KLS PROFESSIONAL ADVISORS GROUP, LLC
Complete Financial Management

Recent Developments and Portfolio Changes

During the past year we have balanced the desire to participate in the investment gains we anticipated to be available in the capital markets, against seeking to protect capital still vulnerable to structural risks confronting the global economy. Presently, there are new challenges to the post financial crisis worldwide economic recovery, namely the geopolitical events unfolding in the Middle East, and the devastation in Japan from earthquake, tsunami and the ensuing nuclear power plant event. The human tragedy is heartfelt worldwide.

In 2010, the risks notwithstanding, S&P 500 corporate profits grew at an estimated rate of 47% on revenue growth of 6%, and are expected to grow at 15% and 14% in 2011, respectively. This high level of earnings growth was achieved in 2010 and is anticipated for 2011 notwithstanding the many challenges to the U.S. economy which have resulted in relatively slow growth in GDP and high unemployment. The driver of corporate profit growth outpacing U.S. economic growth is the increasing impact of foreign sales and operations. In particular, with the prosperity of emerging economies comes increased demand for infrastructure and increased consumerism. The rate of growth in these economies has been outpacing that of the United States and has significantly impacted the rate of earnings growth. We anticipate that this trend will continue. We are mindful, however, that ultimately U.S. economic results must be reinvigorated for overall earnings growth to be robust, and for share prices to continue to reflect reasonable multiples of earnings.

Our caution with regard to portfolio construction continues to be focused on the many structural risks confronting the U.S. and global economy. These include asset valuation reflected on bank balance sheets (albeit improved since the depths of the financial crisis), a fragile housing market, burgeoning federal budget deficits and debt levels, trade imbalances, cutbacks in spending at the state and local level that slow the economy, the absence of a definitive plan (rather than a bail and delay approach) in Europe to address the economic underpinnings of several troubled economies, reversal of Federal Reserve liquidity policies, and the potential inflation and economic slowing effect that could result from increases in energy prices specifically (attributable to developments in the Middle East) and commodity prices generally as a result of increased international demand and supply and capacity reductions (temporary or permanent).

While we endeavor to capture a significant portion of potential equity gains, we appreciate that the aforementioned risks do not always correspond directionally and manifest as competing considerations or crosscurrents. We are therefore, in most client portfolios, reducing our investment in PIMCO as the risk of rising interest rates has shifted the risk/reward balance in that fund. We are also increasing (for most clients) investment in two tactical funds – Ivy Asset Strategy and Blackrock Global. Each of these funds is well positioned to capitalize on the growth themes outlined above while responding to increases in risk through asset allocation and other risk reduction techniques. We will continue to monitor developments and adjust portfolios as required to maintain the optimum balance of risk and reward.

As you are aware, client portfolios are managed individually and portfolio construction goals and objectives are accordingly modified as appropriate. Please contact your KLS advisor should you wish to discuss these or any other matters.

March 21, 2011

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