Cary Street Partners
EXPERTS LEAD. SUCCESS FOLLOWS.

Market Matters Q3 2011

Quarterly Outlook

ISSUED NOVEMBER 2, 2011

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MARKET COMMENTARY

Trick or Treat

October 31, 2011

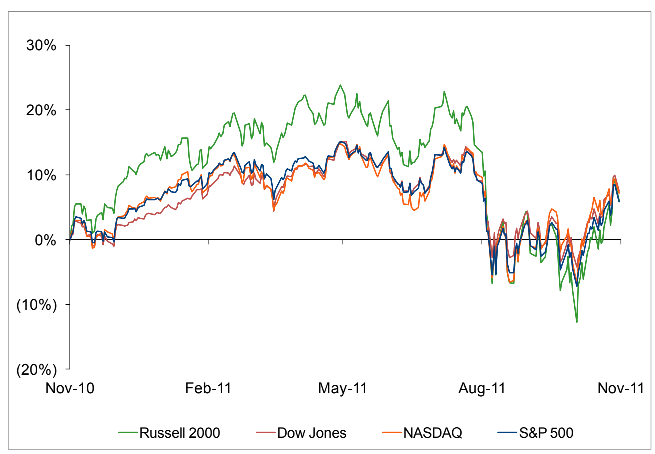
After a tricky period of stock market volatility in July through September, investors were treated to the best monthly performance through Friday for the S&P 500 in 37 years. In the September 27 issue of Leading View, we noted the potential for positive catalysts for stocks. Two of these catalysts were better than expected near term economic growth and Europe handling the Greek situation well sooner rather than later. Both of these catalysts contributed to the strong market for stocks since October 3.

During the late summer investors became progressively concerned about the potential of a double dip in the U.S. economy. A number of economic indicators for August tended to bolster these concerns. However, as reflected in the third quarter GDP report, consumption and capital spending performed well and the economy grew 2.5%, the best quarter for 2011. Nonetheless, consumer spending growth was aided by a drawdown in savings. With employment and wages still growing modestly, it is likely that aggregate economic growth for this quarter and next will not be much better than the third quarter results and could even be less in the first quarter of 2012. Meanwhile third quarter productivity growth may be 2.5-3.0% and this prospect has already been reflected in relatively strong earnings reports, with 70% of companies that have reported beating expectations.

The bigger boost to equities has been the actions that Europe has taken to quell a crisis of confidence in financial management of sovereign debt. Agreement was reached for the banks to take a 50% haircut on their holdings of Greek debt, for the European Financial Stability Facility to leverage itself to provide 1.4 trillion Euros support for future bond issues, and for banks to raise Tier 1 capital to 9% from 5% by June 2012. These measures are a positive step forward, but details are still lacking. Consequently, European credit markets did not participate in the bullish celebration by stock investors last week. We suspect that bouts of periodic volatility still lie ahead for stock markets in Europe and elsewhere.

The U.S. stock market burst out of its two month trading range last week. Strong price moves by the indices were supported by improving breadth of stock performance and by a growing number of new highs for the past 12 months. A strong move in stock prices with the aforementioned characteristics usually does not roll over and collapse. Stock prices may pull back from their surge, but should be supported by a relatively large amount of cash in investors' hands. Investors are likely to have been caught flat footed by the persistence and swiftness of the recent rise in the market. Moreover, they are aware that stocks usually perform well in the

LTM U.S. Equity Market Performance as of 10/31/11



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November to February period. Consequently the remaining two months in this year may represent a period when pressure increases to put cash to work in order to recover any previous loss in portfolio performance. Further supporting this view is the decline in risk as represented by the stock volatility index (VIX) falling from its high in the low 40s to the mid-20s. Finally, stock valuations remain reasonable at 12x expected 2012 earnings. This valuation is below the median of 14x during the past 10 years. Nonetheless, we note that profits growth expectations for next year are coming down and consequently, many stocks may not be as cheap as they appear.

On the cautionary side, we observe that the stock market has become overbought. An overbought condition is not always a negative especially during a strong market uplift. Nonetheless it does suggest some short term consolidation of recent gains. Investor sentiment has turned more bullish from relatively bearish levels in recent weeks. Bullish readings are not yet extreme, but are clearly no longer depressed. Over the next 12 months we expect that U.S. economic growth will be slow, perhaps 2.0% to 2.5% at best. Some quarters may be slower, some a bit more robust. This perspective setting will weigh on profits growth. Moreover, European economic growth is likely to be very slow over the next year or more. If credit spreads narrow, European equities may perform well, but if they widen, volatility will return. Europe remains a long term workout, as does the U.S.

The next potential catalyst for the U.S. market is action by the Congressional Super Committee at Thanksgiving time. We certainly hope it will not be a turkey. With the public perception of Congress quite negative already, we believe that positive developments may be forthcoming to bring down the budget deficit. Members of Congress are certainly cognizant of next year's election season. This should provide some motivation for producing an agreement. We suspect any agreement will contain tax reform. Failure to produce an agreement would bring a huge cut in defense spending, further aggravating the jobs picture and clouding the future for members of Congress in districts dependent upon defense spending.

Finally, while stock market leadership this month has been in value stocks and in mid cap issues, we continue to advocate a focus on growth, especially large cap growth stocks, because of our belief that economic and profits growth will be slow in 2012. Yield will also remain a solid theme in the equities sector. Looking toward 2012 to 2013 we believe emerging markets, which declined 20% this year before a recent rebound, are beginning to look more interesting. Many of the constituent countries have raised interest rates to dampen inflation. Assuming relatively slow global growth in 2012, inflation should be contained, opening the prospect of easier monetary policies in emerging markets in 2012 and 2013. We suggest using any near term volatility to either begin to build positions in emerging markets or to add to existing holdings.

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CAPITAL MARKETS UPDATE

Mergers and Acquisitions

The strong start to the year brought optimism that the U.S. M&A market would see a sustained rebound in deal activity, as deal volume in the first half of 2011 increased 9.4% from the first half of 2010, with aggregate deal value up 86.5%. However, M&A activity deteriorated in the third quarter as deal volume decreased 14.3% from the previous quarter, representing the largest decline through ten previous quarters. Aggregate M&A spending dropped 10.0% to $222.9 billion from $247.6 billion in the second quarter. Several macroeconomic factors contributed to the reversal of the positive trend including concerns over the global debt crisis, volatility in the equity markets, and the threat of growing inflation.

Despite the gloomy statistics, the third quarter boasted several blockbuster deals. Express Scripts agreed to purchase Medco Health Solutions for $29.1 billion, the largest deal in over ten years among U.S. companies that manage prescription-drug benefits. Hewlett-Packard's $10.3 billion acquisition of Autonomy represented a strategic shift for the company towards software and services. The deal was the largest in the computer and software industry, which was the most active sector through the third quarter, with 1,264 announced transactions and total deal value of $78.9 billion.

Private equity buyers remained active throughout the third quarter. While volume declined 4.5%, aggregate deal value saw a year over year quarterly increase of 15.5%, with $60.9 billion in transactions versus $52.8 billion in 2010. While it received little attention, the number of billion dollar exits has increased in 2011 with 40 completed thus far, yielding $123 billion in proceeds.

Looking forward, we believe concerns over the debt crisis in Europe, slow global economic growth, and stock market volatility may temper some M&A market participants. That being said, there remains significant enough interest and available capital to continue to drive deal volume for the foreseeable future, particularly in sectors like energy and healthcare where entities are seeking scale or new avenues to reposition themselves against changing market dynamics.

Financing Markets: Debt

Negative macroeconomic influences that created headwinds in the debt markets in late Q2 continued in the third quarter, causing lenders and investors to remain cautious. Following a relatively positive start to the year, commercial and non-commercial lenders tightened their standards as they reassessed their outlooks on the market. As a result, loan issuance experienced a drastic slowdown in Q3. Investors bought U.S. Treasuries in a 'flight to safety' in the quarter, pushing 10-year Treasury yields down 126 bps to 1.92%.

U.S. investment-grade corporate bonds delivered a +2.85% return in Q3, 511 bps below similar-maturity Treasuries for the period. During the quarter, solid fundamentals were overshadowed by the signs of a global economic slowdown, which caused U.S. corporate bond spreads to reach close to recessionary levels, widening by 85 bps to 238 bps over Treasuries. Even with widening spreads, U.S. corporate debt pricing remained relatively stable compared to other sectors given the overall market volatility. However, U.S. investment grade issuance was down 22.7% relative to last quarter. This year's total issuance has increased 2.2% compared to the first nine months of 2010 despite the third quarter results.

U.S. high-yield bonds were down -6.3% during the third quarter as risk-averse investors fled towards more 'safe haven' sectors. Spreads in the high-yield sector continued to rise, and in Q3 jumped 241 bps to 808 bps over similar-maturity Treasuries, reflecting both the sharp decline in Treasury yields as well as the rise in non-investment grade securities. These high-yield spreads are now at their widest point since October 2009, which is a notable indicator of the current market sentiment. Year-to-date, high-yield bonds are down 1.7%. Further, high-yield loan issuance experienced a sharp decline in activity in the third quarter, following a strong first half of the year when we saw a record issuance. Through the first nine months of 2011, $187.1 billion of high-yield bonds were issued. In the longer term, we would expect improved market conditions as investors seek out more current income, and because many potential issuers are better positioned than in previous years due to their liquidity levels and abilities to refinance at attractive interest rates.

In light of recent market conditions, commercial and non-commercial lenders have tightened credit policies. Cash flow lenders are taking a stricter view of the market and are being more selective in lending to sub-$10 million EBITDA companies, volatile sectors and non-sponsored transactions. As always, lower middle market credits face an uphill battle in accessing cash flow lenders, and those lenders who are willing to do a cash flow loan are often hesitant to go above 2.0x EBITDA given continued macroeconomic concerns. Nevertheless, commercial lenders are being aggressive for superior credits even in the middle market, with pricing in the L+2.50%-3.25% range. According to the Federal Reserve, commercial and industrial loans rose by 4% in September and by 35% in the third quarter over the prior year. While pricing may have backed up for the moment, we see banks continuing to look aggressively for commercial and industrial loans as they are otherwise seeing a fall off in overall loan demand.

Financing Markets: Equity

Market volatility and macroeconomic uncertainty posed significant pricing challenges during the quarter, resulting in a significant decline in IPO activity. Only eighteen companies went public during the quarter, the lowest level of quarterly IPOs in two years. Of the eighteen total offerings, fourteen were before the end of July. With the IPO window effectively closed, the pipeline became clogged with potential issuers.

The eighteen companies completing IPOs during the quarter raised \$3.5 billion, a 72% decrease from the \$12.3 billion raised by 46 companies in the second quarter of 2011. When compared to the third quarter of 2010, the story is much the same with decreases in both the number of offerings and total deal value.

Private equity and venture capital exits continued to drive the activity in the U.S. IPO market, as these firms backed eleven of the offerings generating \$1.8 billion in value. The mega offerings seen in the first half of 2011 came to a halt as no single offering exceeded \$1 billion during the quarter. The largest offerings during the quarter were SandRidge Permain Trust, an acquirer and holder of royalty interests in oil and natural gas properties (\$540 million); followed by Dunkin' Brands, a quick service restaurant franchise (\$423 million); and C&J Energy Services, a specialty equipment provider to the oil and gas industry (\$334 million).

Consumer, technology and energy growth stories attracted IPO investors into these sectors during the quarter. Consumer and technology companies garnered approximately 50% of the total proceeds raised. Excitement around U.S. natural gas shale plays provided support to the energy sector. Highly visible, subscription -based revenue models were the story in technology.

As we look to the end of the year, companies are continuing to "hurry up to wait" as financial sponsors look for exits and private companies seek to take advantage of investors' desire to take part in growth stories. With market volatility likely to continue, we believe the IPO market will remain challenged for the balance of the year except for very strong and dynamic companies.

Financing Markets: Venture Capital

Venture capital ("VC") investment activity declined in the third quarter in terms of both dollars and deal volume. Venture capitalists invested \$7.0 billion in 876 deals during the quarter, representing a 12% decrease in capital invested and a 14% decline in the number of deals compared to Q2 2011.

Amid the market turbulence, the Software industry emerged as a bright spot for VC activity. It received the highest level of funding among all industries, attracting \$2.0 billion of investment during the third quarter. This was a 23% increase in dollar investment compared to the second quarter and the highest quarterly investment in Software since the fourth quarter of 2001. Contributing to that figure was Twitter's \$800 million round completed in July (\$400 million of which was used to cash out existing shareholders), the largest VC deal in the quarter valuing the company at nearly \$7 billion. Cvent, Inc., a McLean, VA based event and e-marketing software company, raised \$136 million.

Software was clearly an exception to the overall market trend, as fourteen of the seventeen sectors profiled by PWC MoneyTree saw a decrease in dollar investment in the third quarter. Most notably, investments in the Life Sciences sector (Biotechnology and Medical Devices) fell 18% in dollars and 21% in deal volume. Uncertainty in the regulatory and reimbursement environment for Life Sciences companies may be prompting VCs to look to other industries for faster returns on investment.

Overall, we see mixed indicators in the venture capital industry. The virtual shutdown in the IPO markets in September and October had a negative impact on VC exits. Fundraising levels are the lowest they have been in nearly a decade. Still, there are some signs of optimism. In the first three quarters of 2011, venture capitalists invested \$21.2 billion into 2,725 deals, representing 20% more dollars and 3% more deals than the first three quarters of 2010. If deal activity picks up slightly in this quarter, 2011 could yet be one of the strongest years for capital commitments in recent VC history.

INVESTMENT BANKING SECTOR COMMENTARY

Business Services & Technology Group

Through our Business Services & Technology Group, Cary Street Partners serves middle market companies in a variety of sectors. Among others, these include:

- consulting,
- information technology services,
- marketing services,
- outsourcing/BPO,
- software-as-a-service and tech-enabled services,
- staffing, and
- distribution and logistics.

Despite recent market volatility and macroeconomic worries, we continue to see strong interest in these sectors from both strategic and financial buyers. As organic growth prospects remain tempered in the near term, strategic players are looking for acquisitions to gain scale. Professionally-run organizations that fill a specific niche are attractive targets. Among private equity groups, companies that provide cost-reduction or efficiency-driven solutions, particularly ones with a highly leverageable, technology-driven product enabling the solution (e.g. transaction processors or revenue cycle management), are very appealing as new platform investments in this environment.

To pick out one of the sectors mentioned above, we are seeing some interesting dynamics in the marketing services space. Online marketing and related services (e.g. SEO, design, e-commerce, social media solutions) remain hot as Internet access and usage expand, and social media continues its dramatic growth. This is exemplified by Web.com Group's announcement on August 3rd that it would acquire Network Solutions, LLC, a provider of online marketing and other Internet services, at an implied enterprise value of approximately $760 million. Web.com Group saw the acquisition as an "opportunity to create the largest online marketing solutions company focused on the $19 billion web services market for small and medium sized businesses (SMBs)." Likewise, rapid growth of mobile usage and mobile web browsing has created tremendous opportunity for mobile advertising and solutions companies.

Even providers of more traditional marketing solutions such as direct mail advertising have continued to garner investor interest in recent quarters. Direct mail advertising is generally viewed as a relatively cheap and very targeted form of marketing. It has historically grown faster than other modes of advertising during periods of slow and moderate economic growth (conversely, in periods of strong economic growth, direct mail services tend to underperform as marketing budgets expand). The industry remains incredibly fragmented as its four largest players – Valassis Communications, Harte-Hanks, Vertis Communications and Transcontinental – hold a combined market share of less than 20%. As a result, we foresee continued consolidation initiatives in the space. We are currently working with a direct marketing provider and have seen solid investor interest first hand.

Among some of the other business services sectors, there were a couple of large strategic acquisitions of note last quarter in information management and business process outsourcing (General Dynamics/Vangent, Inc. at a $1.3B enterprise value; 1.8x EV/Revenue; 14.9x EV/EBITDA) and staffing (Randstad North America/SFN Group, Inc. at a $732B enterprise value; 0.4x EV/Revenue; 10.2x EV/EBITDA).

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MARKET DATA

Domestic Equity Markets

Returns	Q3 2011	LTM
Dow Jones	(12.1%)	1.2%
NASDAQ	(12.9%)	2.0%
S&P 500	(14.3%)	(0.9%)
Russell 2000	(22.2%)	(4.7%)

Source: Capital IQ.

International and Emerging Equity Markets

Returns	Q3 2011	LTM
EAFE (Europe, Australasia, Far East)	(19.6%)	(12.0%)
Europe	(23.0%)	(14.4%)
Pacific ex Japan	(20.9%)	(14.4%)
BRIC (Brazil, Russia, India, China)	(26.3%)	(25.2%)
World ex USA	(19.6%)	(11.7%)

Source: MSCI Inc.

Hedge Funds

Returns	Q3 2011	LTM
CSFB Tremont Hedge Fund Index	(4.8%)	1.3%
HFRI Fund Weighted Composite Index	(6.2%)	(0.4%)

Source: FactSet.

Interest Rates

	9/30/2011	6/30/2011	9/30/2010
Federal Funds	0% - 0.25%	0% - 0.25%	0% - 0.25%
LIBOR - 3 Month	0.37%	0.25%	0.29%
10 Year Treasury	1.92%	3.18%	2.53%
30 Year Treasury	2.90%	4.38%	3.69%

Sources: Wall Street Journal and U.S. Department of the Treasury.

Key Economic Indicators

Unemployment Rate	9.1%
Capacity Utilization	77.4%

	S&P Earnings Growth*	GDP Outlook*
2010	**47.3%**	**3.00%**
2011	*16.4%*	*1.70%*
2012	*11.6%*	*2.00%*
Q2 '11	**18.9%**	**1.30%**
Q3 '11	*15.5%*	**2.50%**
Q4 '11	*14.7%*	*2.00%*

Sources: Standard &Poor's Index Services and Bloomberg.

Initial Public Offerings

	Q3 2011	Q2 2011	Q2 2010
Number of Deals	20	49	39
Aggregate Value ($MM)	$3,138	$12,273	$5,071

Q3 Notable Deals†:	Date	Amt ($MM) (1)	Return (2)
SandRidge Permian Trust	8/10/11	$540	(6%)
Dunkin' Brands Group	7/26/11	$423	46%
Francesca's Holding	7/21/11	$170	25%
Zillow	7/19/11	$70	37%

(1) Excludes underwriter over allotment.
(2) Represents performance from IPO date through September 30, 2011.
Sources: PriceWaterhouseCoopers and Renaissance Capital LLC.

Venture Capital

	Q3 2011	Q2 2011	Q3 2010
Number of Deals	876	1,015	850
Aggregate Value ($MM)	$6,952	$7,885	$5,307

Q3 Notable Deals†:	Date	Amt ($MM)	Industry
Twitter, Inc.	9/8/11	$800	Social Media
Reata Pharmaceuticals	7/13/11	$300	Biotechnology
Bloom Energy	9/15/11	$150	Fuel Cell Tech.
Cvent, Inc.	7/20/11	$136	Software

Sources: Capital IQ and PWC MoneyTree.

High Yield New Issuances

	Q3 2011	Q2 2011	Q3 2010
Number of Deals	46	174	136
Aggregate Value ($MM)	$26,503	$82,689	$70,494

Source: Thomson Reuters.

Mergers & Acquisitions

	Q3 2011	Q2 2011	Q3 2010
Number of Deals	2,260	2,535	2,353
Aggregate Value ($B)	$223	$248	$202

Q3 Notable Announced Deals†:

Target	Acquiror	Date	Equity Value ($MM)
HSBC US Credit Card Bus.	Capital One	8/10/11	$32,190
Medco Health Solutions	Express Scripts	7/21/11	$28,529
Motorola Mobility	Google, Inc.	8/15/11	$11,935
CNX Gas Company	Noble Energy	8/18/11	$5,409

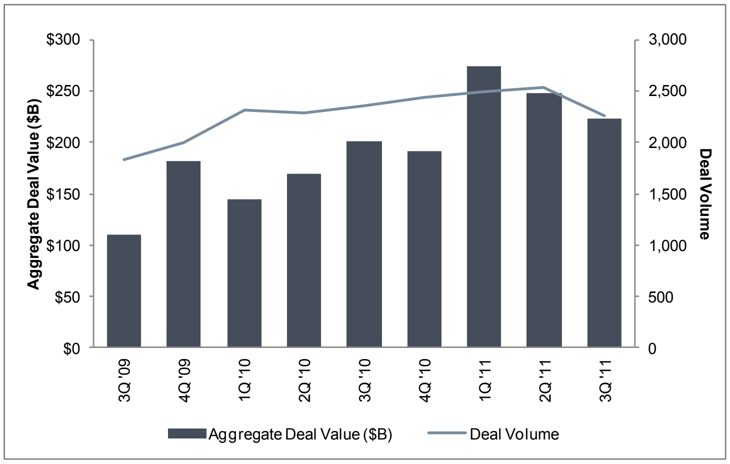
Sources: Mergerstat and Capital IQ.

* S&P Earnings Growth and GDP Outlook statistics are derived from third-party, non-affiliated analyst estimates. Cary Street Partners does not make estimates. Actual figures are in bold and estimates are italicized. Figures subject to change. Data as of 10/27/11. **Please refer to Page 8 for additional important disclosures.**

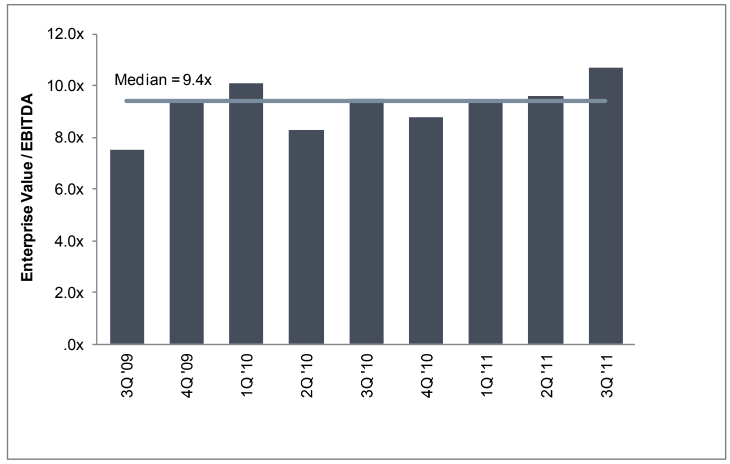
† Notable deals presented herein were selectively chosen by Cary Street Partners as deals which, in our opinion, are representative of recent activity in that sector of the capital markets. This is not an exhaustive list. **Please refer to Page 8 for additional important disclosures.**

MARKET DATA

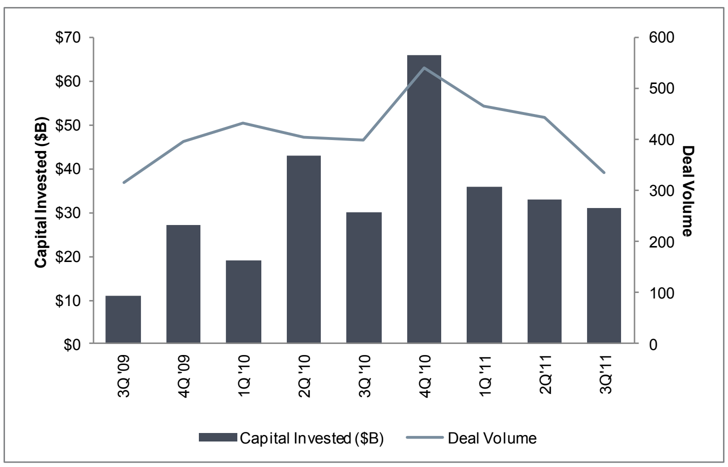
U.S. M&A Activity



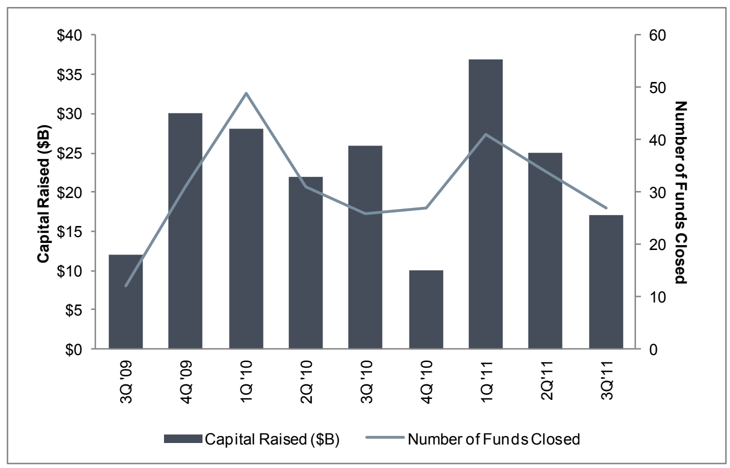
U.S. Middle Market M&A Multiples



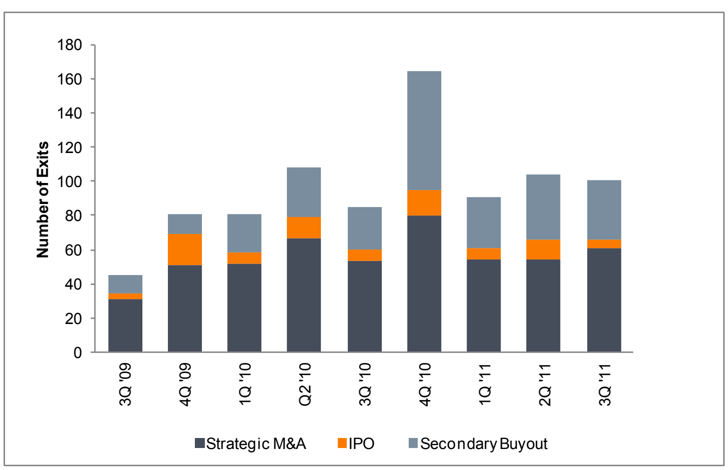
U.S. Private Equity Investment Activity



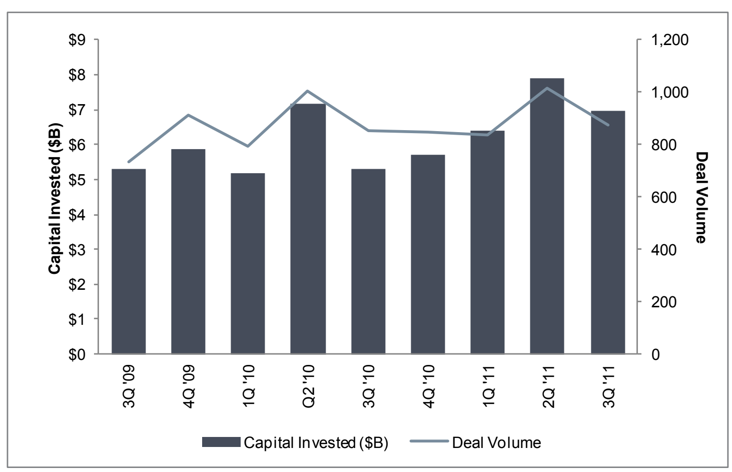
U.S. Private Equity Fundraising



U.S. Private Equity Exits



U.S. Venture Capital Activity



Sources: FactSet Mergerstat; PitchBook Data, Inc.; Thomson Reuters.
Note: "Middle Market" defined as transactions with an enterprise value between $1 million and $500 million.

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