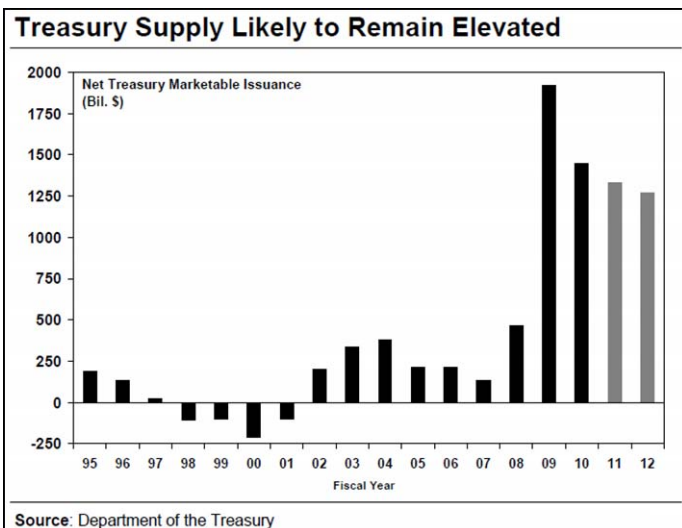


July 2011

Commentary: The “End of the Beginning” of the Great Experiment

“Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning.”
– Sir Winston Churchill

Navigating an investment environment without any true historic precedent to draw upon is challenging to say the least. The impact of extraordinary fiscal and monetary stimulus measures has significantly guided our investment outlook and implementation in recent years. Throughout this period of unprecedented governmental intervention, we positioned our clients’ portfolios for moderate economic growth and benign inflation, correctly anticipating the environment that subsequently unfolded. In addition, we have successfully “threaded the needle” in bond portfolios, balancing client demands for higher yields with the investment risks inherent in operating in an increasingly artificial interest rate environment. Today we find ourselves at an interesting crossroads between uncertain economic recovery and the “beginning of the end” of the extreme accommodative policy measures.



The end of the second quarter also marked the end of the Federal Reserve’s most extreme accommodative policy measures. Besides the ongoing concerns about the Fed’s exit, the markets also moved in response to macro events – rising and falling as investors became alternately optimistic and despondent about global economic growth, European debt concerns, the U.S. debt limit debate and the impact of Japan’s earthquake and tsunami. Even though the equity and bond markets ended slightly higher for the quarter, the positive results belie the volatile nature of the underlying investment environment – including the considerable though fairly normal pull-back in the global equity markets late in the quarter.

Interestingly, this year’s spring market decline mirrored that of last year’s downturn in many ways, with headlines dominated by Greece as well as weakening economic data. Although we harbor few illusions that 2010’s late year surge can

be repeated without the Federal Reserve’s rocket fuel this time around, we have concluded that conditions this year are generally more sustainable than they were last year when authorities attempted to wean the economy off the first dose of quantitative easing. Still, the coming environment will be anything but calm. Specifically, the precarious balancing act that the U.S Treasury and the Federal Reserve have achieved will change significantly in the second half of 2011, and more so in 2012.

As the charts depict, there is a clear mismatch in the affect of the end of the Federal Reserve’s purchases of Treasuries and our elevated deficit spending. Over the course of the previous eight months, the Federal Reserve acquired a shocking 85% of the bonds offered by the Treasury. However, the charts show the Fed’s accumulation of Treasuries is winding down while Treasury issuance is expected to continue at an elevated clip. As a result, we believe that the Treasury market will enter a significant readjustment period, possibly starting as soon as the latter part of this year. Although we do not anticipate any “cliff effect” to the end of the Fed’s stimulus measures, our expectation is that longer term interest rates will rise modestly in 2011 and then at an accelerated pace throughout 2012, *ceteris paribus*, as outside market buyers set Treasury prices. This increasing interest rate environment is the justification for our emphasis on shorter maturity holdings, and our focus on capital preservation within our fixed income portfolios.

Commentary (cont'd)

While the Federal Reserve may no longer purchase new Treasury securities, they are by no means completely ending their accommodative stance. The combination of “rollover purchasing,” whereby maturing bonds on the Fed’s balance sheet get reinvested back into the Treasury market, and the Fed’s implicit guarantee that is underscored by their “extended period” language, both remain in place throughout 2011. Ultimately, the Fed’s dual mandate of fighting inflation and promoting employment will

Fed Buying Will Dry Up Soon			
	2011 H1	2011 H2	2012
Treasury Issuance	417	609	1311
<i>Coupons</i>	696	603	1129
<i>Bills</i>	-278	6	182
Fed Purchases	613	39	-163
Net Coupon Issuance to Market	83	564	1292

Note: Estimates assume no resumption of SFP, Fed rolls over maturing MBS into Treasuries through September, ceases reinvestment of maturing Treasuries in December.
Source: Department of the Treasury, Federal Reserve Board

cause it to raise short-term rates once inflation pressures are viewed as no longer transitory and the labor markets make further improvement. In the meantime, the laws of supply and demand should result in higher longer-term rates as the bond market is forced to absorb over a half-trillion dollars of incremental issuance in 2012.

And yet, despite the beginning of the end of the stimulative process, and the slow motion train wreck in Europe on top of the budget and debt ceiling brinkmanship inside the Beltway, we believe the recovery will continue and the pace of economic growth and attendant inflation should be the primary drivers of market returns from here. With full acknowledgement that the economy’s

sub-par performance in the first half of the year was less than inspiring, we at Sand Hill Global Advisors are incrementally more optimistic about the potential for the world to reaccelerate in the second half of 2011. With Wall Street and the financial press having now reset the growth bar lower, combined with an attractive valuation level, we are focused on several catalysts for a stronger environment in the second half, including: an improved outlook for consumer spending given the pullback in oil and gasoline prices; the reversal of temporary set-backs tied to Japanese supply chain disruptions; the potential for additional stimulus in the form of payroll tax cuts or a corporate profit repatriation holiday; a likely surge in capital spending in front of year-end depreciation tax law changes; and, improved exports on the back of our weaker dollar.

We have concluded that the first half growth scare will ultimately be seen as a temporary “soft patch” - and the recovery will strengthen in the remainder of the year. In part, we view the market’s shallower 7% correction this spring (versus last year’s more substantial 14% pullback) as evidence of this underlying economic strength. This, combined with the expectation of a likely reacceleration of growth in the second half of the year, should result in decent overall returns for client portfolios in 2011.

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Performance Indices

Asset Class	Index	Q2 2011	FYTD	1yr	3yr	5yr
				Annualized		
Domestic Large Cap	S&P 500	0.1	6.02	30.69	3.34	2.94
Domestic Small Cap	Russell 2000	-1.61	6.21	37.41	7.77	4.08
Foreign	MSCI EAFE	1.83	5.35	30.93	-1.3	1.96
Emerging Markets	MSCI Emerging Markets	-1.1	-0.83	27.85	4.4	11.56
Bonds	Muni 7 year	3.34	3.94	5.03	6.7	5.97
REITs	NAREIT	2.87	10.06	33.13	5.7	1.72
Commodities	Dow Jones-AIG	-6.73	-2.58	25.91	-11.87	-0.05
Cash	U.S. Treasury Bill (30 day)	0.06	0.12	0.12	-46	2.09

Personal Planning: The Constant Gardener

The tax rate on long-term capital gains is currently at its lowest federal level since the early 1930's. However, the existing maximum rate of 15% is scheduled to increase at the end of 2012 to at least 25%. This expected new rate will include the new 3.8% Medicare tax on unearned income—such as dividends, interest, and realized capital gains—that goes into effect on January 1, 2013. This implies an almost two-thirds increase in the cost of selling appreciated assets after next year, and Congress could conceivably raise the base rate even more by then. State taxes add further to the overall burden. And yet, long-term capital gains have typically been taxed at preferential rates—versus ordinary income—as incentive for investors to make capital investments and fund entrepreneurial activity, and as compensation for inflation and the underlying corporate income tax. Long-term capital gain tax treatment occurs if an asset is held for more than a year before it is sold, or realized. Anything held less than a year is treated as short-term capital gain, which is taxed at higher ordinary income tax rates.

Taxpayers may deduct capital losses only on investment property and not on property held for personal use, like primary residences or most vacation homes. If capital losses exceed capital gains in any given year, then up to \$3,000 of their net losses can be used to reduce other income. If their net losses exceed \$3,000, the “unused” losses are carried

“The expected upcoming increase in the overall tax cost of realizing gains provides additional motivation to maintain the discipline of rebalancing now.”

forward. Net capital losses can be carried-forward indefinitely, and used to reduce gains realized in subsequent years. Sales and rebalancing of portfolios during the financial crisis of 2008 and early 2009 typically generated enough capital loss and loss carry-forward to offset gains realized during the 2009-10 recovery years. The impact was a significant reduction or elimination of gains taxes over those years. At this point, though, that “tax shelter” has been nearly or fully exhausted, and we are back to generating net realized gains as ongoing, sensible rebalancing of portfolios occurs. Of course, capital appreciation is a “good problem” to have—especially after the extreme events of the past few years—and regular rebalancing and appropriate

realization of gain remain important contributors to achieving superior risk-adjusted returns over time. Whether or not taxable investors still enjoy the benefit of net loss carry-forwards, the expected upcoming increase in the overall tax cost of realizing gains provides additional motivation to maintain the discipline of rebalancing now.

Gains come both as a result of company or stock-specific decisions made within a portfolio, as a result of a strategy change from more to less aggressive, or very often, from the regular discipline of rebalancing portfolios. An apt analogy to highlight the benefits of portfolio rebalancing is the perennial struggle to maintain a well-managed garden, especially given this year's wet winter and lush spring. Because of this year's unusual weather, many gardeners are probably still in their yards doing the work that they might have typically performed earlier in the year. Heavy rains contributed to more abundant growth than usual; and periods of extraordinary growth require more work—and related expense—to keep things healthy and well-maintained. The same is true of prudent portfolio management. Few people think twice about pulling weeds or removing underperforming items from their gardens (or portfolios). But even thriving, desirable, well-established plants and trees need to be regularly and properly pruned and cared for in order to encourage the best individual results and overall condition for the entire garden. Even less formal gardens enjoy the best results with deliberate attention and maintenance.

Like homeowners whose gardens have prospered from abundant rain, sunshine, and mild temperatures, investors have been “treated” to excellent returns since the market lows of early 2009. As a result, it makes sense to pay the price (in capital gains taxes) to prudently trim and rebalance carefully constructed portfolios in order to keep the overall balance intact and risks under control. The cost associated with proper maintenance of portfolios—and gardens—is fundamental to the process, and the current historically low tax cost of “pruning,” or realizing portfolio gains, allows investors to make (and keep) more hay while the sun shines.

Sand Hill in the Community

Founded in 1965, the American Occupational Therapy Foundation (AOTF) is a charitable nonprofit organization devoted to advancing the science of occupational therapy. The Foundation administers the profession's largest library and bibliographic database, awards more than 50 scholarships and fellowships annually, coordinates a network for doctoral candidates in the field, and publishes a professional research journal.



AOTF's mission is to advance research in occupational therapy and raise public awareness of the importance of enabling individuals to participate fully in life regardless of their physical, social, mental, or developmental circumstances. Sand Hill Global Advisors is honored to have a role in helping AOTF and its dedicated staff fulfill their impressive mission and achieve their short- and long-term goals.

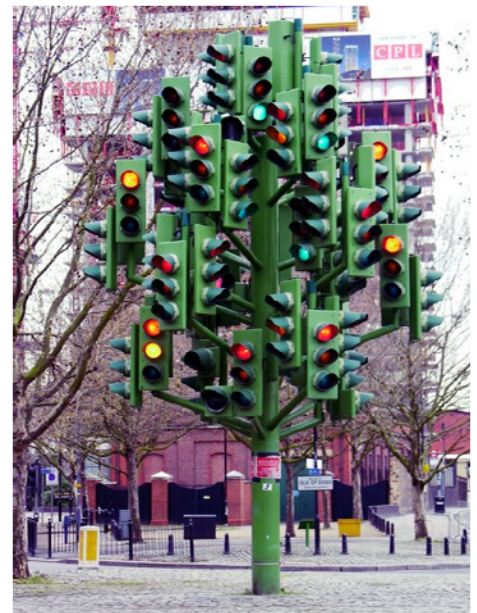
For further information on AOTF, visit their website at www.aotf.org or contact Pamela Spears, Director of Development, at pspears@aotf.org.

From the Desk of the CEO

Traffic lights in every possible direction—some red, some yellow, some green. So much going on that you really don't know whether to stop, go, slow down, speed up.....contradictions everywhere you look!

Visually, this is a good metaphor for the way many of us feel at some point in our lives about our financial condition. We come to major crossroads where we know we need to take action, but there's just too much information to digest it all and make a well-informed decision.

Our job, as your financial advisor, is not only to be knowledgeable but to understand how to put the pieces together to create the future you envision. As a team, our expertise and training allow us to consider all the elements that affect your decisions, such as your goals, values, and interests. We help you weave your way through considerations such as taxes, retirement, and estate planning. We delve into the issues surrounding risk. Our approach is client-centric, and our planning focus is always on you.



A handwritten signature in black ink, which appears to read "Jane H. Williams".

Jane H. Williams
Founder & CEO

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