TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

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Quarterly Insights

EXECUTIVE SUMMARY

Second Quarter 2011

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Stocks Finish Flat In Second Quarter, Bonds Rise

In the Second Quarter, the domestic S&P 500 Index rose 0.10%. However, the quarter was anything but uneventful. Halfway through June, the index had dropped 7.2% from April 29. A welcome rally in the last four trading days of the quarter, spurred by an abated Greek debt crisis, brought the market to an overall flat quarterly position. Through the first half of the year, the S&P 500 Index is up 6.02%. Bond prices rose modestly in the quarter. Yields are at or near record historic lows.

US Blue Chip Stocks: Unloved And Attractive

US blue chip stocks are being left for dead, yet are trading at outstanding valuations. They have some of the healthiest balance sheets ever and are paying strong dividends. They are trading at nearly a 40% discount to small cap companies.

Tepid economic growth, the winding down of stimulus plans, the end of the Fed's quantitative easing, and a move away from accommodative policy are all factors that point to blue chip out-performance. Investors are usually late to the party. We don't want to be late and are shifting the portfolio further towards blue chips.

John Barber, CFA
Chief Investment Officer

Dan Laimon, MBA
Managing Member

Michael Harris, CFA
Vice President

www.trivant.com

1-866-4-TRIVANT

toll free

US Blue Chip Stocks: Unloved And Attractive

Investors Are Usually Late To The Party

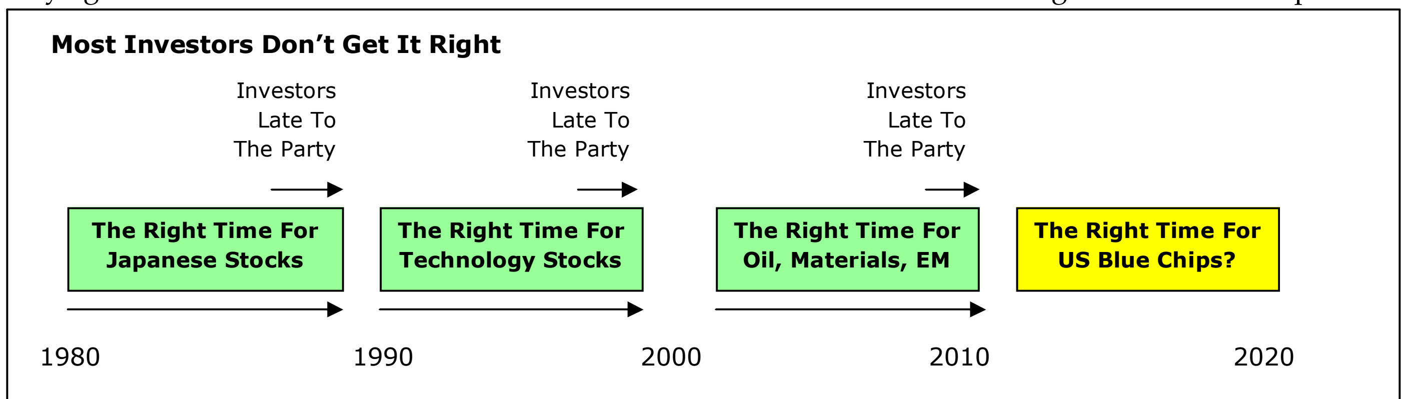
More often than not, the consensus is wrong when it comes to investing. Investors are usually late to the party. Perhaps Warren Buffett has said it best: "Most people get interested in stocks when everyone else is. The time to get interested is when no one else is. You can't buy what is popular and do well."

Missed investment opportunities have played out numerous times. In the 1970s, US consumers scoffed at the Japanese auto manufacturers. Most couldn't see how they could compete with American know-how and watched in the 1980s as the Japanese started to export high gas mileage cars to the US. By the end of the decade, Japan was a global economic power and universally hailed for innovation and high quality products.

Investors were late to the party, flocking to Japanese stocks by the late 1980s in a herd mentality rather than buying in the early 1980s. The run-up in the Tokyo Stock Exchange from 1983 to 1990 was unprecedented. At its peak in 1990 before it fell hard, Japan accounted for over 60% of the world's stock market capitalization.

At the Japan market peak, most Americans could not see how we could compete with the Japanese with any industry. All the attention was directed at Japan. All the money was directed at Japan. And it was at this time that US technology was in its early stages of changing the world. It took until near the end of the 1990s for investors to move to US technology stocks in a frenzy-like fashion. Again, they were late to the party. The sector run-up had already occurred and was to soon come to a screeching halt.

Fast forward a decade to now. Skyrocketing oil prices, higher emerging markets demand for oil, and a weak US Dollar stemming from the Fed's quantitative easing, has resulted in oil companies making more money than any industry in history. Gold has broken through the $1500 an ounce range. Emerging markets regions such as China and India boast higher GDP growth and are up 200% in market value over the past decade. In a delayed response, investors are hitching up to oil, materials, and emerging markets. Will they be late to the party again? We think so. Investors should look elsewhere. We think the time is right for US blue chip stocks.



The Time Is Right For US Blue Chip Stocks

US blue chip stocks are being left for dead. Why? The perception is that the US simply cannot compete with China, India, or Brazil. After all, emerging markets have considerably out-performed in the past 10 years. The US also has serious fiscal, employment and housing market problems. This scenario has played out many times. Unloved areas of the market often sell at compelling valuations. High performing areas do not.

We believe that US blue chip stocks are unloved and trading at outstanding valuations. They have some of the healthiest balance sheets ever and are paying strong dividends. They are trading at nearly a 40% discount to small cap companies.

US Blue Chips Are Poised To Return To Leadership This Decade

Index	1990 to 1999	2000 to 2010	Price/Earnings Ratio 2011
Small Cap (Russell 2000 Index)	251.1% (ex-dividends)	62.1%	26.9
Large Cap (S&P 500 Index)	432.2%	3.5%	18.9
Mega Cap (S&P 100 Index)	381.5% (ex-dividends)	(28.6%)	16.9

Source: Standard & Poor's

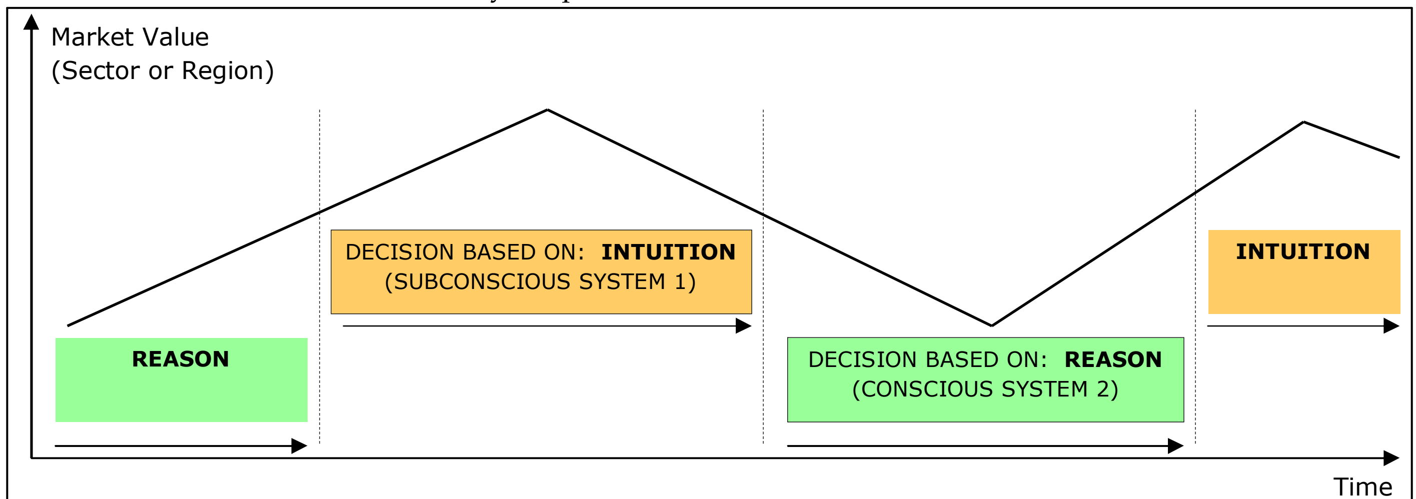
Why Are Investors Loath To Buy Blue Chips?

One explanation for current investor reluctance towards blue chips lies in cognitive psychology. Nobel laureate Daniel Kahneman's new work focuses on how decisions are made in one of two ways:

1. Intuition (subconscious System 1 decision making) or
2. Reason (conscious System 2 decision making)

Imagine you are driving a car. As an experienced driver, you don't think so much about the mechanics of driving. You make decisions based on intuition (subconscious System 1 decision making). For example, you immediately hit the brakes when the traffic light turns red without really thinking about it. The decision is automatic. When you were learning how to drive many years ago, your reaction to a red light was not so automatic. Your decision was based on reason (conscious System 2 decision making) versus intuition. You had to consciously think about putting your foot on the brake, how fast you were going and how long you needed to safely stop.

This concept has implications for how markets function. Investors are usually late to the party, buying into areas of the market when they have already had most of their run-up. These investors are buying based on intuition versus reason. Put another way, they are buying based on assumptions versus research. When this occurs, over-valued areas pick up further momentum and become more over-valued. And undervalued areas become more under-valued. Eventually the process reverses itself.



The End Of Quantitative Easing Should Be Catalyst For Blue Chip Out-Performance

Ben Graham, a legendary value investor, once said "in the short run the market is a voting machine, but in the long run it's a weighing machine". But waiting for compelling values to be realized can cause frustration and can derail an investor from a disciplined approach. Often a catalyst is needed to cause value to be realized.

Monetary policy has historically been a key factor in market performance and a vital indicator for stock market segmentation leadership. Interest rates are at historic lows. Accommodative policy, like the current situation, often helps small companies lead the market. This is because small companies have an easier time accessing the credit markets to fund their growth. Because of their more cyclical nature, rapid expansion causes cyclical companies to fare better.

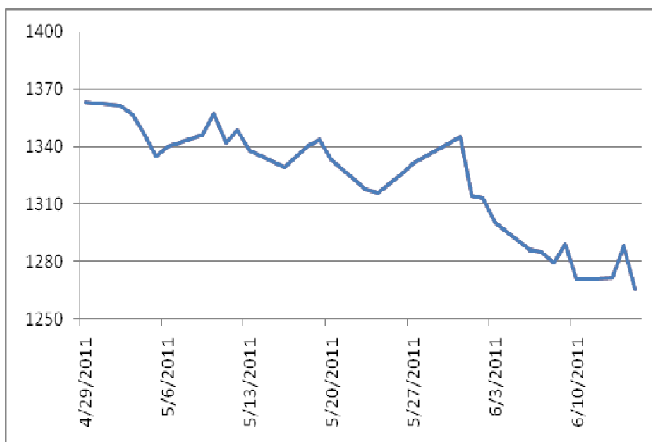
Tepid economic growth, as we are seeing right now, starts to favor more mature companies. With increasing concern about deficits, we think it is likely that stimulus plans will start winding down and new ones are unlikely. The Fed's QE2 (quantitative easing) ended in June. A move away from accommodative policy will tighten available credit to smaller companies. With rates at 0%, the Fed can only raise rates. Smaller companies are more vulnerable to interest rate increases than larger companies. All of these factors point to blue chip out-performance.

Stock Market Spotlight

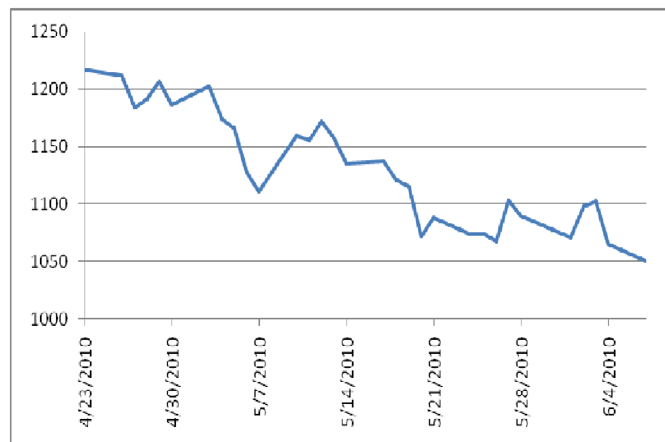
The Second Quarter Was Déjà Vu All Over Again

In the Second Quarter, the domestic S&P 500 Index rose 0.10%. However, the quarter was anything but uneventful. Halfway through June, the index had dropped 7.2% from April 29. A welcome rally during the last four trading days of the quarter brought the market to an overall flat quarterly position. The market decline within the quarter, which certainly concerned investors, was a similar pattern to what we observed in the Second Quarter last year. At that time, the S&P 500 Index fell 13.7% from April 23 to June 7.

Market Drop Within Second Quarter 2011



Market Drop Within Second Quarter 2010



During the downturn this year, the leading causes of market concern were the Greek debt crisis and the state of the domestic economy. During the downturn last year, the leading causes of market concern were the same: The Greek debt crisis and the state of the domestic economy. Last year, the economy and the market rebounded nicely in the Third and Fourth Quarters. This year, we believe history will repeat itself and the economy will continue to grow (albeit at a tepid pace) and the market will strengthen.

Greek Debt Crisis Is Abated For Now And The Economy Is Allowing Strong Earnings

Through the first half of the year, the S&P 500 Index is up 6.02%. Our 2011 forecast (Quarterly Insights, January 2011) was that "we believe global equity markets will advance 8% to 10%". We see no signs at this point to deviate from our outlook.

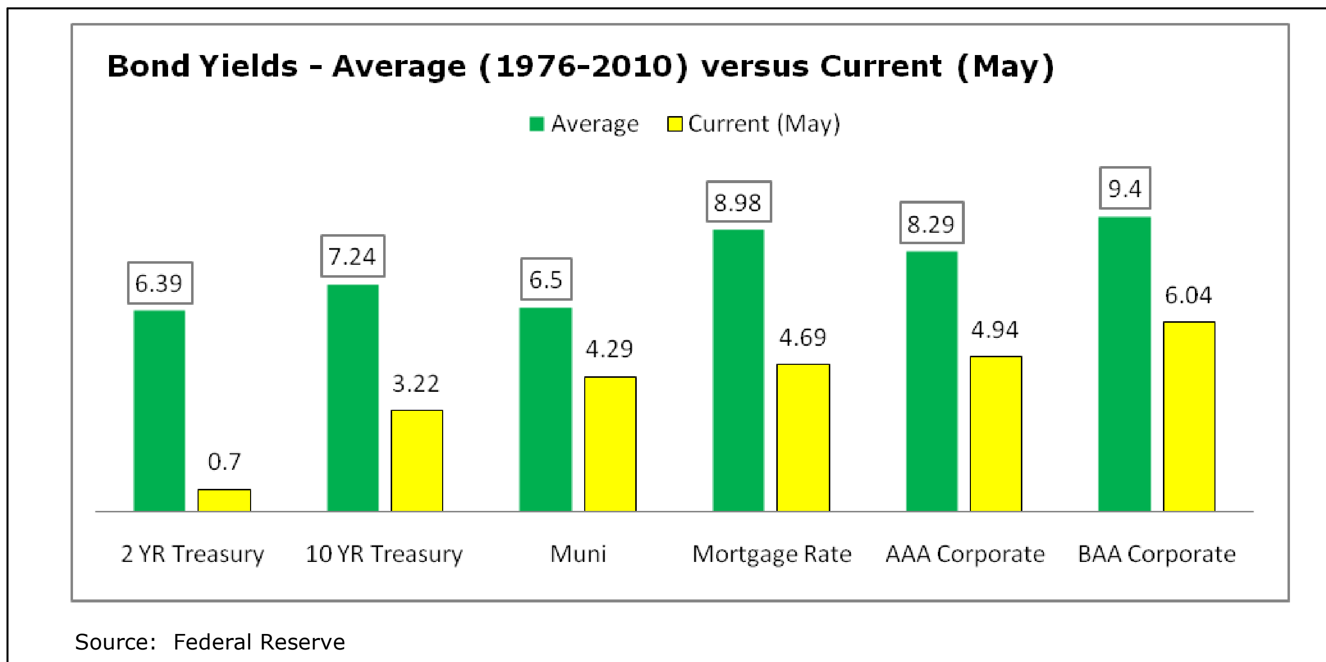
For the time being, the Greek debt crisis is no longer an issue that is spooking the market as it did in the middle of the Second Quarter. The Greek debt that was primed for default was rolled over near the end of June. In return, Greece was forced to adopt unpopular austerity measures that included higher taxes, cuts in social benefits, reduced public services, and privatization of state property. The end-of-the-quarter rally was due to a sigh of relief. Greece should not be an issue to hold back the market through the rest of 2011.

Last year, the Second Quarter earnings reports were a major catalyst to push the S&P 500 Index up 22% over the last half of 2010. The 2011 Second Quarter earnings announcements have started and the initial reports are excellent. Diverse companies such as Fedex, General Mills, and Oracle reported favorable results that indicate the overall economy is doing well enough to support strong earnings. This bodes well for the stock market in the last half of this year.

Bond Market Spotlight

Bond Yields Are At Or Near Record Historic Lows

The Barclay's Capital U.S. Government / Credit Bond Index, a broad-based representation of bond performance, returned 2.32% in the Second Quarter and is up 2.61% for the year. Total returns for bonds have remained reasonable as interest rates have fallen. However, rates are at or near record low yields for all areas of fixed income.



Source: Federal Reserve

Many fixed income investors face the dilemma in the current market of creating adequate returns on their bonds. There are two primary sources for higher bond yields: longer maturities or lower quality bonds. Both increase risk. Ironically, many stocks, especially blue chips, have higher dividend yields than bonds. Bill Gross, manager of the world's largest bond fund (PIMCO), said he now prefers stocks to bonds in his June speech at the Morningstar Investment Conference.

Number of S&P 500 Stocks With A Higher Dividend Yield Than Select Bond Categories

2 Yr. Treasury	10 Yr. Treasury	Municipal	Mortgage	AAA Corporate	BAA Corporate
336	71	34	25	19	4

Source: Federal Reserve, Standard & Poor's

Quantitative easing (QE2), the program where the Fed has been buying bonds to keep interest rates low, ended on June 30. Without a large buyer for Treasurys, yields will eventually rise (there will be a more opportune time to buy Treasurys). Historically low current yields have resulted in fewer attractive opportunities in the bond market. Yet it is still important to maintain a bond component to a portfolio strategy where appropriate for risk control. Within our clients' portfolios, we have received an attractive yield (and simultaneously managed risk) from a combination of roughly 40% government and 60% corporate bonds.

Your Portfolio

The stock market rallied nicely in the last week of June, lifting the Second Quarter S&P 500 Index performance to an essentially flat position. In the height of the market drop within the quarter, we did not panic. Rather, we stuck with our portfolio strategy in the belief that the drop would be temporary.

Our patience was rewarded. We have had an over-weight position to Health Care for over a year. Health Care was the leading sector for the quarter (+7.29%) and now leads sector performance year to date (+12.65%). Wellpoint (WLP), Watson Pharmaceuticals (WPI) and Novartis (NVS) were three of our strongest stocks.

Our portfolio performance also benefitted from an under-weight to the Energy sector. During the Second Quarter, Energy was down (-5.07%).

Technology (-1.61%) lagged in the Second Quarter, so our over-weight to the sector did not help performance. We believe the sector will do better in the second half of the year, and we will maintain our over-weight.

During the quarter, we purchased Visa (symbol: V), which is consistent with our goal to shift your portfolio further towards US blue chip stocks. Visa is a large company with a dominant position in the credit card and debit transaction markets.

Over the next few months, we anticipate further adjustments to both the stock and bond components of your portfolio. Stay tuned for updates.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

John Barber, CFA
Chief Investment Officer

Dan Laimon, MBA
Managing Member

Michael C. Harris, CFA
Vice President

Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.