ASSET MANAGEMENT, INC.

1800 West Loop South, Suite 1790
Houston, Texas 77027

FOR QUARTER ENDING JUNE 30, 2010

ABOUT LEGACY

Legacy Asset Management, Inc. is an independent Registered Investment Advisory firm, committed to providing the best solutions for our clients' success.

We offer professional money management and sound objective advice throughout a full range of investment and Qualified Retirement Plan consulting services for the institutional and high net worth client.

Contact Info:

Tel: 713.355.7171
Fax: 713.355.7444

Joseph R. Birkofer, CFP® - Principal
jbirkofer@legacyasset.com

Rick Kaplan, CFA - Principal
rkaplan@legacyasset.com

Kyle Ezer
kezer@legacyasset.com

Dennis Hamblin, AIF®
dhamblin@legacyasset.com

IN THIS ISSUE

It's All In The Equation 1

Second Quarter Review 2

Quarterly Activity 3

Arounf The Firm 4

IT'S ALL IN THE EQUATION

DIRTY LAUNDRY

When watching CNBC, I can't help but to think of the cynical Don Henley song "Dirty Laundry". The song was part of the singer's 1982 debut solo album *I Can't Stand Still*. In the lyrics, Mr. Henley laments that news anchors operate around the periphery - focusing on the extreme to promote sensationalism rather than digging deep to develop and determine the important aspects of a story.

In today's free-flowing cycle of news, CNBC anchors have access to some of the most respected private and public investors, money managers, economists and politicians. Yet, many times, questioning and substance falls short. There is no accountability as these high profile guests can say whatever they want to support their agenda. The "talking heads" seem tentative when pressing guests on controversial views. Most notably, I find it surprising that when optimistic advisors or money managers predict the financial markets will rally higher by year-end, anchors fail to ask the most obvious and pertinent question - where will the economic growth come from to support a higher equity market?

REFRESHER COURSE

I spend the majority of the day reading – periodicals, trade magazines, investment websites, research reports, company press releases and their financial statements. Recently, I came across an article written for a website that I frequent - Seeking Alpha. The article, written by John Mauldin entitled, "*Be Careful What You Wish For*," outlines some of the potential economic consequences of trying to aggressively get the budget deficit under control. While that is an interesting topic for another day, he references the basic economic equation for measuring growth. It is this basic equation that can offer insight into how our economy grows and how policies initiated in Washington can be either be supportive or disruptive.

GDP = C + I + G + (X-M)

The basic economic growth equation is additive where GDP (total market value of all goods and services produced in the country) is the sum of 4 variables; personal and business consumption (C), gross investment (I), government spending (G) and net exports which derives from exports (X) minus imports (M). As you can see, in order to have economic expansion, there must be growth in at least one of the four variables (assuming the other three are stable). There are different philosophies that can be implemented to achieve growth. The Obama administration is following a pseudo-Keynesian model where government spending increases to make up for a short fall in personal and business consumption. This was the impetus behind the stimulus package that Congress passed last year.

Typically, government handouts (stimulus checks, first time home buyer credits and tax rebates) can temporarily and superficially encourage personal consumption which can jump start the economy. As demand and consumption increase, corporations are more willing to hire and invest, creating real economic growth. Furthermore, greater consumption enables the government to turn off the spending spigot. However, this time the economy is a bit more stubborn as consumers and businesses have continued to reign in spending due to uncertainties related to

employment, higher costs associated with rising taxes and increased regulations. This has put Washington in a box. It can't count on continued government spending to stimulate growth due to a growing backlash from Americans on the size of the national deficit and debt. Americans are skeptical of further spending since the administration's $790B bet on the 2009 Recovery and Reinvestment Act has failed to provide the stimulus or economic returns that were promised.

With three of the four variables stuck in neutral, the remaining hope for economic growth rests with strong exports. Unfortunately, this does not look promising as the global recession is taking a bite out of demand in large industrial countries. Europe is laden with debt as Greece, Germany, Spain, Italy, Portugal, France and the UK have initiated austerity (significant reduction in spending) measures to bring their respective budgets into balance. Japan is no longer the industrial force of the past. Furthermore, the growth panacea of China is in the midst of systematically slowing its economy to make it more stable and predictable. There are pockets of growth in South America, S.E. Asia and Australia. However, these economies are not big enough to support the amount of products and services necessary to lift our economy out of its malaise.

There you have it folks! It is not real difficult. If you have all four variables contracting or stagnating, then it is mathematically impossible to have growth in GDP. Over the last 5 years, there has been a high correlation between GDP and returns on the S&P 500. Without a change in policy to encourage consumption or investment it may be a while before the economy can rejuvenate and create significant job growth, to support market returns. Perhaps, now you can understand my frustration when CNBC anchors fail to require their guests to provide assumptions that support their predictions. Casual or off-the-cuff comments can cause the casual investor to make hasty and uninformed decisions that could affect accounts.

"We can do the innuendo, we can dance and sing
When it's said and done, we haven't told you a thing
We all know that crap is king, give us dirty laundry"

Don Henley

2nd Quarter Review

The optimism that was building in the first three and a half months of the year has faded far into the sunset. After reaching a 24 month high on April 26, (the Dow hit 11,204) the major financial indices began a systematic decline as the reality of weak economic reports, bulging U.S. debt and budgetary problems in Europe could push the U.S. economy back into a recession. If May and June are any indication, it looks as if the equity markets believe a double dip is inevitable, as the Dow, S&P 500 and the NASDAQ dropped approximately 11%, 13% and 14% respectively. For the quarter, the Dow fell 1,083 points or approximately 10%. Unfortunately, the Dow did better than both the S&P 500 and the NASDAQ which both fell approximately 12%.

All ten sectors of the economy declined for the quarter and are negative for the year. The Materials sector was the worst performer – falling over 15% due to worries that China's slowing economy could adversely impact global demand for base metals such as aluminum and copper. The Financial sector was also very weak dropping almost 14% due to questions surrounding the FinReg legislation that is currently being negotiated in Congress. The uncertainty centers on the proposed regulatory changes that could dramatically alter banks business structure and capital requirements while limiting leverage and risk. The Energy and Industrial sectors declined approximately 13%, influenced by expectations of slower global growth and declining consumption. The Utilities (-5%) and Telecom Services (-6%) sectors were the bright spots in the quarter as higher dividends provided investors some shelter from declining prices.

There was divergence in style in the quarter as value and growth stocks moved basically in tandem in the large and mid cap arena. However, for small cap companies, growth managed to do better (not fall as much) than value stocks. This divergence can be attributed to investor psychology. Typically, in times of uncertainty, risk-averse investors favor the stability of larger stocks sporting value characteristics. Risk takers like smaller company stocks that are perceived more risky as they pay no dividends and are not widely followed by Wall Street creating the potential for outsized returns.

Looking Forward

The economy is playing out just as we predicted. Over the last two quarters, we had been preaching that equities would fall and slowly recover (like the Nike Swoosh) as signs of economic improvement materialize. In fact, in last quarter's recap, we expressed apprehension over the speed at which the equity markets had recovered and cautioned that the potential risks of regulation, taxes, debt and consumer confidence would weigh on stocks. Under this backdrop, we created cash throughout the quarter, enabling our equity portfolios to outperform the S&P 500.

Looking out on the horizon, we expect the equity markets to be trendless as the typical daily news cycle of economic and geopolitical headlines weigh both positively and negatively on investors' psyche. Short-term trading strategies don't work well in trendless or volatile markets as investors find themselves losing sight of their goals and objectives by trying to time the peaks and valleys of unpredictable market movements. Our clients have amassed a large cash position that we intend to cautiously reinvest. Our buy, hold and monitor strategy is an efficient way to capitalize on volatile market movements by finding high quality, debt-free and dividend paying stocks that have been caught up in a wave of trading which can create an unwarranted discount to its valuation.

Since I have referenced the headwinds that face investors, I

feel compelled to highlight possible catalysts that might push stocks higher. They include: (1) attractive absolute and relative valuations in certain sectors, (2) the 10-year treasury bond with a yield under 3% (stocks provide a greater long-term rate of return over Treasury bonds), (3) better than expected earning season with positive commentary on future quarters (4) economic rebound lead by higher employment and (5) over $4T in money sitting on the sidelines in money market funds that could be allocated to equities.

I know I must sound like a broken record, but we continue to like the technology sector due to cheap valuations and strong balance sheets that feature big cash balances and no debt. These companies are poised to add to dividends and initiate stock buy backs. More importantly, it's comforting to invest in companies that have the financial flexibility to sustain and grow their business model even in an economic downfall.

Another ol' favorite is the healthcare space. This group continues to be left for dead due to skepticism and confusion over the ramifications of Obama Care. Nonetheless, many companies have attractive absolute and relative valuations and have strong cash flow that can support future research and development, acquisitions and/or higher dividend yields. Over time, the rules of the game will become clear and healthcare participants will learn how to adapt and thrive within this environment.

Finally, there may be opportunities in the financial sector to take advantage of improvements in capital structure, credit quality, reserves and default rates. While non-performing assets and write-offs of bad debt will probably continue to trend higher, we believe that key metrics such as returns on equity and assets as well as net interest margin should improve significantly.

Quarterly Activity

Legacy initiated positions in the following companies:

Citigroup Inc. (C) - Legacy added money center bank Citigroup to the portfolio this quarter. After falling 95% from its highs in the midst of the financial crisis, Citi's fundamentals have stabilized and appear to have bottomed. 1Q earnings results showed encouraging progress on the credit quality front with loan loss provisions falling by 16% year over year. Special asset valuations, such as subprime mortgages, have improved significantly while top line revenue exceeded expectations. More importantly, Citi is working with the Treasury to eliminate their stake in the company over the course of 2010. While uncertainty related to financial reform represents a short-term headwind for the entire industry, the shape of the yield curve (with low short-term interest rates) provides a positive backdrop for operating earnings growth. As a turnaround story, Citi stands out from its money center competitors as it faces specific issues unique to the company. As management continues to address loan losses, capital structure, strategic business direction and the ever changing regulatory environment, the discount attached to the company's valuation will subside. Given the extreme dislocation in the company's earnings over the past several years, we focus on price to book as the key valuation variable. Citigroup is currently trading well below book value (.7X) which is a significant discount to its historical ranges as well as that of industry peers and provides an attractive entry point and margin of safety.

Traveler's Companies, Inc. (TRV) – Traveler's is a leading issuer of commercial property and casualty insurance as well as non-life reinsurance products worldwide. The insurance industry has been suffering from overcapacity which has held down pricing/premium growth. Typically, premium growth and pricing improvement tends to follow GDP growth by 1-2 years. Therefore, premium growth is expected to stabilize and improve given the recent improvements in GDP. TRV has a history of displaying impressive (and profitable) underwriting results in both good and bad pricing environments and has grown its tangible book value per share by 13% over the past 5 years. While TRV's investment portfolio has recovered along with the general market, its focus on small commercial and personal lines has insulated it relative to its peers. The company has a robust share buyback and dividend payout policy in place. While the company trades at book value (a significant discount to its 10-year median valuation of 1.6X), we consider the company's strong execution through the downturn to be noteworthy. The robust share buyback and strong 2.9% yield are "paying investors to wait" for the turn in pricing and premium growth, which should in turn bode well for valuation expansion.

Teva Pharmaceuticals (TEVA) – TEVA is the largest generic and branded pharmaceutical company, with current revenues of $14B. Company management projects revenues will double to $31B by 2015. From an industry perspective, generic pharmaceutical companies expect to benefit from the passage of healthcare reform given the increased focus on costs, generic substitution, and the higher number of insured patients going forward. In addition, "big pharma" companies are facing a patent expiration cliff of approximately $150B over the next five years. TEVA has a strong management team that has doubled revenue over the past five years through both organic growth and acquisition. Having successfully completed its 2008 acquisition of competitor Barr Pharmaceuticals, Teva has set its sights on its most recent purchase, Ratiopharm, a leading European generics company. TEVA generates strong cash flow and its debt was recently upgraded by Moody's and S&P following its recent acquisition. The company is trading at an unusual discount relative to both historical valuations and its industry peer group. Furthermore, Teva is the only dividend paying stock in the industry with a yield of 1.3%.

ChevronTexaco (CVX) – We added CVX to portfolios as a swap for Royal Dutch Shell (RDS). We wanted to add ChevronTexaco to client portfolios due to CVX's low valuation and unlevered balance sheet. Under the ever changing

political landscape and stronger regulations, large integrated oil companies might have to look toward acquisition as a more efficient way of increasing reserves. On that basis, ChevronTexaco is head and shoulders above RDS with net debt of $1(B) at Year-end '09 compared to $25(B) for RDS. CVX has significantly stronger free cash flow and higher returns on both equity and capital, enabling the company flexibility to look toward the natural gas market for a target acquisition, similar to what Exxon did when it purchased XTO Energy. On an absolute basis, ChevronTexaco is cheap. It is trading at a discount to its 5 and 10-year median on all of our value metrics. It is also paying a 4% dividend. When comparing valuations to RDS, CVX investors are paying less for future earnings relative to Royal Dutch Shell. RDS has a slightly lower P/B and P/S ratio, as the market places a slight premium on CVX's operations and superior fundamentals. We believe investors have a more compelling opportunity to benefit from CVX's strong market and financial position.

Legacy liquidated positions in the following companies:

Alberto Culver (ACV) - Alberto Culver was sold over both fundamental and valuation concerns. The company continues to have execution problems as it missed Q2 earnings due primarily to snafus in implementing its new supply chain initiatives. Disruptions and delays in deliveries likely contributed to market share disruptions for leading products such as Tresemme which suffered a 1.7% decline in sales. To complicate matters, the company is focusing on integrating its recent acquisition of the U.K.'s Simple brand. ACV will likely need to increase spending on marketing and customer service going forward to overcome the negative perception by customers. Finally, with the stock trading at a forward P/E of 16.1X and with 36% of sales generated outside the U.S. and potentially at risk, we exited the position.

BP (BP) - Duh! Any explanation needed? We sold all client shares early in the crisis at approximately $53.00 – it closed the quarter at $28.88. Furthermore, we even managed to make a little money on the position.

Costco Wholesale (COST) - We took profits in Costco this quarter due largely to valuation concerns. From a fundamental standpoint, our conviction level around the company's ability to deliver on forecasts has decreased over the past few quarters. Results have been mixed around expense control, ability to price vs. competitors, as well as the inherent volatility in the company's gasoline business. In addition, food cost deflation remains a drag on the firm's results. Costco is a high quality company and has executed well in the past. However, without a meaningful catalyst to drive earnings results above what is already expected we can't make a case for meaningful appreciation from here. Costco trades at a significant premium to the market and to its peers.

Nike (NKE) - We took profits on our Nike position after having held it for more than 3 years. While the company does have the benefit of the World Cup, growth opportunities in China, and strong fundamentals, valuations have become extended. We also believe that the current price reflects all of this good news. In addition, with the sluggish economy, we think it will become increasingly difficult to meet analysis expectations as consumers continue to spend at slower rates and become more choosey in what they are willing to buy.

Royal Dutch Shell (RDSA) – Please reference ChevronTexaco Above.

Staples (SPLS) - Legacy sold all positions in SPLS this quarter given concerns around challenges to the fundamental picture coupled with a "not cheap" valuation. The company has produced mixed results in recent quarters due to increased competitive pressures, continued challenges and losses in China, and the distractions posed by integrating its acquisition of Corporate Express. In addition, the company has one of the largest exposures in the industry to Europe, which looks to be a headwind in the near term. On the valuation front, Staples trades at a premium to other leading "big box" retailers as well as the market. While SPLS is the leader within the office products space and should be a beneficiary of a broad economic recovery, we believe there are more compelling opportunities with better valuations and clearer catalysts. However, we will be monitoring SPLS for signs of stabilization and more consistent results.

Around the Firm

The past several months have been busy here at Legacy. Rick continues to be sought out in public forums for his market insights. He spoke at the CEO Network 2010 Economic Forum. He also provided commentary for the Houston Chronicle's "Houston's Top 100" Annual Business Survey.

Joe provided commentary in various media outlets on "common sense financial planning", focusing on Roth conversions and retirement plan ideas. He also completed another semester lecturing at the Rice University CFP program.

We mourned the passing in May of Annette's son-in-law, Jeff Tully. He was a fine young man and leaves a beautiful wife and family. We all appreciate the outpouring of support from our friends and clients.

We are happy to welcome new neighbors next door: Dulworth & Company. They are an insurance, estate planning, and executive benefits firm, founded in 1953 by Jack Dulworth. The company is now headed by his son, Mark. We are working extensively with the principals at Dulworth & Company to provide insurance reviews and estate planning advice for our clients.

We wish you all a safe and hurricane free summer of 2010.