VERITY Investments, Inc.

Market Commentary and Outlook

DEC. 31, 2010

CORE ALLOCATION

INDEPENDENT ADVICE ACTIVE MANAGEMENT

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Equity markets finished strong in 2010, extending the gains from the powerful rebound of 2009. Unlike 2009 though, the route was choppy, with more than a few scares along the way. Abroad, sovereign debt crises in Greece and Ireland were reminders of deep systemic issues that remain unresolved. At home, a somewhat lackluster and sputtering recovery sparked repeated fears of a slide back into recession.

After two years of the federal government pulling out all of the stops, the domestic economy certainly shows signs of progress, but there is little sense the country has transitioned to a self-sustaining expansion. The undeniable economic and political challenges that face us, whether now or somewhere further up the road, remain daunting. Yet, we cannot completely discount the market's implications that, in the interim, we could also see a much stronger expansion than most would expect.

Target Allocation by Asset Class / Strategy

55.5%	Equities - Domestic & Foreign
16.5%	Gold, Energy & Commodity Related
5.0%	Merger Arbitrage
8.5%	Equities - Short (Leveraged 200%)
4.0%	Bonds
7.5%	Bonds - Short
3.0%	Cash

In this still complex environment, the central themes that continue to inform our investment strategy began to develop strong trends as we moved through the year:

- **Equity strategy** has been dually focused on **targeted U.S. sectors** and **selected emerging markets**.
    - Nearly all domestic equity sectors in the portfolio strongly outperformed the broad S&P 500 as the market moved up off its July lows, including the larger allocations to small caps, water companies, biotech, and agricultural companies.
    - Though China lagged, overall emerging markets performance was strong, far surpassing the 2010 performance index of the developed foreign nations. Fortunately, unlike much of the developed world, many developing countries have improving sovereign credit along with expanding middle classes, so major price declines will typically be viewed as buying opportunities.

- By maintaining a **short equity position in developed foreign countries**, we hedged our risk at the point where major equity markets were weakest during 2010 and where we expect to derive the greatest benefit in the event of another serious market tumble.

- After building a position with direct exposure to **grain prices** while those commodities were emerging from a period of extreme price weakness, we have witnessed a surge in prices in response to generally favorable supply/demand conditions that have been accentuated by unfavorable weather. Longer term, currency devaluation in the developed world, coupled with increasing demand for resources from emerging countries, creates an environment where prices of certain commodities are likely to move higher. Consequently, we expect to identify additional opportunities in this area of investment.

- We won't debate whether it will become the active intent of the U.S. government to debase the currency as its obligations accelerate out of control. We simply note that, under these types of circumstances, it can be prudent and potentially profitable to hold a currency "alternative" that provides a tangible store of value. **Gold**, frequently denigrated from a traditional investment perspective, has occupied this role for centuries. It was a strong contributor to portfolio gains for 2010.

- Interest rates have been generally declining for nearly 30 years. Whether or not the recent bounce in rates represents the ultimate end of that cycle, it is likely that the longer term trend for rates will be up. With government obligations rising at dramatic rates, the supply of Treasury bonds, through increased offerings, continues to rise. In addition, the eroding quality of the U.S. credit situation makes it likely that demand will suffer. Both factors argue for significantly higher rates , which should only accelerate if economic expansion is more robust than expected. This is a long-term thesis, as we believe we are near the inception of a new secular trend, so our **short against Treasuries** appears to provide a very favorable risk/reward opportunity moving forward.

Building overall investment strategy around these central themes, we were able to capture over 70% of the total return in the S&P 500 during 2010 with roughly half of the associated volatility risk. As we enter a new year, we expect these themes to remain intact for some time. But, recognizing the danger of being "married" to expectations, we remain alert to any emerging evidence that would dictate a rethinking of current strategy.