

Week of: October 26, 2009

2009 MARKET VIEWS – SUMMARY

Economy

- We believe the U.S. economy is stabilizing and there may be modest growth by year end 2009.
- Our forecast conclusions include sustained low inflation and interest rates, weak consumption activity, and relatively weak corporate earnings during the next 18 months.
- In our view, the U.S. unemployment rate will probably not peak until 2010, and may remain persistently high as consumer retrenchment causes dislocation in employment.

Equity Markets

- Beginning in the second half of 2009 and extending into 2010, we anticipate domestic equities may lead most global equity markets in terms of price recovery.
- We believe the domestic equity market's rebound from March lows seems to reflect investors' belief of a return to economic and market normalcy and provides a degree of optimism regarding the unfolding global recovery.
- We anticipate that emerging markets may lead developed international markets over the near and intermediate term.

Fixed Income Markets

- Current rates on Treasury securities appear to be too low and may represent a risk to investors; rates are likely to rise.
- The credit markets, outside of Treasuries, may represent a potentially attractive opportunity for investors.
- Non-Treasury spreads narrowed during the first half of 2009, but are still historically attractive in investment grade and high yield corporate debt.

Commodity Markets

- We expect commodity prices to track the global economy.

Real Estate Markets

- Residential real estate may be near its nadir, but high unemployment and housing supply will likely keep prices low.
- Commercial real estate seems to be weakening and we anticipate this weakness could track into 2010.

CURRENT ECONOMIC UPDATE

Domestic

- Recent U.S. economic releases still seem to indicate an improving economy with little inflation on the horizon.
 - The index of Leading Economic Indicators (LEI) experienced its sixth consecutive monthly gain by jumping 1.0% in September, and the report indicates this trend is consistent with a developing recovery.
 - Signs of inflation have started to disappear in the government data, at least temporarily as the Producer Price Index (PPI) report is still lagging the recent rise in oil prices.
 - > Overall PPI fell back 0.6% in September after rebounding 1.7% the previous month.
 - > The PPI core rate slipped by 0.1%, due in part to a drop in prices for light trucks.

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CURRENT ECONOMIC UPDATE

Domestic, Cont'd.

- The Federal Reserve's Beige Book, prepared for the upcoming November Federal Open Market Committee (FOMC) policy meeting, reported most Districts "indicate either stabilization or modest improvements in many sectors since the last report."
 - > The report also mentioned that gains in economic activity generally outnumber declines.
 - > Leading the improvement were more positive reports in residential real estate and manufacturing.
 - > Consumer spending and nonfinancial services were mixed.
 - > Commercial real estate was reported to be one of the weakest sectors.

Global

- Global economies are showing a resumption of growth in their third quarter gross domestic product (GDP) reports.
 - As an example, South Korea's Central Bank reported their economy grew at the fastest pace in seven years, increasing 2.9% during the third quarter.
 - > This increase compares to a year earlier when GDP rose 0.6%.
 - According to preliminary estimation, China's GDP for the first three quarters of 2009 is up 7.7% year over year.
 - > Contributors include a quarter-over-quarter improvement in the growth rate of industrial production and retail sales of consumer goods which are up 15.1% year over year.
- The Eurozone reported that the industrial new orders index rose by 2% for August 2009 after a 3% increase in July.
 - Excluding the volatile transportation sector, industrial new orders rose by 2.4%.

MARKETS AT-A-GLANCE

	Fed Funds Target Rate	10-yr Treasury Yield	S&P 500 Close	DJIA Close
LAST WEEK (10/23/09 close)	0.00 – 0.25%	3.48%	1,079.60	9,972.18
Prior Week (10/16/09)	0.00 – 0.25%	3.42%	1,087.68	9,995.91
Last Month (09/30/09 close)	0.00 – 0.25%	3.31%	1,057.08	9,712.28
Year End (12/31/08)	0.00 – 0.25%	2.25%	903.25	8,776.39

Data Source: Factset

CURRENT MARKET EVENTS

Equity Markets

- The equity markets, domestically and around the globe, eased modestly last week as macro concerns re-entered the picture, and both interest rates and oil prices continued to move higher.
 - The S&P 500 and Dow Jones Industrial Average were down 0.74% and 0.24% respectively with the MSCI EAFE (Morgan Stanley Capital International Europe, Australasia, Far East) up 0.48%, and other country-specific equity market measures ended the week mixed (with many down).

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CURRENT MARKET EVENTS, Cont'd.

Equity Markets, Cont'd.

- The Dow Jones Transportation Average (e.g., airlines), shed over 5% last week likely due to fears related to oil and swine flu issues.
- As mentioned in previous weeks, the small- and mid-cap segments of the domestic equity market appear to have stalled for now as evidenced by the drop in the S&P 400 MidCap (-0.92%) and the S&P SmallCap 600 (-2.38%), which both performed lower than the S&P 500 for the week.
- We continue to believe a rotation to large cap stocks is now underway and will be a theme over the next few weeks as the rally is now at a more mature phase.
 - > Dividend yield, relative stability, and the international exposure that large cap names can bring to the table could now be appealing attributes.
 - > Active management generally beats passive strategies in the lower growth phase of the market advance.
- Third quarter earnings continue to be a central market driver.
 - With 39% of the S&P 500 companies reporting for the quarter, fully 80% have exceeded published earnings expectations.
 - > Importantly, 62% of these companies have exceeded estimates on the top line, indicating that some degree of revenue momentum is returning to the marketplace.
 - > The high degree of operating leverage, production-led inventory re-stocking, and foreign earnings participation appear so far to be key themes of third quarter earnings.
 - Of the companies reporting, 12.2% have missed estimates with much of this activity centered in the Energy and Materials segments (possibly due to difficult pricing on the base commodity complex, and also some elements of weak demand).
 - The year-over-year earnings growth rate now stands at negative 18.2% for the S&P 500, but the third quarter versus second quarter growth rate is 6.8% with possible modest acceleration as we move into 2010.
 - > We are anticipating that a degree of government stimulus driven demand, increased domestic consumer participation, dividend increases, and low earnings expectations will most likely combine and possibly result in an above expectation fourth quarter earnings experience.
 - Higher oil prices and/or a plunge in the U.S. dollar are current equity market concerns.

Fixed Income Markets

- Rates rose last week across the yield curve as reports that the Federal Reserve may be contemplating changing the language from the FOMC to open the door for interest rate increases on Fed Funds.
 - The Fed has a delicate balancing act since it doesn't want to indicate an imminent rate increase during a time when unemployment is still rising and the financial system is still experiencing lending issues among the banking industry.
 - > Premature tightening could possibly cause an economic setback, which is something the Fed is anxious to avoid.
 - The two-year Treasury note rose above 1% for the first time in over a month and the 10-year note rose nine basis points to 3.49%, which is also the highest rate in a month.
- Another major factor in the rise of interest rates last week was likely the large supply of Treasuries coming to market this week.
 - A record \$123 billion in Treasuries will be auctioned, including \$44 billion in two-year notes, \$41 billion in five-year notes, \$31 billion in seven-year notes, and \$7 billion in five-year Treasury Inflation-Protected Securities (TIPS).

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CURRENT MARKET EVENTS, Cont'd.

Fixed Income Markets, Cont'd.

- Demand for previous auctions has been very strong with significant interest from banks (possibly due to regulatory changes that will require banks to hold more liquid assets, like Treasuries).
 - > According to Federal Reserve Bank data, U.S. commercial banks bought \$81 billion in Treasury debt so far this year.
 - > U.S. households have also been big buyers of Treasuries, nearly tripling the amount held at the end of 2008; as of the end of second quarter 2008, individual holdings stand at \$605 billion.
- Another important factor involved in helping keep rates low appears to be purchases of Treasury debt made directly by the Federal Reserve Bank.

- We are becoming more convinced that the low level for interest rates has already been set for 2009 and that the anticipated growing supply for 2010 will likely start to push rates higher from today's levels.
 - We believe that this week's release of third quarter GDP and jobless claims data will probably have a big impact on the bond market.

- We continue to expect investment grade and high-yield to outperform in a rising interest rate environment.
 - Intermediate municipal bond rates have increased to levels that we now view as attractive for tax-exempt investors.
 - U.S. agency debt spreads are now at historically tight levels and we currently view this as an attractive sector.

Commodity Markets

- The price of crude oil pushed above \$80 per barrel based on a higher forecast for global oil demand from the International Energy Agency (IEA).
 - Demand appears to be steady for gasoline at a year-over-year rate of 4.2%, but very weak for distillates where demand is down 12.1%.
 - > In the U.S., gasoline stocks fell steeply for the second straight week; down 2.3 million barrels for the October 16 week.
 - > Distillate stocks were also down for the second week by 0.8 million barrels.
 - As a result of the optimistic International Monetary Fund (IMF) economic prognoses and stronger preliminary data from the Americas and Asia, the IEA revised global oil demand upward by 200,000 barrels per day for 2009 and by 350,000 barrels per day for 2010.
 - > Global oil demand now averages 84.6 million barrels per day for 2009 and 2010 estimates are for 86.1 million barrels per day, which implies yearly growth of negative 1.7 million barrels per day for 2009 and positive 1.4 million barrels per day for 2010.

Real Estate Markets

- Existing home sales jumped in September in what appears to still be a mixed report for the housing sector.
 - Existing home sales rose by 9.4% to a 5.57 million annual rate.
 - > The West was the strongest region, up 13% to 1.30 million, with the Northeast showing the least strength, up 4.4% to 950,000.
 - > Supply in the market fell back sharply (down 7.5% for September to 3.63 million units), which is very good news and is the lowest level in the past two and one-half years.
 - > Inventory levels fell to 7.8 months which is down from 9.3 months in August and compares to the September 2008 level of 10.1 months.

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CURRENT MARKET EVENTS, Cont'd.

Real Estate Markets, Cont'd.

- The bad news revolves around the continued tumbling of prices, which are down 1.4% in September to a median price of \$174,900.
 - > The year-over-year decline is, however, moderating from low double-digits in previous months to 8.5% in September.
 - > Distressed sales made up 29% of total sales for the month, down from 50% levels reported earlier this year and down from 31% reported in August.
- September's total may represent a peak or near peak in home sales for the year given the approaching end of the first-time buyer credit program.
 - > There are efforts underway in Washington to possibly extend the credits, and the ongoing declines in prices may help add steam to these actions.
- Commercial property values in the U.S. have plunged since 2007 as employers cut jobs and the recession reduced demand for offices, retail space and rental apartments.
 - The Moody's/REAL Commercial Property Index (CCPI) fell 3% in August, bringing the decline to almost 41% since October 2007.
- One of the largest U.S. commercial real estate finance companies, Capmark Financial Group, Inc., filed for bankruptcy protection after posting a second quarter loss of about \$1.6 billion.
 - According to Sam Shandan, president and chief economist of Real Estate Econometrics LLC, which is a real estate consulting firm in Manhattan, "The Capmark bankruptcy reinforces that, in the case of institutions with large concentrations in commercial real estate, current disruptions to the market have the potential to impact their viability."

CURRENT ASSET ALLOCATION STRATEGY

- The Asset Allocation Committee modified our tactical asset allocation guidance this week.
 - We believe that developed equity markets, both domestic and global, may soon represent leadership within the marketplace and are therefore increasing our exposure in these asset classes by moving from neutral to overweight positions.
 - Due to our belief that the trend for higher Treasury rates is in tact, we have moved to an underweight allocation in investment-grade fixed income.

Balanced Portfolio Strategy – Tax Aware

Equity – 69% / Overweight

Domestic Large Cap: Overweight
Domestic Mid-Cap: Overweight
Domestic Small-Cap: Neutral
Developed International: Overweight
Emerging International: Overweight
Private Equity: Neutral
Hedged Equity: Overweight

Fixed Income – 26% / Underweight

Investment Grade: Underweight
High Yield: Overweight
TIPs*: Underweight
Foreign Debt: Neutral
Hedged Fixed: Neutral

*Treasury Inflation-Protected Securities

Real Estate – 0% / Underweight

Commodities – 5% / Overweight

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DEFINITIONS

Basis point is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument.

Beige Book is the commonly used name for the Fed report called *The Summary of Commentary on Current Economic Conditions by Federal Reserve District*. It is published just before the Federal Open Market Committee (FOMC) meeting on interest rates and is used to inform the members about changes in the economy since the last meeting. Each Federal Reserve bank gathers anecdotal information on current economic conditions in its district.

Capmark Financial Group, Inc., formerly known as GMAC Commercial Holding Corp., is based in Horsham, Pennsylvania, and is one of the largest U.S. commercial real estate finance companies, with more than \$10 billion originations, according to Moody's Investors Service. They service more than \$360 billion of debt.

Central Bank is an entity responsible for overseeing the monetary system for a nation (or group of nations).

Dow Jones Transportation Average (DJTA) is the most widely recognized gauge of the transportation sector and is composed of 20 stocks that are chosen to represent the transportation industry.

Earnings are perhaps the single most studied number in a company's financial statements because they show a company's profitability. Ultimately, a company's earnings are the main determinant of its share price, because earnings and the circumstances relating to them can indicate whether the company will be profitable and successful in the long run.

Eurozone is one of the largest economic regions in the world and consists of all European Union countries that have fully incorporated the euro as their national currency.

Federal Open Market Committee (FOMC) is the branch of the Federal Reserve Board that determines the direction of monetary policy. They meet eight times per year to set key interest rates and to decide whether or not to increase or decrease the money supply.

Gross Domestic Product (GDP) is the total market value of all final goods and services produced in a country in a given year.

International Energy Agency (IEA) is an intergovernmental organization which acts as energy policy advisor to 28 member countries in their effort to ensure reliable, affordable and clean energy for their citizens. The IEA conducts a broad program of energy research, data compilation, publications and public dissemination of the latest energy policy analysis and recommendations on good practices.

International Monetary Fund (IMF) is an international organization which plays three major roles in the global monetary system. The Fund surveys and monitors economic and financial developments, lends funds to countries with balance-of-payment difficulties, and provides technical assistance and training for countries requesting it.

Leading Economic Index (LEI) is an index that is compiled by The Conference Board, a private-sector consulting firm. The index is designed to indicate the future direction of economic activity. A rising index signals that economic activity can be expected to increase in the near future.

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DEFINITIONS, Cont'd.

Moody's/REAL Commercial Property Index (CPPI) is designed to track same-property realized round-trip price changes based purely on the documented prices in completed, contemporary property transactions within the U.S. commercial investment property market.

Producer Price Index (PPI) is a family of indexes that measure the average change in selling prices received by domestic producers of goods and services over time; specifically measures price change from the perspective of the seller.

Spread is the difference between the yields of two bonds with differing credit ratings (most often, a corporate bond with a certain amount of risk is compared to a traditionally lower risk Treasury bond); the bond spread will show the additional yield that could be earned from a bond which has a higher risk.

Treasury Inflation-Protected Securities (TIPS) are a special type of Treasury note or bond that offers protection from inflation. Like other Treasuries, an inflation-protected security pays interest every six months and pays the principal when the security matures. The different is that the coupon payments and underlying principal are automatically increased to compensate for inflation as measured by the consumer price index.

Treasury yield is the effective rate of interest paid on a debt obligation issued by the U.S. Treasury for a specified term (e.g., two years).

Yield Curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates.

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- **Equities:** Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. **Fixed income securities:** Investing in fixed income securities are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors. Investment in debt securities typically decrease in value when interest rates rise. The risk is usually greater for longer term debt securities. Investments in lower rated and non rated securities present a greater risk of loss to principal and interest than higher rated securities. **Commodities:** There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes, and the impact of adverse political or financial factors. **Real Estate:** Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties, such as rental defaults. **Hedge Funds:** An investment in a hedge fund involves a substantially more complicated set of risk factors than traditional investments in stocks or bonds, including the risks of using derivatives, leverage and short sales, which can magnify potential losses or gains. Restrictions exist on the ability to redeem units in a hedge fund. Hedge funds are speculative and involve a high degree of risk. **International:** International investing involves special risks, including foreign taxation, currency risks, risks associated with possible difference in financial standards and other risks associated with future political and economic developments. **Emerging Markets:** Investing in emerging markets may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. **Small/Mid Cap:** Stocks of small- and mid-cap companies pose special risks, including possible illiquidity and great price volatility than stocks of larger, more established companies. **High-Yield Bonds:** Investments in high-yield bonds offer the potential for high current income and attractive total return, but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer's ability to make principal and interest payments. **Treasury Inflation-Protected Securities:** A special type of Treasury note or bond designed to offer protection from inflation. Interest payments vary with the rate of inflation. These securities offer a lower return compared to other similar investments. The principal value may increase or decrease with the rate of inflation. Gains in principal are taxable in that year, even though not paid out until maturity. The original principal of such a security issued by the U.S. Treasury will be repaid at maturity during periods of deflation. Other issuers may not provide such a guarantee, and the principal repaid at maturity may be less than the original principal value. **Private Equity:** Consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Potential investors should remember that investments in private equity are illiquid by nature and typically represent a long-term binding commitment. The investments made by private equity funds are not readily marketable and the valuation procedures for these positions are often subjective in nature.