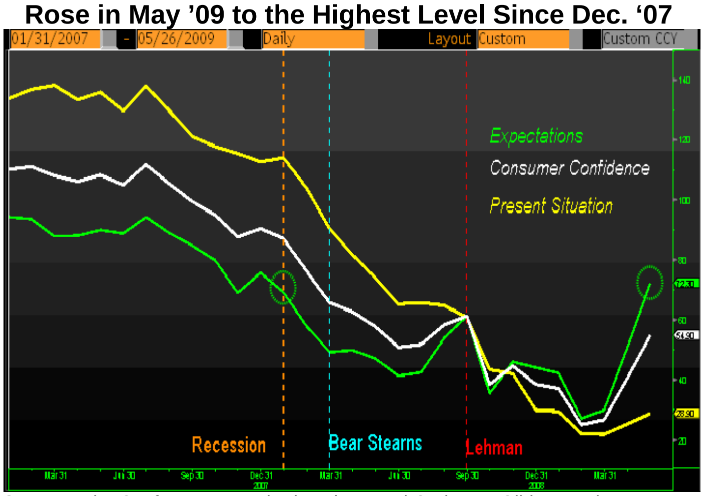
July 2009

Pre-Lehman Conditions Return and Risk Tolerances, Bond Yields, Inflation and Deficit Expectations All Rise, But Consumer Debt, Real Estate and Jobs Remain Recovery Risks

Multiple signs of economic growth, commonly referred to as ‘green shoots’, emerged in the second quarter, bringing evidence that the worst of the Great Recession that started in December 2007 is behind us. Investors embraced the signs of economic stability and credit thawing with enthusiasm by increasing their risk appetites for stocks, especially those of lower quality, and shunning bonds, sending yields higher. While early indicators from the economic data show that we may have seen the worst of the downturn, our outlook is guarded as consumer balance sheet repair, growing residential and commercial real estate delinquencies and a weak labor market could all work to moderate near-term economic growth. Moreover, recoveries from recessions accompanied by a financial crisis have historically been slower than other recoveries.

A number of leading economic indicators including the Conference Board’s consumer confidence measure, multiple regional Federal Reserve surveys, including the Richmond Fed’s manufacturing index, and new orders for durable goods reported by the Department of Commerce all rose in the second quarter. While many of these measures were previously at or near multi-year low points, we view the relative improvements as incremental positives for the economy. Credit markets also showed signs of recovery as a key short term interest rate, the London interbank offer rate (Libor), and a widely watched indicator of credit risk, the TED spread, both contracted to levels not seen since before the Lehman Brothers bankruptcy last fall.

The Consumer Confidence Index for Expectations Rose in May ’09 to the Highest Level Since Dec. ‘07

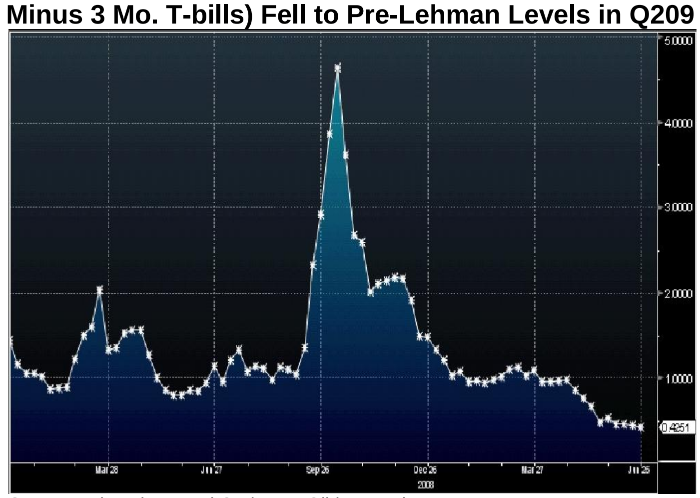


Sources: The Conference Board, Bloomberg and Godsey & Gibb Associates

Led by members of the Financial sector, more than 150 companies successfully accessed the capital markets for more than $85 billion in dilutive secondary equity offerings, and ten financial institutions repaid $68 billion in aid from the Troubled Asset Relief Program. Stocks rose sharply from the 12-year lows reached in March and U.S. Treasury interest rates moved higher in lock step with higher risk tolerances, growing budget deficits and record supply issuance. The yield difference between U.S. Treasury 2-year and 10-year notes, known as the slope of the yield curve, widened to a record 2.80%, surpassing the previous record of 2.74% set in August of 2003. Investors are shying away from longer-term debt as the government borrows record amounts for stimulus, stabilization programs and other spending.

Even after the Federal Reserve announced plans to purchase $300 billion in U.S. Treasuries in March, 10-year yields climbed to near 4% in June, threatening to further moderate economic growth. While the liquidity needs of banks and other financial institutions had been driving the Fed’s decisions, we may be transitioning to a period where economic data and the implications for future growth will play more of a role in Fed actions. In its efforts to anchor consumer and mortgage rates, the Fed could always increase its purchases of U.S. or agency debt; however as long as rates are rising with an improving economic outlook, the Fed will probably not increase the size of its interventions.

Credit Risk Measured by the Ted Spread (3 Mo. Libor Minus 3 Mo. T-bills) Fell to Pre-Lehman Levels in Q209



Sources: Bloomberg and Godsey & Gibb Associates

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Inflation expectations also increased in the second quarter, evidenced by the difference between yields on 10-year inflation-indexed bonds and nominal Treasuries of the same maturity. While it is hard to project any imminent pickup in inflation in the near-term due to excess capacity in both labor markets and industrial capacity, some investors fear that the historic levels of monetary and fiscal policies enacted around the world will ignite significant inflation. Inflation, which is a lagging indicator, will likely remain contained until available credit and demand return in a meaningful way. However, we will be closely monitoring volatile commodity prices and the value of the U.S. dollar for any signs of increasing import prices.

In Washington, the deficit for the current budget year, which ends on September 30, is estimated to reach an all-time high of $1.8 trillion. As a share of the overall economy, the deficit this year would be the highest since 1945, when the government was borrowing heavily to win World War II. Rating agency Moody's reaffirmed its 'Aaa' rating for the U.S. government in the second quarter but said that several factors including a reassessment of the long-term growth prospects of the economy and the ability of the government to return to a sustainable debt trajectory could put negative pressure on the rating in the future. In order to promote long-term economic growth, we believe the administration in Washington will need to significantly reduce the level of projected deficits.

Several risks including consumer balance sheet repair, rising delinquencies in residential and commercial real estate and weak labor markets lead us to believe that overall economic growth in the U.S. will remain below trend for at least several quarters. Historically, rate sensitive sectors such as autos and housing have helped drive economic recoveries, but with consumer deleveraging expected to keep spending levels weak, we think this time will be different. The overall level of demand for new homes and new cars appears to be resetting at a lower base in our analysis and it is unclear that a sharp recovery in either sector can occur until consumer balance sheets have undergone a significant amount of debt reduction.

Budget Deficit, National Debt and Debt Service 2006 – 2012 (Billions)

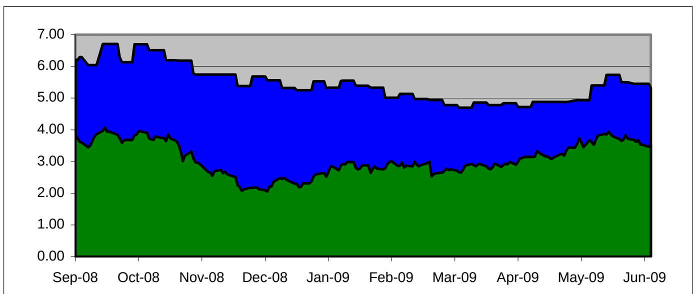
Fiscal Year	Budget Deficit	National Debt	Debt Service (Net)
FY 2006	$434.5	$8,451.4	$226.6
FY 2007	$343.5	$8,951.0	$237.1
FY 2008	$641.8	$9,985.0	$248.9
FY 2009E	$1,889.6	$11,874.6	$235.0
FY 2010E	$1,750.0	$13,626.7	$371.0*
FY 2011E	$1,250.0	$14,876.7	$475.0*
FY 2012E	$1,100.0	$15,976.7	$555.0*

Sources: Congressional Budget Office, Silvercrest Asset Management
* Assumes 50 basis point annual increase in average interest paid

Given these risks, the economic recovery will likely take longer and be more muted than in past cycles, as unemployment and housing markets may not begin to recover until next year. While the consensus view is for a recovery in the second half of this year, we believe 2009 will be more of a year of repair, stabilization, and healing, and that modest economic growth will resume in 2010. In anticipation of a return to growth in the overall economy and a more sustainable level of corporate earnings next year, we have become more optimistic at the margin regarding equities. As leading indicators, equity markets historically anticipate economic recoveries. However, we expect that the relative growth advantage in emerging markets will persist and that developed markets could be range bound until more of the drag from the consumer, residential and commercial real estate sectors, and the labor markets abate.

We continue to invest in companies with sustainable growth characteristics, trading at reasonable valuations with exposure to the secular themes we have identified. In the second quarter, we made additions to procyclical stocks and investment vehicles in industry sectors like Technology and global Materials. We also added equity exposure to emerging markets, as we believe they offer greater potential for near-term economic growth due to fiscal and monetary flexibility and attractive characteristics such as industrialization and increasing consumer demand. Unlike in the U.S., banks in Southeast Asia are relatively free of toxic assets, and the debt loads of governments, corporations and consumers in emerging markets are a fraction of those in developed economies. Overall, we maintain a prudent mix of defensive growth companies, and exposure to companies and industries that are positioned for growth as we emerge from the downturn. In balanced and fixed-income portfolios, we initiated positions in Ginnie Mae mortgage pools. These securities offer high credit quality, a yield advantage to Treasury notes and relatively low interest rate sensitivity. While we have reduced cash balances from historically high levels, we maintain an overweight for capital preservation and future flexibility.

30-Year Conforming Mortgage Rates (Blue) and U.S. Treasury 10-Year Yields (Green) Rose in Q209 (in %)



Sources: Bloomberg and Godsey & Gibb Associates