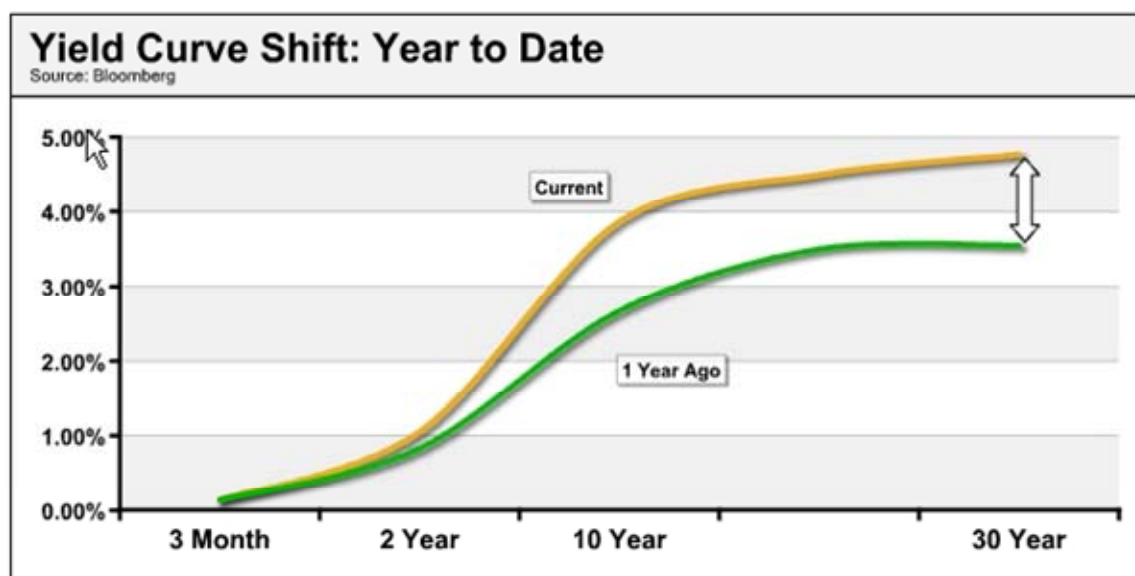


Market Overview

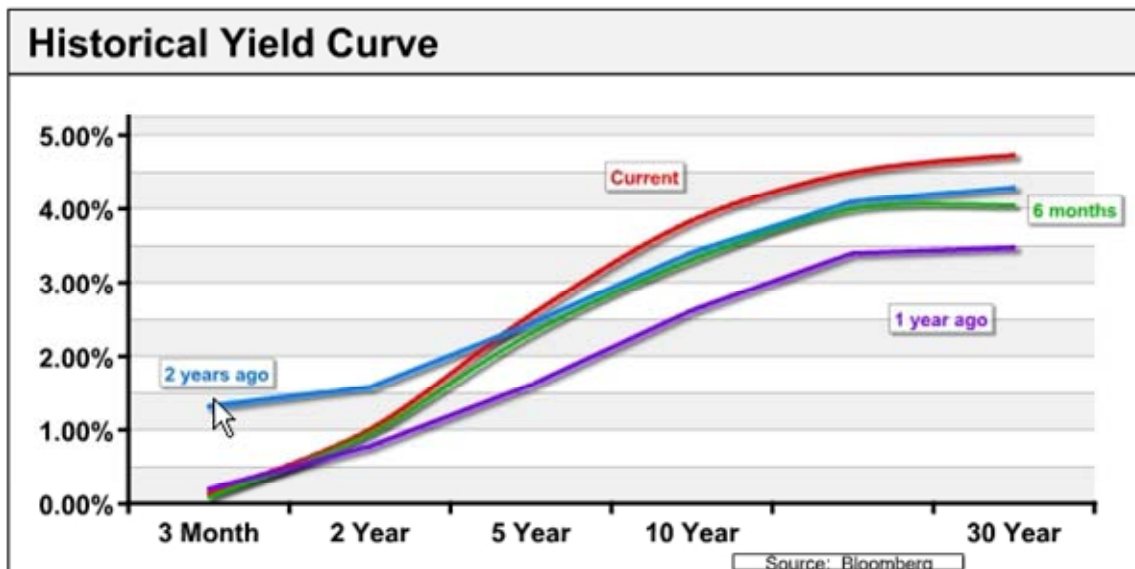
In the first quarter we continued to see signs of a global economic recovery and this enabled the majority of risk assets to post positive results for the quarter. Continuing their leadership from 2009 REITs, as measured by the MSCI US REIT Index, tacked on 10.05% for the quarter and have returned close to 150% since bottoming on 3/6/09. Equities were next in line, as measured by the S&P 500, which gained 5.39% for the quarter and have now posted positive results for four quarters in a row for a total gain of near 77% since hitting bottom on 3/9/09. Despite this strong rally, the trailing P/E for the S&P 500 sits just below 19 which is about an 8% discount to its long-term average of 20.62. Yields on corporate bonds continued to move lower in the quarter and that helped propel them, as measured by the Barclays Capital US Corporate Investment Grade Index, to a gain of 2.30% for the quarter. Rounding out the asset classes we have commodities, as measured by the Dow Jones – UBS Total Return Index, which lost 5.03% for the quarter. Commodities were the last to peak in the previous Bull Market and they have also registered the smallest recovery of the four asset classes. Commodities were up 32.65% since their 3/2/09 bottom which we believe provides opportunity as inflation, which is in check now, should begin to rise along with commodity prices as global economies continue to recover.

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As mentioned above, inflation continues to remain in check and though the US economy has shown signs of recovery we saw the US Treasury yield curve essentially end the quarter almost exactly as it began. All maturities were within ± 14 basis points of their beginning yield with the biggest move up (+10 bps) coming at the 3-month maturity and the biggest move down (-14 bps) coming at the 5-year maturity. The steepness (difference between the 30-year and 3-month yields) decreased slightly (3 bps) over the period and we would expect this to continue as we move closer to the time when the FOMC will begin to raise rates. The Fed has stated that rates will remain low for an "extended period," and based on the Fed Funds Implied Probabilities that looks to be at least another six months. Just a month ago there was a 24% probability that the Fed would raise the target rate at the 8/10/10 meeting and now that is down to a 10% probability. We believe we will see the Fed raise rates near the end of the year and we will most likely see the short end move up in basis points more than the long end in anticipation. This would produce a shallower yield curve by year-end.



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The US economy has now recorded two quarters in a row of GDP growth and we expect this trend will continue, but the coming values will most likely moderate from the 5.6% reading we got for the fourth quarter of 2009. In our last commentary we highlighted that the consensus for US GDP growth in 2010 was 2.6% with our estimate being in the 3.0% to 3.5% range. The consensus is now 3.0% and we are thinking we should come in closer to 3.5% which was the upper bound for our estimate. Outside of employment and housing the economic statistics continue to surprise to the upside and show the recovery is gaining steam, especially in the manufacturing arena. Looking at the ISM Manufacturing Index we had a 59.6 reading for March (> 50 signifies expansion) which is the highest level since July of 2004. Reinforcing this reading, capacity utilization has increased eight months in a row and now sits at 72.7% after hitting 68.3% in June of 2009. Vehicle sales increased 24% year-over-year in March and inventories were down. This indicates even more activity to come despite pleas that the "Cash for Clunkers" program last summer would pull too much demand forward. However, with vehicle sales running at an annualized pass of about 11.77 million vehicles we are still a far cry from the long-term average of 15.09 million vehicles but we think we are beginning to see some signs that will push vehicle sales and other metrics back towards healthy levels.

The recent release of the Business Roundtable's Economic Outlook Index showed a rise to 88.9 for the first quarter which is the highest level since the second quarter of 2006. Of particular note was the fact that 47% of executives said they plan to invest in capital equipment and 29% said they plan on hiring over the next six months, a 10 percentage point increase from last quarter. This is welcome news as the one main ingredient that has been missing so far in this recovery has been a substantial improvement in the employment picture. We have seen Initial Jobless Claims and Continuing Claims moderate considerably over the last year however; they are still not at levels that indicate a significant number of individuals are being put back to work. Specifically, Initial Jobless Claims now sit at 460,000 which is much improved from the peak reading of 651,000 a year ago, but it is still about 90,000 above the long-term average. Continuing Claims currently sit at 4.55 million which is much improved from the peak of 6.57 million last summer but still sits about 54% above the long-term average of 2.95 million. The moderation of these numbers did correlate to a positive gain of 162,000 for the Change in Nonfarm Payrolls number for March and a steady reading of 9.7% on the unemployment rate. Concerning the latter, we think a measurable improvement is coming, however, it will not occur as quickly as many would like and most likely will not approach the 50-year average of 5.9% in this current recovery.

We studied the unemployment rate over the last 50 years and we found six cycles where unemployment trended down. On average these cycles lasted about 3.5 years with the unemployment rate decreasing on average about 0.65% per year. Looking at consensus estimates for unemployment for the next two years we see the estimate of 8.85% (4th quarter 2011) matches almost exactly our findings. If we assume this is an average recovery we can surmise the unemployment rate should decrease to about 7.9%. We think we will end up better than this bottoming at around 6.5 to 7%; however, due to the fact that productivity levels are high and will most likely remain high due to technology improvements, we will not achieve the long-term average of 5.9% in this cycle. The good news is this improvement should begin to fuel more gains in the housing market.

One of the more stubborn areas of the current recovery has been housing. This makes sense when you consider that housing had a great deal to do with the last bubble. Looking at both existing home sales as well as new home sales we are still well below the 10-year averages. Specifically, existing home sales currently sit at a 5.02 million annualized rate, about 14% below the 10-year average of 5.83 million, but higher than the cycle low of 4.53 million from January of 2009. New home sales haven't fared as well and currently sit at a cycle low rate of 309,000 annualized and about 65% below their 10-year average of 890,000. Low rates, low prices, and tax credits have helped the sales of existing homes but fears of rates moving up as the Fed stops buying mortgage-backed securities and tax credits ending at the end of June (April contract, June closing) has some thinking housing will exhibit a double-dip, but we do not believe this will be the case. First, we must remember that the Fed is going to stop buying mortgage-backed securities which doesn't mean they will be selling them from their balance sheet. This action should cause rates to move up in a somewhat orderly fashion. Second, though the tax credit is slated to end at the end of June we might see an extension to this or, like in California, we might see it addressed at the state level. Inventories did move up last month to about 8.6 months of supply but that could be partially attributed to worse than expected weather and sellers putting their house on the market as they prepare to buy another. We continue to believe that the drivers (low rates, low prices, and an improving economy and employment picture) are in place for housing to continue to recover, however, the recovery will be slow and choppy.

Outlook

This current recovery continues to surprise both pessimists and optimists (of which we are one) alike and we believe this will be the case for the foreseeable future. As detailed above employment and housing continue to be stubborn, however, that is usually the case. Employment is a lagging indicator and we have seen some stabilization and improvement. Housing is the largest purchase many will ever make, and as such it is a purchase that will only be made if the buyer has confidence. However, we have seen the consumer begin to return to the cash register as retail sales have grown (year-over-year) at least 3% for three months in a row and the same store sales being reported for March are, on average, well ahead of expectations. There is a tremendous pent up demand for everything from khakis to jewelry to automobiles and we are seeing the consumer returning in earnest. Once confidence builds we should see bigger purchases which should drive home sales and the wares to fill them. Remember the consumer is just one, albeit important, piece of the puzzle.

Another potentially large source of fuel for the economy is the record amount of cash sitting on corporate balance sheets. At the end of 2009 there was \$832.4 billion on the balance sheets of the non-financial companies of the S&P 500. This is up 27% year-over-year and it is the highest figure on record. As mentioned above, the Business Roundtable's Economic Outlook highlighted the fact that 47% of companies planned capital spending over the next six months and 29% planned on adding to payrolls. In addition to this large cash hoard, companies are also running extremely lean which means as the economy rebounds their cash flow and cash should only increase this quarter. Eventually these companies will be driven to deploy that cash via capital spending, hiring, raising dividends, buying back shares, or participating in M&A activity. All of these should help keep the economy moving in a positive direction. In the last recession it was the consumer, riding high on home equity, that helped get the economy moving again. This time the consumer should have some assistance from the private sector.

Given all of this, continued economic growth is not a certainty. We mentioned last quarter that these hurdles might need to be navigated in 2010: commercial real estate, healthcare, possible tax increases, questions concerning bank capitalization, unwinding of the Fed's \$2.2 trillion balance sheet, and mid-term elections in November. Some of these have now been navigated and some have fallen off the radar screen while even more have popped up like the sovereign debt concerns of some European nations (nicknamed the PIIGS for Portugal, Italy, Ireland, Greece and Spain). However, there will always be hurdles

to face, both seen and unseen, and a recovering economy should be able to tackle those hurdles successfully even with a couple of stumbles. Low inflation provides the ability to keep rates low which should, coupled with low inventories, pent up demand and an extremely well capitalized private sector, provide the fuel to drive economic growth above consensus levels through the remainder of 2010.

Peroni Method

The healthiest stock market is most often one that is forward looking, seemingly eschewing current affairs and daily economic, fiscal and political headline banners. This variety of market behavior was evident through much of the first quarter. In fact, the bullish divergence based on the disparity between rising stock trends and lingering negative economic data has been prominently on display since the earliest indications of a market bottom in October 2008. What may be even more telling about the outlook, however, is the market's reaction to positive news items in recent weeks. The market is not selling off into the good news, suggesting that investors perceive that there is robust economic activity just over the horizon. The forefront stock performers represent an impressive array of broad and diverse sector leadership. This breadth has bolstered the bullish underpinnings of the ongoing trend establishing a resilient tone that might portend less vulnerability than one based on micro-thematic factors such as those found in the technology run following an urgent effort by the Fed to bolster the economy after the Long Term Capital Hedge fund collapse in 1998.

The intriguing aspect of this market cycle is that even with technical trends arguably sturdier than in the late 1990's, retail investors are substantially more reluctant today to commit to a stock market that offers more impressive breadth amid fertile conditions of low interest rates and improving corporate earnings. Perhaps there is a feeling of having missed the train. After all, the DJIA has rebounded more than 4,000 points from the March 9, 2009 lows. While this emotion is understandable it is not in sync with the quality of price patterns that have formed over the last year. These burgeoning bullish formations represent a well honed bottom established initially by subtle net money flow improvements and later confirmed by initial breakaway moves above intermediate-term resistance levels (typically 200-day moving average levels). Following mid-first quarter 2010 general market weakness, most leadership sectors have bounced back with some representative stocks hitting all-time highs. Although many technicians have expressed concern about low volume, I believe such worry may be a bit premature. It is important to note that this low volume is agnostic, favoring neither decline nor advance based on observations of both daily and hourly market movements. The low volume may suggest that sidelined investors are still not convinced that there is a reliable recovery underway. While I am inclined to interpret the low volume as a glass-half-full scenario that implies a healthy pinch of caution, light volume could represent formidable pent up buying potential that could be unleashed later in the cycle. This is not the sort of condition found near a market top.

It is worth noting that the Dow Jones Transportation Average substantially outperformed the Dow Jones Industrials in the first quarter of 2010, providing a Dow Theory confirmation. From January thru the end of March, oil climbed 5.5% which makes the Transports' feat even more impressive. In addition, oil rose as the dollar strengthened. The Transports are easily withstanding higher energy costs and oil is defeating the argument made by some that its rally since 2002 was simply the result of a weaker dollar as it was when the Transports also led the Industrials out of that market bottom. These performance evaluations suggest strongly that the stock market is correctly forecasting an economic revival and it remains my contention that at these levels the market is more likely to produce positive surprises than unsettling stumbles.

Core Tax Exempt

In the first quarter of 2010, municipal bonds continued their positive total returns of last year as the forces of strong investor demand and reduced supply of traditional tax-exempt municipals combined to generally raise municipal bond prices and lower yields. A modest shrinkage in credit spreads also contributed to positive total returns. A sharp upward move in municipal bond yields at the very end of the quarter prevented the occurrence of an even stronger performance for municipals.

The reasonably positive total returns for municipal bonds in the first quarter are interesting and somewhat counterintuitive given the very large current concern among investors of rising interest rates and challenged municipal bond credit quality. These two large concerns are understandable and legitimate, given current conditions, and would usually produce lower prices

and higher yields. That may still come to pass as this year progresses, but it can not be denied, at the present moment, that the anticipation of higher tax rates down the road and the continued strong issuance of Build America Bonds are dominating the municipal bond market. In short, the forces that can dull the impact of higher rates and troubled credit quality are currently triumphant and are having their way with the municipal bond market.

In difficult periods when credit concerns intensify, it is predictable that a large, diverse, and complex market such as the municipal bond market comes to be painted negatively with a broad brush. This has been happening to municipals for past two years or so and it continues today. In managing our Core Tax Exempt approach, we continue to stress the importance of uncovering value through careful, day-to-day security selection. Diversification and balance in portfolio construction remain as important as ever. While spreads are not as wide as the historically attractive levels of two years ago, we believe strongly that municipal bonds, among conservative investment alternatives, remain attractive for high net worth investors and that there continues to be value to unearth in the municipal market. Our consistent, balanced, investment grade, intermediate maturity approach continues to be an important contributor to our long term performance through a variety of interest rate cycles.

Core, Core Plus and Credit Opportunities

As previously mentioned, the corporate bond asset class continued its strong performance in the first quarter as evidenced by the 2.3% return of the corporate component of the Barclay's Capital U.S. Aggregate Index. Financials continued to be the key contributor to the corporate component and returned 2.86% during the period. The bond markets saw continued tightening of spreads throughout the fourth quarter. As money came off the sidelines, pricing improved and spreads dropped across all ratings. Spreads fell on triple-A (AAA) paper by 11.5 basis points while triple-C (CCC) paper fell 38.8 basis points.

Mortgages also demonstrated strong performance during the quarter with the securitized component of the Barclay's Capital U.S. Aggregate Index returning 2.14%. The mortgage market still shows mixed signs between bid and ask prices.

The **Core Plus Strategy** had solid results across the corporate bond holdings and mortgages. The Core Plus strategy also has a preferred stock component, weighted towards the financials. These issues performed well with all positions showing gains for the quarter. Mortgage metrics in the strategy remained strong as some of the efforts to stabilize the housing market began to take hold.

Our Core Plus asset allocation did change during the first quarter. We reduced our mortgage exposure from 35% to 25% and increased our Other asset allocation to 15%.

	4th Quarter 2009 Asset Allocation	1st Quarter 2010 Asset Allocation
Corporates	50%	50%
Mortgages	35%	25%
Treasuries	5%	5%
Agencies	5%	5%
Other	5%	15%

The **Core Strategy** was again led by the Financials and Industrials during the first quarter of 2010. The returns on this strategy were well balanced across each of the asset classes with the Agency and Mortgage holdings showing overall gains. We believe the strategy remains well positioned for 2010.

The **Credit Opportunities Strategy** saw improvement across the board as spreads tightened and interest in the sector increased. The high yield market had another strong quarter, as evidenced by the Barclay's Capital U.S. High Yield Index which returned 4.62%. We saw significant issuance of high yield paper during the quarter (approximately \$60 billion). Financials and energy-related holdings led the way with added support from the materials sector. We anticipate maintaining the exposure to

our key sectors of finance, materials, technology and housing during the coming quarter. We believe these sectors are well positioned as the economy strengthens.

The housing sector saw January starts jump 21% from a year ago to be followed by a more modest gain of 0.2% for February. Permits, while slowing month over month, are up year over year in both January and February. The mortgage portfolio metrics continue to hold up with delinquencies remaining steady and any losses being absorbed by subordinate tranches of the securitization.

Technology had an up and down quarter with most positions posting gains and one position giving up some ground on pricing. Overall this sector should benefit from the improving economy as companies begin spending on IT infrastructure and outsourcing.

Restructuring activity in the strategy was active during the quarter due to price appreciation in exiting holdings and opportunities to enhance the portfolio yield. We continue to feel the strategy is well positioned for 2010.

Indices listed are used as a general measure of the economy and of market performance for a particular asset class or type. Indices assume reinvestment of all distributions and interest payments and do not take into account brokerage fees or taxes. It is not possible to invest directly in an index.

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