Dear <client name>:

Better-than-expected U.S. economic statistics and positive developments in the European government debt crisis helped to lift major stock indexes to strong returns during the past quarter. Fixed income indexes delivered modestly positive returns, as rates increased slightly.

First-quarter economic environment broadly positive

In the U.S., our economy may have turned a corner. At least that's the impression given by recent trends in economic statistics, such as:

- Job growth up by an average of more than 200,000 jobs for four consecutive months
- Strength in retail sales, especially auto sales
- Improvement in existing home sales
- An increase in consumer confidence
- Double-digit year-over-year growth in sales of durable goods

These are good signs, although unemployment is higher than desirable and risks persist.

Concern about the European government debt crisis eased during the quarter. During 2011, investors worried about potential defaults and another global financial crisis. This weakened 2011 stock market returns amid a general sense of uncertainty. However, investors' sentiment improved with the adoption of the European Central Bank's long-term refinancing operations in late 2011. This initiative provided liquidity for the European banking systems, which reassured investors that European banks and governments have the funds necessary to stabilize the European banking system.

These positives overshadowed other factors, such as the failure of the U.S. government to get its spending under control. If the U.S. continues its positive trend, it may lead the rest of the developed world out of its malaise. This could happen even though economic growth is likely to be subdued, as compared to the historical average.

Stocks rose, especially those with high earning growth rates, as bonds delivered modest returns

In this more stable environment, investors were less anxious and more willing to accept an increased level of risk. During 2011, dividend-paying stocks of U.S. blue chip companies had significantly outperformed their peers. In contrast, in the first three months of this year, stocks with higher growth rates and betas (greater sensitivity to swings in market returns), such as technology stocks, did well. Mid- and small-capitalization stocks also performed well. This environment favored our Core Growth Strategy, which performed better than the market.

Outside the United States, emerging stock markets outperformed developed non-U.S. markets in addition to the U.S. They snapped back significantly from their 18.2% decline in 2011. Non-U.S. developed markets slightly underperformed the U.S., but still delivered positive returns. Both benefited from the stabilization of the European banking system and the global economy.

In the bond market, the month of March saw a significant rise in longer-term Treasury yields following the Federal Reserve's March 13 statement, which appeared more optimistic about the economic outlook. This made investors worry that the Fed may raise interest rates sooner than anticipated. This steepened the yield curve, broadening the gap between longer-term and shorter-term rates. The yield on the 10-year Treasury ended the quarter at 2.22%, up from 1.91% on December 31, 2011. However, aside from this, interest rates generally fluctuated within a narrow range.

Municipal bonds' after-tax yield advantages versus taxable bonds declined during the quarter, but still remain favorable.

It's harder to find attractive opportunities in the bond market. However, if the uptrend in yields continues, it could boost the appeal of bonds with maturities of 10 years or longer. Low yields in the investment-grade bond market drove some investors to seek higher income in high-yield bonds, real estate investment trusts (REITs), or master limited partnerships. It is important for investors to carefully consider the risks that accompany the potential for higher income.

Positive outlook for the stock market

We believe the U.S. stock market has the potential to move higher, although it's not likely to move up in a straight line. In our view, the first quarter's upward move reflected prices starting to catch up with 2011's strong corporate earnings and attractive valuations. We expect modest corporate earnings and economic growth in 2012. Many stocks' valuations remain attractive. There's probably still room for stocks' price/earnings ratios to rise.

Risks remain: See *Economic Outlook* for more details

Of course, risks persist. For example, there could be an Israeli strike against an Iranian nuclear threat. The tax cuts originally enacted under President Bush could expire, raising taxes on dividends and capital gains. Global economic growth could slow, which could be especially damaging if it occurs in large markets such as China. Based upon this uncertainty and the variability in investment performance, we urge clients to maintain proper diversification within their portfolios, including investments beyond holdings of large-cap U.S. stocks and U.S. bonds. A properly diversified portfolio increases the likelihood of a smoother pattern of returns over the long run.

For more a more complete list of risks and additional details on our views, please see the enclosed Economic Outlook 2012.