WINFIELD
ASSOCIATES

Winfield Quarterly

July 2010

Customized Investment Portfolios and Private Wealth Advisory Services

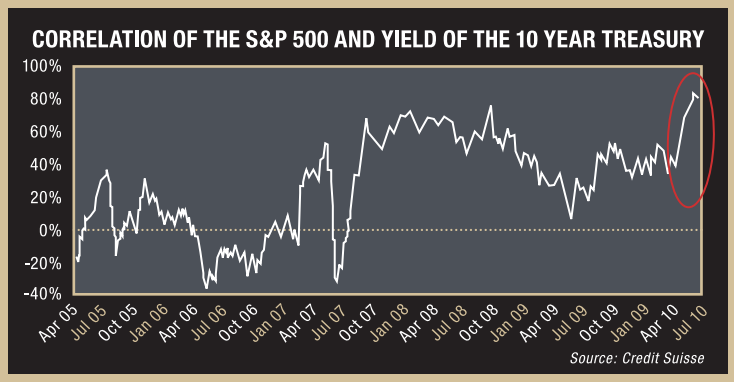
MARKET COMMENTARY

The reemergence of risk aversion dominated the markets during the second quarter. Economic data including jobless claims, housing starts, China's Purchasing Manager Index (PMI) and the Institute for Supply Management's (ISM) manufacturing and non-manufacturing indexes all pointed to a slowdown from the first quarter. Investors translated the weakening data into the probability of a significant economic downturn later this year or early next year. Fears of a "double dip" recession led investors out of equities and into bonds and gold. The S&P 500 suffered a loss of -11.45% for the quarter, the weakest showing for the period since 2002. Gold closed near an all-time high of $1,245 per ounce on June 30, and the yield of 10-year Treasury bond dipped below 3% for the first time in over a year.

The list of investors' concerns is daunting: unemployment stubbornly hovers around 10%; housing starts remain below normal levels; and the fiscal condition of the US and other developed countries raises uncertainty about financing deficits. Quantitative easing by the European Central Bank (ECB) abated the risk of a European financial collapse but leaves a lingering fear of a relapse. The stock market decline in May and June diminished investors' wealth, making individuals and businesses reluctant to commit capital. In the US, the health care and finance bills created the uncertainty of potential increased costs for both households and businesses. And, despite great promise and impressive growth, for the most part, emerging markets underperformed the developed markets. China's Shanghai Index finished the first half of 2010 down over -25%, reflecting concerns of slower growth largely engineered by the Chinese government to soften inflationary pressure.

Perhaps of greatest concern and certainly the most notable event of the second quarter was the "flash crash" on May 6 when the Dow Jones Industrial Average (DJIA) dropped 999 points in 30 minutes of trading. Remarkably, stocks recovered two-thirds of the loss by the time the markets closed, marking it as one of the most volatile days in the history of the New York Stock Exchange (NYSE). The specific cause has yet to be determined, but most analysts believe computerized trading, which allows rapid sequential trading without intervention, amplified the downdraft. Uncontrolled markets are, of course, unacceptable and add to investors' fear. As a result of the sudden and chaotic drop, the Securities and Exchange Commission (SEC) and the NYSE instituted new rules on June 10 which implement circuit breakers in the trading of individual stocks. While we cannot be sure the changes will better control a similar incident in the future, we believe regulators will make the mitigation of trading irregularities a top priority.

Investors confirmed that the safest route to preserve capital is to buy US Treasuries, highly rated corporate bonds and/or certificates of deposit (CDs). This strategy was successful in the second quarter as fear precipitated a flight to safety and pushed Treasuries and high grade corporate prices higher. The graph below illustrates the recent high correlation of 10-year Treasury yields and the S&P 500. Put simply, this chart demonstrates that as the S&P 500 fell, the yield of the 10-year Treasury fell at a similar pace (in excess of 80% correlation). The last time the two indexes showed such strong correlation was in the fall of 2008 when Lehman Brothers collapsed. Clearly, fear reached critical levels in the second quarter.



Contrary to current bearish sentiment, many data points suggest the economy is merely slowing, not crashing, after the strong momentum of last year's fourth quarter. Corporate profits continue to surge and are near a record high. Core inflation is at a post – World War II low of 1.0%. The cost of money is low as the Federal Reserve has no need to raise rates in the near-term to fend off inflation. Combined corporate and household liquidity is at a record high of $11 trillion. Over the past two weeks, most economists lowered second half GDP estimates, but nonetheless, predicted positive growth. Consensus estimates of average quarterly GDP growth are in excess of 3% well through the first half of 2011.

Our investment strategy reflects the increased levels of risk facing our markets. We continue to allocate appropriate amounts to fixed income as insurance and invest both strategically and opportunistically in equities. Often, bearish investor sentiment provides a contra-indicator of future equity performance. During the first week of July, the American Association of Individual Investors (AAII) Bearishness Index reached 57%, a level not seen since the low in March 2009. Upcoming second quarter earnings results and guidance for the remainder of the year should determine the tone of the markets for the rest of the summer.

MACROECONOMIC OUTLOOK

	April 2010	July 2010
US GDP	Positive	Positive
Inflation	Neutral	**Positive**
Employment	Neutral	Neutral
Productivity	Positive	Positive
Corporate Profits	Positive	Positive
Consumer Debt	Negative	Negative
International Growth	Positive	Positive

We are changing our view of Inflation from Neutral to Positive. The core inflation rate of 1.0% remains extraordinarily low due to substantial excess capacity in the economy. With no signs of inflation and unemployment at almost 10%, the Federal Reserve is not likely to raise interest rates in the near future.

ROTH IRA CONVERSION PRESENTATION

On May 5, Winfield co-hosted a seminar to review the tax and estate planning issues surrounding Roth IRA conversions. While the new law allows high income earners the opportunity to convert to a Roth, a number of questions should be reviewed prior to making a decision.

- Can you pay the conversion tax with assets other than those in your plan?
- Will you need this money to live on in retirement?
- What is your marginal tax rate now?
- What will your marginal tax rate be when you withdraw the money from the retirement account?

Answers to these questions will vary by individual. Please call us or consult your accountant to find out if a Roth IRA conversion is right for you.

ROLLOVER YOUR 401(K) ASSETS TO YOUR IRA

An IRA generally gives you more flexibility because you're not limited to the investments in your employer's plan. Rollover IRAs allow you to combine money from employer sponsored plans, such as 401(k), 403(b) and governmental 457 plans, as well as existing IRAs, into one IRA account. Consolidating retirement accounts simplifies portfolio management and may reduce the costs associated with your investments.

MARKET PERFORMANCE

	2Q 2010	2010 YTD
Dow Jones	-9.39%	-5.04%
S&P 500	-11.45%	-6.66%
Nasdaq	-12.04%	-7.05%
Russell 2000	-10.19%	-2.54%
MSCI EAFE	-14.91%	-14.72%
Barclays Agg	3.49%	5.33%

WHEN TO WORK WITH WINFIELD

PRIVATE INDIVIDUAL INVESTORS

- Manage accumulated wealth, inheritances and settlements to meet investment objectives

ENDOWMENTS AND FOUNDATIONS

- Manage assets with a long-term growth strategy while meeting investment policy requirements

BUSINESS OWNERS

- Customize investment portfolios to meet investment objectives and lessen risk of concentrated assets
- Defer taxable earnings in profit sharing plans
- Manage and advise 401(k) plans

BUSINESS PROFESSIONALS

- Customize investment portfolios, manage stock options and consolidate 401(k)/IRA plans to meet investment objectives and lessen risk of concentrated assets

RETIREES

- Customize investment portfolios to meet investment objectives with the option of drawing income
- Management of IRAs, trusts and taxable accounts

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