TRITON

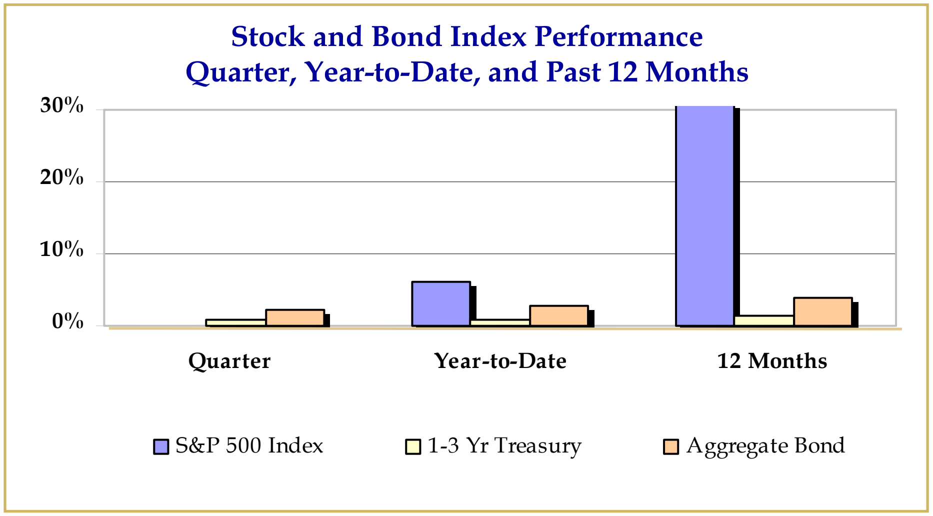
INVESTMENT ADVISORS, LLC

**You can imagine we're pretty disappointed…**
**~ Family Radio aid after apocalypse fails to materialize**

## Growth and Debt Concerns Make for a Volatile Quarter

The world did not end in April when S&P revised its outlook for U.S. debt from stable to negative – that event was scheduled for later in the quarter. The good news is that the apocalypse failed to materialize, and (unless you were Osama Bin-Laden) May 21st came and went like any other day. The market's reaction to the al-Qaeda leader's demise was miniscule – particularly in relation to the economic morass created in response to his attacks. The S&P 500 Index finished the volatile quarter a mere 0.10% higher than where it started. The general bond market posted a 2.29% gain, as growth and debt concerns fueled the purchase of defensive assets.

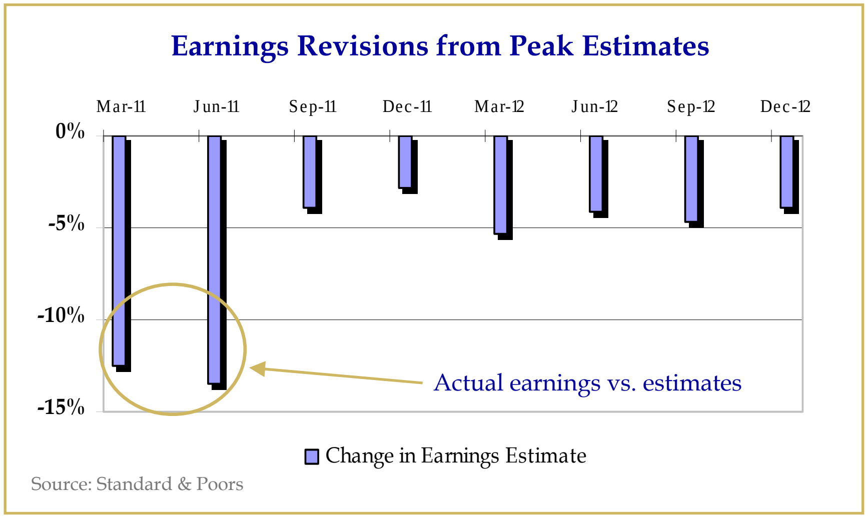
Markets are presumed to be discounting mechanisms, able to anticipate future outcomes and price assets accordingly. The process begins by combining various forecasts to derive a consensus forecast. Consensus forecasts, while more accurate than individual predictions, are not always correct. Recent economic reports have fallen short of modest growth expectations. Thus far, corporate earnings have grown despite the weak recovery. As GDP estimates ratchet down, we wonder if S&P 500 consensus earnings estimates can stand up to the pressure.




## The Wisdom of Crowds

The S&P 500 has had a very nice run over the last twelve months. Rising from last year's pessimistic double-dip-June-swoon, and fueled by strong earnings growth, the index has tallied a 30.76% gain. While current worries regarding growth, debt, and employment are nationally evident, changes to the underlying earnings outlook are not well publicized. Given that market returns have leaned heavily on earnings growth, the new trend is definitely worth noting.

Reported first quarter S&P 500 earnings were 13% below peak estimates. June earnings (53% of companies reported) are also




coming in well below recent expectations (see chart above). At their recent peak, earnings for the S&P 500 were expected to exceed $100 by 2012. Our number was closer to $98.70, and has since been reduced to the consensus estimate of $96.30. (Having noticed the March shortfall, we didn't factor the $100 number into our allocation decisions. The number we are using to trigger additional stock purchases is quite a bit lower than the $96.30 number).

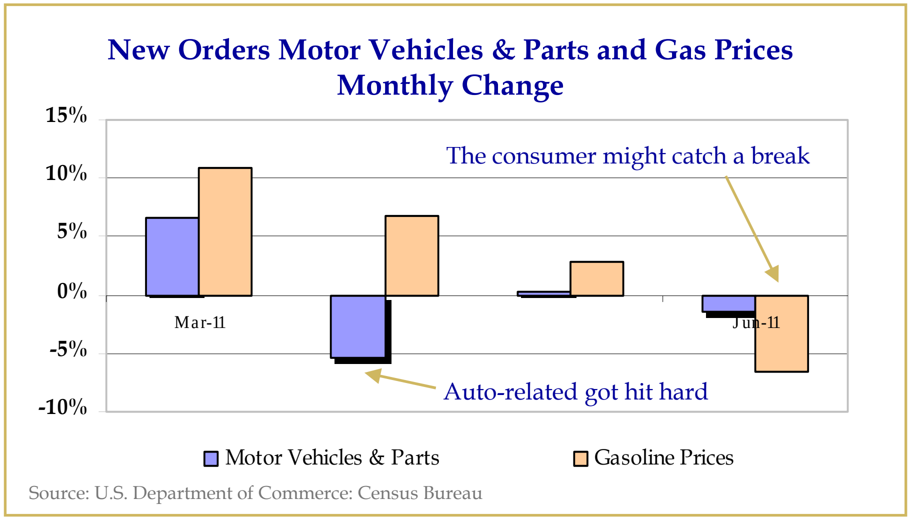
**Whether it's the Weather**

The retrenchment of earnings optimism could be a function of Japanese supply chain disruptions, U.S. natural disasters, a weak financial sector, gasoline prices, or austerity measures. Our suspicion is that two of these factors – Mother Nature and gas prices – meaningfully affected economic activity in the second quarter.

The Federal Reserve's latest survey of business contacts showed numerous reports of supply chain and weather related disruptions. Several regions of the country reported lower vehicle production due to parts shortages. Meanwhile, gas prices rose going into the quarter before spiking at $3.90 in May.

A review of our Economic Cycle Indicators reveals a softness in Industrial Production, New Orders, and Non-farm Payrolls, although all remain positive for the year. Additional weakness in these readings would most likely force a reduction in 2011 third- and fourth-quarter estimates. On the positive side, gas prices have moderated, and auto production is expected to pick up in the second half of the year (see chart below).

Prior to the recent earnings revisions, stock values based on the real earnings yield looked fairly compelling. Factoring in these changes, however, pushes the quarter-end (S&P 500 1320.64) real earnings yield much closer to our historical average. Earnings are still strong and we still like the market. The price at which we are the marginal buyer is just a bit lower.



## Investing in an Uncertain and Volatile Environment

Stocks started off the quarter very strongly before giving back their gains in May and June. The April price spike coincided with a peak in earnings growth expectations that has since receded. We believe that extraordinary events contributed to the fall off in growth and earnings, but we won't know if our suspicions are correct until the later half of the year. In the mean time, bond investors are enjoying the uncertainty.

If natural disasters weren't enough, mankind somehow felt compelled to add to the disturbance. When he wasn't predicting the end of the world, he was trying to push it in that direction. I would assume, unlike followers of Harold Camping, that most people would like to avoid Armageddon – even if it is just economic – but then, who would have ever imagined hearing the words "default" and "U.S. Treasury" in the same sentence?

Last September we noted economist J. M. Clark's warning that "to assume that the economic system will give us unlimited time to find cures for its worst evils is not wise." Our warning today: It would be wise to find cures that do not produce economic evils. The move toward austerity here and abroad will be disruptive. Policymakers should keep in mind that rapidly reducing our debt ratio has historically led to slow growth and high unemployment.[1]

Earnings growth rates may have peaked, but corporate earnings are still strong. Expectations will need to adjust to a new set point. Given the transitory nature of recent events and the uncertainty regarding future policies, it is difficult to ascertain what that point will be. Our overall Outlook for Stocks remains positive, but we have lowered the price at which we add to our positions.

[1] Reinhart and Rogoff (2009) analysis of deleveraging.

## Glossary of Terms Mentioned

**Earnings Yield** – Earnings divided by price (the inverse of the price-earnings ratio), it is used to compare the relative attractiveness of stocks, bonds, and interest bearing assets.