MTB Investment Advisors

Monthly COMMENTARY

August 31, 2010

DOW JONES INDUSTRIAL AVERAGE	10,014.72	90-DAY TREASURY BILL	0.14%
S&P 500	1049.33	10-YEAR TREASURY NOTE	2.47%

The Economy

August brought an end to the "Summer of Our Discontent" (with apologies to William Shakespeare and John Steinbeck). Stocks suffered their worst August in nine years, which cast doubt on the progress of the economic recovery. However, by writing the Monthly Commentary on the first Friday of the following month, we were able to note the bounce during the first week of September.

The revised estimate for second quarter GDP, announced by the Commerce Department on the final Friday of August, came in at 1.6%. This was lower than the preliminary estimate, and lower than most economic predictions. Real consumer spending was revised up, which partially offset the downward revision to inventories and the drag from foreign trade. We remain in the slow economic growth camp, and note that some "double dip recession" advocates are beginning to join this group.

The employment numbers continue to have an impact on consumers and businesses, but the August report does not indicate a reversion to economic contraction. The job numbers are still weak, but are beginning to appear "less weak." The Labor Dept. reported unemployment at 9.6% and the creation of 67,000 net new jobs by private employers. Overall, the U.S. lost 54,000 positions, but this was expected due to the elimination of temporary Census jobs. Unemployment is a lagging indicator, and will remain weak as the economy slowly recovers.

Housing statistics in July reflect the impact of the first-time homebuyer credits and its subsequent expiration. Existing homes sales plunged 27% in July to an annual rate of 3.8 million units. This decline was the largest monthly drop since record-keeping began in 1968. On a positive note, pending sales of existing homes climbed in July. This relatively new index from the National Association of Realtors was up 5.2%. Although considered a leading indicator for actual home sales, not all pending sales result in contracts for final sales.

Despite a decline in sales and an increase in inventories of unsold homes (now back to an 11 month supply), the median price of an existing single-family home increased 0.9% in July (year-over-year), matching the 0.9% gain in June. Low mortgage rates and indications of easing in bank lending standards could provide stabilization in housing during the second half of this year and through 2011.

Signs of easing in bank lending standards (May through July) appeared in the Federal Reserve Board's Senior Loan Officer Opinion Survey (SLOOS). Maury Harris and Samuel Coffin of UBS Securities LLC commented on this survey in their August 20th, Economic Perspectives Report. They mentioned that an increase in competition among banks contributed to bankers' willingness to make loans. Additionally, greater availability of credit, especially in the important housing and small business sectors, should keep the economy on a positive track in coming months.

Inflation, as reported in the Consumer Price Index (CPI), was up only 1.1% year-over-year. The closely watched "core" rate (excludes food and fuel) was up 0.9%, year-over-year. Presently, the U.S. economy is experiencing a period of "disinflation"; neither inflation nor deflation, but prices rising at a slower rate of increase. At the same time, we continue to share the concern of many economists that the budget deficit will lead to inflation in future years.

Gasoline prices (at the pump) are falling. According to the Lundberg Survey (August 29, 2010), the national average price at the pump for self-service, regular gas was $2.70 a gallon. This is the lowest level since February and down 22 cents from a peak price in May. Contributing factors are lower crude prices and a drop in consumer demand. Unemployment is also hurting gasoline demand.

Politics will play a role in the second half economy. We have a mid-term election, consideration of additional stimulus and a scheduled end to the Bush tax cuts. A survey of economists by CBS News (September 1, 2010) noted that 54% supported extending the tax cuts. Even former Federal Reserve Chairman Greenspan noted that he was, "very much in favor of tax cuts, but not with borrowed money." It will be an interesting fall season.

Stock Market

As we noted at the beginning of this month's Commentary, and will report in performance numbers below, August was not a good month. However, equity markets experienced a nice bounce during the opening week of September. When markets closed on Friday, September 3rd, they were basically unchanged from the beginning of the year. Please find equity total return performance below:

Equity Total Return Performance as of August 31, 2010

INDEX	AUGUST 2010	YEAR-TO-DATE
S&P 500	-4.5%	-4.6%
DJIA	-3.9%	-2.1%
NASDAQ	-5.9%	-6.0%

(Source: Bloomberg)
Past performance does not guarantee future results.

This year, world stock market performance has lagged other asset classes such as fixed income and select commodity groups. Volatility continues, with many trading days ending with a gain-or-loss of one percent or more. Historically the months of September and October post declines, but our analysis and outlook continues to call for S&P 500 earnings per share of $83 this year and $90 in 2011. Using historical price-earnings valuations, this could equate to 1260 on the widely watched S&P 500 Index by year-end 2010 and the early months of 2011.

Although no one can accurately predict the future, and "black swans" will appear, a survey by *Barron's* (September 6, 2010) quoted a number of leading market strategists forecasting 1200 to 1300 for the S&P 500 by the end of this year. The best approach to investment management continues to favor diversification and quality in portfolio representation.

Fixed-Income Market

The treasury market achieved its strongest monthly gain since late 2008 in August. A decelerating economy, the Federal Reserve's commitment to maintain its $2 trillion balance sheet by buying treasuries, and a near-zero inflation rate caused yields to drop significantly.

The yield on the benchmark 10-year treasury fell from 2.91% to 2.47% over the month of August. Yields on two-year treasuries only fell 8 basis points during the month, from .55 to .47, producing a flatter yield curve. Investors continue to go out the curve and down in credit quality to maintain their yields. We continue to suggest that a flatter yield curve lies ahead in both the taxable and tax-exempt markets.

Index performance is noted below:

Fixed-Income Total Return Performance as of August 31, 2010

	AUGUST 2010	YEAR-TO-DATE
BARCLAYS CAPITAL AGGREGATE BOND INDEX	1.29%	7.83%
BARCLAYS CAPITAL GOV/CREDIT INDEX	1.86%	8.67%
BARCLAYS CAPITAL INTERMEDIATE GOV'T/CREDIT INDEX	1.17%	6.94%
BARCLAY'S MUNICIPAL BOND INDEX	2.29%	7.00%
BARCLAY'S HIGH YIELD	0.04%	8.37%

(Source: Bloomberg)
Past performance does not guarantee future results.

High yield had a more difficult month in August, as supply was extremely heavy, and the stock market (a proxy) was negative. We continue to overweight both the investment grade and high yield markets, though at a lower allocation than in 2009.

Municipals had a very strong month, driven by the same factors we have been highlighting for some time, reduced tax-exempt supply and greater demand.

Given the slow, "disinflationary" environment, we expect the Federal Reserve to be on hold until perhaps 2012. We continue to advocate bond portfolio durations at 100% of benchmark for those investing in taxables, and 105% of benchmark for those accounts buying tax-exempt municipals.

Appendix

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Important Information

Past market performance is no guarantee of future results.

Index performance cited is for illustrative purposes only and is not indicative of the performance of any specific investment. An investment cannot be made directly into any index.

International investing involves special risks including currency risk, increased volatility of foreign securities, political risks, and differences in auditing and other financial standards.

Diversification does not assure a profit nor protect against loss.

Bond prices are sensitive to changes in interest rates and a rise in interest rates can cause a decline in their prices.

High yield, lower-rated securities generally entail greater market, credit and liquidity risks than investment grade securities, including higher volatility and higher risk of default.

Dow Jones Industrial Average (“DJIA”) - An unmanaged index, which represents share prices of selected blue chip industrial corporations as well as public utility and transportation companies.

The Consumer Price Index (“CPI”) - A measure of change in consumer prices as determined by a monthly survey of the U.S. Bureau of Labor Statistics.

Nasdaq Composite Index - An unmanaged index that measures all Nasdaq domestic and non U.S.-based common stocks listed on the Nasdaq Stock Market.

The S&P 500 Index - An unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Barclays Capital Intermediate Government/Credit Bond Index - An unmanaged index which includes non-convertible bonds publicly issued by the U.S. government or its agencies; corporate bonds guaranteed by the U.S. government and quasi-federal corporations; and publicly issued, fixed rate, non-convertible domestic bonds of companies in industry, public utilities, and finance.

The Barclays Capital Aggregate Bond Index - An unmanaged index composed of securities from the Barclays Capital Government/Corporate Bond Index, Mortgage-Backed Securities Index, and the Asset-Backed Securities Index.

The Barclays Capital Municipal Bond Index – This is a market-value-weighted index for the long-term tax-exempt bond market. To be included in the index, bonds must have a minimum credit rating of Baa. They must have an outstanding par value of at least $7 million and be issued as part of a transaction of at least $75 million. The bonds must be fixed rate, have a dated-date after December 31, 1990, and must be at least one year from their maturity date.

The Federal Funds Rate - The interest rate at which one depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight.

GDP - Gross Domestic Product, the output of goods and services of a country annually.

Weekly Treasury Auctions – Treasury securities are sold through weekly auctions.

Examples of bond issuers are cited for illustrative purposes only and are not representative of any particular investment portfolio.

The Consumer Confidence Index – An index based on a monthly survey of representative sample of 5,000 U.S. households.

The Lundberg Report/Survey - A research report by an independent market research company (Lundberg) specializing in U.S. Petroleum marketing and related industries.

Municipal Bonds – These are debt securities that are issued by states, municipalities or counties, to help fund expenditures.

"Black Swan" – An event that deviates from a normal situation and that is difficult to predict

Federal Reserve Board Senior Loan Officer Survey – A quarterly survey of domestic and foreign bank branches by the Federal Reserve that often includes topics of current interest.

*The information contained in this **Monthly Commentary** was prepared from sources believed to be reliable, but we do not guarantee that the information is complete or accurate. Opinions and projections contained herein reflect our opinion as of the date of the analysis and are subject to change without notice. This report is distributed for information purposes only and in no way should be construed as advice on how to conduct an investment program. Before acting on any information, you should consult with your professional advisor.*

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