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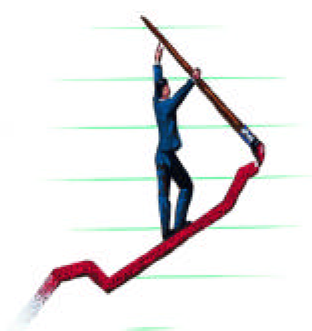
First Quarter 2010

LEAVELL INVESTMENT MANAGEMENT

Investment Commentary

The first quarter of 2010 was a good one, with U.S. stocks enjoying healthy gains and bonds earning at least small positive returns. Following a strong March, all domestic equity asset classes are now well into positive territory year-to-date. The Standard & Poor's 500 Index was up 5.4% for the quarter, while the S&P Midcap 400 benchmark returned 9.1% and the small-cap Russell 2000 gained 8.9% for the first three months. Foreign stocks also posted strong gains in March and are now in the black for the year so far, with the MSCI EAFE international stock index up 0.2% for the quarter after a 5.5% gain for the month. Turning to fixed income, the domestic intermediate-term, investment-grade Vanguard Total Bond Market Index gave up a bit of ground (-0.1%) in March, though it posted a positive 1.7% return year-to-date.



A year ago the stock market had just started its rebound from the depths of the worst bear market in over 70 years. The powerful rally in "risk" assets over the past year is certainly comforting. The worst case of a great depression has been avoided but the global economy continues to deal with the aftermath of significant wealth destruction and the reality of coping with the decades-long trend of expanding indebtedness. We have seen massive growth in debt throughout society, reaching excess levels in the last decade.

The path to the current process of deleveraging (reduction of debt) is generally understood by investors. The generation that grew up in the 1930s had learned to minimize debt. Debt relative to income was less than 40% in 1950. But over time new generations of adults increasingly viewed the economic collapse of the thirties as something that would not be repeated for various reasons and they thus became more and more comfortable with borrowing. By 2008 household debt relative to annual income had more than tripled from the 1950 level, hitting 130%. During this period borrowing supported a large portion of consumer spending and economic growth. There was a particularly steep acceleration of indebtedness in the 2000s as many used credit cards and home equity to amass large debt relative to their earning power. The belief that home values would continue their relentless increase, coupled with inadequate lending standards, created an environment of complacency on behalf of borrowers and lenders alike. It is now abundantly clear that the deleveraging process has started for households with their debt recently declining at the fastest pace since 1942, certainly a positive step for household balance sheets.

From a macro-perspective, spending by the government has kept the economy moving at a reasonable pace, though the longer-term cost of massive deficits will have to be dealt with at some point. Shifting gears to cut budget deficits will have to be managed more delicately to prevent another period of economic weakness. The recent economic strength stems mostly from the stimulus spending and smaller inventory drawdowns. It is important to note that both of these factors are temporary in nature.

Impressive strength has been shown by the manufacturing sector and there remains plenty of room for further growth given current capacity utilization. In normal economic cycles the consumer is the key to sustained growth, representing approximately 70% of Gross Domestic Product. The weakness in this critically important sector will be challenging for policy-makers over the next couple of years and the management of governmental stimulus policies will be important in maintaining positive economic growth.

There are several important variables to a strong and sustainable economic rebound, but jobs are the most important. The big question is not whether the job picture will improve, but how much it will improve and how quickly. While the labor market remains very weak, monthly job losses likely peaked some time ago, and we appear to be entering a period of net job creation. The Congressional Budget Office projects that the unemployment rate will be back down to 6% by 2013 and 5% by 2014. These certainly seem to be aggressive projections, but there can be little doubt that we are moving in the right direction towards creating new jobs.

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Other issues to contend with in the months ahead include huge amounts of commercial real estate debt coming due, continued strains in the housing market, and possible inflation down the road from deficit spending. However, there are certainly some positives that could contribute to a better outcome, including continued strength from emerging economies.

Domestically, we could see stimulus spending, low interest rates, and inventory rebuilding create a virtuous circle in which businesses with strong balance sheets add jobs, and consumer and business confidence builds and feeds on itself.

As we have all experienced in the last twelve months, adherence to a well thought out investment strategy and asset allocation is critical to meeting your long term objectives and goals. Though often unsettling, market volatility is a byproduct of free markets and often provides the opportunity for the commitment of capital in an appealing risk/reward scenario. We will continue to take advantage of such opportunities when available and adapt our investment philosophy to the ever-changing global market environment.

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