LOWE, BROCKENBROUGH & CO., INC.

INVESTMENT COUNSEL

2010
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The Financial Markets

- Firmer economic trends, strong corporate earnings and improving sentiment drove domestic equity markets to their best first quarter in over 10 years. Markets weakened in late January to mid-February with concerns over growing Federal Government intervention, Chinese reserve tightening and European sovereign debt problems. As the European Union moved to calm debt concerns, the market reversed course, with the S&P 500 ending the quarter up 5.4%. The Dow Jones Industrial Average posted a 4.8% return. Money continued to pour into bond funds, giving support to the bond markets.

- S&P 500 sectors showed wide performance divergences. Industrials, financials and consumer discretionary companies produced strong positive results, while Telecommunications and Utilities suffered negative returns. Small and mid cap stocks outperformed large cap stocks, returning over 8% for the quarter.

- International markets lagged domestic markets, with the MSCI EAFE Index up 1.0% for the quarter and the Emerging Markets Index up 1.5%. European markets struggled with sovereign debt problems and a slower recovery. The Chinese markets turned in negative results, weighed down with larger bank reserve requirements, tighter lending standards and the fear of an "overheated" boom in real estate prices.

- The Federal Reserve Bank maintained its pledge to keep short rates low for an extended period, yet markets are priced for a rate increase by year-end. Treasury yields rose in March, ending the quarter nearly unchanged from year-end levels. Corporate bonds continued to outperform, with yield spreads narrowing in the first quarter, led by lower quality credits. The Barclays Capital Aggregate Bond Index rose 1.8% for the quarter.

- The municipal bond market ended the quarter weaker, after a long stretch of expensive relative valuation peaked in mid-March. The diminished supply of tax-exempt paper in longer maturities helped flatten the tax-exempt yield curve, and enabled long maturity bonds to outperform short and intermediate bonds.

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The Economy

- Increasing signs of economic improvement are filtering through the volatility of shorter term data releases. Early evidence of improving employment trends is beginning to help consumer confidence. Currently standing at 9.7%, the Unemployment Rate will decline only stubbornly, though March payrolls rose for the third time in 5 months, the most since March 2007. Weekly unemployment claims seem to be generally improving, but remain very volatile. All eight components of the Conference Board's Employment Trends Index rose in March.

- Housing is bottoming in some areas, and beginning to recover in others. The Index of Pending Home Sales surged 8.2% in February after falling in January. Nationwide, housing prices are now showing a slight increase after many months of decline. A recent survey by Fannie Mae found that two-thirds of Americans think now is a good time to buy a house, and three-quarters think housing prices will be higher in a year – psychology is improving.

- As confidence builds, the consumer is increasing purchases while still decreasing credit balances – a unique time. A combination of pent-up demand and replacement buying is driving higher purchases in clothing, automobiles and other durables such as appliances and furniture. Retail comp sales are very strong for retailers, driving strong earnings in the companies that have pared excess costs and inventories.

- Inflation remains benign, as the gap between capacity and demand continues to cushion pricing pressure. Labor is not yet in position to demand higher wages, the historical signpost that inflation will become problematic. Commodity prices are mixed so far this year. Oil and gasoline are at their highest levels in 17 months, copper is at a 20 month high, and nickel up 33% this year. Conversely, agricultural grain prices are weaker, and natural gas is down 27%.

- International economies are mixed. The European Union is facing significant economic challenges – the risk of default is looming for countries such as Greece and Spain – as they attempt to shore up sovereign debt to avoid further damage. A bright spot is Germany, which is seeing strong increases in exports. In Asia, China is now forecasting growth this year of 10%, resulting in its central bank reigning in increases in bank reserves and tightening lending standards.

Future Prospects and Portfolio Strategy

- The domestic economic recovery is gaining momentum, but will likely remain sluggish, with higher unemployment persisting in 2010. Inventory rebuilding should continue to contribute to near term economic growth. Corporate profits could surprise on the upside as revenue growth materializes. Consumer spending is expected to grow, but will remain muted relative to past recoveries.

- Equities remain reasonably valued at about 15X estimated 2010 earnings. They have historically traded closer to 18X earnings, on average, in interest rate and inflation environments similar to what we are experiencing today. However, given macroeconomic headwinds, we believe a lower multiple is appropriate, with further market gains more dependent on earnings growth. On this front, the picture currently looks bright, as earnings estimates continue to increase. While interest rates have risen lately, the interest rate and credit market environment are still supportive of equities. The exception would be spreads on bonds in some of the smaller European countries, where concerns over budget deficits, particularly in Greece, have roiled markets. This will be a key area to monitor closely as governments across developed economies begin to cut back on fiscal support to focus on containing budget deficits. Short term sentiment has become fairly optimistic, suggesting that equities could be due for a pause. Longer term sentiment measures are still favoring equities – since March 2009, almost $350 billion of new money has flowed into bond funds while only $24 billion has gone into equity funds.

- Bond yields may move higher due to massive government borrowing to finance the staggering budget deficit. Reports by the Congressional Budget Office and others show the current path of government debt accumulation is not sustainable. This will eventually have to be addressed by Congress and American taxpayers at some point. Higher inflation is a likely by-product of continuing higher debt and deficits, but given current slack in the economy, is expected to remain tame in the near future.

- Corporate bonds should outperform Treasuries, but credit spreads have already normalized for many segments of the corporate market. Global and high yield bonds offer a yield advantage for income investors. These sectors should perform well as the economy recovers, and may be less sensitive to rising rates than core fixed income vehicles. Prospects for short and intermediate municipal bonds continue to be challenged by low absolute yields and concerns over municipal credit conditions. When short rates eventually start to rise, look for the yield curve to flatten further.

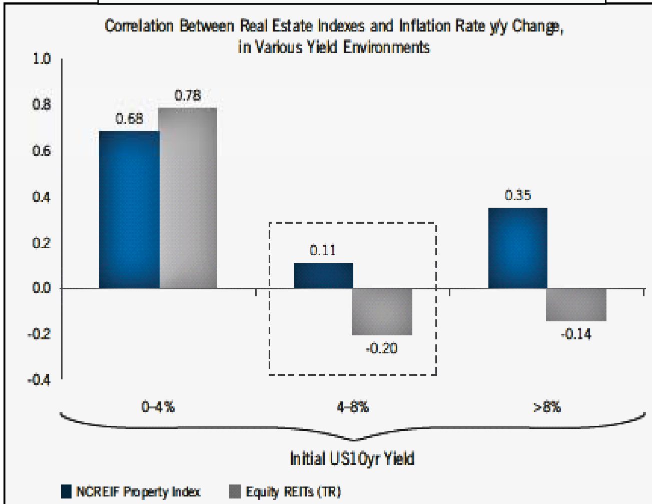
- For clients with balanced portfolios, we still favor equities relative to fixed income given their more attractive valuations and support from economic growth. For diversified equity portfolios, we continue to see some opportunities across both geographies and market capitalizations. Specifically, large capitalization, high quality, US equities still appear to be one the most attractive investments. Within fixed income, we still favor spread-oriented products over Treasuries. However, the magnitude of outperformance enjoyed over the past year will moderate, as yield spreads have tightened significantly.

Thoughts on Commodity Investing

The massive amount of monetary and fiscal stimulus injected into the global financial system over the last year has generated much discussion and speculation about the potential for higher future inflation. Predictably, we have been asked by many clients about the appropriateness of commodity investments in such an inflationary environment. In this quarterly review, we attempt to evaluate the pros and cons of commodity investing, while clarifying some firmly-held beliefs about their investment benefits.

Generally speaking, commodities deserve a place in most broadly-diversified investment portfolios. Historically, their inclusion has been for the inflation-hedging benefits they provide. In fact, commodities have outperformed inflation over the past 20 years, with about a 60% correlation. However, over longer periods of time the correlation is not stable enough to justify a large, strategic allocation to the asset class. Importantly, commodities do well in periods of higher inflation when equities and bonds tend to suffer. Their role as an inflation-hedge is more compelling relative to other alternatives during periods when interest rates are likely to rise, though they remain fairly closely correlated to inflation rates under all interest rate environments. Other common inflation protection vehicles, such as real estate, tend to exhibit poorer correlations as interest rates rise.

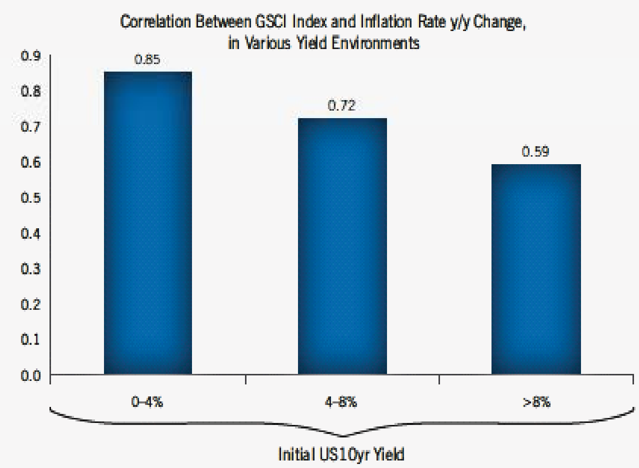
Short-term inflation-hedging power of real estate is often compromised by its interest-rate sensitivity...



Inflation rates measured by US CPI. Data from December 31, 1978 to December 31, 2009. Past performance is no guarantee of future results.

Source: Bloomberg, MSIM

...But the inflation hedging power of commodities has been strong across various yield environments



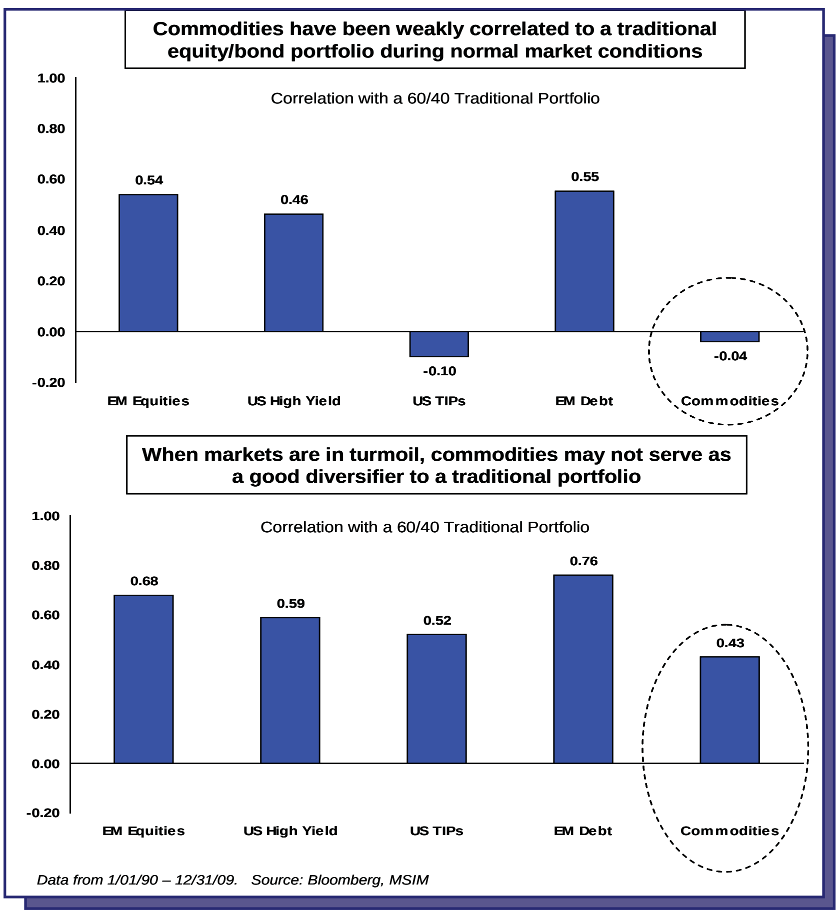
Inflation rates measured by US CPI. Data from December 31, 1978 to December 31, 2009. Past performance is no guarantee of future results.

Source: MSIM, Bloomberg

While we do not foresee an imminent acceleration in broad-based inflation, the massive global stimulus in the system, as well as underinvestment in commodity resource development during the past few years, should eventually push commodity inflation higher as global growth improves.

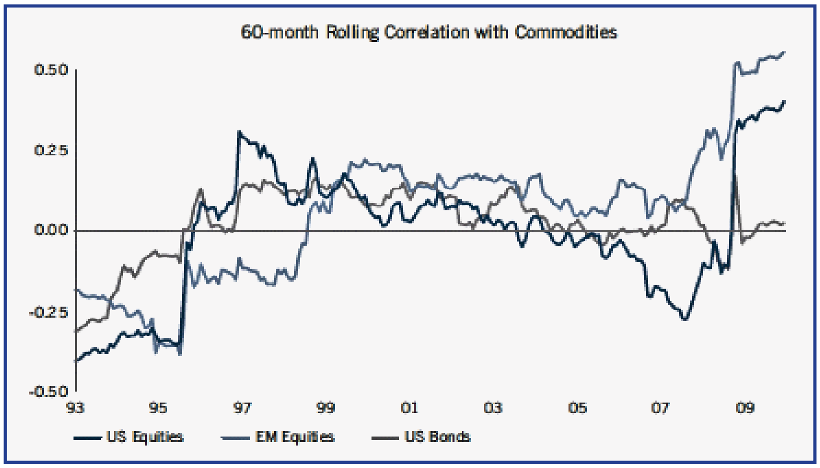
Commodities can also act as an important portfolio diversifier in many instances. Over longer periods of time, commodities have been uncorrelated to more traditional balanced 60% equity/40% fixed income portfolios. Commodities have historically had a modest correlation to equities and negative correlation to fixed income. The role of commodities as a diversifier of risk in overall investment portfolios is particularly strong in periods of geopolitical instability. However, the biggest criticism of commodities is that they have not been good diversifiers in periods of economic stress, as seen in 2008 and early 2009 when commodities underperformed in a poor period for risky assets. During downturns, the correlation with a 60/40 portfolio has gone from -4% to 43%, meaning commodity prices have tracked more closely with weakening equities. This adverse correlation can be explained by the fact that during downturns, inflation typically declines, which is anathema to commodity performance.

This can be seen in the following charts, which show the correlation of a 60% equity/40% fixed income portfolio to various asset classes, including commodities, in both normal economic periods and periods of economic weakness.



Over the past several years, commodities have become more positively correlated with equity markets, as changing macroeconomic conditions have been the dominant influence on trading and market direction. While the chart below suggests that correlations are likely to revert to lower levels over time, in periods of significant equity weakness, high quality bonds have proven to be a much more reliable source of diversification.

Commodities are now increasingly correlated to equity markets, especially emerging market equities



Data from 1/01/93 – 12/31/09. Source: Bloomberg, MSIM

From a tactical standpoint, commodity investment now looks attractive. Relative to equities, the CRB (Commodity Research Bureau) benchmark has been an investment laggard over the past six months. In addition, global economic growth and a developing socioeconomic transition in emerging economies may create upward pressure on global demand for commodities. In the years ahead, emerging markets will enjoy the greatest benefits of global economic growth. The shift of lower income households toward the middle class in those economies will result in growing demand for commodities. Commodity consumption tends to pick up quickly when per-capita income levels reach $5,000-$20,000, and there are 1.7 billion consumers in emerging markets that have moved to this income range. Monetary stimulus, while beginning to moderate in several countries, is still generally supportive across the globe. Also, most governments are still pushing forward expansionary fiscal policy. Lastly, rising capital and investment inflows into emerging markets are lending support to commodity prices, as these inflows support infrastructure and other commodity-intensive investment. On the downside, given their recent stronger correlation to equities, commodities can add additional volatility to investment portfolios.

In terms of actual investment vehicles, there are several options to consider aside from direct investment in actual commodities or commodity futures. Mutual funds, Exchange-Traded Funds (ETFs) and Exchange-Traded Notes (ETNs) generally provide broad diversification and good liquidity, but, depending on the particular vehicle, have some drawbacks as well. ETFs that invest directly in commodity futures are not tax efficient, as investors are taxed on appreciation every year regardless of whether the investment is sold in that year, and most are structured as partnerships, requiring the issuance of burdensome K-1s each year. ETNs track more closely to underlying commodities, and have a more favorable tax treatment, but are unsecured obligations of the issuer, raising questions of financial stability and credit worthiness. A more esoteric concern currently is the issue of "contango." Contango is a situation where the longer dated future price of a commodity is higher than more current futures and spot prices. Many of the aforementioned investment vehicles that invest directly in commodity futures regularly roll those futures from short term maturing contracts to longer dated contracts at higher prices, incurring a loss. Throughout the 1980s and 1990s, when commodities struggled as an asset class (spot prices higher than futures prices), investors enjoyed a positive return from this roll feature as longer dated contracts were cheaper than shorter maturing contracts ("backwardation"). In the current contango environment, returns on ETFs that roll commodity futures will likely trail spot prices and their respective indices.

Because of these peculiarities, and in order to further diversify risk, Lowe, Brockenbrough has focused its commodity strategy on investing in a basket of securities for those clients seeking commodity exposure: ETNs from only the financially strongest issuers, and mutual funds and ETFs that own the equities of the underlying producers of commodities (these ETFs do not suffer from the unfavorable tax treatment). Given their underlying exposure to equity markets, these last two investments are not as closely correlated to the performance of the underlying commodities, and may produce positive or negative variances to spot price movements. In all of the investments we use for clients, our focus is on instruments that have broad exposure to a large number of underlying commodities.

In summary, commodities make sense as a part of a broad asset allocation strategy. However, given their higher volatility, strong correlation with equity markets, and episodic diversification benefits, commodities should not account for a significant portion of a portfolio's overall allocation. Instead, a modest allocation should be tactical in nature, as part of a bucket of riskier assets that includes equities, global and high yield bonds.

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