TALIS ADVISORS

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QUARTERLY INVESTMENT REVIEW

Second Quarter 2010

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MARKETS OVERVIEW

Second Quarter 2010

- After four consecutive quarters with very strong performance, which continued into April, the US equity market saw a sharp reversal in May and June and ended the second quarter with large negative returns. The broad US market lost over 11% in the quarter, with most asset classes in double-digit negative returns.
- Performance in other developed markets around the world was generally worse, especially in Europe. Indeed, the worst-performing developed markets in the quarter were mainly European countries in the midst of severe sovereign-debt crises such as Greece and Spain. Developed markets in the Asia Pacific region generally fared better. The US dollar gained ground against most major currencies, especially the euro and the Australian dollar, which hurt the dollar-denominated returns of developed market equities.
- After being the top-performing asset class in 2009, emerging markets continued to cool off in the second quarter, although returns there were generally better than in developed countries. As in the case of developed markets, there was much dispersion in the performance of different emerging markets and asset classes. The US dollar also gained ground against the main emerging market currencies in the second quarter, which hurt the dollar-denominated returns of emerging market equities.
- Value stocks had mixed performance relative to growth stocks in the US during the second quarter. In other developed markets, value stocks greatly underperformed growth stocks across all market capitalization segments. In emerging markets, value stocks outperformed growth stocks across all market capitalization segments.
- Along the market capitalization dimension, small caps outperformed large caps in the US, in other developed markets, and in emerging markets.
- Notwithstanding the continued weakness in the commercial and residential real estate markets, real estate securities had negative returns, but good performance relative to other asset classes.
- Fixed income securities had good returns in the second quarter, as there was a flight to safety in the second quarter as a result of the sovereign debt problems in Europe and weak economic data in the US and abroad. Intermediate government securities and inflation-protected securities did particularly well.

Three Years as of June 30, 2010

- Equity markets around the world suffered significant losses in the three years that ended in June. In US dollar terms, developed non-US markets were generally the worst performers, followed by the US equity market, and by emerging markets, which had slightly negative returns. In the US, the value effect was sharply negative across all size categories. In developed non-US markets, the value effect was mixed: positive among small cap stocks and negative among large cap stocks. With regard to the size effect, small cap stocks outperformed large cap stocks in the US, but performed on roughly par with large caps in developed non-US markets. In emerging markets, the value effect was very strong across all market capitalization segments in the three-year period that ended in June, while the size effect was smaller but still positive over that time period.
- The US dollar had mixed performance against major currencies in the three-year period that ended in June. The US dollar sharply depreciated against the yen and the Swiss franc; it sharply appreciated against the euro and the British pound; and was flat against the Australian and Canadian dollars. As a result, currency fluctuations between the US dollar and developed country currencies had a minimal impact on the dollar-denominated returns of developed market equities over the three-year period that ended in June. On the other hand, the US dollar had relatively good performance against the main emerging markets' currencies, and the impact of currency fluctuations on the dollar-denominated returns of emerging markets strategies was to decrease those returns by approximately 1.5% per year.
- Real estate securities in the US had sharply negative returns in the three-year period that ended in June, and real estate securities in other developed markets finished that three-year period as the worst-performing asset class.
- Over the three years ending in June, fixed income securities delivered annual returns that ranged from 8.9% to 3.1%, and were the best-performing asset classes.

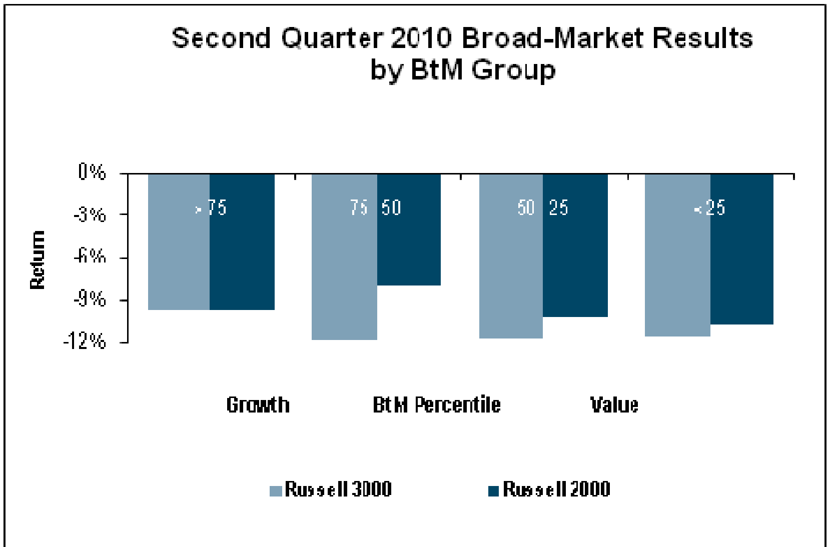
US STOCKS

- After four consecutive quarters with very strong performance, which continued into April, the US equity market saw a sharp reversal in May and June and ended the second quarter with large negative returns. Weaker-than-expected economic data in the US, especially in the labor and housing markets; the sovereign debt problems of Europe, which, in addition to Greece, began to severely affect Spain and Portugal, and prompted European policymakers to deliver a $1 trillion rescue package for Greece and other Euro-zone countries; and regulatory uncertainty in the US as policymakers put the finishing touches on a new financial regulation law were some of the factors that led investors to turn away from risky assets and seek a safe haven. Investors' anxiety and uncertainty were reflected in higher-than-average levels of volatility. For instance, the Chicago Board Option Exchange's VIX, which is a measure of the volatility of the S&P 500 Index that has a historical average of around 20, jumped from about 18 at the beginning of the quarter to almost 46 by mid-May, before dropping back to around 35 by the end of June.
- That uncertainty also contributed to the higher-than-normal percentage of trading days with big market movements (defined as days during which the broad US market moved by more than 1% in absolute value) that we saw in the second quarter, especially in May and June. In fact, almost 50% of the trading days in the second quarter had big market movements.
- The weakest sectors in the quarter were financials and materials, while the strongest sectors were REITs and highly regulated utilities. Quarterly returns for the broad US market, as measured by the Russell 3000 Index, were -11.3%. Asset class returns ranged from -9.2% for small cap growth stocks to -11.8% for large cap growth stocks.
- Value stocks had mixed performance relative to their growth counterparts in the second quarter, although deep value stocks underperformed deep growth stocks across all market capitalization segments. Using the Russell indices as proxies, small cap value stocks (Russell 2000 Value) underperformed small cap growth stocks (Russell 2000 Growth) by 1.4% in the quarter, while large cap value stocks (Russell 1000 Value) outperformed large cap growth stocks (Russell 1000 Growth) by 0.6% in the quarter. Over the three-year period through June 30, however, the Russell 2000 Value Index underperformed the Russell 2000 Growth Index by 2.3% annualized, while the Russell 1000 Value Index underperformed the Russell 1000 Growth Index by 5.4% annualized.

As of June 30, 2010	**Return (%)**		
Index Returns	**Second Quarter**	**One Year**	**Three Years Annualized**
Russell 3000	(11.32)	15.72	(9.47)
Russell 2500	(9.98)	24.01	(7.99)
Russell 2000	(9.93)	21.48	(8.61)
Russell 2000 Value	(10.59)	25.07	(9.85)
Russell 2000 Growth	(9.22)	17.96	(7.54)
Russell 1000	(11.45)	15.22	(9.54)
Russell 1000 Value	(11.14)	16.93	(12.32)
Russell 1000 Growth	(11.74)	13.62	(6.91)
S&P 500	(11.43)	14.43	(9.81)

US STOCKS

- A look at the determinants of stocks performance—relative price and market capitalization—provides some insight into the sources of returns. Historically, value stocks, as measured by the ratio of book-to-market equity (BtM), have outperformed growth stocks, while small stocks have experienced higher returns than large stocks.



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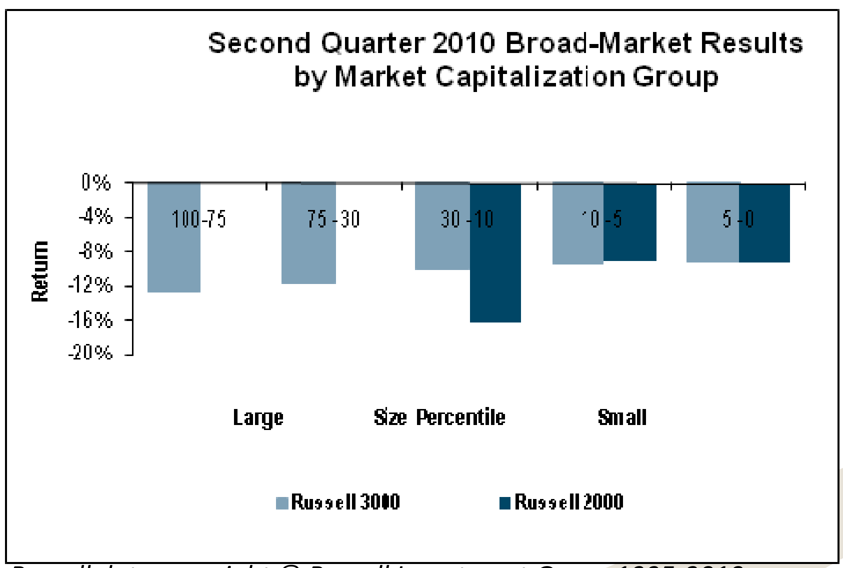
- Along the market capitalization dimension, small caps (Russell 2000) outperformed large caps (Russell 1000) by 1.5% in the quarter. Over the three-year period that ended in June, small cap stocks outperformed large cap stocks by 0.9% on an annualized basis.
- For the Russell 2000 Index, the best relative performance came from growth-oriented stocks, while the worst relative performance came from deep-value stocks in the 0-25th BtM percentile range.

- For the Russell 3000 Index, the best relative performance came from deep growth stocks in the 75th-100th BtM percentile range, while the worst relative performance came from growth-oriented stocks in the 50th-75th BtM percentile range.



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NON-US STOCKS

- Developed non-US equity markets had very poor performance in the second quarter, and, with few exceptions, ended the first half of 2010 with double-digit negative returns. There was a lot of variation in performance at the country and asset class levels. For instance, the difference in performance between the best-performing developed market, Singapore, and the worst-performing one, Greece, was over 38% (-0.2% vs. -38.6%).
- The sovereign debt crisis in Greece and in other European countries, and the uncertainty and disagreements surrounding the response to those crises by European governments and institutions were probably the main factors behind the poor performance of equity markets in Europe in the second quarter. Europe's sovereign debt crises also created significant disruptions in that region's credit markets. The uncertainty about the exposure of different European financial institutions to sovereign debt from the countries that are experiencing the greatest financial strains caused liquidity in the European interbank lending markets to dry up significantly in the quarter. In fact, the problems in those markets became so severe that the European Central Bank announced in early May a set of emergency measures to promote the liquidity and well-functioning of those markets.
- Commodity-rich countries such as Canada, Norway, and Australia also performed poorly in the second quarter, most likely on investors' concerns that the global economic recovery will falter and that commodity prices, which fell in the quarter, will continue to drop in coming months. Volatility and cross-sectional dispersion in developed markets increased during the second quarter. As a result, small differences in portfolio weights between different strategies or between strategies and benchmarks often resulted in large differences in performance.
- Developed market equity returns for US investors were hurt by the relative strength of the US dollar against all major currencies except the yen in the second quarter. The US dollar appreciated by 9.5% against the euro, as investors reacted to the European debt crises and their likely impact on the viability of the euro as a common currency for most countries of the European Union. On the other hand, the US dollar depreciated by 5.7% against the yen, which likely reflected the flight to safety that we saw in the second quarter.
- The overall impact of currency fluctuations between the US dollar and developed country currencies was to decrease the dollar-denominated returns of developed market equities by approximately 3.0% in the second quarter. Consumer staples was the best-performing sector, while energy was by far the weakest sector in the quarter.

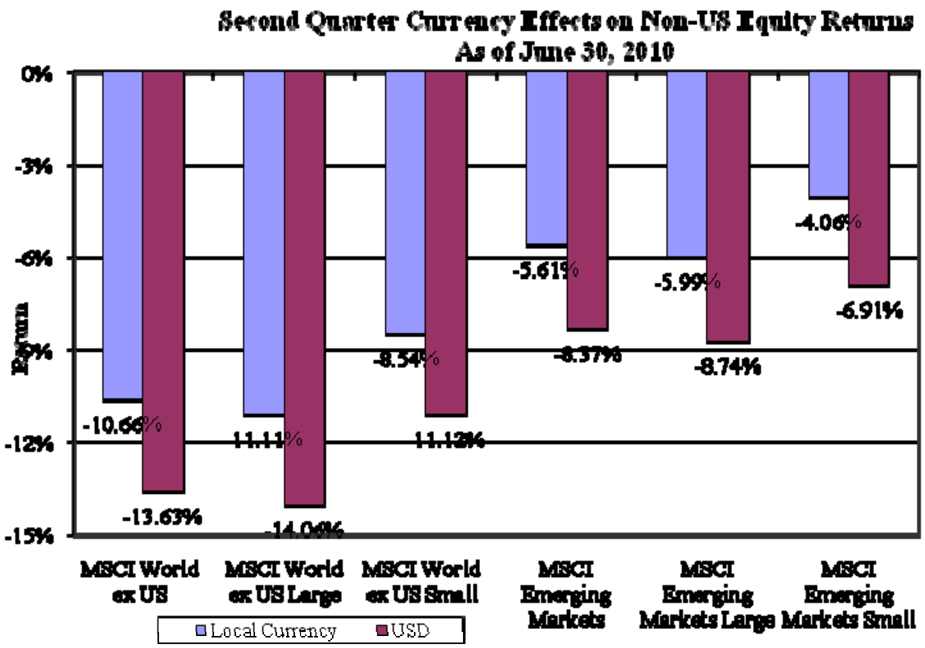
Non-US Equity Returns

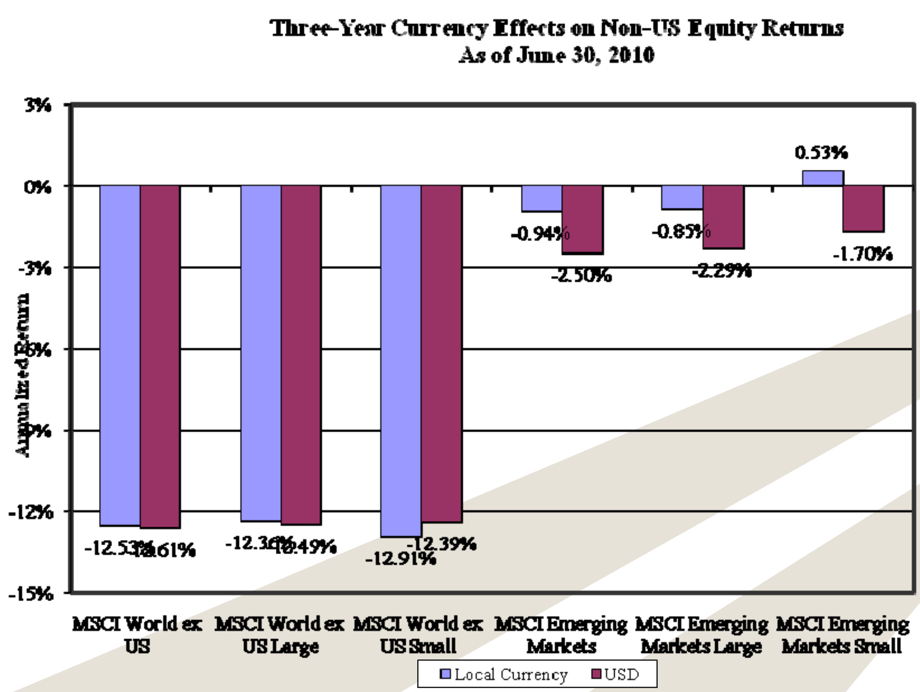
As of June 30, 2010	**Return (%)**		
Index Returns	**Second Quarter**	**One Year**	**Three Years Annualized**
MSCI EAFE Small Cap	(11.33)	12.30	(13.08)
MSCI World ex USA Small	(11.12)	15.70	(12.39)
MSCI EAFE	(13.97)	5.92	(13.38)
MSCI World ex USA	(13.63)	7.03	(12.61)
MSCI EAFE Value	(15.53)	3.21	(15.11)
MSCI EAFE Growth	(12.44)	8.59	(11.70)
MSCI Emerging Markets	(8.37)	23.15	(2.50)
MSCI Emerging Markets Small	(6.91)	35.16	(1.70)

MSCI indices are total returns net of foreign withholding taxes on dividends. *Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.*

NON-US STOCKS

- Using the MSCI World ex USA Index and its sector and country segments as proxies, value stocks in developed markets underperformed growth stocks across both size categories in the second quarter. Small cap value stocks (MSCI World ex USA Small Cap Value) underperformed small cap growth stocks (MSCI World ex USA Small Cap Growth) by 0.7% in the quarter, while large cap value stocks (MSCI World ex USA Large Cap Value) underperformed large cap growth stocks (MSCI World ex USA Large Cap Growth) by 3.3% in the quarter.
- Over the three-year period through June 30, the value effect was negative in large cap stocks and positive in small cap stocks. Large cap value stocks underperformed large cap growth stocks by 4.4% on an annualized basis, while small cap value stocks outperformed small cap growth stocks by 1.5% annualized.
- Along the market capitalization dimension, small caps (MSCI World ex USA Small Cap) outperformed large caps (MSCI World ex USA Large Cap) by 0.7% in the quarter. Over the three-year period that ended in June, small cap stocks slightly edged large cap stocks by 0.1% annualized.





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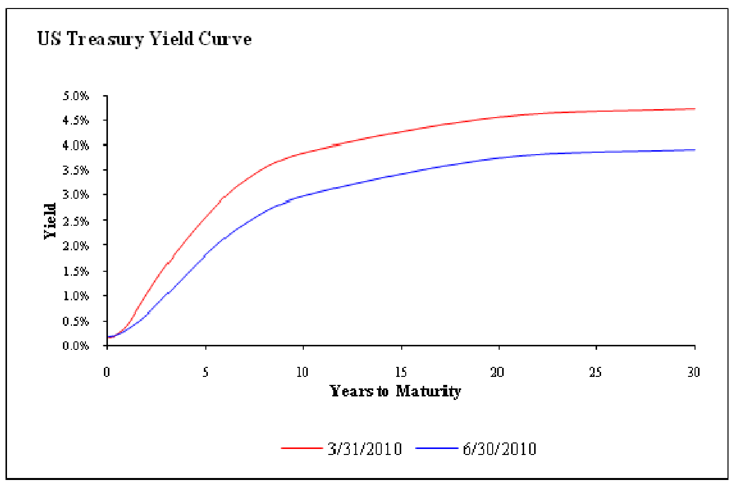
BONDS

- Europe's debt problems, weak economic data, especially in the housing and labor markets, and a high degree of uncertainty about economic conditions and economic policy in the US and abroad turned investors more risk averse during the quarter. Indeed, the second quarter saw a significant flight to safety that was reflected in lower yields for safe-haven securities such as US Treasuries.
- Other fixed income markets also reflected the increase in risk aversion. For instance, the so-called A2P2 spread, the spread between high- and low-quality thirty-day nonfinancial commercial paper; the TED spread, the difference between the rates on three-month interbank loans and three-month Treasury bills; and the difference between yields on investment-grade and speculative-grade corporate bonds, on the one hand, and yields on Treasury securities, on the other, all rose substantially during the quarter. The spread between yields on investment-grade and yields on speculative-grade corporate bonds rose during the quarter as well.
- The Federal Open Market Committee maintained its target range for the federal funds rate between zero and 0.25% in the first quarter, and reaffirmed its goal to maintain that target at very low levels for an extended period. The Federal Reserve's balance sheet, currently the main focus of monetary policy actions, increased slightly from about $2.35 trillion at the end of the first quarter to about $2.37 trillion at the end June. Finally, as previously indicated, the Federal Reserve closed down the remaining emergency lending facilities that it created to support markets during the financial crisis. However, with the reemergence of strains in U.S. dollar short-term funding markets in Europe, the Federal Reserve reestablished temporary U.S. dollar liquidity swap facilities with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank in May.
- Yields on very short-term Treasury bills were little changed in the second quarter relative to the end of the first quarter, while yields on longer-term Treasury securities fell substantially in the second quarter. As a result, the yield curve flattened over the quarter. The difference in yield between ten-year Treasury bonds and one-month US Treasury bills was 280 basis points at the end of the second quarter, compared to 369 basis points at the end of the first quarter.



As of June 30, 2010	Return (%)		
Index Returns	Second Quarter	One Year	Three Years Annualized
Merrill Lynch Three-Month US T-Bill	0.04	0.16	1.57
Merrill Lynch One-Year US Treasury Note	0.26	0.99	3.15
Citigroup World Government Bond 1-3 Years	0.49	1.98	4.19
Barclays Capital US Government Bond	4.24	6.46	7.58
Merrill Lynch US Treasury/Agency 1-5 Years	1.91	4.04	5.96
Citigroup World Government Bond 1-5 Years	0.95	3.04	5.02
Barclays Capital US TIPS	3.82	9.52	7.62

REAL ESTATE INVESTMENT TRUSTS

- Real estate securities had negative returns in the second quarter, but good performance relative to other asset classes.
- US real estate securities performed better than any other US asset class, except fixed income.
- Real estate securities in other developed markets also had better performance than all other equity asset classes in developed markets.

As of June 30, 2010	**Return (%)**		
Index Returns	**Second Quarter**	**One Year**	**Three Years Annualized**
Real Estate Securities	(3.93)	54.39	(9.65)
Intl. Real Estate Securities	(9.54)	17.08	(18.94)

Dow Jones data (formerly Dow Jones Wilshire) provided by Dow Jones Indexes. S&P/Citigroup data is gross dividends, provided by Standard & Poor's Index Services Group. Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.