

Investment Policy Committee Notes

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Economic and Stock/Fixed Income Market Outlooks

Economic Outlook

Recent Reports

- In May, Bookings for goods meant to last at least three years, excluding autos and aircraft, increased 0.9 percent, the third gain in the past four months. Separately, a Labor Department report showed the number of claims for jobless benefits last week hovered near this year's average.
- Incomes grew faster than spending in May for the second consecutive month, making it possible for American households to simultaneously increase savings and support the economic recovery.
- Companies in the U.S. added fewer workers in June than forecast. The 13,000 gain was the smallest since February and followed a revised 57,000 increase the prior month according to ADP. Companies may be slow to add workers until there's evidence the gains in demand will be sustained.

Upcoming Reports

- (7/01) June ISM Manufacturing (59.0 vs. 59.7) & (7/02) May Factory Orders (-0.5% vs. 1.2%).
- (7/01) May Pending Home Sales (-14.2% vs. 6.0%).
- (7/02) June Nonfarm Payrolls (-125k vs. 431k) with Private (110k vs. 41K) & Unemployment Rate (9.8% vs. 9.7%).

Longer-Term Outlook

- While not in the double-dip recession camp just yet, we are concerned by recent weakness in the economic data. We knew much of the growth had been stimulus related and will be watching upcoming data closely. We still believe that GDP growth will be subdued for years to come ("New Normal") due to structural challenges and that being nimble within our asset classes will be a very important.
- One major challenge is our growing Federal Debt which will be the focus of our June commentary. The past two years have made the economic consequences of too much leverage painfully clear to individuals and businesses. Some of the same basic math applies to the governments such as we're seeing in Euro-zone. By themselves, high debt-to-income levels don't necessarily strain resources but problems arise quickly as interest rates rise. For now, the U.S. remains the global choice for investment quality and safety as well as the reserve currency.

Market Outlook

Equity Outlook

- Most valuation measures suggest that small caps remain expensive relative to large caps. Given the magnitude of small-caps' outperformance over the past decade, this is not too surprising. We continue to believe that for the time being, large-caps are likely to do better than small-caps over our five-year tactical time horizon as this valuation relationship returns to more normal levels.
- Last week from a "Technical" standpoint, we cited that the "Head and Shoulders" formation could result in a leg down which did materialize. Fundamentally, valuations are beginning to look compelling. We believe that the upcoming earnings season could prove to be a positive catalyst.

Fixed Income Outlook

- For June, Treasury yields continued their downward path as the 2-year note hit a record low of 0.6%. The 10-year Treasury which hit 4% in April ended the month below 3%. From here the risk seems to outweigh reward. As one would expect, spreads have increased particularly high yield.
- Tax-exempt bond prices should finish slightly negative in June as mid-month levels did attract bidders. On a relative basis, valuations are looking very attractive particularly given the anticipated tax increases next year. Fitch Ratings downgraded KY "Appropriation Bonds" back to AA- from the recalibration's AA but changed the negative outlook to stable.

S&P 500 GICS Sector Performance and Recommended Sector Weightings

| S&P 500 Sector | % Total Return | | | Forward P/E Ratio | Actual Sector % Weightings | Forward Looking |
|------------------------|----------------|-------|------|-------------------|----------------------------|----------------------|
| | MTD | YTD | 2008 | | | CB&T Sector Emphasis |
| Consumer Discretionary | -9.7 | -1.6 | 41.3 | 13.8 | 10.1 | Marketweight |
| Consumer Staples | -2.4 | -2.8 | 14.9 | 13.6 | 11.5 | Marketweight |
| Energy | -5.7 | -12.2 | 13.9 | 10.9 | 10.7 | Overweight |
| Financials | -5.9 | -3.7 | 17.2 | 13.3 | 16.3 | Underweight |
| Health Care | -1.7 | -8.8 | 19.7 | 10.8 | 12.1 | Marketweight |
| Industrials | -6.9 | -0.9 | 20.9 | 14.4 | 10.4 | Marketweight |
| Information Technology | -6.2 | -10.6 | 61.7 | 12.7 | 18.7 | Overweight |
| Materials | -6.9 | -12.9 | 48.6 | 13.7 | 3.4 | Marketweight |
| Telecommunication | -0.2 | -8.4 | 8.9 | 13.8 | 3.0 | Marketweight |
| Utilities | -0.6 | -7.1 | 11.9 | 11.5 | 3.8 | Underweight |
| S&P Composite 1500 | -5.4 | -6.0 | 27.3 | 13.0 | | |
| S&P 500 | -5.2 | -6.7 | 26.5 | 12.7 | | |
| S&P MidCap 400 | -6.6 | -1.4 | 37.4 | 16.2 | | |
| S&P SmallCap 600 | -7.1 | -0.9 | 25.6 | 18.5 | | |

Sector recommendations are market-cap weighted, influenced by economic, fundamental, and technical consideration.

The above information is provided by outside data vendors; CB&T cannot guarantee the accuracy of the data provided.

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