

ASSET ALLOCATION QUARTERLY

A Report from Confluence Investment Management

- The U.S. economy should move from a slow growth rate to an average growth rate during 2011.
- We don't believe the bond market formed a true bubble, and therefore don't expect a "bursting of the bond bubble." We may see interest rates stabilize in 2011.
- We continue to favor corporate bonds, including speculative grade bonds, with short and intermediate maturities.
- We believe the environment for equity investing is positive and we continue to emphasize domestic stocks, while avoiding foreign developed country stocks.
- Emerging markets offer higher growth, albeit with higher risk. Commodities offer an alternate way to participate in emerging market growth, while simultaneously helping to address currency and geopolitical risks.
- We favor growth stocks over value and most cyclical sectors over defensive ones.

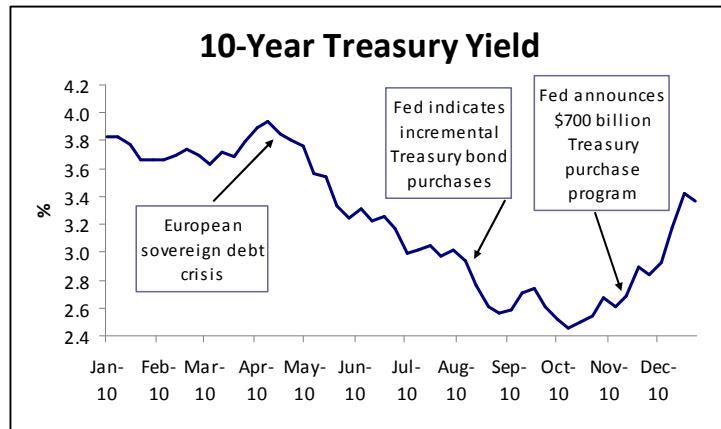
CONFLUENCE ASSET ALLOCATION – FIRST QUARTER 2011 COMMENTS

As 2010 came to a close, there were growing signs that at last the U.S. economy seemed to be gaining some sustainable traction. Of particular note was a gradual improvement in consumer behavior. Although the housing market, unemployment and uncomfortable amounts of debt remain as challenges, consumer spending appears to be rising. This trend is important, as consumer activity is related to approximately 70% of U.S. economic activity.

The economy is reaching a point where it can begin to create its own momentum. The various forms of monetary policy assistance and federal spending were helpful to avoid a much deeper recession, but consumer deleveraging, regulatory uncertainty and structural trade challenges have muted the recovery. Normally, the two years following a recession are characterized by higher-than-average real GDP growth. It obviously hasn't happened this time around, but we think we're finally emerging from the slow-growth period and average growth (around 3%) is likely in 2011.

Of course, the big story in recent months has been rising rates in the bond market. For much of 2010, the capital flows into the bond market were enormous, helped in part by concerns about a double-dip recession, European sovereign debt default risks, unattractive cash yields and investor ambivalence toward stocks. Rates fell through the first half of the year, and got a final push lower when the Fed announced it would purchase billions in Treasury securities in an effort to muscle rates down even further. The following chart shows the ten-year Treasury yield over the course of 2010, with the low of approximately 2.4% set in October.

This chart illustrates an important dynamic, which is the forward-looking nature of markets. Bond investors had been anticipating the Fed's purchase program and bought bonds in advance. The Fed referenced the program around mid-year, but formally spelled it out in November. Then, with the commencement of Fed purchases, interest rates actually began *rising*. One could infer that the expectation of what the Fed might do turned out to be more influential than what the Fed actually did.



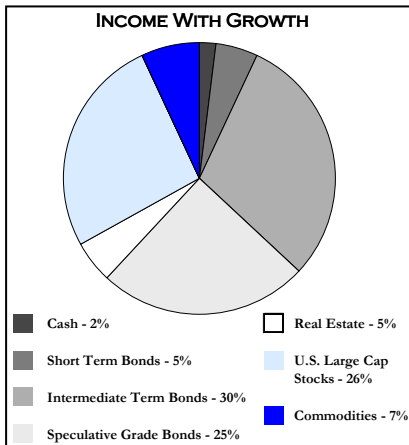
Many bond investors have been trying to stay in front of the rising interest rate trend by selling bonds, and talk of a “bursting bond bubble” has become a common theme. We are not of the opinion that the bond market ever formed a true bubble. We do believe parts of it became quite expensive; but investment bubbles are almost never recognized until after their collapse. The mere fact that so many investors identified the hazards indicates a speculative bubble probably never formed.

Without a bond bubble to burst, we don't expect rates to spike upward. In fact, the ten-year Treasury has already begun to approach our fair value. Absent a surprise surge in economic growth, rates may begin to stabilize, at least in the near-term. Further out, through the next phase of the business cycle, we may see rates grind higher, driven by the overall supply of government debt and the removal of certain Fed policies. But even for that point we don't expect a catastrophic bond market.

For some time now, our bond allocations have reflected concerns that interest rates might rise. Portfolios have been positioned in short and intermediate maturities, while avoiding longer maturity bonds, which experience more dramatic price declines when rates rise. We have also emphasized credit risk through corporate bonds (including speculative grade bond allocations) instead of interest rate risk. We favor corporate bonds because of their attractive yields and our expectation that default risk should decline as the economy strengthens. Our overall strategy has provided a measure of protection through the recent increase in rates, and we continue to believe it remains an effective way to invest in the bond market.

Our equity allocations this quarter remain largely unchanged because the economy has been progressing in line with our expectations. The constructive environment for equities should continue and we maintain our strong bias toward U.S. stocks. In fact, we continue to have no allocations to foreign developed country stocks because we expect both Western Europe and Japan will trail the U.S. in economic recovery. Within our domestic equity allocations, we continue to favor large cap stocks. Valuations for large caps have risen, but remain attractive, particularly given strong corporate fundamentals. We include small caps because of higher growth potential, but only where risk tolerance is higher. We continue to avoid mid caps, where higher valuations make the asset class less attractive. We include emerging market stocks for investors with growth as a primary objective. Emerging market countries continue to offer high growth potential, albeit with much greater risk. Commodities continue to offer a lower risk way to participate in emerging market growth. This asset class also helps to protect against broader currency and geopolitical risks. We are shifting the commodity allocation this quarter to temper the exposure to crude oil as certain geopolitical risks appear to be declining.

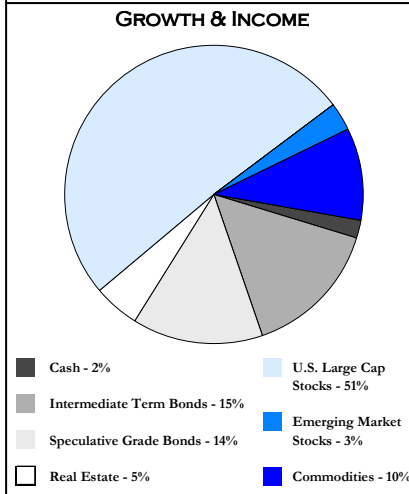
Our style guidance remains oriented toward growth over value due to our expectation of ongoing improvements in the economy. We favor cyclical sectors including energy, industrials and materials. We move to an underweight position in technology and telecom, based upon valuations and challenging business conditions. Healthcare is also underweight, as its defensive characteristics have less utility in an improving economy.



INCOME WITH GROWTH

In this portfolio, the fixed income allocation includes short and intermediate maturities. The investment grade portion of the bond allocation includes Agency mortgage-backed securities and Treasuries, but is principally invested in corporate securities, which offer attractive yields and an improving default outlook. Speculative grade bonds contribute to overall portfolio income.

The equity allocation is primarily oriented toward large cap stocks. This asset class tends to have lower volatility relative to other equity asset classes, and we believe current valuations form an attractive return/risk profile. Commodities are included for diversification and as a lower volatility way to participate in emerging market growth.

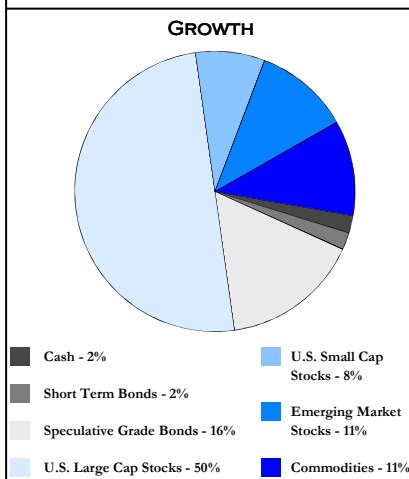


GROWTH & INCOME

The fixed income portion of this portfolio is divided into investment grade and speculative grade bond allocations. The investment grade side includes U.S. Agency mortgage-backed securities, Treasuries and corporate bonds. This high quality profile complements the higher credit risk characteristic of the speculative grade bond exposure.

This quarter we pare back the exposure to speculative grade bonds and emerging market equities. Both asset classes have performed well, but we do so to increase the allocation to large cap stocks. We believe this asset class is particularly well-suited for growth and income investors, due to the combination of reasonable valuations and strong fundamentals. Although we believe the potential return opportunity in emerging markets is attractive, we prefer to limit the allocation because of its high volatility.

Commodities remain in the portfolio to provide exposure to the growth of emerging markets albeit in a less volatile way than through a direct emerging markets allocation. This asset class also helps to address various currency and geopolitical risks.

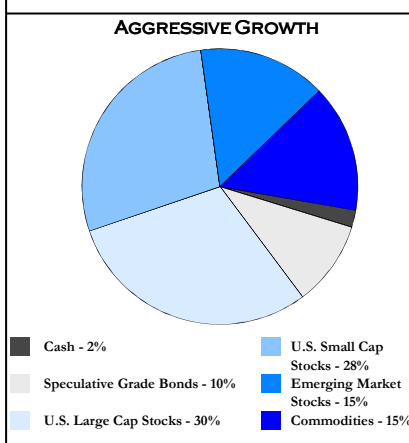


GROWTH

Half of this portfolio remains allocated to large cap stocks, our favored equity asset class. We believe the combination of reasonable valuations and strong fundamentals position this asset class to perform well as the U.S. economy continues its recovery. We also include a smaller proportion of small cap stocks, which contribute higher growth potential and may also deliver attractive returns as the economy grows.

We maintain a somewhat outsized allocation to speculative grade bonds. Yields remain attractive and we believe default trends should continue to improve as the economy strengthens.

Emerging markets are volatile, but also have high return potential. To help address the higher risk of this portfolio, we balance the portfolio with a relatively stable investment grade bond allocation. The commodity allocation also positions the portfolio to benefit from emerging market growth.



AGGRESSIVE GROWTH

The equity allocations of the Aggressive Growth portfolio remain as a combination of large cap, small cap and emerging market stocks. Domestically, we find valuations and growth rates most attractive in large and small caps, while avoiding the higher valuations of mid caps. Our foreign allocations are entirely directed toward emerging markets, which currently offer attractive growth potential. Ongoing economic challenges in Western Europe and Japan create a challenging environment for equities and we continue to exclude foreign developed stocks.

Speculative grade bonds remain in the portfolio because we believe the total return potential remains very attractive. Relatively high yields and declining defaults form an attractive opportunity.

Commodities may benefit from growing global demand. This asset class may also benefit from various international currency policies aimed at devaluation.

**Confluence Asset Allocation Models
First Quarter 2011**

	Income With Growth		Growth & Income		Growth		Aggressive Growth	
	Current	Change	Current	Change	Current	Change	Current	Change
Cash	2%	-	2%	-	2%	-	2%	-
Short Term Bonds	5%	-	-	-	2%	-	-	-
Intermediate Term Bonds	30%	-	15%	-	-	-	-	-
Long Term Bonds	-	-	-	-	-	-	-	-
Speculative Grade Bonds	25%	-	14%	(4%)	16%	-	10%	-
Real Estate	5%	-	5%	-	-	-	-	-
U.S. Large Cap Stocks	26%	-	51%	6%	50%	-	30%	-
U.S. Mid Cap Stocks	-	-	-	-	-	-	-	-
U.S. Small Cap Stocks	-	-	-	-	8%	-	28%	-
Foreign Developed Country Stocks	-	-	-	-	-	-	-	-
Emerging Market Stocks	-	-	3%	(2%)	11%	-	15%	-
Commodities	7%	-	10%	-	11%	-	15%	-
<i>Total</i>	<i>100%</i>		<i>100%</i>		<i>100%</i>		<i>100%</i>	

The Confluence Team

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The Confluence team is comprised of experienced investment professionals who are dedicated to a high level of service and communication to our clients. We develop innovative investment solutions for our clients, and our disciplined investment process has stood the test of time across a broad range of economic and market cycles.

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