond (Broad Bond Market)	2.29%	2.72%
BarCap Municipal	3.89%	4.42%
BarCap US Treasury Long	3.36%	2.32%
BarCap US Corporate	2.28%	3.16%
BarCap US Corporate High Yield	1.05%	4.97%

The broad bond market produced solid results during the quarter as bond yields fell. Long U.S. Treasuries were particularly strong as the volatile equity markets produced somewhat of a "flight to quality" move. The high yield corporate space, which is more tightly correlated with equities, produced positive results but was not as strong as some of the other sectors due to investors generally preferring higher quality fixed income instruments.

Economic Outlook

The focus over the next several months will be to determine whether the recent softening of economic data is due to temporary factors (such as elevated oil prices and supply disruptions from the earthquake in Japan) or issues that are more longstanding. Either way, the recovery will likely be modest until we see stronger job growth and consumers feel more comfortable spending money.

U.S. consumers, the U.S. Government, and others around the world are just in the beginning stages of working through the painful process of deleveraging (reducing debt levels). The U.S. Government, in particular, will continue deliberations regarding the budget and the debt ceiling over the coming weeks. The budget debate will center on either 1) less spending or 2) raising taxes, but the compromise will likely balance the two approaches. This budget debate is necessary and critical if the U.S. wants to reduce debt levels and place the economy on stronger long-term footing.

Market Outlook

U.S. equity prices should remain volatile over the 2nd half of the year as investors sort out the strength of the recovery and work through the global debt issues. With solid corporate earnings year to date, U.S. equity prices still seem reasonably priced, but as GDP estimates have been coming down, there are concerns about the strength of corporate earnings over the second half of the year.

2nd quarter earnings reports will be released in the coming weeks and are expected to be strong. A solid showing for 2nd quarter earnings coupled with strong company guidance for

Source: standardandpoors.com, bls.gov, Morningstar, BEA.gov, CNBC.com and federalreserve.gov.
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the second half of the year could be a favorable backdrop for equity markets.

With the Fed on hold and modest economic growth forecasts, interest rates should remain relatively low for the remainder of 2011 but will likely bounce around in a trading range in the coming months. The longer term expectation, however, is that rates will move higher as the Fed becomes less accommodative, the economy expands and U.S. debt levels continue to rise.

In the context of a broadly diversified portfolio, it seems that owning shorter term fixed income securities and leaning towards Large Cap equities is a reasonable approach to portfolio construction at this point.

Murray Investment Management

If you would like help with establishing an investment plan or would like to schedule a portfolio review, please contact Sam Murray at 713.850.7444. Also, please pass along my name to anyone that may be in need of investment advice.

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