

TITLEIST

ASSET MANAGEMENT, LTD.
MEMBER FINRA-SIPC

www.tamgmt.com

For literature and account information, please visit the firm's website.

or write or call:

TITLEIST ASSET MANAGEMENT, LTD.
ESTABLISHED 2003

609 Castle Ridge Road, Suite 315
Austin, Texas 78746
512.494.1003

7373 Broadway, Suite 108
San Antonio, Texas 78209
210.826.2424

This report is submitted for the general information which reflects our views and opinions as of December 31, 2010, the end of the reporting period. Any such views are subject to change at any time based upon market or other conditions, and Titleist Asset Management, Ltd. disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions for the firm's clients are based on numerous factors, may not be relied on as an indication of trading intent on behalf of Titleist Asset Management, Ltd.

2010

Fourth Quarter Report

The Dow Jones Industrial Average finished with returns of 13.99% while the broader based S&P 500 finished with returns of 15.06%. The consumer discretionary and industrial sectors provided the strongest returns while healthcare and utilities underperformed. The Barclays Aggregate Bond Index finished with a return of 6.54%. Long term treasuries and investment grade corporate bonds were the strongest performers while muni bonds were the biggest decliners.

The equity markets finished with solid returns after a volatile year that included the EU debt crisis, flash crash, BP spill, financial regulation, and mid-term elections. Returns were even more impressive considering the healthcare and financial sectors were faced with significant legislative headwinds while the energy sector was burdened with regulatory challenges; these three sectors alone account for 40% of the S&P 500's earnings.

On the economic front, fiscal and monetary policy remains extremely accommodative with the Federal Reserve taking unprecedented measures to stimulate growth and Congress extending the tax cuts. Real gross domestic product, the government's inflation-adjusted measure of the economy's total output, is expected to hit a new high this quarter. Most leading economic indicators are signaling a strong economy in 2011. Housing and employment remain a drag however, we expect the employment picture to strengthen as both the U.S. and global economy shifts from the recovery portion of the cycle to the expansion phase.

Global GDP ex-Europe should grow at a healthy clip of 5% in 2011. Even though Europe remains a drag, the largest economy within the Eurozone - Germany - has what is arguably their best economy since re-unification. The peripheral countries within the Eurozone are pretty much irrelevant on the global economic stage but unfortunately their debt, and its harmful effects on the banking system, is not. It will probably take further austerity measures and bailouts but it does appear that EU member countries, ECB, IMF, and other central banks around the world are fully committed to preventing further disruption.

Looking ahead, we think the equity markets remain attractive on a fundamental basis. Earnings on the S&P 500 should exceed \$94 next year and that would eclipse the prior record of \$86 set in 2006 by over 9%. Even though earnings should be at record highs, cash on corporate balance sheets is the highest since 1951, and interest rates are at all-time lows, the market is still 20% lower than its prior highs in 2007.

In more certain times, using the historical average forward multiple of 18x would have seemed more than reasonable considering interest rates are at record lows and earnings are growing at a healthy rate of 12%; this would suggest the market is 34% undervalued at today's levels. We do not, however, think the market multiples will expand to their long term historical averages in the near/intermediate term in an era where U.S. debt is at extreme levels and so many structural issues need to be addressed.

In addition to valuations, other key measures of market health look great with an 8.6% increase in dividend payouts, a 221% increase in corporate buybacks, and a 128% increase in mergers and acquisitions. On a rear view mirror basis, the S&P 500's price to normalized earnings on a 3, 5, and 10yr basis looks undervalued.

Historically, the third year of the election cycle has produced the strongest returns with an average gain of 17.5%. Furthermore, a GOP Congress and Democratic president has been the best performing mix during this 3rd year cycle of market outperformance.

In addition, the financial sector should start to meaningfully contribute to earnings growth in 2012 and 2013 after the banks work through the massive amount of write-downs to come in the next few years. This

is very important because it will provide the market with earnings growth in the out years. The financial sector used to represent 21% of earnings whereas now it's closer to 16%.

We are about to the point in the cycle where businesses believe in the sustainability of the recovery and will begin to start hiring. Every recovery in the past century, except 1983, has had at least one quarter of 2% growth during a recovery. Now that we have moved past this typical slowdown pattern in Q2 and Q3 the likelihood of a double dip recession is small and we expect employment growth to improve as a result.

The draconian, and often absurd, predictions in the financial press and media should decrease the longer these people remain wrong. It is hard to remain credible when you have missed the biggest market gains in over 80 years. Their disdain for the markets is usually followed by a political rant citing the same fears and concerns we all have. Even though we share many of those same sentiments, it is important to realize just how much the market has already discounted, or overly discounted in our opinion.

It was almost heretical to have a positive market outlook over the past few years. If anyone did use the word "optimistic" it is almost always preceded by the term "cautiously" and it seemed nobody wanted to take a stance and commit to anything other than being excessively negative. This year, Goldman Sachs, Morgan Stanley, and several other major firms have come out with very bullish forecasts of 15-20% stock market returns.

Institutions, endowments, hedge funds, and both retail and professional investors remain extremely underweight equities compared to historical averages. There is still an unprecedented amount of money on the sideline or sitting in alternative strategies such as hedge funds that could potentially come back into the market this year. The HFRI fund of funds composite returned a modest 3.43% in 2010 and 11.66% in 2009 significantly underperforming the S&P 500 and Barclays Aggregate Bond Index.

Our market outlook for equities remains very positive, but for the first time in the past 3 years we are not as positive as most of the street. We think earnings will probably come in higher than consensus forecasts but the difference is we are not anticipating the same level of multiple expansion. Volatility should decrease as economic conditions continue to improve and most of the political uncertainty has been addressed.

We do not see any value at all in the fixed income markets and continue to keep durations low in anticipation of higher rates. We are avoiding municipal bonds and expect they will continue to decline until the latter half as the outlook for state and local governments remains bleak. Investors looking to the bond market for stability and real returns - yield after backing out inflation - could be in for a big disappointment.

We do not foresee rising interest rates to be a problem anytime soon for the equity markets. It would be healthy in our opinion to see interest rates on the 10yr increase to 4.00%-4.50%. Anything above 4.5% in the short term could potentially have a negative impact on the equity markets, especially the areas leveraged to international markets. Oil at \$90 and \$3 gasoline hasn't become a problem yet but anything more than 20% higher would start to have a meaningful impact on economic output.

Short term catalysts include further efforts by the administration to expand trading relationships such as the recently signed treaty with South Korea or a tax break on the repatriation of profits held overseas. U.S. corporations have over 1 trillion dollars sitting overseas that they could repatriate here should the government reduce the federal tax of 35%, the highest in the world. These dollars coming back here could provide a stimulus of epic proportions as that money could be invested in jobs, capital assets, research and development, and more.

In closing, we remain optimistic on most risk assets. Our portfolios remained positioned with large investments in energy, oil service in particular, and technology. Even though sectors such as healthcare and utilities have historically outperformed in the third year of an up cycle, we remain neutral on healthcare and underweight utilities and consumer staples.

We will continue to seek optimum returns and will keep you updated as we adjust to changing economic and market conditions. Thank you for your continued confidence in our firm.