

LARGE-CAP CORE EQUITY

MODERATE GROWTH AHEAD, BUT AREAS OF STRENGTH WILL PERSIST

Consumer Discretionary Sector and Information Technology Sector companies are positioned well for the evolving economic environment.

A tumultuous third quarter left many investors more confused than ever about the prospects for the economy and the stock market. Following the news this past quarter was like watching a ping pong match. The economic data was worse than expected one week, and then the economy was back on the path to recovery the next week. There were worrisome comments from the Federal Reserve and company CEOs, only to be offset by strong corporate earnings and more optimistic guidance. The financial markets reacted quickly to this back and forth. The stock market rose 7% in July, only to fall 5% in August on increased concerns about a double-dip recession. Then in September, a month known for its weak returns historically, the S&P 500 rallied 11% – the strongest September gain in 71 years.

We believe it is paramount to always focus on broad economic trends and not get caught up in the day-to-day fluctuations in the data, but this perspective is particularly important in environments like we experienced last quarter. The third quarter economic data as a whole indicated that the recovery was intact, despite some softer data and investors' concerns about a wide range of issues ranging from a slow-to-improve labor market to European sovereign debt.

We continue to believe that U.S. economic growth will stay positive, and the economy will transition to more trend-like growth later this year or early in 2011. The Large-Cap Core Equity portfolio is overweight Sectors that should stand out positively in the moderate growth environment we see ahead – and this portfolio positioning paid off in the third quarter. The Large-Cap Core Equity portfolio outperformed the S&P 500 during the quarter as more investors' shifted their economic outlook in line with our forecast, and numer-

ous Large-Cap Core Equity portfolio companies delivered strong earnings and robust outlooks.

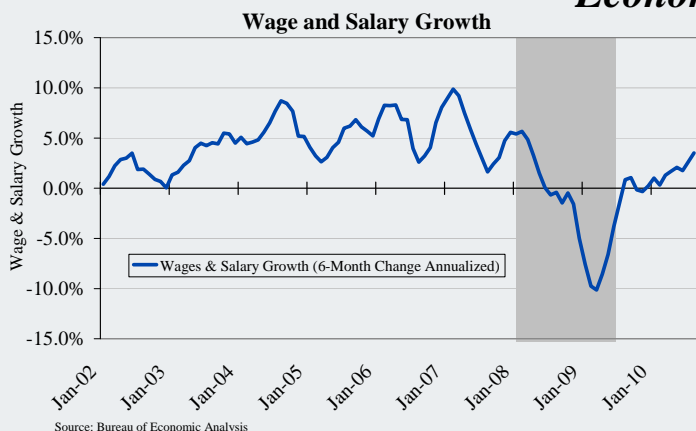
Areas of Economic Strength

Our forecast of trend-like economic growth may concern some investors, and we would agree some Sectors are likely to post disappointing returns over the next year. Nevertheless, there will be areas of strength in the environment ahead. The Consumer Discretionary Sector, to the surprise of many investors, is the best performing Sector year-to-date, and we believe the attractive fundamentals behind the Sector's performance this year should continue.

Limited layoffs and increased hours worked have boosted workers' sense of job security. The monthly payroll data continues to indicate that widespread layoffs ended last year, and in fact, the recent readings of the Challenger survey of layoff announcements showed that layoffs were at the lowest level since 2001. Consumers are spending more, not only because they feel safer in their jobs, but also because their incomes continue to grow. Wages and salaries grew at a 3.5% annualized rate over the last six months, which is the strongest growth in more than two years. The broadest measure of personal spending, Real Personal Consumption Expenditures, is just below the measure's all-time high on the back of these improved consumer fundamentals.

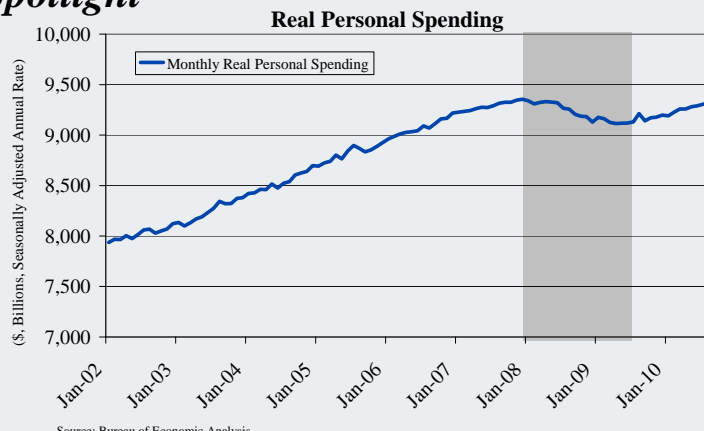
A number of recent Large-Cap Core Equity portfolio companies' earnings reports provided further evidence of the strength of the consumer. Best Buy Co., Inc, Bed Bath & Beyond Inc. and Nike Inc. each not only posted strong year-over-year earnings growth, but also

Economic Spotlight



Source: Bureau of Economic Analysis

Wages and salaries increased at a 3.5% annualized pace over the last six months. This is the strongest growth in over two years.



Source: Bureau of Economic Analysis

Personal consumption expenditures, the broadest measure of consumer spending, was just below an all-time high as of August 2010.

beat the consensus earning per share estimates by more than 10% in their most recent quarters. While these companies have outperformed many of their peers, they are not unique in their strong earnings growth. Earnings for the Consumer Discretionary Sector as a whole are back to the peak achieved in late 2006. The earnings outlook is even more favorable for Consumer Discretionary stocks when you consider that these companies have delivered this substantial recovery in profits over the last year and half even as the personal savings rate has increased and remained near 6%.

Technology spending has been another area of strength in the economy this year. Business capital expenditures (CapEx) on technology grew at a strong 15% annualized rate in the second quarter, and early indications are that CapEx on technology should outpace other types of business CapEx in the third quarter. This trend should persist as businesses continue to shift CapEx dollars to technology to boost productivity and grow profits as the economy grows at a moderate pace. In addition, businesses have the resources to make these investments with corporate profits at an all-time high and over a \$1 trillion in cash on corporate balance sheets.

Businesses' increased focus on enterprise technology has translated into strong earnings growth for all of the Large-Cap Core Equity portfolio Technology Sector holdings. Oracle Corp. and Research in Motion, Ltd., which reported earnings in September, grew earnings per share 40% and 42%, respectively, compared to the same quarter a year ago.

Increased Differentiation Among Sectors

Investors will become more aware that not all Sectors will excel in the environment ahead. We expect this differentiation to unfold as the economy transitions from the burst of growth, which began last year, to sustained trend-like growth in the immediate period ahead. We have begun to see evidence of this differentiation through Sector performance and analysts' revisions to their earnings estimates for the second half of 2010 and 2011. The table below illustrates this trend.

Change in 2011 EPS Estimates by Sector Since 2011 Estimates Became Available

Market Sector	Change Since 3/5/2010
Industrials	11.99%
Information Technology	7.46%
Consumer Discretionary	4.34%
Telecommunication Services	3.36%
S&P 500	-0.26%
Materials	-1.43%
Consumer Staples	-1.65%
Health Care	-3.99%
Financials	-5.41%
Utilities	-6.38%
Energy	-10.32%

The earnings estimates for companies in certain Sectors have increased substantially while the estimates for companies in other Sectors have been lowered, even as the earnings estimate for the S&P 500 overall is little changed. Today's situation, with some Sectors being revised higher and others revised lower, is very different from what we saw a year ago

Source: Thomson Reuters

when analysts increased earnings estimates across all Sectors as the economic recovery took hold.

We are encouraged to see that investors have raised their expectations for earnings growth for companies in the Information Technology, Consumer Discretionary and Telecommunication Services Sectors as the Large-Cap Core Equity portfolio is overweight each of these Sectors, and has been all year. We believe, however, we are only in the early stage of this differentiation in earnings growth across Sectors, and that analysts' estimates are likely still too low for Large-Cap Core Equity portfolio companies in these overweight Sectors.

Economic and Market Outlook

The U.S. economy continues to move to more moderate, but sustained GDP growth (2.5% to 3.0% per year). In the near term, however, growth may surprise to the upside as the economy moves beyond the summer soft patch. In fact, investors who have focused on the 1.7% reading for second quarter GDP growth as a sign of economic fragility have likely underestimated the current strength of the economy. If investors look below the headline Q2 GDP number, they will find the major components of GDP tell a very different story from the headline reading. Imports, which detract from GDP growth, grew last quarter at the fastest rate since 1984. If you evaluate the U.S. economy based on the consumption of goods and services from within the U.S. (GDP excluding the impact of imports and exports), this measure of the economy increased 5.1% in the second quarter, up from a strong 3.9% increase the prior quarter.

Just as economic growth could be stronger than most expect in the near-term, investors should not rule out additional double-dip recession scares. It is natural to see both positive and negative fluctuations in the data as the economy transitions to a period of healthy, but trend-like growth. A high unemployment rate and a sluggish housing market will likely characterize the economic environment ahead, but a lack of strength in the labor and housing markets won't undermine other areas of economic vitality. Consumer spending growth should be solid as personal incomes rise and sparse layoffs lead to improved consumer sentiment. Moderate overall economic growth, along with excess capacity across many businesses, will force management teams to invest in enterprise technology to improve productivity to meet their earnings growth targets. The Large-Cap Core Equity portfolio is positioned to benefit from these key trends in the economic environment ahead with substantial allocations to the Consumer Discretionary and Information Technology Sectors.

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