



ATLANTIC TRUST
PRIVATE WEALTH MANAGEMENT

Economic and Investment Overview
Third Quarter 2011

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Economy

- U.S. economic growth faded in the first half of the year
- Uptick in growth expected in the second half
- Budget issues will dominate in Washington, D.C.
- Euro sovereign debt woes will be a source of market angst for the foreseeable future

Equities

- Returns volatile—but ultimately flat—in second quarter
- U.S. equities attractively valued
- Corporate America: Impressive profit growth and balance sheets
- Emerging market equity fundamentals improving

Bonds

- QE2 ended, with mixed results
- Private sector credit formation critical to boost the economy
- Corporates: Spreads widen, yields still low
- Munis: Market volatility has subsided

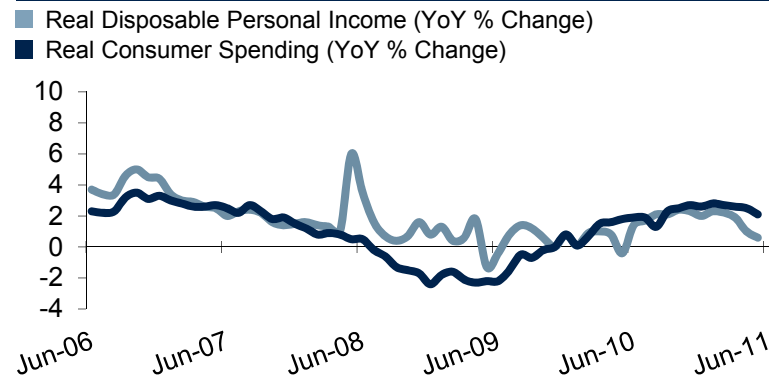
Asset Allocation Themes

- U.S. Equities: **Large caps** and **long/short hedge funds** most attractive strategies
- **Emerging markets** equities, local currency debt and commodities will benefit from pickup in global economic activity
- Very low bond yields make **alternative sources of income** attractive: EM and senior bank debt, energy MLPs and diversified equity income
- **Real Estate**: Opportunities in distressed real estate, as buyers and sellers become realistic

Slow growth gets even slower

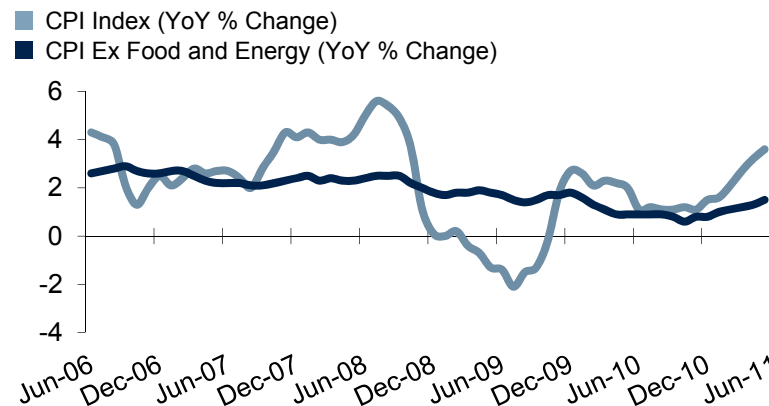
- While the expansion continues, momentum came to an abrupt halt for the U.S. economy in the second quarter.
- Weighing on the economy were:
 - Higher energy prices acting as a tax on consumers
 - Constrained production due to parts shortages from quake-stricken Japan
 - Renewed weakness in the housing markets
- These factors are largely temporary, and we anticipate somewhat stronger growth for the rest of 2011. Even with this expected improvement, the economy is likely to remain stuck in a slow growth channel. Private sector deleveraging continues and public sector stimulus is waning, constraining income and spending.
- Growth and inflation news out of China will be critical for the global economy. The prime minister's recent declaration of "victory" over inflation may signal an easing of restrictive monetary and fiscal policies in the months ahead.
- The recent pullback in commodity prices should allow the headline U.S. inflation rate to slow in the months ahead. Core inflation, excluding food and energy, remains well contained.

Consumers Struggling



Source: Bloomberg, LP, 5/31/11

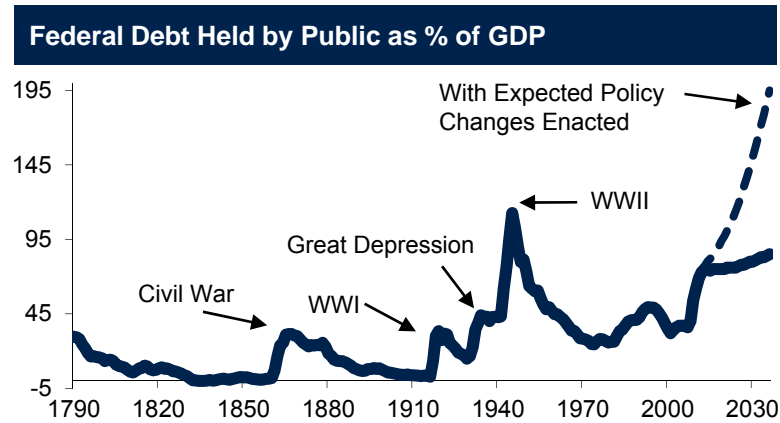
Inflation Pickup Mostly Due to Higher Energy Prices



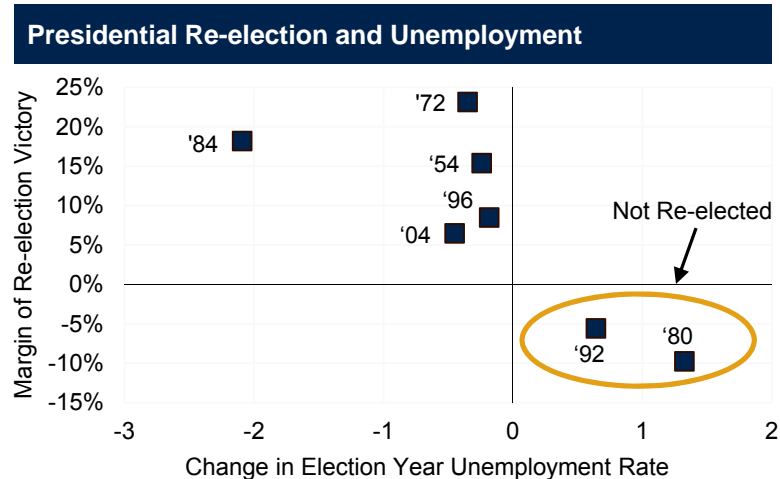
Source: Bloomberg, LP, 5/31/11

Government debt remains a big problem

- Financial markets are very focused on both the short-term debt ceiling debate in Washington as well as the long-term trajectory of government obligations. While not assured, a deficit reduction package is likely to pass in July in conjunction with an increase in the debt ceiling.
- The long-term debt challenge is profound. As the chart shows, more fundamental budget reform beyond this summer's likely compromise will be necessary to avoid an unsustainable debt burden. Such reform is unlikely to be considered until after the 2012 election.
- Slow economic growth leading up to an election year complicates the calculus for elected officials—especially the president. The importance of reducing the accumulating \$14 trillion federal debt is balanced by fears that austerity in the short term could further weaken the economy.
- While a short-term funding fix for Greece has been agreed to, a variety of sovereign debt problems in Europe will likely persist for years. This will continue to be a source of sporadic market volatility.



Source: Congressional Budget Office's Long-Term Budget Outlook, data after 6/30/11 is projected.

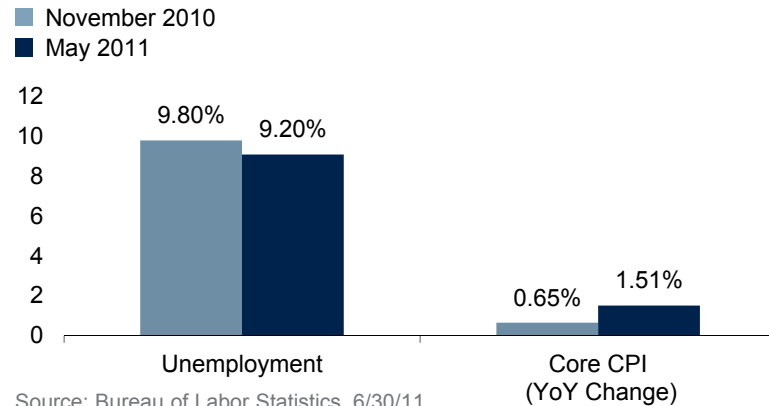


Source: Strategas, 6/30/11

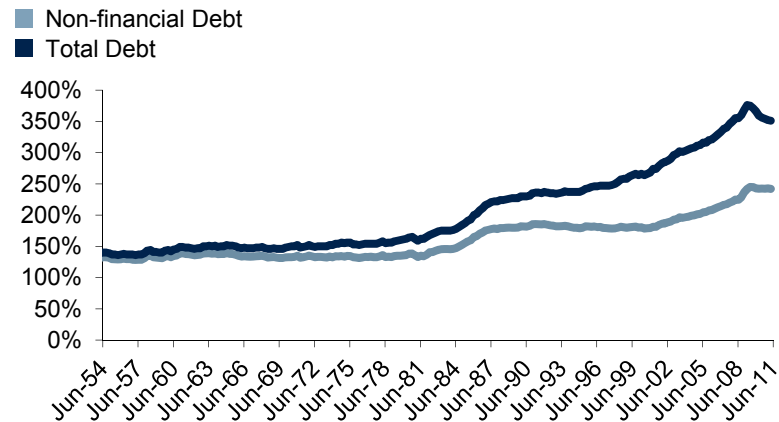
QE2 postmortem

- The Fed's second Quantitative Easing (QE2) program ended, as scheduled, on June 30. The Fed introduced QE2 with the expectation of reducing unemployment and averting deflation. Modest progress was made on both fronts, but looked tentative following a quarter of soft economic data and a pullback in commodity prices.
- Sustainability of the expansion will require private sector credit formation to replace QE2 and other government-engineered initiatives.
- Developed economies are not ready to take on more leverage; further deleveraging is required before organic private demand for credit can take root.
- Fed Chairman Ben Bernanke set expectations for a variety of approaches to persistent economic weakness, but QE3 is not likely at this point.

QE2 Focus: Unemployment and Deflation



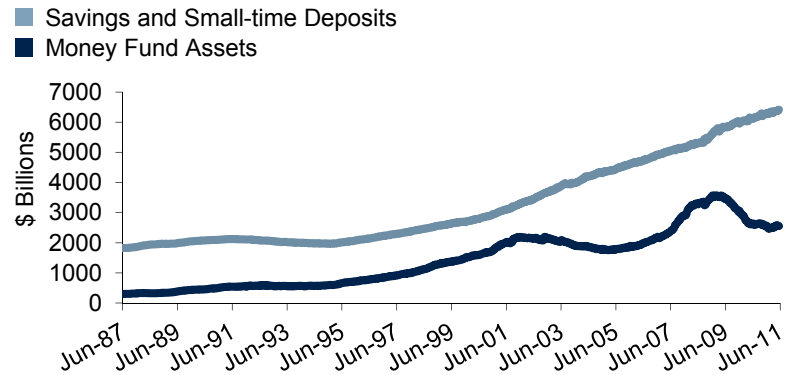
Debt to GDP Ratio, Private and Public Sectors



Mini flight to quality

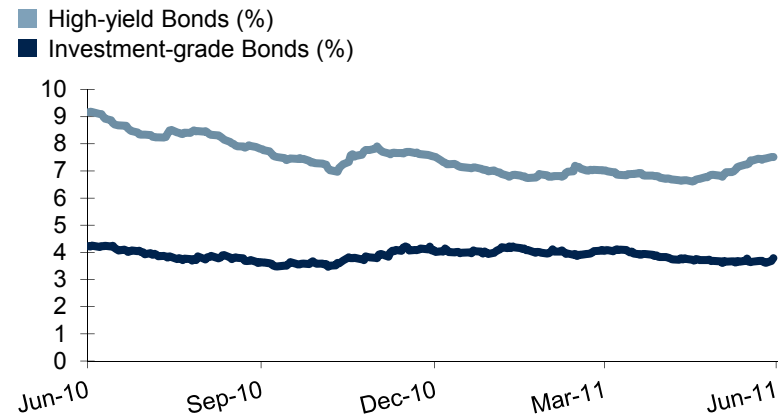
- Domestic banks are gathering deposits despite low rates and should continue to have the ability to improve balance sheet quality.
- U.S. branches of foreign banks are heavy issuers of commercial paper, making them big players in money market funds; this raises contagion risk if there is a “credit event” in the European periphery and partially explains investor preference for bank deposits over money markets.
- To date, high-yield bonds have borne the brunt of the Greek debt crisis, with a limited impact seen on investment-grade sectors. Cost of capital to investment-grade corporations has risen relative to the U.S. government, but the absolute cost of debt remains near the historic low.
- The recovery in municipal sentiment has improved the cost of capital for those entities, as well, but the political cost of debt-funded spending is likely to restrict an expansion of municipal supply over the coming quarters.

Investor Preference for Money in the Bank



Source: Bloomberg, LP, 6/30/11

Corporate Bond Yield

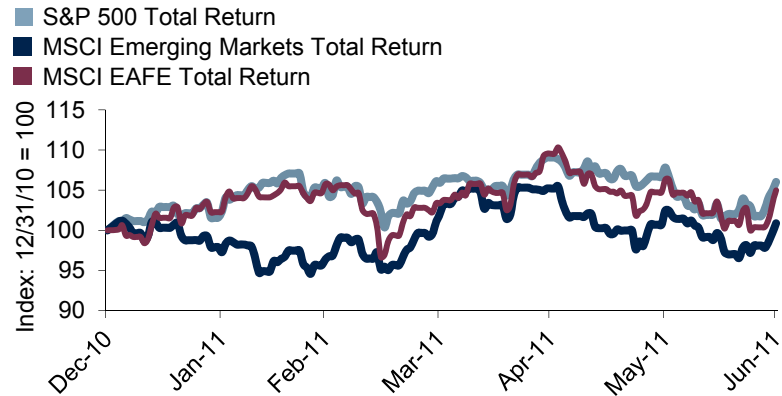


Source: Bloomberg, LP, 6/30/11

Despite mini correction, equities still in positive territory

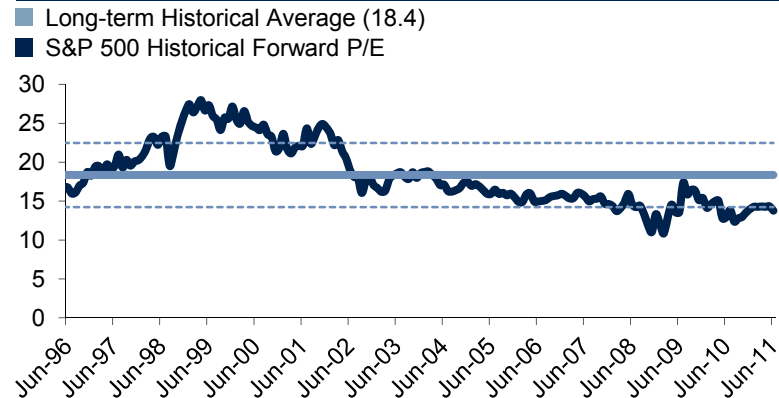
- Despite falling nearly 3% from its April peak, the S&P 500 was up 6% in the first half of the year. Stronger than expected corporate earnings more than offset weaker economic activity.
- Despite near-term volatility, equity valuations remain moderate. Earnings estimates have continued to rise during the first half so that multiples on expected profits remain well below their long-term averages. Profits on the Standard & Poor's 500 Stock Average are forecast to increase by at least 10% in 2011, which means that the multiple on expected earnings for the year ahead is roughly 13 times.
- A key issue for equities going forward will be how long the divergence between strong earnings and a weak economy can persist. Most of the negative macroeconomic headwinds are likely reflected in stock prices, and economic activity should pick up a bit in the second half of this year. We anticipate moderate upside for equity prices over the balance of 2011.

Global Equity Returns



Source: Bloomberg, LP, 6/30/11

Equities Relatively Inexpensive

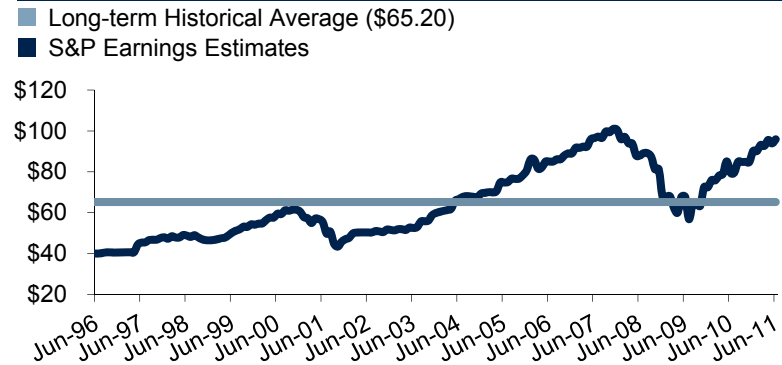


Source: Thomson Financial, 6/30/11, Average from 6/30/96 to 6/30/11

Large-cap equities remain attractive

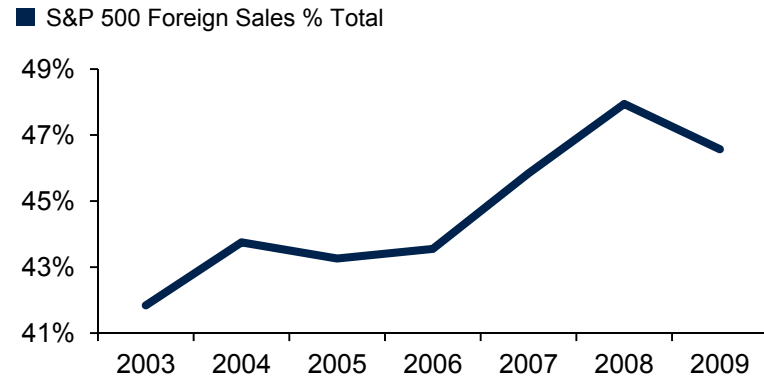
- As significant as the Great Recession was in collapsing corporate profits, the ensuing recovery has been—to date—equally as significant. Earnings on the S&P 500 are forecast to exceed peak (calendar) earnings of 2006 by the end of 2011, two and a half years after the recession officially ended.
- Despite a sharp rebound in profits, large-cap U.S. companies have lagged smaller companies in this cyclical bull market. Valuations on this high quality universe remain very attractive, as do their balance sheets and dividend growth potential. Our focus remains on firms with consistent cash flow and the ability to return value to shareholders in myriad ways.
- The focus on quality has yielded an additional benefit for domestic investors, as many of the high quality companies we look to invest with are multinational corporations. Exposure to a broad range of economies and their growth is at the heart of our diversified thesis and helps to limit economic risks in any particular economy. It is also a way to gain exposure to stronger revenue streams from economies growing more robustly than the U.S.

Corporate Profits Recovery Is Complete



Source: Thomson Financial, 6/30/11. Historical estimates are the historical expected (consensus) earnings. It consists of a rolling four-quarter sum expressed as a monthly series.

U.S. Companies: Rising Reliance on Overseas Revenues

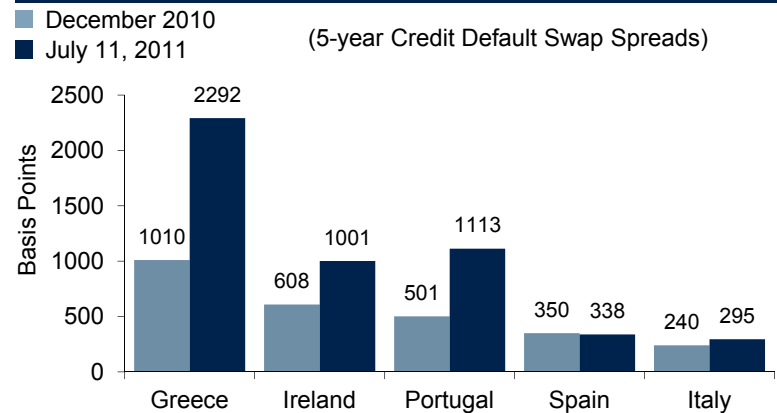


Source: Strategas, 12/31/09

The situation in Europe...disparity between core and periphery

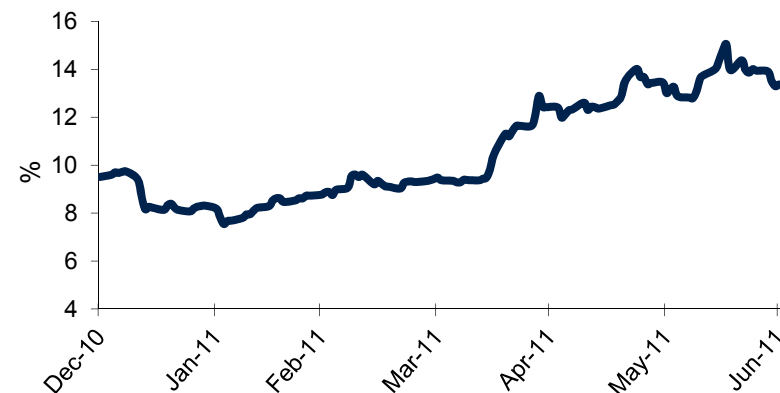
- An equity market rally in June helped offset a volatile quarter after it became apparent that Greece's austerity package would be approved and curb fears of default. Greek lawmakers finalized a €28 billion package of austerity measures and asset sales in a bid to avert the potential default.
- Over time, Greece is unlikely to be able to satisfy creditor claims in full. The recent vote buys additional time and is not a long-term solution.
- Beyond Greece, Portugal received a €78 billion bailout and Standard & Poor's lowered the outlook on Italian debt to negative. In Spain, government cuts are resulting in stagnating economic growth as structural headwinds make implementing solutions difficult.
- Together with the IMF, the EU has approved bailout packages for Greece, Ireland and Portugal totaling €273 billion. European sovereign debt troubles are expected to linger, while the growth disparity between core and periphery countries is likely to widen as indebted countries impose more austerity measures.
- Peripheral European countries will have difficulty "growing" their way out of their debt problems as austerity plans act as a headwind to growth. Meanwhile, continental Europe's main anchors—Germany and France—continue to exhibit economic strength attributable to the positive impact of a weaker euro on export demand.

Default Risk Rising in Some Countries



Source: Bloomberg, LP, 7/11/11

10-year Bond Yield Spread: Greece Versus Germany

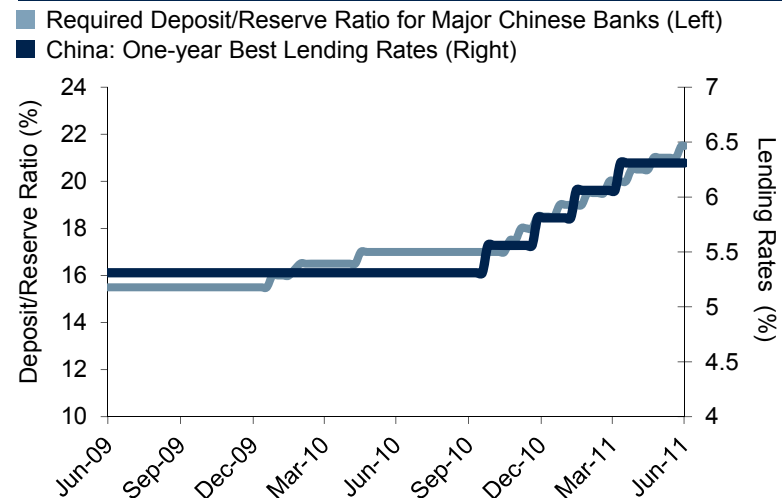


Source: Bloomberg, LP, 6/30/11

Emerging markets are not showing signs of a “hard landing”

- For the second quarter, emerging markets lagged developed markets over concerns about the impact of monetary policy restraint in many emerging market (EM) countries, including China.
- A higher interest rate environment is leading to moderation of EMs’ economic growth, which we consider a positive. We do not subscribe to the viewpoint that EMs will experience a “hard landing” due to fiscal and/or monetary policy. Indicators are beginning to support the idea of a “soft landing,” as EM growth will continue as domestic consumption and labor productivity increase while inflation moderates.
- Disruptions to global supply chains caused by the Japanese earthquake have abated. Production bottlenecks will ease in the second half of 2011 for EM manufacturers who are dependent on units produced in Japan.
- Risks to EM growth remain tied to the macro landscape and whether or not developed market austerity measures will result in lower demand for EMs’ goods. While EMs are transitioning their economies to focus more on domestic demand, growth is still very much tied to overall global growth.
- EM fundamentals and valuations still look attractive in the long term, despite our continued expectation for shorter-term volatility.

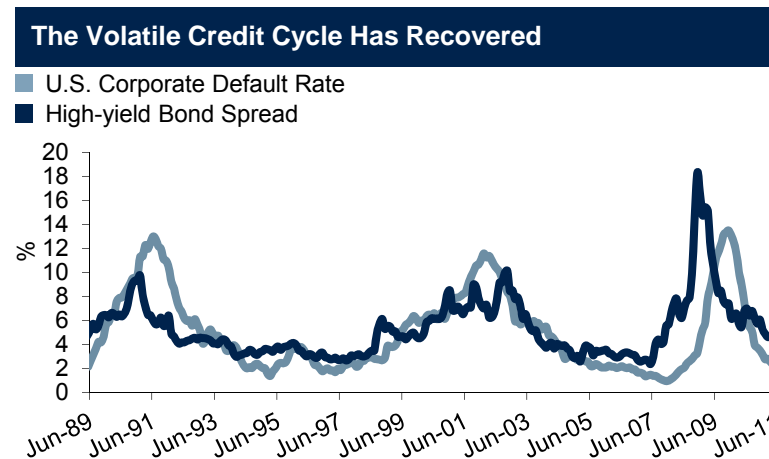
Tighter Monetary Policy in China



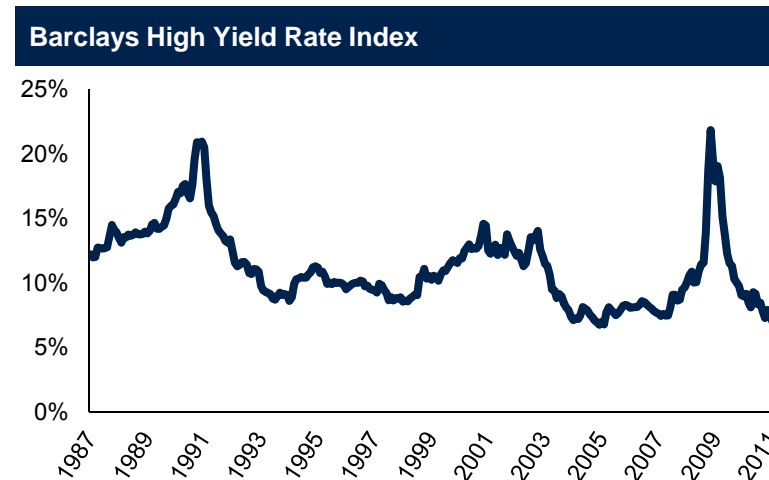
Source: Bloomberg, LP, 6/30/11

Investing through the credit cycle

- The credit market traverses through cycles consisting of four stages. Our investment strategy should also evolve to capitalize on each stage of the cycle.
 1. Recession: Credit trading, then long high-yield
 2. Recovery: Long high-yield, then distressed
 3. Expansion: Fundamental credit long/short and trading
 4. Correction: Credit trading and cash
- The significant drop in default rates and compression of high-yield spreads to below average levels over the past two years seems to indicate a credit market in the “muddle-along” expansion phase. The interest rates on high-yield bonds are also at historically low levels now.
- Since corporations in many cases have emerged from bankruptcy at a faster pace than expected, the universe of investment options for distressed hedge funds has shrunk. These funds are now either in crowded trades or have larger than desired cash positions.
- We believe this is an opportune time to reallocate away from distressed hedge funds to even less directional and more liquid fundamental credit long/short and credit trading strategies that can exercise greater flexibility as we await the next correction, which could take years.
- Declining correlation in stock returns points to an attractive environment for long/short equity investing



Source: Moody's, Bloomberg, LP, 6/30/11



Source: Bloomberg, LP, 5/31/11