BEACON'S POINT: NEVER A DULL MOMENT

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CONFIDENTIAL – PROPRIETARY

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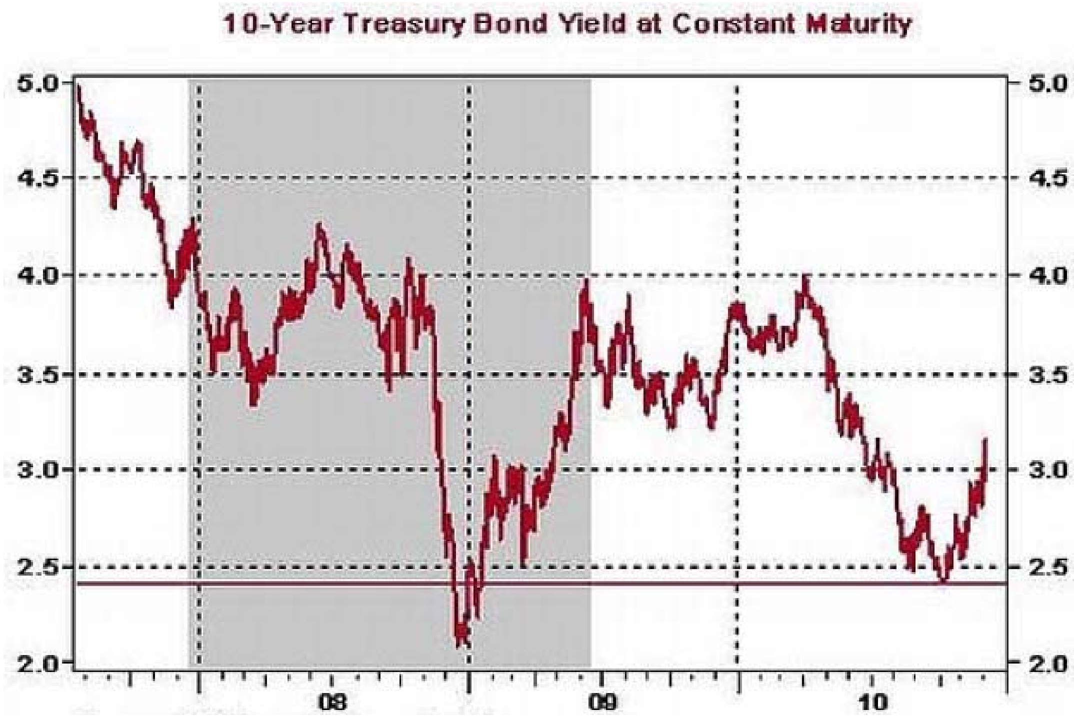
In early October of this year, the 10-year U.S. Treasury yielded 2.41%. Over the past two months its yield has risen to 3.27%, the highest level since June 2010. Half of this gain came over the past week, leading many observers to ponder the question: Is the bond market pendulum poised to swing back? The answer will reveal itself in hindsight: at some point in the future, we will be able to look back and determine whether or not the winter of 2010 marked a turning point in interest rate levels and fixed income pricing trends.



Source: The Northern Trust Company, U.S. Treasury, and Haver Analytics

The advance in yields over the past week was most likely driven by market participants' perceptions that economic conditions are improving and, as a result, future expectations are being reassessed to the upside. A tax compromise coming out of Washington, ongoing government debt issuance in the U.S., and an element of shifting fund flows have all had an impact on the direction and magnitude of change in fixed income markets. In addition, many investors who had earlier this year built positions in Treasuries in anticipation of QE2, have started to exit that trade and transition to a more risk-seeking mentality.

Beacon Pointe maintains an ongoing dialogue with the select group of fixed income firms that manage accounts on behalf of our clients. For instance, in a recent conversation with PIMCO, we gained some insight into its current views and portfolio positioning. The Total Return Fund has a slight duration overweight relative to the Barclays Capital Aggregate Bond Index. There has been no change to that position yet, although adjustments to duration are to be expected at some point in the future. The firm is comfortable owning the short end of the curve based on its assessment of current employment, growth, and inflation conditions. PIMCO's base case over the cyclical time horizon (defined as 1-2 years) remains one of slow growth and no inflation. The potential for inflation is more meaningful over the firm's secular time horizon (defined as 3-5 years) and PIMCO's strategies will undoubtedly start to adjust to this scenario as the team sees signs that it is approaching.

Also this week, PIMCO's mutual funds paid out a capital gain distribution to shareholders. In the case of the Total Return Fund, this resulted in a NAV downward adjustment of approximately 5%. Importantly, the change in NAV is not representative of the return of the fund. In fact, according to Morningstar, despite the interest rate advance over the past week and PIMCO's slight duration overweight, the Total Return Fund has outperformed its benchmark, the Barclays Capital Aggregate Bond Index (-0.55% vs. -0.75% for the 1-week period ending December 8, 2010). Moreover, the Fund continues to outperform the benchmark by a significant margin over the longer-term.

In the municipal fixed income space, yields have also moved higher as a result of increasing supply, uncertainty surrounding the Build America Bond program, and mutual fund outflows. The municipal bond managers Beacon Pointe works with continue to focus on the credit quality of their portfolios with a view towards controlling downside volatility risk. One of these firms provided that following comments on two of the factors that have likely impacted municipal bond yields and prices over the past weeks:

- *"<u>Possible BABs Expiration at the end of 2010:</u> Before this week, the municipal market had generally expected there would be an extension of BABs past 2010, albeit at a lower subsidy than the current 35% rate. However, there has been some amount of uncertainty about the extension, so we have seen a large amount of BABs issuance as we have headed into the end 2010. Over the past year and a half, the heavy issuance of BABs has crowded out a large amount of tax-exempt issuance causing yields to decline across the curve in the tax-exempt market. If the BABs program expires, we would expect to see yields increase further in tax-exempt municipals. The impact will be pronounced on the longer end of the curve since that is where the vast majority of BABs issuance has been. However, it is quite possible that the short and intermediate portions of the curve will trade off since municipalities may need to issue more short/intermediate tax-exempt debt to satisfy the traditional retail demand in this portion of the curve. We will continue to monitor the BABs situation, but we are very comfortable with our clients' portfolios. We will be in a good position to take advantage of any rise in rates as a result of the BABs program expiring. In our estimation, the market now perceives less than a 50/50 chance that the BABs subsidy will be extended."*

- *"<u>Bowles/Simpson Deficit Reduction Proposal to end Tax-Exempt Status for Municipals:</u> We expect heavy opposition to any attempts to end the tax exempt status for all new municipal bonds. Opponents say that this violates the tenets of Federalism, and this move will obviously increase capital costs for municipalities. Completely removing the tax-exempt status would be a very abrupt departure from recent history, given the ARRA stimulus that the government has provided over the past year to municipalities, as well as the BABs subsidy to enable municipal issuers to maintain low borrowing costs on longer term debt. However, if this were to pass, we understand it would only affect newly issued bonds, so the tax exempt status of outstanding municipal bonds would not be affected. We believe the passage of this proposal would likely create a fair amount of uncertainly in the municipal market, providing additional opportunities for us to find value and mispriced securities for our clients."*

Beacon Pointe's Investment Committee has a lot of confidence in the investment managers we have selected for our clients' portfolios. In the coming months, we will watch closely the ongoing developments in the fixed income markets, speak with representatives of the fixed income asset management firms on a regular basis, and monitor their evolving views and portfolio strategies. In addition, we will continue to update clients of any major shifts in terms of risks posed and opportunities presented by the ever-changing market environment. Never a dull moment, indeed!

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.