CRESTWOOD
ADVISORS

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Perspectives

INSIDE THIS ISSUE

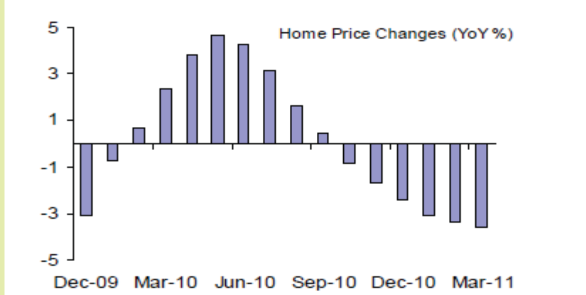
Market Outlook: Challenging Landscape

The stock market's volatility and performance in the second quarter was not driven by any breaking news events but by a continuation of the difficult economic and political environment in which we find ourselves. With investor sentiment declining and market volatility increasing (the S&P 500 fell over 8% inter-quarter), it is hard to believe that the S&P 500 finished roughly flat (up 0.1% during the quarter). Also, as confidence in a sustainable recovery declined, investors understandably reduced risk and increased allocations to bonds. The Barclays Muni 5-year gained 2.7% for the quarter while the Aggregate/Credit index increased 2.3%.

While the risks to the global economic recovery rose, the current underlying fundamentals do not suggest a relapse into recession. It is clear that the U.S. economy has slowed but, importantly, it still remains in the midst of a modest expansion as forecasts for GDP growth have been decreased from 3% to a range of 2% to 2.5%. What is worrisome to most economists is that at this point in an economic recovery, the U.S. should be experiencing growth rates twice these levels. Hence, the present economic recovery is not strong enough to solve many of our broad economic and social problems including consumer confidence, budget deficits, housing, wage stagnation, and employment.

It has been five years since the housing market peaked and, though housing is now more affordable, it is apparent that the housing market will take years, not months, to improve. Unfortunately, over 25% of all homes have "negative equity". This reality has been exaggerated by the ongoing challenges in the banking industry where balance sheets are still strained and new and more stringent capital requirements and regulations make getting conventional loans even more difficult.

Chart 1:The decline in home values has been troubling as hope prices have been dropping at an accelerated pace
S&P/Case Shiller Index (year over year changes %)



Source: Case-Shiller

Other significant global events -- including the devastation in Japan (and the supply disruptions that followed), the end of quantitative easing (QE2) and the rise in oil prices (i.e. inflation) – are all temporary factors and their initial impact should diminish as the year progresses.

Global Debt Concerns Threaten the Recovery

The ongoing global, sovereign debt crisis, if left unaddressed, will be a significant drag on future growth. The seriousness of the political debate on this crisis both in Europe and in the U.S. is encouraging, though the impact from these events is not yet known. In the U.S.,

Crestwood Advisors Welcomes

Lindsay W. Singer

We are pleased to announce that Lindsay W. Singer joined Crestwood Advisors in June of 2011. Lindsay is primarily responsible for general support of the firm's operations, client service and administration.

Prior to joining Crestwood, Lindsay was a Mutual Fund Operations Specialist at Eaton Vance Investment Management in Boston. She earned a BA in Economics from the University of Delaware and plans to pursue the CFP designation.

Lindsay can be reached at lsinger@crestwoodadvisors.com.

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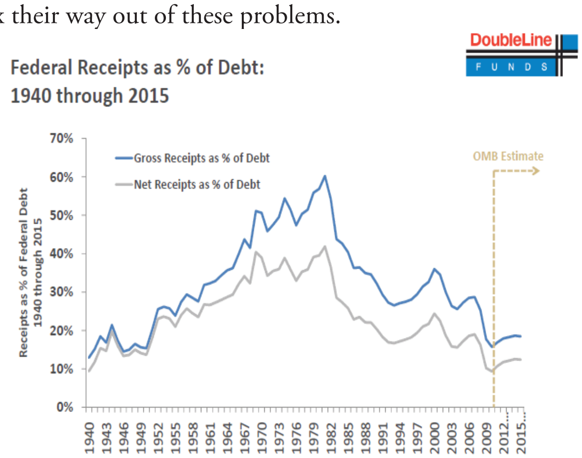
the fear is that short-term solutions that address the debt ceiling might catch headlines, but the necessary and more difficult steps required will continue to be "kicked down the road" to the next generation of politicians. In the U.S., government spending has almost reached 25% of GDP so the consequences of balanced budgets and debt reduction will be painful and will undoubtedly affect every citizen. Given the riots in Greece, one can only imagine how the rest of Europe and America will accept these types of austerity measures as it becomes clear that developed economies cannot just grow or tax their way out of these problems.



Ben Bernanke commented last month that the banking and real estate problems may be "more persistent than we thought". Though many believed that these comments could be interpreted as setting the foundation for another round of quantitative easing (QE3?), it is more likely that the Fed will just continue to hold short-term rates down as well as utilize its balance sheet to maintain supportive monetary conditions for the foreseeable future.

Regrettably, the combination of artificially low rates, stimulative initiatives, tax cuts, and budget deficits has not accelerated economic growth to the extent policy makers have hoped. However, as history has shown, these actions have laid the groundwork for future inflation. This is apparent in the recent data released by the Organization for Economic Cooperation and Development which showed consumer prices in its 34 member countries rising by 3.2% in the 12 months to May 2011, with food and energy prices driving much of the increase.

With the global recovery still fragile in many developed economies, the response of central banks to the inflationary indicators has varied. In Europe, the Central Bank raised its key interest rate in April and many anticipate that they are not finished. These actions, combined with the debt crisis and unprecedented austerity measures, pose great risks to an already fragile European recovery.

With artificially low rates in the U.S., and inflation running in excess of 3%, returns on short and intermediate U.S. government bonds remain negative in real terms. The ongoing accommodative stance of the Federal Reserve continues to weaken the dollar. Though most U.S. bond investors don't realize it when they open their statements, their purchasing power is gradually being diminished.

Our Strategy

At Crestwood Advisors, we recognize these risks and, in our fixed income portfolios, our focus remains on short-term, high quality corporate and municipal bonds in order to ensure we are minimizing credit and interest rate risks. We continue to tactically expand our fixed income exposure to other asset classes that provide diversification and enhance income. This exposure includes bank loans (priced off floating rate LIBOR) and non- U.S. bonds. We have increased our fixed income weighting in local currency emerging markets given the opportunity for higher yields, improving credits and favorable currency exposure. For example, Brazil's headline inflation is running at 6%, but their bond yields are closer to 11%, giving investors a real return of 5%. With its improving economic position, Brazil is a good example of an emerging economy that, over time, will offer better credit risks than much of the developed world.

A prolonged low U.S. rate environment also means that in order to maintain purchasing power, investors must have exposure to growth assets such as equities and commodities. Higher quality global equities with strong franchises continue to look attractive from both a growth and valuation perspective and many offer dividends with yields greater than U.S. treasury bonds.

Given the anemic economic recovery, we continue to focus on more secular growth businesses and avoid cyclical industries, money lending banks, as well as industries that would benefit from an unlikely dramatic acceleration in consumer spending. We also recognize that the recent equity rally has expanded valuations, making our security selection and sell discipline critical. In spite of the recent rally, we continue to believe that stocks as an asset class remain "the best house in a bad neighborhood" and we cannot lose sight of some of the positive underlying drivers. Manufacturing remains solid (though cooling slightly), corporate profits remain strong, interest rates remain low, liquidity remains abundant, and importantly, corporate balance sheets are as strong as they have ever been. Corporations continue to sit on over $2 trillion in cash!

Ironically, with the developed world struggling to grow, many of the world's fastest-growing emerging economies are now in later stages of the economic cycle, with rising inflationary pressures and tightening monetary policies. This is clearly apparent in a slowing China, where the government is attempting to maintain 8% to 10% growth while moderating

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inflation. Though they recently increased reserve requirements for banks to 21% to stem a feared real estate bubble, the success of the government's actions is still in question. We, therefore, have chosen to underweight China in favor of other emerging markets. As we have pointed out with Brazil, the breadth of emerging-market growth remains solid and many of these markets continue to offer superior return prospects and attractive valuations. In many cases, these economies have budget surpluses, positive demographic trends and are resource rich.

We have recently reduced our overall commodity exposure due to valuation. We do, however, believe that there remains a longer-term supply and demand imbalance as it pertains to natural resources. Not only did the "Arab spring" rapidly move oil up from $90/barrel to $115/barrel within weeks, it highlighted how vulnerable the global oil market is to supply shocks. Additionally, gold has become a store of value as debt-burdened countries continue to de-base their currencies. To that end, our thesis on this asset class will probably only vary once we see the behavior of central banks change and real interest rates begin to rise.

The challenging global economic landscape continues to require a disciplined approach and well-diversified portfolios. Though the U.S. and global economies continue to grow, it is clear that the recovery is quite tenuous and any global economic or political shock could quickly and easily cause another economic setback.

Crestwood Research: Sticking to our Knitting

Much of the recent stock market rally was driven by stocks that are more leveraged to a strong economic recovery as opposed to more stable, high quality, high dividend yielding stocks with less economic sensitivity. During this time the market has given us opportunities to purchase some of these less cyclical, quality businesses at significant discounts to what we think they are worth. Examples include C R Bard, Whirlpool, and McCormick & Co.

A by-product of our focus on strong stable businesses, trading at attractive valuations, is that the portfolios started the year with significant holdings in Healthcare and Consumer Staples stocks as well as Master Limited Partnerships and Exxon Mobil.

Last December the S&P was up 7%, generating nearly half of the 2010 annual (15%) return in just one month! This performance was driven by the more cyclical, highly leveraged, stocks while the more stable, higher quality stocks significantly lagged the rally. The Healthcare and Staples sectors were only up 4% vs. 8% for Industrials and 9% for Financials. As a result, despite the relative stability of their earnings, strong economic returns, superior balance sheets, and high dividend yields, the higher quality stocks (ie. Staples, Healthcare, Exxon Mobil) were trading at significant discounts to the more cyclical stocks and the broader market at the beginning of 2011. As economic visibility and confidence in the economic recovery has faded, these higher quality stocks have begun to perform quite well and have demonstrated less volatility than the broader market and the more cyclical stocks that drove the December rally.

The significant volatility during the second quarter, which included an 8% correction in the S&P intra-quarter, allowed us to be opportunistic and sell a few stocks that had been strong performers but became too richly valued (ie. Adobe Systems and DENTSPLY International). In addition to less cyclical dividend paying stocks, we have also recently taken advantage of market volatility and added two high quality businesses with some greater cyclicality because they represent unique situations with significant long term upside potential. We have been patient with these stocks on valuation due to the inherent cyclicality and volatility and waited to purchase when they afforded a large margin of safety relative to our estimate of intrinsic value.

Urban Outfitters (URBN) is a specialty retail company that operates 382 stores primarily under the Urban Outfitters, Anthropologie, and Free People brand names. The company's unique merchandise selection has created a loyal customer base and sales have been less volatile than competitors over time due to their unique inventory. The company also benefits from a customer base with strong demographics and higher income profile. Disciplined growth has generated industry leading margins and consistently stable returns on equity of 20%, translating into solid long term returns for shareholders. The stock is trading near a trough valuation which created an attractive entry point.

Akamai Technologies (AKAM) is the world's leading provider for the delivery of internet content, streaming media and applications. The company is uniquely positioned to benefit from the growth of internet video usage, mobile internet and cloud computing. AKAM has a competitive advantage due to the size of its network of servers and its proprietary software. In addition to delivering internet content, AKAM also provides optimization of website performance and internet video delivery. The company has a strong balance sheet with $1.3 billion of cash and is trading at an attractive valuation relative to the long-term growth potential for the business.

The Biotechnology industry is another area we continue to view favorably given the societal need for high quality innovative drugs and the ongoing mergers and acquisitions in the

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Healthcare sector as the large Pharma companies seek to buy growth through biotech acquisitions. We maintain diversified exposure to the industry given the potential binary outcome for many biotech companies by investing in the SPDR S&P Biotech ETF (XBI) which is comprised of over 40 companies of various sizes and stages of maturity.

With overall corporate profit margins at prior cycle peaks we remain concerned about the sustainability of current valuations given the continued economic challenges and likelihood of less incremental support from fiscal and monetary stimulus going forward. Bond yields remain near historic lows (1.76% 5 year Treasury yield at June 30th) and offer modest nominal return potential and negative real (after inflation) return potential. As such, we continue to seek opportunity in high quality equities that offer attractive real return potential via pricing power, dividends and capital appreciation.

Fidelity Charitable Gift Fund

When making charitable donations, it is important that the effects of the donation are maximized for the charity and the donor. An individual's "Giving Account" within the Fidelity Charitable Gift Fund provides a simplified approach to maximizing charitable donations and donor tax benefits. The Giving Account will allow the support of multiple charities through a single donation. When the donation is made to the Giving Account, an immediate tax deduction is available. The donation an irrevocable gift which allows for the immediate tax benefit without specifying the charity at donation time.

Donations made to the Giving Account are eligible to be invested, under the account holder's discretion, and may grow tax free until the desire to distribute the funds to the preferred charities. The Giving Account has numerous options for investing these funds, including individual investment pools allowing for a custom selection, or asset allocation pools which allow the donor to implement a diversified investment strategy in one step.

The other tax benefit, besides the initial deduction for a charitable donation, is the avoidance of potential short and long term capital gains taxes. When the assets are selected for donation they are transferred in kind to the Giving Account, which then immediately sells the assets and invests in the preferred method of investments specified by the account holder. Assuming appreciated securities were used, The Giving Account has absorbed the capital gains as a tax-exempt entity, as opposed to an individual first selling the stock and then gifting the cash which would mean the gains tax would fall on the donor. By gifting through The Giving Account, cash donations are possible without the additional tax implications for the donor.

The Giving Account is easily accessible through the Fidelity.com login and will appear alongside any additional Fidelity accounts. The online access allows for easy selection of assets or cash to be transferred from a current account held at Fidelity to the Fidelity Charitable Gift Fund Giving Account, which will then handle all the administrative aspects of the charitable giving. The Gift Fund will verify that the charity holds IRS public charity status. Based on request, a cover letter can be sent to each charity specifying the special purpose of the donation. Copies of all gift confirmation and letters are available online for easy reference. Confirmations for each contribution to the Gift Fund serve as the tax receipt and a single IRS Form 8283 is provided for filing for non-cash contributions of $500 or more.

For additional information or to set up a Fidelity Charitable Gift Fund Giving Account please refer to www.charitablegift.org.

Voltage Security

Recently we initiated a change to protect non-public personal data that is sent via email. Going forward, all email communication from Crestwood Advisors that contains non-public information (date of births, social security numbers, account numbers, etc.) will be encrypted using a service from Voltage Security. It is extremely important to us that this information be transmitted in a secure manner.

In order to read encrypted emails we send, you will need to set up this free service. Please note that you do not need to set this up until you receive an encrypted email from Crestwood or would like to communicate non-public information to us in an encrypted format. Set up is a one-time occurrence, however, you will need to remember the password that you choose.