



Letter to Investors

Dr. Charles Lieberman, Chief Investment Officer

A quarterly report from Advisors Capital Management, LLC a registered investment advisory firm

Second Quarter 2010

ACM Quarterly Letter to Investors: July, 2010

Investor sentiment shifted very sharply this quarter once again, this time in a negative direction. Investors flipped from thinking that a solid economic recovery is underway to the idea that the expansion might give out under the weight of credit problems in Europe and, perhaps, fiscal austerity in the U.S. This loss of confidence encouraged a renewed interest in capital preservation, so money flowed into bonds, specifically government bonds, despite extraordinarily low yields. This behavior reveals more about market psychology than it does about the economic or investment outlook.

The media were filled this past quarter with a series of adverse events. These included the possibility of a default by Greece, budget problems across Europe, the possibility of fiscal austerity across Europe to address these budget problems, an unexplained equity market plunge, ongoing conflict in the Middle East from Israel to Afghanistan, populist policies domestically, and the worst man-made environmental disaster ever in the U.S. when BP's oil well collapsed. None of the events mentioned helped sentiment, but the real driver of the falling stock market was the fear of a double-dip recession.

Underlying economic fundamentals have improved quite dramatically, even if there are more problems to overcome. First, the excess inventory overhanging on new production has been worked off completely after a record rate of inventory liquidation. If anything, stocks are overly lean. For example, car sales have increased sharply off the lows of 2009, yet new car sales are still below the rate at which autos are junked. The computer replacement cycle was deferred during the recession, so PCs are far older and more obsolete than in the previous recovery. The collapse in our housing market has also been arrested and housing is in the earliest stage of a recovery. New construction declined so sharply that unsold new inventory is at 40-year lows. Homes prices have bottomed and have started to rise, once again.

There is a genuine confusion between the state of the economy, which is still not good, and the trend in the economy, which is headed for improvement. For example, the unemployment rate, despite its decline from 10.1% to 9.5%, is still very high and finding a job, especially for young people entering the workforce, is not easy. So the condition of the labor force is poor. However, the labor market's direction is good. We have gone from losing 700,000 jobs each month during the worst part of the recession to averaging about 100,000 new jobs monthly so far in 2010 (excluding census workers). As people are hired in the private sector, rising incomes will

permit increased spending, so business will, in time, hire more workers. Thus, it is far more likely that the small job gains we have experienced so far will gradually increase a bit faster and the recovery will gradually develop into a solid expansion. These gains are being overshadowed by the idea that the recovery should be stronger and the situation is far from satisfactory, as yet, particularly with an election coming up in the fall. So the rhetoric is running at a fever pitch, even if it is highly inaccurate.

The market's performance has reflected the issues and concerns discussed above. Fear of a double-dip encouraged some investors to seek safety. The decline in stock prices has been taken as an indication that the economy must be deteriorating. However, as the late Nobel laureate Paul Samuelson famously quipped, "Wall Street indexes predicted nine out of the last five recessions." (Newsweek 1966.) Rather than forecasting the economy, the selloff in stock prices suggests to me that investors remain extremely nervous and the scars from their dreadful experience in 2008 have not healed, as yet. Their thinking is that if it happened in 2008, it could happen again.

Anything is possible but certainly economic conditions have vastly improved. The banking system has been recapitalized. A slow recovery is underway. Companies have greatly restructured their balance sheets, refinanced debt at a record pace, and are now sitting on \$1 trillion in cash. Corporate profits have increased sharply and are almost back to their prior peak, even though the economy still has enormous excess capacity and has lots of additional room for growth. Household savings rates have rebounded and debt has been reduced. More can be done to improve each of conditions further, but the right trends are in place.

Our portfolios displayed more divergence of performance this quarter than usual, but all of them performed quite well relative to the market, given their objectives. Because the economy remains on a recovery track, in our opinion, we think the risk of a further large retrenchment in stock prices is lower than feared by the market, while the upside is considerable. And we intend to deploy our remaining excess cash, likely sooner rather than later.

(continued next page)

MANAGING IN THE QUARTER

A look back at ACM's strategic management decisions from the most recent quarter.

Fixed Income: Continued to purchase high yield and convertible bonds. Doing so should help protect clients in a rising interest rate environment. Should inflation move higher, and bond prices move down, we will look to buy in the mid-term time frame. In the meantime, we are continuing to operate with a yield curve bar-bell investment strategy.

Convertible Bonds: These securities continue to be very attractive for their bond features with the added potential for equity like capital appreciation. As equity prices move higher, these should follow suit.

Master Limited Partnerships: Increased weighting to MLP's for income oriented accounts. MLP's should continue to provide an inflationary hedge. During the quarter, MLP's experienced very healthy returns.

Trust Preferreds: Maintained weighting to trust preferred positions. These investments continue to provide recurring income while their prices have moved back to par. In some cases, the higher yielding preferreds now trade above par.

U.S. Equity: Our fundamental analysis provided stock selection to compliment our top-down approach in favor of a cyclical recovery.

Non U.S. Equity: Maintained our commitment in China for our Growth investors. Sold holdings with large exposure to Europe.

Letter to Investors



ADVISORS CAPITAL
MANAGEMENT

A quarterly report from Advisors Capital Management, LLC a registered investment advisory firm

Second Quarter 2010

Growth Commentary - John Petrides, Portfolio Manager

For the first time in five quarters, being overweight those sectors of the equity market favoring a cyclical economic recovery produced negative returns and slight underperformance versus the benchmark. Due to a flurry of economic and geopolitical concerns during the quarter, investors sought safety in cash and US Treasuries not seen since the first quarter of 2009. Tactically, we raised some cash mid-quarter, as we decided to create some dry powder to benefit if the market decline continued, as it did. However, we continue to find value in the equity market that should reward patient, long-term oriented investors, and continue to be overweight companies that will benefit from long term secular global economic growth that we expect will continue.

Volatility increased over the quarter, as investors reacted out of fear that economic conditions might deteriorate. But, in our opinion, the equity market and the growth strategy, in particular, is cheap from a fundamental valuation standpoint. Furthermore, the companies are high in quality from a balance sheet perspective. From a valuation perspective, on a weighted-average basis, the strategy trades at 10.3x 2011 price-to-earnings multiples, and 8.4x 2012, well below the S&P 500 at around 11.5x 2011, and its 50 year normalized multiple of around 15.5x. This suggests the market has little confidence in consensus earnings estimates. From a quality perspective, 27.2% of the growth strategy is comprised of companies in a net cash position (having more cash than debt) on its balance sheets. In addition, approximately 5% of the strategy has meaningful debt due in the next two years. So, if there is a lock-up in the credit markets from a fall out in the Eurozone countries, as some fear, the direct impact on these companies should be minimal. Finally, the strategy earns an average 5.9% free cash flow yield, an approximate 3% higher return than the current ten year US Treasury yield. In an environment where cash is king, the companies in the strategy have the flexibility to adjust to a changing economic environment to grow earnings and return cash to shareholders.

Overall, we continue to seek to invest in great business models trading at attractive prices with solid earnings growth. As

reported last quarter, the companies in the growth strategy announced over \$10 billion in share repurchase programs and participated in five M&A deals. During the second quarter, two companies in the strategy were bought out, over \$1.2 billion in share buybacks were announced, along with five more M&A deals – we think this trend continues.

Growth with Income Commentary - Dr. Charles Lieberman, Portfolio Manager

The Growth with Income portfolio performed in line with the market in the second quarter. This is the first quarter since early 2009 that the portfolio failed to exceed its S&P 500 benchmark. The market decline reflected concern with the strength of the recovery, with some people suggesting another leg down for the economy, a view that hurt equities.

The Growth with Income portfolio retains its pro-cyclical allocation, with over-exposures to consumer discretionary, industrials and financials and its under-exposure to utilities and telecom, healthcare, and consumer staples. Thus, it is very satisfying that the portfolio remained abreast of the overall market, despite a sharp decline in the equity market in the second quarter. We would have expected the portfolio to underperform in a down market.

We also raised some cash in this portfolio tactically around the middle of the quarter, reflecting our judgment that stocks might continue to slide. Some of that cash was reinvested a few weeks later and the rest is likely to be redeployed sometime soon. Even so, it remains our judgment that stocks are quite cheap and should perform better, as confidence rebounds in the economic recovery. The market decline has increased dramatically the number of stocks that we find attractive. So while we plan to put our cash to work, selecting from so many different choices is difficult. A year from now, we suspect investors will look back at the summer of 2010 as an excellent time to have invested, as they now see March 2009 with the benefit of hindsight.

Income with Growth Commentary - Dr. Charles Lieberman, Portfolio Manager

The equity market declined sharply in the second quarter, although the Income with Growth portfolio held its value and sharply

outperformed its benchmark, once again. As investors bailed out of “risky” assets, they fled into safer investments, which is typically what is held in this portfolio. The diversity of this income oriented portfolio also helped during the quarter, as Master Limited Partnerships (MLPs) fell in value in May, but rebounded in June. Some of these companies also benefited from dividend increases, which helped restore their luster.

Notably, the volatility of this portfolio is declining quite significantly. During the credit crisis, the volatility, or beta, of many of the components in this portfolio, certainly including MLPs, preferred stocks and real estate investment trusts, increased quite sharply to extraordinary historical levels. These companies were taken to be more vulnerable to disruptions in credit availability and they became highly sensitive to everyday market fluctuations. They performed as badly or worse than the market during the heart of the credit crisis in 2008 and early 2009. As financial market conditions improved over the past five quarters, the behavior of these stocks started to revert to their historical, much lower volatility. MLP volatility appears to have gone fully back to much lower, normal levels and other sectors, like REITs, are also experiencing an ongoing rapid decline in volatility. And with the decline in their volatility, they have rebounded quite sharply, both absolutely and relative to the overall market.

Many of the companies in this portfolio have worked hard to reduce leverage, raise capital, and retain cash flow. As their financial health has strengthened, investors have become ever more comfortable with them. The recovery in credit markets also implies that these firms will be able to roll over maturing debt more easily. And as they become financially stronger, we expect more of these firms to raise or restore dividends in the coming months and quarters.

(continued next page)

Fixed Income Commentary - Dr. Charles Lieberman & John Petrides, Portfolio Managers

Investors fled to U.S. Treasuries during the second quarter of 2010 out of concern that the economic recovery was faltering and fears of a default by Greece might disrupt credit markets. These concerns accounted for the decline in all "risk markets", notably in stocks. This also accounted for the underperformance of the Fixed Income strategy relative to the Barclays Aggregate during the quarter, since the benchmark includes a sizable allocation in Treasury debt. Our fixed income allocations are based on our longer term judgment that the economic recovery will gradually strengthen and a solid expansion will emerge in due course. Thus, we have been avoiding the lowest yielding, safest parts of the credit market, specifically U.S. Treasury debt and have focused our holdings in the corporate sector.

Given the weaker tone to the macro data reported in June and the events in Europe, we believe the Federal Reserve will remain on hold somewhat longer to insure that growth momentum continues to build. Most critically, we consider the risk of a relapse into recession to remain quite low. Prevailing low yields on US Treasuries reflect investor's fears of a repetition of the sell-off and crisis of 2008. We consider this unlikely, therefore we remain very comfortable with our strategic allocations. Indeed, we think a case can be made that U.S. Treasuries are in something of a bubble as some investors seek the ultimate in asset protection.

Our fixed-income allocations remain positioned for a gradual recovery. So we remain in a barbell maturity strategy, since the intermediate part of the yield curve is most vulnerable to a rise in interest rates that will occur in due course. We are also attracted to high yield and convertible bonds, which should hold their value far better when rates do rise.

Will You Have Enough Income for the Rest of Your Life?

According to a recent McKinsey study 69% of Boomers ages 54 to 63 are financially unprepared for retirement. Understanding your retirement living expenses and having realistic expectations of your investments are key components to a successful retirement plan.

ACM can help you overcome the challenges to retirement income planning. By completing our Retirement Income Planning Worksheet we will help you build a comprehensive plan that will;

- Cover essential expenses with existing dependable income sources such as Social Security and any pensions
- Fund discretionary expenses with other financial assets, including retirement plans, real estate and taxable accounts
- Provide an asset management strategy to help you ensure that your income can last a lifetime
- Build in contingencies to address key risks that retirees face, such as outliving their assets, inflation, asset allocation, excess withdrawals, and healthcare.

About an hour of your time can provide you with peace of mind and a realistic plan for the future. Call us today at 800-977-4424 and get started by having a retirement income planning worksheet sent to you.

ANNOUNCEMENTS

ACM Acquires Capital Advisors Wealth Management

ACM has acquired Capital Advisors Wealth Management, LLC (Capital Advisors) of Clifton Park, New York. With ACM having provided portfolio management services to Capital Advisors for nearly a decade, this acquisition was seamless and provides both organizations with additional financial services and expertise for their clients. Stan McDannold will head ACM's Clifton Park office.

ACM Approved Manager for the Regional Independent Broker Dealer, The Comprehensive Group

ACM's investment strategies are now available to investment advisors on The Comprehensive Group's platform.

ACM Quarterly WebCasts

ACM principals will discuss Q2 2010 results. ACM equity and fixed income strategies will be reviewed for holdings and allocation changes. Dr. Charles Lieberman, ACM's Chief Investment Officer will provide current economic and market commentary. Presentation time 45 minutes with open question and answer period.

WebCast for Advisors:
July 21, 2010 at 4pm EST

WebCast for Investors:
July 22, 2010 at 6pm EST

Visit www.AdvisorsCenter.com to register or view recordings.

ACM Expanding Wealth Management Services: Looking For Experienced Investment Professionals

Advisors Capital Management is expanding its wealth management services. We are seeking independent investment advisors, Certified Financial Planners and registered representatives. Registered representatives looking for combined broker dealer and investment advisory services can benefit from our unique investment management services, experience and diverse broker dealer relationships. Contact Kevin Kern for more information at 201-426-0081 or email at Kevink@advisorscenter.com

Q2 2010 Composite performance reports and ACM's Form ADV Part II are available upon request.

To receive weekly investment commentaries and event invitations via email, please visit www.advisorscenter.com.