

Perspective

MANNING & NAPIER ADVISORS, INC.

June 2010

Economic Overview

Unless otherwise noted, all figures are based in USD.

The U.S. Economy

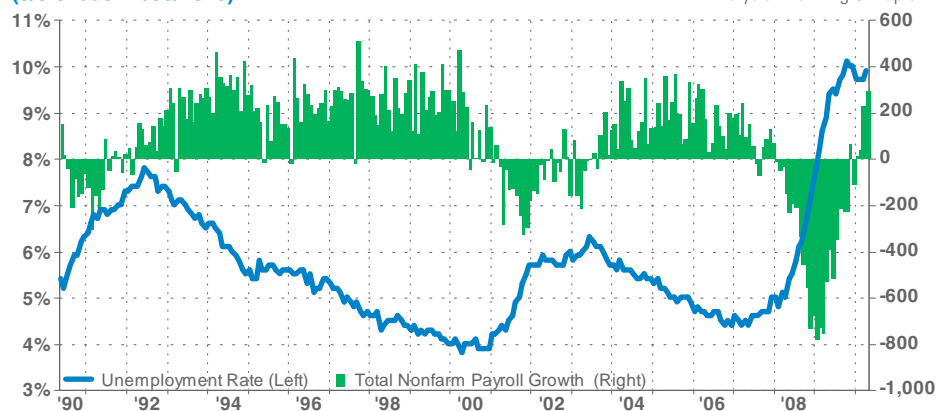
After three straight quarters of expansion, the U.S. recovery has become an established reality, yet the economic momentum could face some growing pains ahead. Following impressive gross domestic product (GDP) growth at the end of 2009, the U.S. economy expanded at a slower 3.0% annualized rate during the first quarter of 2010, and GDP has grown 2.5% compared to the recession conditions at the beginning of last year. Despite the deceleration in the quarterly growth rate, the composition of GDP contained several positive signs in the first quarter. Specifically, consumption increased at a 3.5% annualized pace, while business equipment and software spending accelerated by a stunning 12.7%. Inventory stabilization also accounted for about half of the quarter's GDP growth. On the other hand, several main areas detracted from growth, giving a mixed message for the next few quarters. Commercial real estate contracted at a double-digit pace, as did investment in residential real estate. Government expenditures also declined due to a drop in state and local government spending, and net external trade subtracted from GDP as imports grew faster than exports. Ultimately, while the economy has made noteworthy progress, the recent GDP details imply the recovery could be uneven going forward.

The rebound in the broader economy has finally started to make its way into the labor markets. After solid gains in March, non-farm payrolls rose by 290,000 month-over-month in April, representing the

U.S. Monthly Payrolls Growth & Unemployment Rate (5/31/1990 - 4/30/2010)

Source: FactSet

Analysis: Manning & Napier



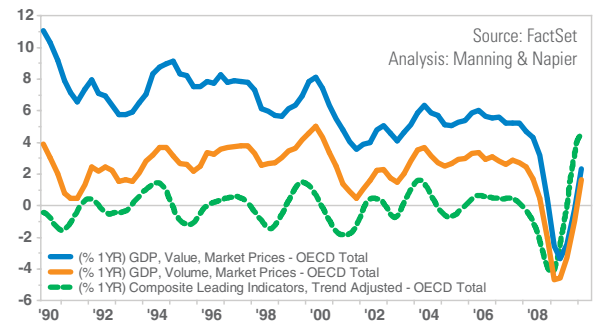
fastest pace in four years. The back-to-back increases send a firm signal that the U.S. economy is heading in the right direction, although in order for the recovery to advance much further, the labor markets need to experience even more extensive job growth. As for specifics, nearly every major sector added jobs in April, and temporary census workers comprised less than a fourth of the new hires, meaning most of the growth likely came from organic job creation. Meanwhile, the unemployment rate climbed to 9.9% from 9.7% in March, resulting from a surge in the labor force as workers began searching for jobs again. While that rise may be disappointing, the main drawback in the current employment situation relates to wages, which reflect the choppy nature of the unfolding recovery. Average hourly earnings have been down or flat over the past two months, and they've only increased 1.6% over the last year. The weakness in wages and the elevated unemployment rate seem at odds with the recent strength in consumer spending, suggesting that element of GDP growth may not be sustainable in the long run.

The U.S. economy is recovering from the damage of the downturn and the credit crisis, but the environment remains fragile. Important challenges continue to exist alongside the positive developments. For instance, the outcome of financial regulation remains uncertain; fiscal stimulus will likely start fading soon; and the year-over-year comparisons will become more difficult in the second half of 2010. These are just a few factors that could contribute to bumpy conditions going forward. With the economic outlook unclear, we believe focusing on company and industry specifics is essential for uncovering investment opportunities.

The Global Economy

In general, the economies across the world seem to be improving. After roughly a year of contraction, the thirty developed countries that make up the Organization for Economic Cooperation and Development (OECD) expanded on an annual basis in the first quarter. However, recent signs of recovery have been overshadowed by the potential sovereign debt crisis in Europe. With the attention on Greece's fiscal troubles, the European Union (EU) and the International Monetary Fund (IMF) agreed on a three-year rescue package worth €110 billion (\$145 billion USD) in an effort to give the Greek government time to lower its deficit without having to access the capital markets. Subsequently, amid fears that Greece's problems could spark a contagion effect, the EU and IMF also announced a major €750 billion (\$995 billion USD) Euro-area bailout plan to try to prevent the escalating debt crisis from spreading to countries such as Spain or Portugal. In additional support, the European Central Bank (ECB) has started purchasing Euro-area bonds to facilitate liquidity in the markets. That move marks a step toward more accommodative monetary policy, similar to action taken by the U.S. Federal Reserve and the Bank of England, but the ECB is attempting to sterilize its bond purchases to keep the money supply from swelling. While some of the weaker European countries face strict austerity measures that could stifle growth in the coming years, core European economies such as France, Germany, and the Netherlands have more solid fundamentals and more favorable growth prospects. As a whole, the Euro-zone has been recovering over the past three quarters, with a modest 0.8% annualized growth rate in the first quarter primarily driven by exports. Exports are fueling growth in Asia as well. Aided by trade to its rapidly-growing neighbors, Japan's economy expanded at a healthy 4.9% annualized rate in the first quarter, although the deflation-plagued economy has several structural issues beyond its cyclical recovery. All in all, the European sovereign debt crisis highlights that the global economy will likely have its ups and downs for some time, but differentiated recoveries continue to take place throughout the world.

GLOBAL (OECD) ECONOMY AND LEI
(6/29/1990 - 3/31/2010)



Inflation

As is often the case in the early stages of recoveries, there are minimal if any inflationary pressures currently in the U.S. Despite near-zero interest rates and billions of dollars in stimulus money, the Consumer Price Index (CPI) fell 0.1% in the month of April, and the headline year-over-year inflation rate now stands at 2.2%. Excluding food and energy prices, the core measure of CPI has slowed to a 0.9% annual rate – a 44-year low. The weakness in prices is fairly broad-based, and the recent decline in wages indicates that disinflationary forces could be present for some time as the economy digests the substantial amount of spare capacity leftover from the recession. Furthermore, survey-based and market-based inflation expectations remain stable, which supports our view that inflation will likely remain contained going forward, particularly in the less volatile core measures of inflation.

Our Perspective

In such an uneven economic environment, the gap between the winners and the losers can become large, which makes a selective investment approach even more important. Through our disciplined, bottom-up investment process, Manning & Napier continues to identify quality companies trading at discounts to their fair value. In addition to our fundamental investment strategies, several economic, valuation, and sentiment indicators are signaling that equities continue to present opportunities relative to bonds, in part due to the risk and reward dynamics in fixed income. Our economic indicators are modestly positive, although contrarian indicators such as corporate credit spreads and retail sales may not be as strong as their initial buy signal near the market bottom last year. In general, our valuation measures are neutral, as specific indicators such as dividend yields relative to Treasury bonds point to a broad market that is likely trading near fair value.

Our time-tested stock selection strategies continue to reveal Profile and Hurdle Rate opportunities in first-class, well-positioned companies, especially in growth areas such as Health Care and Information Technology, and hard-hit cyclical industries such as Airlines.

In the fixed income markets, the credit sectors continue to offer the best opportunities. While investment grade corporate bonds and below investment grade corporate bonds have performed quite well in 2009 and into 2010, the recent market volatility tied to the sovereign credit issues in Europe has increased their relative attractiveness. Mortgage-backed bonds currently offer little relative value, having benefited tremendously from the Federal Reserve's purchase program. However, as the Fed's program ended in March, this sector may present opportunities later in the year. In the tax-exempt marketplace, longer-term higher-quality municipal bonds remain attractive, reflecting the growth of the Build America Bonds program which has muted the supply of longer-term tax-exempt issues; the growing demand for tax-exempt bonds driven by impending tax increases in the top tax brackets helps as well.

Analysis: Manning & Napier Advisors, Inc. ("Manning & Napier")

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Sources: U.S. Department of Commerce, Bureau of Economic Analysis (BEA), Capital Economics, Goldman Sachs, Bloomberg, The Wall Street Journal, MSNBC.com, FactSet.