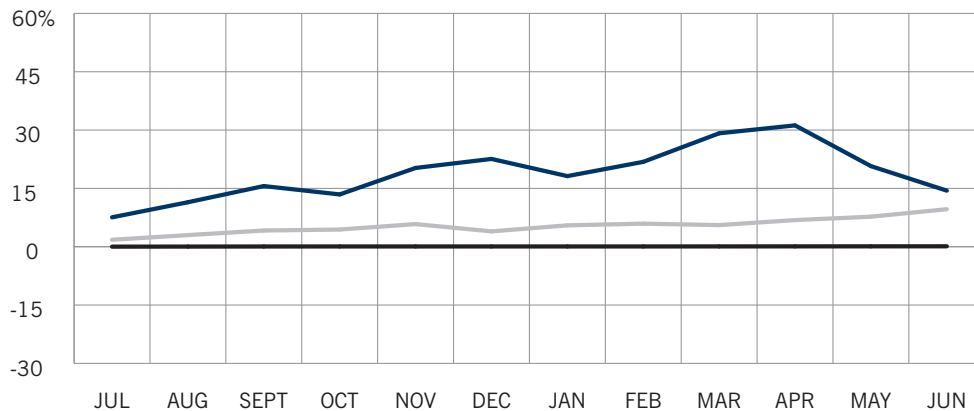


Second Quarter 2010

Investment Review & Outlook

From Eaton Vance Investment Counsel

Total Return Index: July 1, 2009 -- June 30, 2010



	S&P 500	Barclays Capital Gov't./Credit	Treasury Bills
Second Quarter	-11.43%	3.88%	0.04%
Year to Date	-6.65	5.49	0.05

Source: RIMES Technologies

Summary

After a wondrous year of strong equity performance and economic reports that generally exceeded consensus expectations, the mood soured in the second quarter. European worries, coupled with some relatively weak US housing and employment data brought concerns of a “double-dip” recession to the fore. Remarkably, some of the perennial hyperbolic pessimists in the financial press were comparing this period to the 1930s. For the quarter, the S&P 500 lost 11.4%, its worst quarterly performance since the final three months of 2008. Importantly, we do not believe it likely that we are embarking on a new bear market. Corporate profits remain strong, interest rates remain low and equities remain reasonably valued.

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Performance of the Security Markets

Following such a powerful rally from the market lows of March 2009, a correction was not surprising. All equity industry sectors declined in the quarter as would be expected during such a sharp selloff. The biggest drop was in the economically sensitive areas like Materials, Financials, Energy and Industrials. The defensive groups such as Utilities, Telecommunications and Consumer Staples held up better. Developed foreign markets underperformed US equities – a direct result of the concerns emanating from Europe.

Bonds rallied in the quarter as fear intensified and caused investors to abandon the so called “risk trade” and turn to the relative safe haven of US debt. The Barclays Intermediate Government/Credit bond index gained 2.9%. Short-term rates remain at historic lows as the Fed remains committed to its zero percent policy.

The Economy

In our April note, we suggested that skeptics on the economy were right to credit much of the improvement in economic growth to massive monetary stimulus. All things being equal, as the stimulus faded it seemed likely that growth would moderate. We are at that point and, though the direct and indirect benefits of this stimulus will remain with us into 2011, it is likely that we are past the peak of its intensity. Though consumer balance sheets have improved, debt levels remain high and the pace of recovery in the labor market has been choppy recently. It is these characteristics of our growth in the near term that give rise to doubts about the sustainability of the recovery. Though the risks of economic relapse have increased, it does appear that these concerns may be excessively dire. Although the labor market remains weak, it is worth noting that the economy added in excess of 350,000 net private sector jobs in the 2nd quarter, an increase of 50% from the first quarter. Durable goods orders, a leading indicator, are up strongly in the last three months and productivity growth continues. Recently Credit Suisse’s economics team pointed out that the U.S. has not experienced a recession in the past fifty years with the yield curve being steeper than 0.9% (currently at 2.9%), real short-term rates lower than minus 0.3% (now at -0.8%), and inventory levels being 3% below trend (now remarkably 17% below trend). This analysis supports our contention that the expectations for the economy have gotten too pessimistic.

Equity Outlook

There were three main catalysts during the quarter that contributed to the selloff: international concerns, mixed US economic data, and bizarre market behavior. As economic conditions in Greece deteriorated and talks of a possible default on their sovereign debt spread, other weak European countries began to come under scrutiny. Fear of contagion increased, crushing stock and bond markets of other debt-laden European countries. At the same time, concerns regarding the Chinese economy became more prevalent. Many fear the government’s attempts to slow its over-heating real estate markets will go too far and possibly risk derailing the major global growth engine. Weak US employment and housing data during the quarter also depressed the market. While the employment rate improved (from 9.9% to 9.5%), the pace of job creation started to slow - a much more meaningful indicator of economic health. And with the expiration of the home buyer tax credit, home sales and prices have softened - an indication that demand for housing was pulled forward. Lastly, this past quarter the stock market had one of the strangest trading days that most investors had ever experienced. What is now being referred to as the “flash crash” saw, for a few brief moments on May 6, the Dow free fall almost 1,000 points. Though most of the loss was recovered by the end of the day, this was an exceedingly unsettling event. There is still no official explanation of what happened but most attribute the cause to computer driven trading programs at one (or more) of the major investment banks.

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The market may have overreacted some as memories of the financial crisis remain fresh in investors' minds. The pattern of trading in the last quarter was very similar to 2008 and early 2009 – risk assets were sold and proceeds invested in the safety net of US Treasury debt and/or gold. As suggested above, the economic backdrop does not seem as dire as the market suggests. GDP growth is still expected this year and next. Inflation and interest rates remain low and corporate earnings remain healthy. We expect market volatility to continue as investors wrestle with uncertainty around financial reform, the progress containing the Gulf oil spill and long term repercussions from the massive fiscal and monetary stimulus used to rescue us from our own financial crisis. As such, we believe now more than ever, it is important to maintain a well diversified, high quality portfolio. US stocks are attractively priced at a current price/earnings ratio of about 13 times 2010 estimates, well below the historical average of about 15 times, indicating that these stocks are already priced for earnings deceleration.

Fixed Income Outlook

For bonds, much depends on the direction of the economy. With the economy slowing and recession fears increasing, Treasury yields have fallen lower than most had forecast. The 10-year note ended the quarter under 3%. We now expect the Fed to keep short-term rates near zero through the balance of the year to help the economy from slowing any further. Yield spreads (interest rates for bonds above similar maturity US Treasury Notes) in most areas of the bond market have increased as demand for Treasuries has increased. Much like stocks, in this environment, our holdings emphasize high quality.

July 14, 2010

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