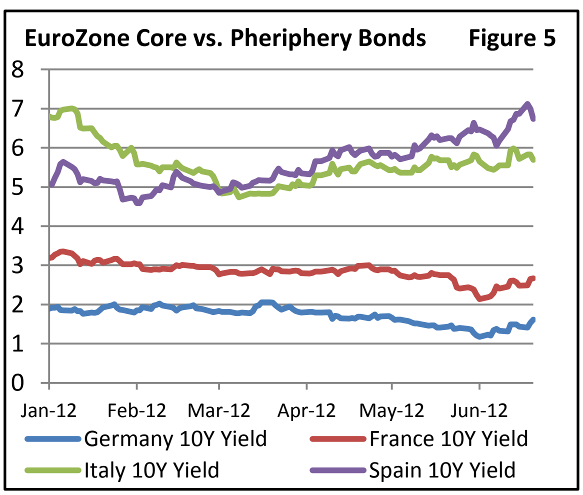
segment with a return of 13%. Given the market decline, it is no surprise that value stocks outperformed growth during the quarter, although over the year to date, growth stocks have been outperforming.

As investors fretted about a European recession and its impact on U.S. growth, defensive sectors such as Utilities, Consumer Staples, Telecommunications and Healthcare provided positive returns during the second quarter. With a 14% return, Telecommunication stocks were the best performers, as investors clamored for their high dividends and domestic focus. The second quarter's late announcement from the U.S. Supreme Court that it would uphold the Affordable Care Act provided a boost to both hospital operators and providers of Medicaid and Medicare, with the Health Care sector ending the quarter up 2%. The more economically sensitive sectors such as Energy and Information Technology underperformed the broader market, falling 6% and 7% respectively during the second quarter. Within Technology, a 2.6% decline in Apple's stock price provided little help to the sector. However, with a 44% year to date gain, the largest stock in the U.S. by market capitalization has provided a significant boost to the overall market return this year.

Internationally, the developed markets, as represented by the MSCI EAFE Index, have again underperformed U.S. markets. European equity markets continued to slump as investor optimism from the first quarter wore off. Greece was the worst performer with a 28% decline, as investors worried about the June election and its impact on austerity plans and the nation's willingness to repay its debt. Elsewhere in Europe, Italy and Spain both suffered 12% declines as markets feared that the cost to refinance their nation's debt was becoming untenable; the Spanish 10-year Government bond yield rose from 4.6% in February to over 7% during June. Figure 5 highlights the increasing divergence of European sovereign debt yields, reflecting investors' fears in certain markets.



Emerging Markets underperformed developed markets during the second quarter with a decline of 8.8%, with slowing demand from both China and Europe (in recession) causing concern. Regionally, Latin America performed worst, with Brazil leading the decline during the second quarter. The Chinese market was resilient given continued fears of an economic slowdown, ending the quarter up 1% and up 6% year to date.

Hedged assets did little to distinguish themselves this quarter, hurt by the sharp reversal in the markets on the last trading day of the quarter (S&P 500 up 2.5% on June 29th). The Dow Jones Credit Suisse Long/Short Equity Index lost 4.6% for the quarter, although it remains up 2.2% year-to-date. Global macro, as represented by the Dow Jones

Credit Suisse Macro Index, fared better, losing 1.4% for the quarter. For the first six months of the year though, the global macro index is essentially unchanged at 0.1%.

REAL ESTATE AND COMMODITIES

U.S. crude oil prices fell 17.5% over the quarter to $85 per barrel. During 2012, oil has declined 14% from a starting price of $99 per barrel on the back of ample supply and global growth concerns. After slumping to a decade-long low of $1.91 per British thermal unit, natural gas prices rallied 48% to end the quarter at $2.83. The demand and supply balance for natural gas has improved, lessening fears of storage capacity being breached later this year. As natural gas prices plummeted below the cost of supply, production rates have fallen. Additionally, power stations have substituted natural gas for coal providing an increased source of demand. Further good news for consumers came with gasoline futures declining to a national average of around $3.36 per gallon at the end of the quarter, down over 60 cents. Independent research firm ISI estimates that every one cent reduction in gasoline prices increases consumer firepower by $1 billion. Among precious metals, gold was relatively range bound, ending the quarter down 4% at $1604/oz. Over the year to date, gold has rallied 2%, but remains 10% below its February high of $1788/oz. as investor's hopes of further quantitative easing have diminished.

Global REITs, as represented by the S&P BMI Global REIT Index, rallied 3% during the second quarter and have returned 14% over the last six months. Within the U.S. market, the REIT sector rallied 3.5% in the second quarter with performance led by Retail REITs, up 5.6%. Over the year to date, U.S. REITs have gained 14.3%, outperforming all the broad U.S. equity market returns. International REITs underperformed U.S. REITs during the second quarter, led down by a loss of 3.3% in the S&P Pan European REIT Index.

OUTLOOK AND STRATEGY

We believe markets will remain choppy for the time being. Government and central banks continue in unchartered territory with an alphabet soup of liquidity programs, trying to stave off a breakup of the Eurozone and weakening growth in the U.S. and China. The political drama of a U.S. election as well as the impending fiscal cliff (see page 6) will create headline risk for the rest of the year. Decisions on the myriad of U.S. economic and tax policy issues could be sacrificed for the partisan politics of an election year. We can never underestimate the ability of the current generation of politicians to put self-interest and self-preservation ahead of the greater good of the country. All these players will need to proverbially "thread the needle" just to keep the precarious balance in the global economy going. One exogenous shock (the Middle East, North Korea, or another large bank trading loss or bankruptcy) could knock the markets down.

Although we continue to position client portfolios to take advantage of liquidity fueled market rallies, we are wary of the above risks. The market reaction to any of these issues is incalculable and too expensive to hedge (even if you could figure out the right hedge). Therefore, we continue with the themes we have talked about over the last several quarters, with some minor adjustments. Specifically during the second quarter, we reduced some of our international bond exposure due to renewed worries on the Euro and a rally in rates. In addition, we took some excess cash from Hedged Assets, where we had terminated a manager last year, to help fund a long only U.S. equity value manager. We continue to add to our positions in high yield municipals and energy infrastructure (through MLPs), which pay solid dividends and have excellent after-tax characteristics.

We have made the following manager changes during the first half of 2012, diversifying as well as adding certain strategies:

Manager	Strategy	Date Added	Description
SkyBridge	Multi-strategy Fund of Hedge Funds	January	Concentrated, focused on mortgages
Gulfstream	Municipal Hedge Fund	March	Niche focus, short dated callable bonds
TA Associates	Private equity	April	Global growth equity
Robeco	All-cap U.S. Equity	May	Value stocks
Harvest	Master Limited Partnerships	June	Energy infrastructure

In the short-term, increased volatility and roller coaster type returns are likely, as investors have a difficult time valuing political and macroeconomic risk. Our goal is to earn a significant piece of any upside while protecting our clients on the downside. We remain focused on the long-term, even in the face of so many serious issues making headlines every day. These are actually very long-term problems which will take years to rectify, but we believe by sticking with a well-constructed, diversified portfolio, we can provide a steadier and smoother ride through the choppy waters.

THE U.S. FISCAL CLIFF

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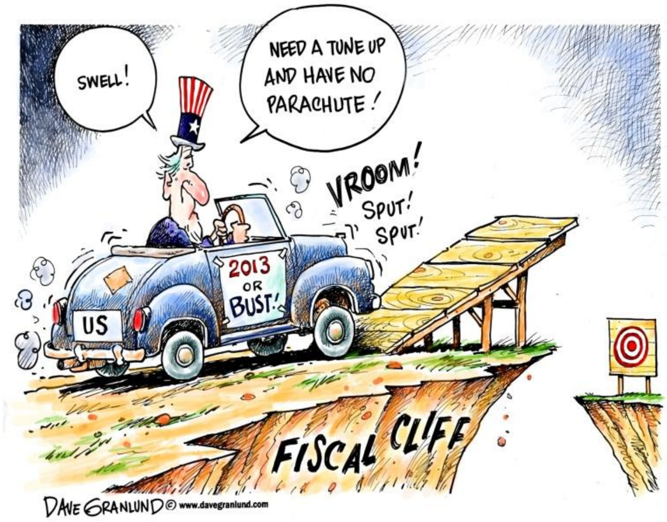
WHAT IS THE FISCAL CLIFF?
The Fiscal Cliff refers to the agreement lawmakers have to reach by the end of 2012 with regards to tax and spending policies. If lawmakers take no action, the Congressional Budget Office estimates the scheduled tax increases and spending cuts will result in a fiscal contraction to the U.S. economy of $600 billion, reducing GDP by an estimated 4% and plunging the nation back into recession.

WHICH TAXES ARE AFFECTED?
The Economic Growth and Tax Relief Conciliation Act of 2001 was enacted by President George Bush to help stimulate the economy during the 2001 recession. The Act reduced income tax rates and increased certain exemptions and deductions. These benefits were due to expire at the end of 2010 but were extended until the end of 2012. Additionally, last year's temporary 2% payroll tax cut is due to expire, at the same time as taxes related to the new Affordable Health Care Act go into effect.

WHY IS GOVERNMENT SPENDING EFFECTED?
In response to the 2011 U.S. debt ceiling crisis, the Budget Control Act of 2011 created a Joint Select Committee on Deficit Reduction, known as the 'Super Committee.' This Committee failed its task, concluding that no bi-partisan agreement to reduce the federal deficit was possible. As a result, mandatory spending cuts of $1.2 trillion over 10 years are due to take effect on January 1, 2013. Known as sequestration, these cuts would include a 10% reduction in defense spending, cuts to Medicare and discretionary spending in areas such as transportation, international affairs and homeland security.

WHEN WILL POLITICIANS MAKE A DECISION?
The Fiscal Cliff drama is heightened by the fact that it is an Election year. Agreement will require bi-partisan politics and it is difficult to imagine either party making the needed compromises prior to Election night. Thus, markets are likely to remain nervous through at least November and possibly through a potential lame-duck session until January 3, 2013.

WHAT EFFECT IS THIS PROLONGED UNCERTAINTY HAVING?
The non-partisan Congressional Budget Office (CBO) estimates that the uncertainty will cause businesses and individuals to alter their spending and investment through the remainder of 2012, decreasing GDP by at least 0.5%. Elsewhere, a May survey by independent research firm ISI found that 16% of companies were already adjusting hiring and capital expenditure due to the Fiscal Cliff uncertainty.



DOES ALL OF THIS AFFECT THE U.S. CREDIT RATING?
How this saga plays out is of critical importance to the credit worthiness of the U.S. The International Monetary Fund (IMF) recently urged U.S. policymakers to take actions to avoid a Fiscal Cliff before the end of this year, warning that the U.S. remained 'vulnerable to contagion from the growing debt crisis in the Eurozone.' Similarly, Standard & Poor's (who downgraded their rating of U.S. debt from AAA to AA+ last August) maintains a long-term negative outlook for the U.S., and has stated that fiscal risks could lead to a further downgrade by 2014. Additionally, Federal Reserve Chairman Bernanke has warned that the failure of politicians to address the Fiscal Cliff poses a 'significant threat to the recovery.'

WHAT IS THE MOST LIKELY OUTCOME?
Given the enormous cost of non-action to the economy, it is likely that politicians will come to a last-minute agreement. While this will not alleviate the effects of uncertainty, it will likely result in a fiscal drag well below the worst case scenario of 4%. There are many different opinions on the outcome. Goldman Sachs, for example, forecast that the Bush era tax cuts will be extended and that sequestration will be delayed, resulting in a hit to GDP growth of around 1%. While this would remain a drag on growth, it must be acknowledged that a certain amount of Fiscal Cliff austerity is necessary; the CBO forecasts that extending all of the various tax cuts and forgoing sequestration would result in the federal debt to GDP ratio increasing to 227% by 2040 – an untenable situation.

Please feel free to contact us if you have any questions about this quarterly Investment Review or Market Street's investment program.

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