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A Message from Barry McInerney

Is The Global Economic Recovery in Jeopardy?

Just as we were beginning to see signs of sustainable global recovery, a fresh crop of concerns has arisen. The debt crisis in Greece threatens to spread within Europe. Here at home, our economy has yet to find its stride in the post-stimulus environment. Capital market risk measures are rising and nervousness about mounting global sovereign debt levels (particularly in the US, the UK, and Japan) is casting doubts on a longer term economic recovery, despite the positive signs that were unfolding for the remainder of this year and into next.

Are we at risk of a double-dip recession or even a repeat of the financial calamity we recently experienced? We think not. Certainly, growth expectations here and abroad need to be tempered somewhat from a few short months ago. And yes, we will probably experience continued bouts of market volatility as these new crises play out (albeit nowhere near the historic levels of 2008). However, many of the economic 'green shoots' from last quarter remain intact.



Barry S. McInerney, CFA
President and
Chief Executive Officer

“Investors should take comfort as fundamental factors such as strong earnings, cash flow, balance sheets and valuations begin to drive stock prices.”

Many factors point to continued global recovery. Let's examine the four most prominent ones:

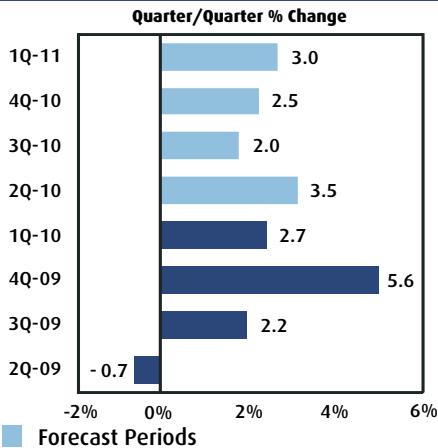
1. US corporate earnings are strong, with approximately 85% of S&P 500 companies reporting an average increase in excess of 50% year-over-year (Bloomberg). The low interest rate environment is highly stimulative and rates are likely to remain low

longer than expected given the slowdown in Europe and a new wave of flight-to-quality by foreign investors adding to their holdings of US securities. Consumer confidence continues to rise as employment slowly recovers. Debt levels at both the federal and state levels remain troubling and will probably result in more modest economic growth than at first hoped but a double-dip recession and earnings stagnation should be avoided.

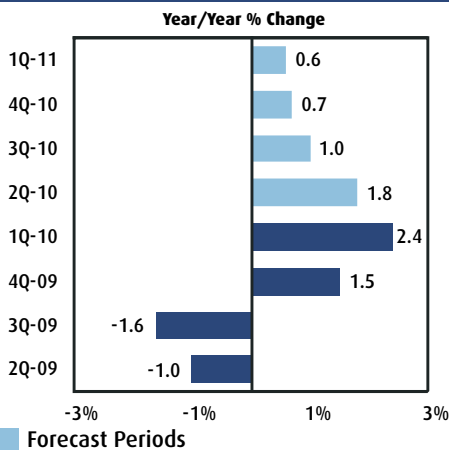
2. Emerging economies (led by China and India) are thriving, fueling strong overall global output growth. The demographic trends in these geographic regions will be the foundation for strong growth for decades to come. The actual economic growth rates will of course fluctuate around this baseline. Case in point, the larger emerging countries will need to address rising inflation and the potential for asset bubbles, which could impede short-term growth. However, this again should result in a slower global recovery than none at all. (cont. page 2.)

ECONOMIC INDICATORS

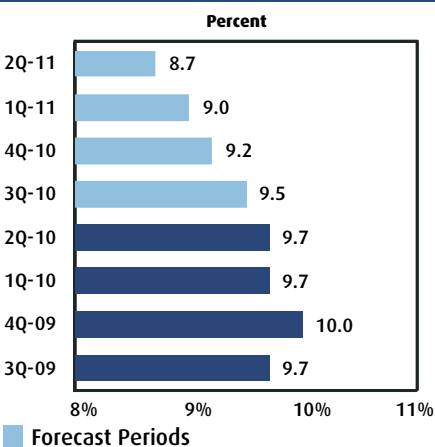
REAL GDP



CONSUMER PRICE INDEX



UNEMPLOYMENT



Is The Global Economic Recovery In Jeopardy? (cont.)

3. While growth prospects in Europe look benign, forces afoot should result in a modest recovery rather than a contraction. As fiscal restraints are implemented, struggles will continue but this bodes well for stronger growth in the long term and the decline in the euro will boost exports and offset fragile confidence.

4. Secular demand for all types of securities is on the rise. While capital markets are driven by economic growth, corporate earnings, fiscal and monetary policies and geo-political events, they are also significantly influenced by the fundamental laws of supply and demand. Aging demographics, higher savings rates, and increased longevity are fueling growth in demand for financial assets in developed countries. As mentioned, investors in emerging nations will be a long-term source of significant demand for securities for years to come. And sovereign funds are fast becoming dominant players for institutional investment strategies and products (with current global assets of \$5 trillion expected to more than double in five years).

All of this points to a continued global recovery. Clearly the market jitters we've experienced over the past month call into question my earlier predictions, in this column, for well-functioning markets by year end. The pace and timing of recovery may continue to vary from quarter to quarter and expectations should be tempered. The Chinese government's recent decision to allow for a more flexible currency policy will no doubt help. And perhaps equally important for investors are recent signs that the global low-quality rally appears to be losing steam after more than a year. We're not out of the woods yet. However, investors should take comfort as fundamental factors such as strong earnings, cash flow, balance sheets and valuations begin to drive stock prices. But the end result will be gradual return to normalcy over the next two to three years.

As always, I hope this Newsletter is both informative and thought provoking. Any and all feedback and ideas for future topics is sincerely welcomed.

Sincerely,

Barry S. McInerney, CFA
President and CEO

Wider Spreads — A Buying Opportunity

Bond market leadership reversed course in May as European contagion fears, legislative uncertainty, slowing economic data and equity market declines reignited a flight to quality by global investors. While the shift in sentiment ended the strong relative performance run of spread-sector bonds, we view the leadership change as a temporary development and widening spreads as an attractive opportunity.

The much maligned financial sector sustained the greatest retrenchment in the shift with energy and commercial mortgage debt also experiencing a significant widening of spreads. Bond investors now must balance the potential for continued bad news from Europe and the expected fallout in the US economy against strong supply-demand technicals in the non-treasury sectors of the bond market. We feel the latter presents the more compelling case for investment and a reason to take advantage of the wider spread levels. Here's how we view the current outlook:

Financials – Fundamentally, financial reform should culminate in passage of financial regulatory reform legislation in July, which would bring clarity to the banking and finance business sectors. Spread volatility, currently heightened due to differing potential legislative outcomes, should decline along with spreads as final rules are put in place.

Energy – The energy sector outlook remains captive to the BP oil spill news cycle and its subsequent negative fallout for all drilling companies. While we expect these issuers to remain volatile, it's instructive to note that the companies themselves hold significant cash balances, which provides some financial flexibility to manage ratings risk.

Commercial Real Estate – Commercial real estate also remains subject to headline risk, however the trend has been kind. Recent transactions garnered higher-than-expected valuations and while a recovery in this sector remains several years away, property levels are nearing a bottom with current appraisals approximately 40% below peak. At current valuation levels, real estate becomes an interesting investment opportunity resulting in a functioning commercial real estate market and a re-invigorated CMBS sector. The shift is especially advantageous for the AAA-rated super duper bonds, offering substantial yields and a zero probability of loss.

From a technical standpoint, demand trends also favor non-treasury assets. Persistently low Treasury yields and the lack of inflation pressures should allow the Fed to remain accommodative for quite some time. As a result, the need for additional yield

remains a pressing issue for most investors, none more so than corporate treasurers, who in many cases hold nearly 9% of their assets in cash-type instruments. Many are now willing to invest further out on a fairly steep yield curve for non-treasury instruments. This serves to create steady demand for all spread sectors. Meanwhile, at the long end of the yield curve, pension fund managers adopting Liability Driven Investing approaches are adding to exposure as they realign asset allocation models in favor of fixed income securities. (For more on LDI and how it is becoming the standard for pension asset management, see Robert Decker's report that accompanies this issue of The Investor) Those sectors expected to see strong interest from the move to LDI are longer-maturity



Maureen R. Svagera, cfa
Managing Director,
Fixed Income

corporate bonds, as well as the taxable municipal issues Build America Bonds. With extension of the Build America Bond legislation a strong possibility, this sector is becoming a larger percentage of credit indices and is experiencing increasing interest by all investor types.

“From a technical standpoint, demand trends ... favor non-treasury assets..”

With supply muted in all investment-grade sectors, except for the Treasury market, the outlook for high-quality corporate bonds also looks relatively attractive going forward.

In summary, the potential for outperformance by non-treasury sectors in coming months remains positive due to supply-demand and technical factors listed. We believe an overweight allocation to these assets is warranted. ▲

Ample Opportunity in Short Duration

Mixed signals in short duration fixed income markets for the first half of 2010 left institutional investors searching for fresh approaches and departing from traditional avenues, a development that could fundamentally change how funds invest at the short end of the curve.

On the positive front, supply stabilized as a result of four distinct developments:

- The return of the U.S. Treasury's Supplement Financing Program increased the issuance of T-Bills by almost \$200 billion, year to date.
- Decreases in asset backed commercial paper balances began slowing, possibly signaling an end to the lack of confidence in this roughed-up sector.
- Unsecured non-financial U.S. commercial paper balances grew over 30% as companies gained confidence in the economic recovery.
- Bank and financial commercial paper, combined with Yankee Certificates of Deposit, saw a rapid decrease specifically due to Europe.

Headlines out of Europe cast a negative tone in the period, prompting rates to rise. Specifically we have seen Libor in the front-end contract double in yield from all-time lows at the start of the second quarter.

The structure of US money markets is likely to continue to evolve, applying multiple pressures across the front end of the yield curve. Issuers are increasingly searching for new alternatives to borrowing from money market funds, given the speed in which headline shocks can significantly cut access to the market. Bond and funding issuers remain concerned over prospective changes embedded in pending financial regulation. Certain provisions emphasize extending issuers' liabilities, which runs counter to many of the liquidity provisions included within the new rules out of Washington. As investors remain concerned with the feasibility of the stable money market product, many fund complexes are exploring ways to increase their volume of cash and short-term investment strategies.

Whether it was anticipated regulatory changes or the European woes, constant cash outflows, coupled with a continued low interest rate environment, have led to nothing but challenges for both sides of the investment business. Although the recently enacted regulations concerning 2a-7 money market funds brought very little surprise, they confirm that the new landscape will be evolving over time to one of lower liquidity risk, increased transparency, and of course little yield for the near future. This combination of issues has forced investors to look for higher yielding investment classes and as a result over \$200 billion have exited the prime money market funds year to date. The only difference from 2009 is that this year these withdrawals are being led by institutional investors.

This trend is likely to continue as investors shake their risk aversion and examine the incentives of separately managed accounts. Consequently we have seen a dramatic increase in demand for our reverse-engineered or solution-based products. Customizing portfolios using an institutional investor's liquidity schedule and approved guidelines provides an added control

measure as well as an enhancement to their overall return. Simply put, more quality controls, higher yield, and lower fees are the demand for the time being.

We anticipate a continued, slow global recovery through the remainder of 2010 and welcome further stabilization of the financial markets whether through private platforms or governmental reform. At this point we envision no change to Federal Reserve rate policy through 2010, as reflected by the shape of futures market curves. There remains ample opportunity, within different sectors to increase yields, if coupled with a disciplined security selection process. Using this unique time in history to review the cost benefit of expanding risk tolerances, we believe there is value within the short corporate, mortgage, and asset backed spread sectors. ▲



Peter J. Arts
Managing Director,
Fixed Income

“Simply put, more quality controls, higher yield, and lower fees are the demand for the time being.”

Equities: The Performance Impact from Quality

In the equity market's recovery from the low of March 9, 2009 some clear leaders emerged – small caps and stocks perceived as low quality. Leaving aside capitalization, what can be learned from the low-quality rally and what is the outlook for fundamentally driven styles?

Quality, as it pertains to equities, is a nebulous term prompting many definitions, almost all imperfect. A commonly followed measure is the S&P Common Stock Rankings System, a gauge of stability and growth of earnings and dividends.

While a common definition proves problematic, a description of the behaviors normally associated with high or low-quality stocks does not. When markets rebound from bear lows, it is often lower-quality issues that rise fastest (generally after having sustained

bear market was one of history's deepest, the 2009 bounce from its trough was one of the best of all time. Falling volatility and rebounding cyclical growth created an environment that proved beneficial to lower-quality issues. Exhibit 1 shows how higher-quality stocks outperformed during the bear market as well as the magnitude of outperformance by low-quality issues in the subsequent rebound.



Daniel L. Sido
Managing Director,
Equities

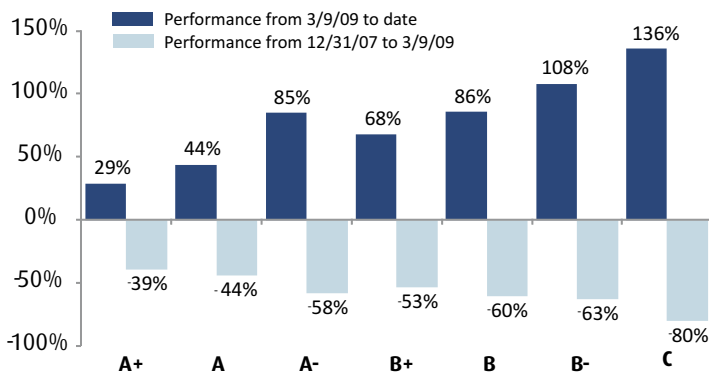
Historically, the S&P Common Stock Rankings have provided proof of a tendency of stocks to perform fairly consistently based on their relative quality. The performance range of the recent period makes this time span distinct. Exhibit 2 shows how the rally from March 2009 has removed most of the performance differential of low-quality stocks from the bear market.

This rally has been driven by the expansion of valuation multiples, an effect most significant at the low-quality end of the market. As a result, high-quality issues today command little premium for their lower earnings risk and stronger balance sheets, a condition that suggests opportunity in higher-quality stocks. (cont. page 7.)

Ex. 1: Cyclical Behavior

Rally since March '09 has been a reversal of '08 performance

S&P 500 Performance by S&P Equity Quality Rating



As of: June 9, 2010

Sources: Standard & Poor's, Morgan Stanley

Quality Moves – Lower-quality stocks tend to outperform in early periods of recovery from bear market lows. Higher-quality stocks generally outperform in most other phases of the market cycle.

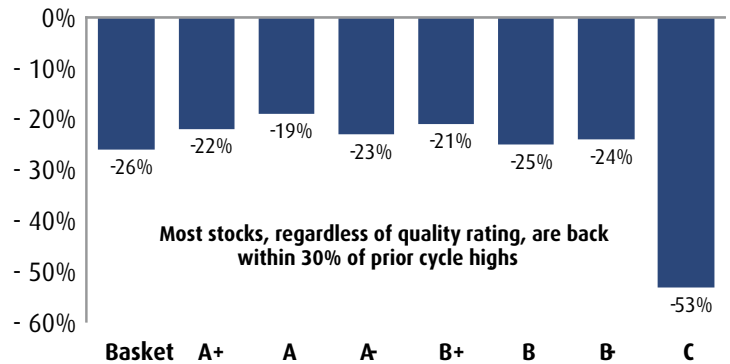
the steepest falls in the bear cycle). In contrast, higher-quality stocks tend to outperform through middle and later stages of bull markets as well as through bear cycles. Viewed another way, high-quality stocks generally outperform when volatility rises and growth slows whereas low-quality stocks tend to post excess returns when volatility falls and growth expands.

In 2008, investors raised volatility levels, acting on concerns about financial markets and a profits recession. This helped higher-quality stocks to outperform during the bear market. Just as the

Ex. 2: An Atypical Period

Only 'C' rated companies remain well below prior highs

S&P 500 Performance 12/31/2007 to date by S&P Equity Quality Rating



As of: June 9, 2010

Sources: Standard & Poor's, Morgan Stanley

Big Bounce – Low-quality stocks better-than-normal move since March 2009 has improved relative full-cycle performance for the group.

Gold Gets a New Shine

The best forecast for the performance of most stocks and commodities in May came from the Bard, who observed, "Rough winds do shake the darling buds of May."

In a month in which US CPI fell and deflationary fears re-emerged from their crypt, the S&P fell 8.2%, oil was down 14%, copper 7.5%, corn 4.6%, and soybeans 6.5%. In contrast, gold closed up 2.7% at \$1,212, getting ready for its June rush to an all-time high of \$1,240.

To those who assume gold is, at best, a hedge against inflation, and at worst, irrelevant—its relative performance was disconcerting. Were gold bugs emerging like spring locusts?

A better explanation is that May was the month in which the economic recovery across the OECD rather suddenly lost momentum, and millions of people in the Eurozone began to lose faith in their currency. Reason: a new banking crisis was engulfing Europe even as banks in the US and Europe were still trying to rebuild balance sheets ravaged from the subprime disaster.

This euro crisis began when Greece admitted its financial statements were fudged, Greek bonds collapsed, and a contagion hit the valuations for the other four over-indebted and economically uncompetitive nations – Portugal, Italy, Ireland and Spain – that, together with Greece, are collectively known as the PIIGS.

For the first time, investors began to question not just the value – but the existence – of the euro, the only major currency not backed by a nation's central bank, its taxation revenues, or its army.

The Germans who had grumbled, but acquiesced, when the new currency was forced on them in place of their beloved deutschmark, watched their televisions in horror as Greek union members rioted to protect their right to retire in their fifties. Central banks across the world, which, overstuffed with dollars, had in recent years been diversifying into euros, were also stunned. The yen, the currency of a nation with the world's worst demographics, was hardly an appealing alternative.



Donald G.M. Coxe
Portfolio Strategist
and Portfolio Manager

Coxe Advisors LLP

So what was left?

The Saudis responded to the crisis by doubling their modest exposure to gold. More significantly, Germans began pouring into gold dealers to buy coins and small gold bars with their euros.

Gold is once again becoming a store of value—not just for central banks and frightened Germans, but for long-term-oriented institutional investors. A store of value is something you hold because you can trust it under almost any conditions—inflation or deflation, war or peace, boom or depression. You don't necessarily buy it because you expect to get very rich very fast, but you feel sure you're not going to become very poor very soon as a result of forces beyond your control. (cont. page 7.)

Ex. 1: Gold's Rise

Gold Prices (\$US)

June 23, 2009 to June 23, 2010



As of: June 23, 2010

Source: Reuters

Store of Value – Gold prices have traced a relatively stable, upward path over the past 24 months, a period marked by both rallies and corrections in financial assets.

Ex. 2: Relative Strength

Gold Prices vs. S&P 500

June 23, 2008 to June 23, 2010



As of: June 23, 2010

Source: Reuters

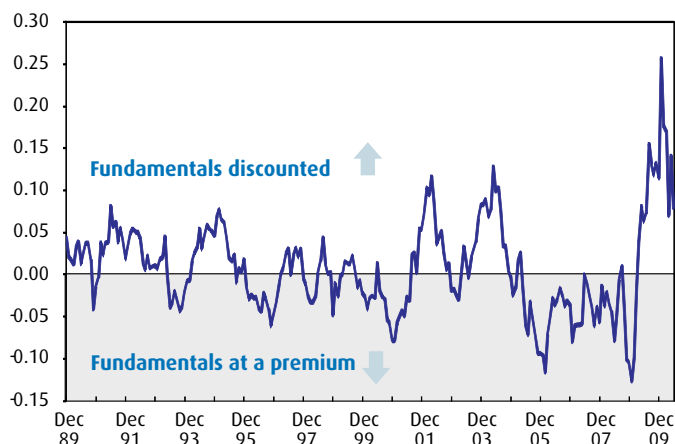
Gold's attractiveness as a store of value has been underscored by investors' reaction to crises this year. For institutional investors gold holds appeal for its durability in a variety of conditions.

Equities: The Performance Impact from Quality (cont.)

Our equity philosophy focuses on investing in issues undervalued relative to fundamentals that exhibit increasing investor interest. In general, issues with stronger fundamentals tend to have higher-quality ratings. Since the bear market low, this has weighed on relative performance. However, it has left us in a unique environment. Exhibit 3 shows the historical relationship between the fundamental strengths we seek and the relative valuations of these attributes. This data suggest that issues with solid fundamentals are as inexpensive as they have ever been relative to valuations.

Ex. 3: Compelling Opportunity

Correlation



As of: June 30, 2010

Sources: Harris Investments, Compustat, FactSet

Fundamental Strengths – Higher-quality companies are less expensive today than their lower-quality counterparts.

With higher-quality companies less expensive today than lower-quality we believe we are positioned to benefit as the market again rewards fundamentals. We feel equities have entered the next stage of the recovery cycle – where markets become sensitive to growth indicators and the focus of investors shifts from multiples to earnings. In this phase of the cycle, gains tend to be characterized more by issue selection than by group cyclicality. Historically, high quality reigns in the second year following a bear market. Earners outperform non-earners. Companies with higher returns on equity beat lower returning firms and the types of issues our philosophy leads us to tend to be rewarded. ▲

Gold Gets a New Shine (cont.)

Until a few months ago, any Eurobond, issued by any member government in the Eurozone, was a sovereign credit with the highest investment ranking as a store of value of any asset class, according to Basel rules for valuing the statements of financial institutions. Greece's bonds have already been downgraded to near-junk status, and downgrades to other PIIGS' bonds will surely be proceeding in coming months.

Gold mining companies' shares have naturally been splendid stock market performers ever since fear about government bonds, the banks that hold them and the economies that back them began spreading. Not only are gold companies' profits surging but, of more importance, the value of their unhedged reserves in the ground, in politically-secure areas of the world, is climbing far faster than the gold price.

Why faster?

Because the average gold mine doesn't make real profits until gold reaches \$700 an ounce, which means its net margins soar as the price of gold improves above the marginal level. Of even more importance to value investors, \$1,200 gold alchemically converts millions of tons of low-grade ore bodies classed as "possible reserves" or "resources"—with no values assigned—into highly-valued reserves. If you just own bullion, your returns track the metal's rise. If you own good stocks, you find you own more ounces of gold the higher its price climbs—and you didn't really pay a significant premium for that permanent option on those extra ounces.

A rational pessimist today is someone who thinks the Eurozone's problems will trigger a new recession—and buys some gold as a hedge against deflation and falling stock markets.

An existential pessimist today is someone who thinks that recession will be so severe that governments will print money so fast that currency and government bonds will become junk—and buys a lot of gold as a hedge against monetary inflation.

We are hopeful the Eurozone will muddle through somehow, so we don't class ourselves even as pessimists. But we're keeping an eye on gold. ▲

Benchmark Performance Summary

Benchmark	As of June 30, 2010					
	3 Month	Year to Date	1 Year	3 Year	5 Year	10 Year
S&P 500	-11.43%	-6.65%	14.43%	-9.81%	-0.80%	-1.59%
Russell 1000 [®]	-11.45	-6.41	15.22	-9.55	-0.56	-1.22
Russell 1000 Growth [®]	-11.74	-7.64	13.62	-6.91	0.38	-5.14
Russell 1000 Value [®]	-11.14	-5.11	16.93	-12.33	-1.65	2.37
Russell 2000 [®]	-9.93	-1.96	21.48	-8.60	0.36	3.00
Russell 2000 Growth [®]	-9.22	-2.31	17.97	-7.53	1.14	-1.73
Russell 2000 Value [®]	-10.59	-1.63	25.07	-9.85	-0.51	7.48
Russell Microcap [®]	-8.85	0.12	20.44	-12.15	-2.42	3.25
MSCI EAFE (Gross Div)	-13.75	-12.94	6.37	-12.94	1.35	0.56
MSCI All Country World Index (Gross Div)	-11.96	-9.11	12.30	-10.02	1.68	0.19
Barclays Capital Aggregate	3.49	5.33	9.50	7.55	5.54	6.47
Barclays Capital Inter Govt/Credit	2.97	4.56	8.29	6.98	5.26	6.06
Barclays Capital Long Govt Credit Bond	8.56	10.24	16.49	9.43	5.57	8.05
Barclays Capital Municipal Bond	2.03	3.31	9.61	5.50	4.40	5.63
Barclays Capital 3-15 Blend Muni	2.02	3.06	8.01	6.30	4.72	5.53
Merrill Lynch BB/B Constrained	0.31	4.53	21.65	5.60	6.10	6.65
Merrill Lynch 1-3 Govt/Corporate	1.01	1.94	3.79	5.04	4.47	4.69
Merrill Lynch 90 Day T-Bill	0.04	0.05	0.16	1.57	2.77	2.70
Merrill Lynch 6 Month T-Bill	0.11	0.17	0.45	2.42	3.28	3.10
30 Day T-Bill	0.03	0.05	0.09	1.13	2.50	2.41

Sources: Russell, MSCI, Barclays Capital, Merrill Lynch and Bloomberg

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