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Quarterly Economic Report

MTB INVESTMENT ADVISORS

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An 80-year study by Ned Davis Research, Inc. shows that the DJIA gained an average 56.8% from its low in the mid-term election year to its high two years later in the presidential election year.

ECONOMIC REPORT

The month of June 2010 brought an end to a second quarter of turbulent equity markets and mixed economic numbers. Equities, as measured by standard benchmarks such as the Dow Jones Industrial Average (DJIA) and the S&P 500, were down approximately 10% in a very volatile quarter. To place the quarter in perspective, the S&P 500 Index was up 7.0% (year-to-date, total return on April 30th) at the end of the first month in the period. When the closing bell rang on June 30th, that standard benchmark was down 6.6% (year-to-date, total return). Investors will remember May 6th as a “day of infamy” when the DJIA slid nearly 1,000 points in 20 minutes before recovering two-thirds of its losses.

By way of contrast, fixed-income investors sought quality, and pushed U.S. Treasury prices higher – with resultant lower yields. At quarter’s end, yield on the 10-year Treasury note was 2.96%.

What caused the dramatic change in risk-reward perception? Investors were, and continue to be, worried about multiple factors including global economic conditions, domestic economics, and regulatory issues. These major issues have overshadowed positive news concerning corporate earnings and growth in selected overseas markets.

Investor concern appears to be centered on the employment numbers and growth in the private-sector job market, housing, and the global financial system. The Conference Board’s Consumer Confidence Index fell from 62.7 in May to 52.9 in June. This was a reversal of gains made during the first five months of the year, and at odds with the University of Michigan Index, which has been moving sideways. The Conference Board’s Index is more sensitive to labor conditions.

The Labor Department reported a loss of 125,000 jobs in June; however, this was prima-

QUARTER HIGHLIGHT: Investor concerns appear to be centered on the employment numbers and growth in the private-sector job market, housing, and the global financial system.

rily due to the loss of temporary Census workers. Businesses actually added 83,000 workers. Although the unemployment rate fell to 9.5% - its lowest level in almost a year – the decline was due to an increase in those who have stopped looking for work and are no longer categorized as unemployed.

Housing is treading water, but this could be a sign of stabilization. Gains made through April had the benefit of the stimulus tax credit for first-time buyers. This credit has ended, and future gains will hinge on financial variables such as lower prices, higher personal income, and low interest rates. According to Freddie Mac and Fannie Mae, the 30-year mortgage rate is now at 4.59%, a 40-year low. This will influence new buyers, and also refinancing.

Inflation is currently not a concern, but it may be at some point in the future. With the core CPI increasing at only 0.9% (year-over-year), and the 10-year Treasury note yielding less than three percent, deflation is a persistent topic. We do not see these factors as indications of deflation, but rather as examples of disinflation, with prices increasing but the rate of increase slowing.

Looking to the second half of the year, we remain in the slow economic growth camp. Analyzing the numbers and dissecting the economic news, there appear to be two other camps: the double-dip recession and the faster growth advocates. The “slow growth” case has support from the Fed. In its latest report, the Federal Open Market Committee has a GDP forecast of 3.4% - 4.5% in 2011. We believe that the U.S. will grow at the lower end of this range, and selected emerging markets at a faster rate.

STOCK MARKET What a difference a quarter makes. When we wrote our first quarter *Quarterly Economic Report*, the S&P 500 was up

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Acknowledging the challenges, growth will be slow, but it is expected to be positive.

ECONOMIC REPORT continued

5.4% and all sectors were positive. In the second quarter, the S&P 500 declined 11.4%, and the only positive sectors were gold mining, residential REITs, and brewers.

Russell Investments' quarterly survey of investment professionals (Investment News, June 28, 2010) noted that the major threat to U.S. stocks is the European debt crisis. Investors are moving between taking on risk, and risk aversion – leading to greater market volatility – which heightens concern in the marketplace. Although we expect slow economic growth, job recovery will lag, yet another headwind for investors. Finally, the May 6 “flash crash” brought computerized stock trading, and its impact on markets, to the forefront.

Equity Total Return Performance		
	Second Quarter (Ending 6/30/10)	YTD 6/30/10
S&P 500	-11.4%	-6.6%
DJIA	-9.4%	-5.0%
NASDAQ	-11.8%	-6.6%
MSCI EAFE	-13.7%	-12.9%
Emerging Markets	-8.3%	-6.0%

Source: Bloomberg
Past performance does not guarantee future results

Corporate earnings are better than expected. According to Standard & Poor's, all of the S&P 500 companies have reported, and first quarter operating earnings are up 90% from a year ago. Much of the gains are in the financial industry and reflect very low earnings of the March '09 quarter plus the government stimulus. While these are temporary factors, it is encouraging to note that consumer demand – not just cost cutting – is playing an important role in the earnings growth. We expect this growth to continue, and estimate earnings of \$90.00 for the S&P 500 next year.

Admittedly, we are in the “skepticism” phase of the market cycle. However, there is “cash on the sidelines”; corporate earnings are expected to grow, and the market correction of the second quarter brought valuations to reason-

able levels. In addition to the cited economic fundamentals, mid-term election years provide favorable buying opportunities for stocks. An 80-year study by Ned Davis Research, Inc. shows that the DJIA gained an average 56.8% from its low in the mid-term election year to its high two years later in the presidential election year.

Using a conservative estimate of \$90 per share for operating earnings of the S&P 500 in 2011, and placing a slightly lower than average 14 times as a price-earnings valuation, we expect to see equity gains in the second half of 2010..

FIXED-INCOME MARKET Treasury prices rallied in the second quarter, propelled by moderating domestic and global economic activity, renewed European banking woes, modest inflation, and the threat of greater austerity and reduced stimulus by global governments. The yield on the two-year Treasury note fell to an all-time low of 0.59% in June. The yield on the 10-year Treasury also fell, ending the first half of 2010 at 2.93%. The substantial gains in the Treasury market were the most surprising event in the bond market year-to-date. At the beginning of the year, nearly every pundit and forecaster was warning investors that the Treasury market would either underperform or, worse, was the next “bubble.” Globally, while stocks fell 9.5% in the first half of 2010, bonds performed very well, rising 4.5%. Bonds beat stocks by the widest margin since 2001. Treasury prices are exhibiting a negative correlation with daily movements in the equity market. The formula for bond market outperformance in the first half of 2010 was to be long duration and to overweight the Treasury sector.

Despite several prominent articles and interviews wary of municipal credits, the municipal market continues to exhibit decent price action. In our view, general obligation municipal credits are strong, accounting for less than 1% of municipal defaults over the last year.

Fixed Income Total Return Performance		
	Second Quarter (Ending 6/30/10)	YTD 6/30/10
Barclays Agg. Bond Index	3.49%	5.33%
Barclays Gov/Credit	3.88%	5.49%
Barclays Intermed. Gov't./Credit	2.97%	4.56%
Barclays Municipal	2.03%	3.31%

Source: Barclay Capital

We recognize that municipal finances are under pressure, but believe that most municipalities have the wherewithal to close their deficits. Additionally, any degradation in municipal credits will be gradual and will not reach the dislocations observed in the corporate bond market over the last three years.

OUTLOOK The Commerce Department has released its early estimate of second quarter 2010 GDP. The estimate was a positive 2.4% annual rate. This number is down from a revised 3.7% in the first quarter and 5.0% in the last quarter of 2009. Inventory rebuilding contributed just over 1% to GDP growth – less than half the contribution in first quarter 2010 and fourth quarter 2009. An end to the restocking cycle could indicate a continuation of slow economic growth in the second half of the year.

Acknowledging the challenges, growth will be slow, but it is expected to be positive. With low interest rates and volatile markets, it is important for investors to remain focused and cognizant of the various asset classes available to meet their goals. Diversification, risk tolerance, and portfolio review are important to assure that an investment approach remains relevant with market conditions.

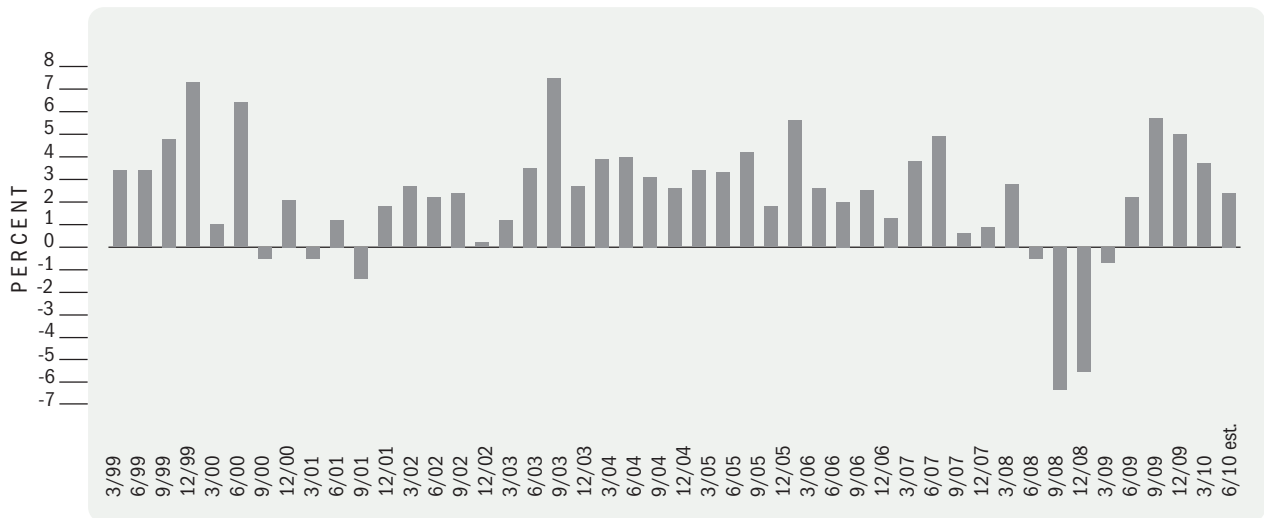
More information about MTB investment Advisors' investment process, capabilities, and solutions can be found at our website, www.mtbia.com

ECONOMIC STATISTICS

Economic Indicators June 30, 2010	2009 Actual	2010 MTBIA Estimate	2011 MTBIA Estimate
GDP (Change, Y/Y)	-2.40%	3.00%	3.00%
CPI (Change, Y/Y)	1.00%	1.35%	1.20%
Housing Starts (Million Units)	0.55	0.70	0.85
Federal Funds Rate (December Target Rate)	0 - 0.25%	0 - 0.25%	0.25 - 0.50%
Profits (S&P 500 EPS)	\$70.00	\$82.00	\$90.00
Capacity Utilization	71.00%	73.00%	75.50%
Unemployment Rate (Dec.)	9.30%	9.60%	8.70%

Source: MTBIA, Bureau of Labor Statistics

GROSS DOMESTIC PRODUCT (QUARTERLY)



Source: Bloomberg

YEAR-TO-DATE 2010 PERFORMANCE

Market Index Summary:
(Period Ending: July 31, 2010)
For Selected Indices

Index	Change 12/31/09 – 7/31/10
S&P 500	-0.11%*
S&P Mid-Cap	5.45%*
Russell 2000	4.79%*
Tokyo Nikkei 300	-9.6%*
France CAC 40	-5.3%*
Hong Kong Hang Seng	-3.8%*
MSCI EAFE Index	-4.7%*
Barclays Capital Aggregate Bond Index	6.5%**

* Represents price change for the period, as reported by Factset (4/30/2010).

** Total return as reported by Barclays Capital.



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