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Quarterly Newsletter

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Market Overview

The U.S. equity markets advanced in April on better than expected corporate earnings reports and then declined for six weeks in May and June based upon fears that a temporary slowdown in economic growth in the U.S. and continued fears of a sovereign default in Greece might lead to a double dip recession. The market then rallied in the last week of June on some stronger than expected U.S. economic data and as Greece passed additional austerity measures in order to receive funds and credit extensions to help keep the country solvent. The quarter's ups and downs mostly offset each other. (see table below). Defensive sectors were stronger throughout the quarter, specifically stocks of Consumer Staples, Healthcare, and Utility companies.

The Federal Reserve continued to provide monetary stimulus to the economy over the quarter as employment remained weak. Fed Chairman Bernanke said that the weaker than expected economic data seen in May was partially due to temporary causes. While the Fed reduced its growth forecast for 2011, they expect an acceleration of economic activity in the second half of this year and do not expect a double dip recession. Interest rates declined a bit over the quarter, although longer-term rates remain above the low levels seen back in October 2010 (see table below).

The U.S. dollar declined over the quarter, however, many global commodities priced in U.S. dollars, such as wheat, corn, cotton, oil and silver also declined, which adds credibility to the Federal Reserve's view that the rise in commodity prices over the past few quarters was transitory and reflected demand and supply imbalances rather than overall rising inflation. Gold was one of the few commodities that rose over the quarter (see table below).

Developed international equity markets also advanced slightly, while emerging equity markets declined mainly due to restrictive monetary policy providing a headwind to growth (and stock prices) in an effort to reduce inflation, primarily in China.

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U.S. Equity Returns Table
Source: Thompson Reuters

Index	Q2 2011 Returns	YTD 2011 Returns
Dow Jones	1.3%	8.4%
S&P 500	0.1%	6.0%
NASDAQ	0.1%	5.0%
Russell 2000	-1.7%	6.1%

U.S. Treasury Yield Table
Source: Bloomberg

	7/2011	4/2011	10/2010
3 month	**0.02%**	0.04%	0.15%
2 year	**0.49%**	0.76%	0.41%
5 year	**1.81%**	2.18%	1.22%
10 year	**3.21%**	3.41%	2.47%
30 year	**4.41%**	4.47%	3.70%

Broad Indices Table
Source: Thompson Reuters

	Q2 2011 Returns	2011 Returns
Gold (GLD)	4.4%	5.2%
Crude Oil	-10.6%	4.4%
U.S. Dollar Index	-2.1%	-5.8%
International Equity Markets (EFA)	0.1%	3.3%
Emerging Equity Markets (EEM)	-2.2%	-0.1%

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Retirement Planning Tool

PacWest would like to remind you that we have a retirement planning tool called the retirement income evaluator. This tool will allow us to determine if you are on track with regards to your retirement. This program has the added advantage of not requiring much in the way of inputs, yet it provides a very robust output, but more on that later.

The evaluator requires inputs such as age, values of liquid assets, retirement expenses as well as social security, annuity and pension information. In addition, the program can factor in one-time financial events such as the sale of a home or receipt of an inheritance.

Given these inputs, the program generates 250 return simulations to determine how your asset mix (stocks, bonds, and cash) may perform over the planning horizon under a wide variety of market conditions. Then the program determines whether or not your assets will support your retirement expenses, but it provides this information with respect to two scenarios. The first scenario assumes that market averages continue, which means that the program looks at all the return simulations that were generated over the planning horizon and picks the simulation where 50% of the portfolios performed worse than the chosen portfolio and 50% performed better than the chosen portfolio. The second scenario assumes that markets perform significantly lower than the historical average. The program again looks at all the 250 return simulations and picks the simulation where only 10% of the portfolios performed worse than the chosen portfolio and 90% performed better than the chosen portfolio.

In this way, you have an output based on an average market and a much more conservative output based on a poor market. We believe a positive result with respect to the conservative output from this program would provide confidence regarding your preparedness for retirement. If you are interested in having us run a retirement plan using our new retirement income evaluator, please let us know and we would be more than happy to send you the data gathering form to facilitate this process.

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Behavioral Finance

Behavioral finance is a field of finance that studies the psychology guiding investors and the decisions they tend to make. Although behavioral finance is a fairly recent field to burst onto the academic scene, many psychological biases have already been identified as playing a large role in the mind of an investor and in the nature of markets in general. These psychological biases may have profound benefits in nature and certain social situations, but as an investor we have much to gain (or much less to lose, depending on the market climate) if we can limit the magnitude of the impact that these biases have on our investing strategy. We have the tendency to believe we are immune from the biases that others suffer from. However, this illusion will be a costly misassumption if we continue to believe it. Therefore, the necessary first step in reducing our susceptibility to these biases is to build an understanding of exactly what they are and how they affect us. Once we build an understanding, we can develop strategies to combat the negative effects that these biases have on investing. Today we'll discuss two of the many biases that investors are subject to.

The first bias is called an "empathy gap", which is the inability to predict our own future behavior under emotional strain. As it relates to the world of finance, market conditions can almost force our hand to make brash investment decisions that we otherwise would not have made in a calm environment; in the heat of the moment it is easy to be carried away by strong market sentiment screaming for you to "sell!" or "buy!". However, as renowned investor Sir John Templeton put it, "The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell." To avoid allowing a stressful environment to lead us to make brash investment decisions out of fear or excitement, we should prepare our investment strategy when the market is relatively static (low state of stress) and make a commitment to stick to our prepared plan. Pre-committing to a rational investment plan ensures that our decision-making process is guided by logic rather than emotion.

The second bias that we are exposed to is called the "self-attribution bias", which is our habit of attributing good outcomes to our skill as investors, while blaming bad outcomes on somebody else or the bad luck of an exogenous event. This bias is potentially dangerous because if we attribute a successful investment decision to skill when it should really be attributed to good luck, then the positive reinforcement might lead us to make similar investment moves in the future that in reality should be avoided. Conversely, if we attribute an unsuccessful investment decision to bad luck, we are less likely to learn from mistakes that experience has already tried to teach us to stay away from. George Soros, another legendary investor, has devised a solution to guard against this psychological pitfall. He keeps a diary to record the thoughts that go into his decision-making process on a real-time basis, as if he is a play-by-play commentator on his investment mind. By keeping a diary, he is able to create a reference to go back and check to see if his decisions were right for the right reasons. The ability to cross-check his previous thinking allows him to gain as much useful information as possible from his past analyses, and is a tool that we should incorporate into our own process.

PacWest is aware of these as well as other behavioral finance biases and incorporates procedures into our investment process in order to improve and mitigate the potential for adverse effects on our investment decisions.

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