HAVERFORD OUTLOOK

Equity markets sold off sharply during the summer months and bond yields have fallen to historic lows. Gold has been bid up to historical highs, and in a flight to safety, many investors flocked to short-term cash investments earning zero returns. Indeed, pessimism and negativity are at levels not seen since the 1970s, with most sentiment barometers signaling extreme fear.

All of this has resulted in extreme market volatility, which can be quite unsettling. However, it is essential to maintain the proper perspective and to filter out the negative hype. The companies in which Haverford invests are performing quite well, growing their earnings and dividends at a good clip. As we detail later in this *Outlook*, our companies benefit from a number of global trends, and they have figured out how to profit even in a slow-growth economic environment. While short-term growth rates might decline due to a slowing economy, valuations have fallen as well. So much, in fact, that longer-term investors will likely be well rewarded.

Economy: A Near-Term Pickup Likely, but Still Slow Growth Ahead

We have long written that the financial crisis would have lingering effects as consumers, businesses, and governments clean up their debt-laden balance sheets and adjust to a more austere environment. This deleveraging process has resulted in an economic recovery that is muted compared to previous upturns, manifesting itself most prominently in a weak housing market and stubbornly high unemployment.

The slow-growth backdrop makes it more difficult for the economy to weather headwinds and unforeseen events. This became quite evident, thus far in 2011, as unrest in the Middle East sent energy prices higher, causing an already strapped consumer more pain at the pump. The tragic events in Japan created a ripple effect along the global supply chain, especially in the electronics and automotive sectors. These events had a significantly negative effect on the domestic economy, with GDP growing by only 0.7% in the first six months of the year.

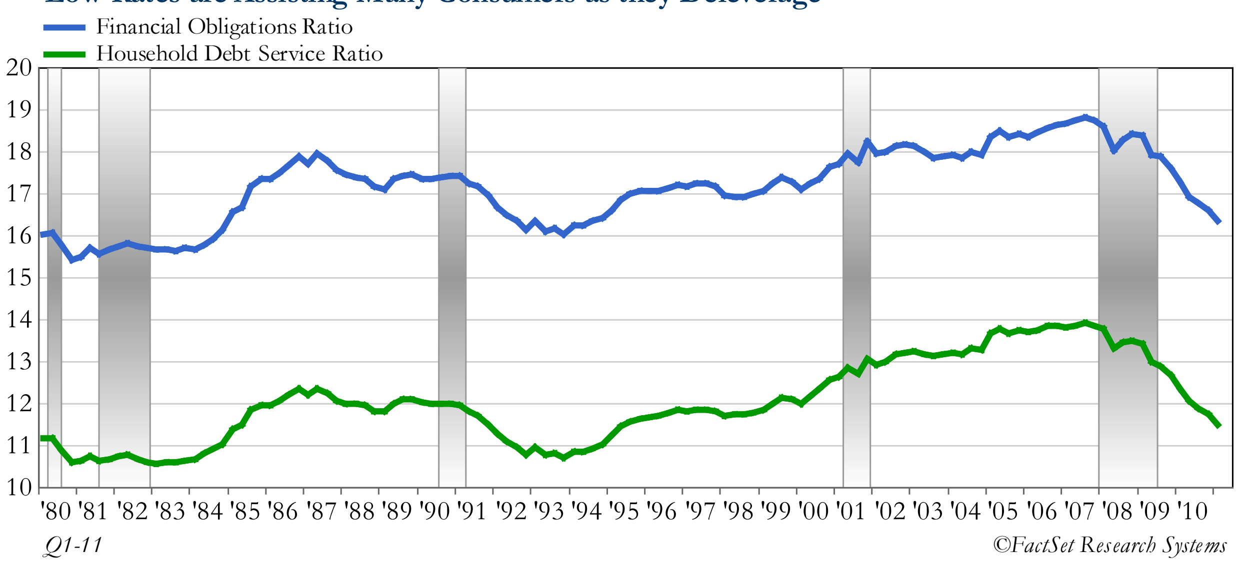
The second half of 2011 got off to an inauspicious start as the debt-ceiling debate morphed into a show of brinkmanship and an actual downgrade of U.S. sovereign debt by a major rating agency. This, combined with the continued lack of leadership in Europe to fully address the sovereign debt problems of peripheral EU countries, roiled the financial markets and dealt a severe blow to business and consumer confidence.

Many economists have reduced GDP forecasts for the coming quarters based on weaker than expected economic data, with some economists speculating that we are currently in a recession. Although a slow-growth environment such as this might feel recessionary, we don't believe the outlook is that dire. We expect growth to pick up somewhat from the meager pace of the first half of the year, and we look for GDP to grow in the 2%-3% range in the coming quarters.

One reason for our optimistic outlook is energy prices. Oil prices are down more than 20% from their Arab Spring-induced highs. The decline has slowly begun to be reflected at the gasoline pump now that the summer driving season has ended. Industrial metals have also fallen substantially, which should help to quell the inflationary forces that have caused many emerging market countries to deliberately slow their economies. In the global economy, higher growth in emerging markets greases the skids for better employment growth in the United States.

Based on the Fed's recent commentary, borrowing costs will likely continue to be extremely low for the foreseeable future. Although the Federal Reserve's actions haven't been without controversy, low interest rates have helped enormously in the economy's recovery. Low interest rates spur investment by lowering the hurdle for new projects and they increase consumer discretionary income as homeowners refinance at lower rates. Lower interest rates have helped the housing market to stabilize with home affordability now at all-time highs. Finally, low interest rates have facilitated the deleveraging of consumer balance sheets, with debt service as a percent of disposable income falling significantly over the last few years.

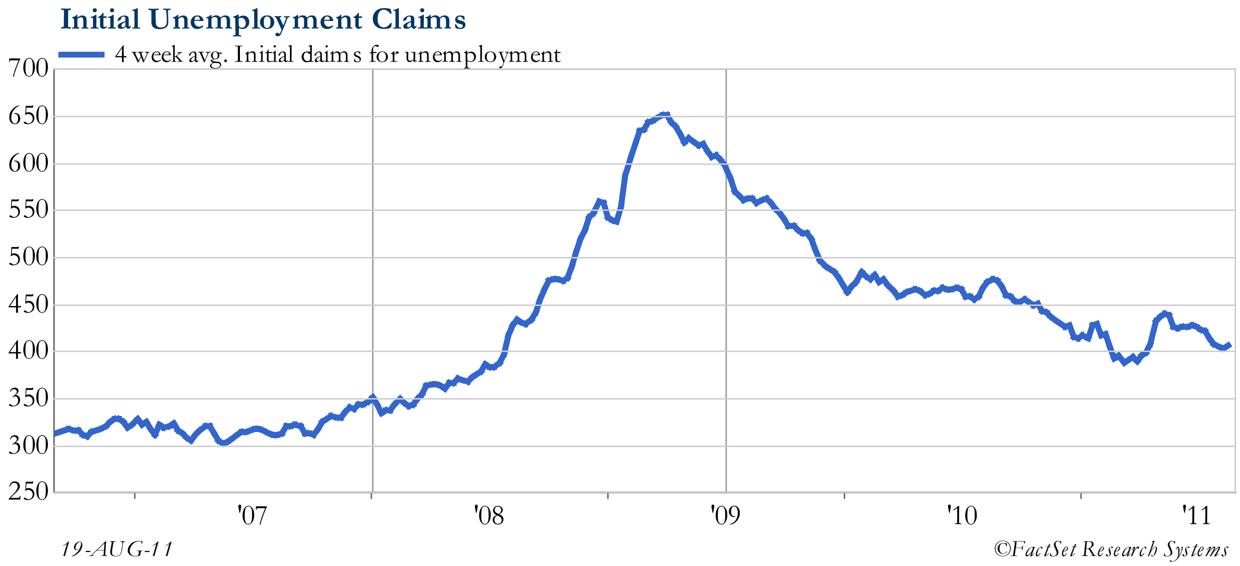
Low Rates are Assisting Many Consumers as they Deleverage



The household debt service ratio is an estimate of the ratio of debt payments to disposable personal income. Debt payments consist of the estimated required payments on outstanding mortgage and consumer debt. The financial obligations ratio adds automobile lease payments, rental payments on tenant-occupied property, homeowners' insurance, and property tax payments to the debt service ratio.

Clearly, the economy is in much better shape than it was only two years ago. That said, job creation is the key ingredient that the economy lacks. Employment is the lynchpin that would favorably alter the trajectory of the housing market, consumer and business sentiment, and future budget deficits. Fortunately, the employment situation appears to have stabilized, but job growth remains below the approximately 250,000 new jobs needed per month to bring down the unemployment rate.

Following recessions, employment growth often lags overall growth in the economy, and this recovery is no exception. Business leaders continue to operate with as few employees as needed, and a lack of confidence and visibility regarding regulatory costs and tax policy exacerbate the situation. Politicians on both sides of the aisle are acutely aware of this, especially as we move toward the November 2012 elections. Although we, like others, have low expectations on any substantial policy changes coming out of Washington prior to the elections, we would not be surprised to see an embrace of pro-growth legislation targeted at creating new jobs.

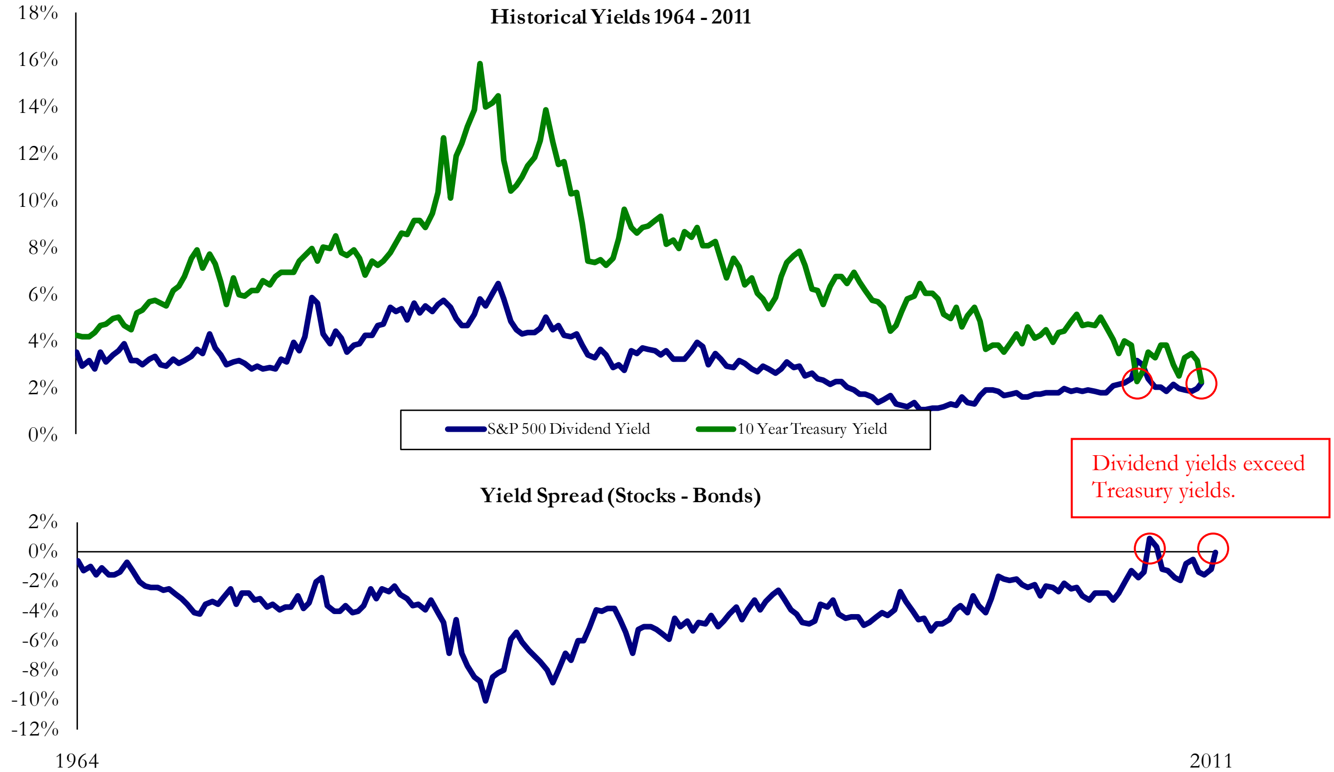


Equities: Long-term Trends Trump Near-Term Uncertainty

The market's volatility reflects a high level of uncertainty surrounding the economy. Because Haverford views the current situation through a longer-term lens, we hold a much more optimistic view of the equity markets. Corporate fundamentals have remained resilient even as the economy slowed during the first half of the year. This confirms our thesis that companies, particularly large multinationals, have learned how to prosper in this slow-growth economic environment.

Volatility can be debilitating, but we continue to believe the equity markets represent excellent value. Haverford's portfolio holdings trade for below 12-times anticipated earnings, but we believe the fair value of these companies, which will be realized in the long-term, to be much higher. At current levels, equities offer an income stream comparable to long-term bonds, with the added potential for dividend growth and price appreciation. Consider the alternative in the fixed-income markets, where the 10-year Treasury trades at approximately 2.0%, the real return on TIPS recently turned negative, and investment grade corporates yield only 3%. The current yield on the S&P 500 exceeds 2%, while Haverford's Quality Growth and Quality Dividend Value portfolios currently provide yields of 2.7% and 4.0%, respectively. We are very confident these dividends will grow over time.

Dividend Yields are Comparable with Treasury Yields



Source: Haverford, Factset. As of August 31, 2011.

Every company in the Quality Growth and Dividend Value portfolios share the important characteristics of being high-quality and dividend-paying. The Quality Growth portfolio is focused on companies with above-average prospects for increasing earnings and dividends, while the Dividend Value portfolio places an emphasis on current income. Both portfolios are well diversified and constructed to weather economic turmoil. These portfolios also share the common investment themes highlighted below, which we believe will transcend the near-term economic uncertainty and prove rewarding to investors during the coming years.

- *Cash flow is king*. Corporations that have excess cash flow can use it to enhance shareholder value through higher dividend payments, share repurchases, or by taking advantage of opportunities to grow their business. We are pleased that 44 of the companies within our portfolios have the financial strength and confidence in their future prospects to have raised their dividends during the past year. McDonald's and ConocoPhillips have been particularly aggressive in returning cash to shareholders.
- *Global exposure*. We favor companies that have exposure to faster growing parts of the world and expect emerging economies will continue to grow at a rate 2.5 times faster than developed markets. Our portfolios generate significant revenue from overseas sources (greater than 45%, on average), which is one reason why earnings have been strong despite the tepid domestic economy. Even a company with no direct foreign revenue, such as Union Pacific, is benefitting from global growth through their exposure to international trade.
- *Emerging middle class*. The demands for energy, raw materials, food, and consumer goods to meet the needs of a burgeoning middle class in developing nations will continue to grow. Chevron, DuPont, and VF Corp are high-quality investments in these historically cyclical sectors.

- ***Dominant brands***. Iconic companies can steadily grow in value regardless of near-term volatility or economic uncertainty. Disney, Procter & Gamble, Pepsi, and Kraft manage billion dollar brands that command customer loyalty and premium pricing.
- ***Pricing power***. Inflation may not be of immediate concern, but equities provide the best hedge against any future inflation. We will continue to look for businesses with the ability to pass through pricing, such as Coca-Cola, McDonald's, and Microsoft.
- ***Fortress-like balance sheets***. Financial strength is always a competitive advantage, and it becomes even more important in a weak economic environment. The U.S. financial sector is stronger now than before the crisis, but risks still remain. J.P. Morgan and Wells Fargo are two of the best capitalized banks in the financial system. Other financial holdings, such as Black Rock and NYSE have virtually no balance sheet risk.
- ***Infrastructure***. There is a global infrastructure race to lay the foundation for the 21st century. According to the *Economist* magazine, the U.S. spends 2.4% of GDP on infrastructure. Europe, by contrast, invests 5% while India and China are at 8-9%. Caterpillar and General Electric are global leaders helping to build energy, health, transportation and technology infrastructures around the world.
- ***Building and energy efficiency***. President Obama has made building efficiency a cornerstone of his domestic spending priorities. Johnson Controls estimates that a recent series of upgrades made on the Empire State Building will reduce energy consumption by 38% with a payback period of only 3.1 years. United Technologies and Eaton are also leaders and primary beneficiaries of business resulting from new building efficiency standards.
- ***Information analytics and mobility***. The combination of an increasingly complex world and the proliferation of business data is requiring new high-tech services that allow for the instant analysis of data and mobile communications. Companies like IBM, Accenture, and Qualcomm are leading providers of these services.
- ***Access and demand for healthcare***. While the cost of healthcare is under attack domestically, global demand and access to healthcare continues to rise with the aging population. Our healthcare exposure seeks to balance branded pharmaceuticals, generics, devices, diagnostic and surgical equipment, and consumer products. Johnson & Johnson and Novartis are two conglomerates with healthy exposure to each of these businesses.

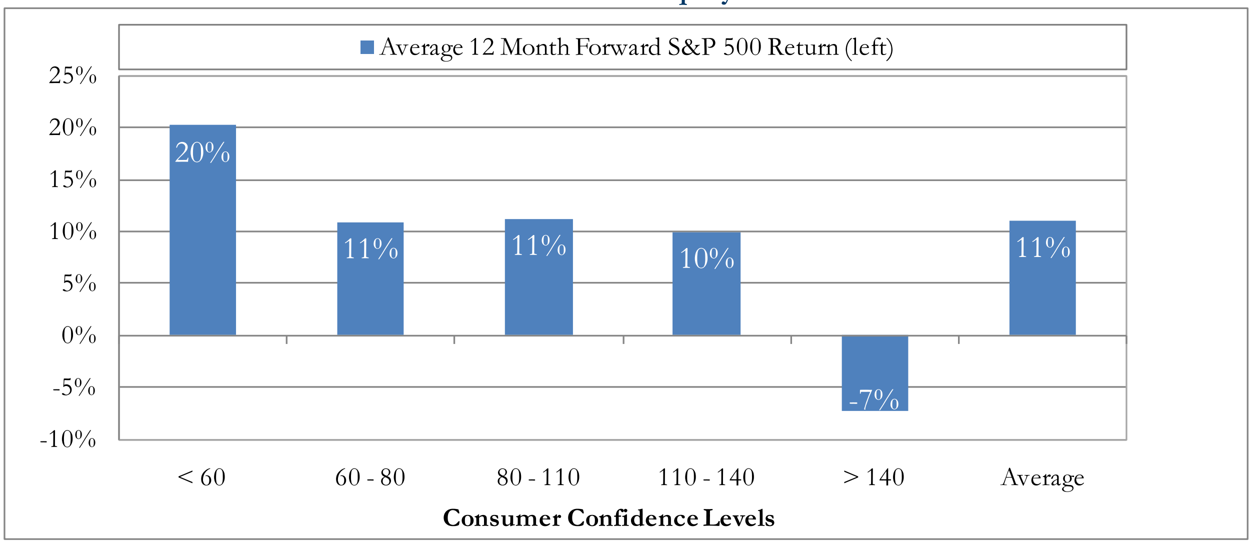
Haverford's Quality Global strategy, which seeks to provide added diversification through exposure to multiple asset classes, is modestly overweight in domestic equities. The resetting of growth and inflation expectations in emerging economies has caused these markets to underperform during the past year. Likewise, European debt concerns and austerity measures have pressured the stocks in the EAFE countries (Europe, Australasian, and the Far East). We believe U.S. equities, given the current macro-environment and valuation levels, can continue to outperform and provide a better risk/reward profile than either emerging markets or the developed markets of Europe and Japan.

We are continually looking to adjust the tactical weightings for the Quality Global portfolio in response to market and economic conditions. Earlier this year we trimmed the portfolio's position in U.S. small cap stocks – which has experienced a multi-year outperformance cycle – and added a position in an internationally diversified small cap fund. More recently, we seized the opportunity presented by the short-selling ban on European financials to reduce European exposure in favor of emerging markets, where we believe there is more upside once economic activity reaccelerates and sentiment turns positive.

In summary, the excessive levels of investor pessimism, fear, and anxiety are inconsistent with corporate fundamentals. Exceptionally strong balance sheets, significant free cash flow, cheap valuations with competitive yields, and the prospect for increased income generation are compelling reasons to own stocks and a recipe for strong returns for investors.

It might seem counter-intuitive to invest at a time when consumer confidence is so low. History shows, however, that poor levels of consumer confidence often coincide with market lows. Markets don't bottom on good news, but when headlines seem most negative. As illustrated in the chart below, extremely low levels of consumer confidence (a reading below 60) historically bodes well for future equity performance.

Poor Consumer Confidence Bodes Well for Future Equity Returns



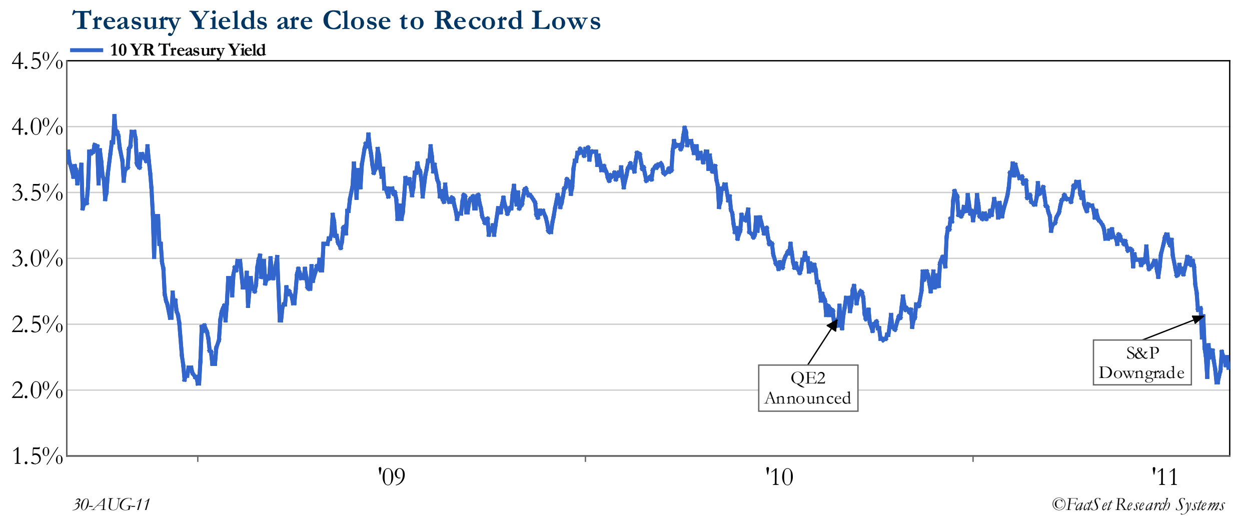
Source: Haverford, Factset. Data from 1967 - 2011

Fixed Income: In Search of Yield

Standard and Poor's created the most controversial headline of the summer when it chose to downgrade the creditworthiness of the U.S. Treasury from AAA to AA+. The price of Treasuries rose (and yields declined) dramatically on the news as investors sought their relative safety, proving they continue to be a desirable refuge in turbulent markets. The benchmark 10-year note was yielding 3.16% on June 30, 2011. Following the U.S. debt ceiling debate and the subsequent debt downgrade, intensifying European sovereign debt issues further spotlighted the safety of U.S. Treasuries, briefly pushing the yield below 2% before rebounding to 2.05% as we go to press.

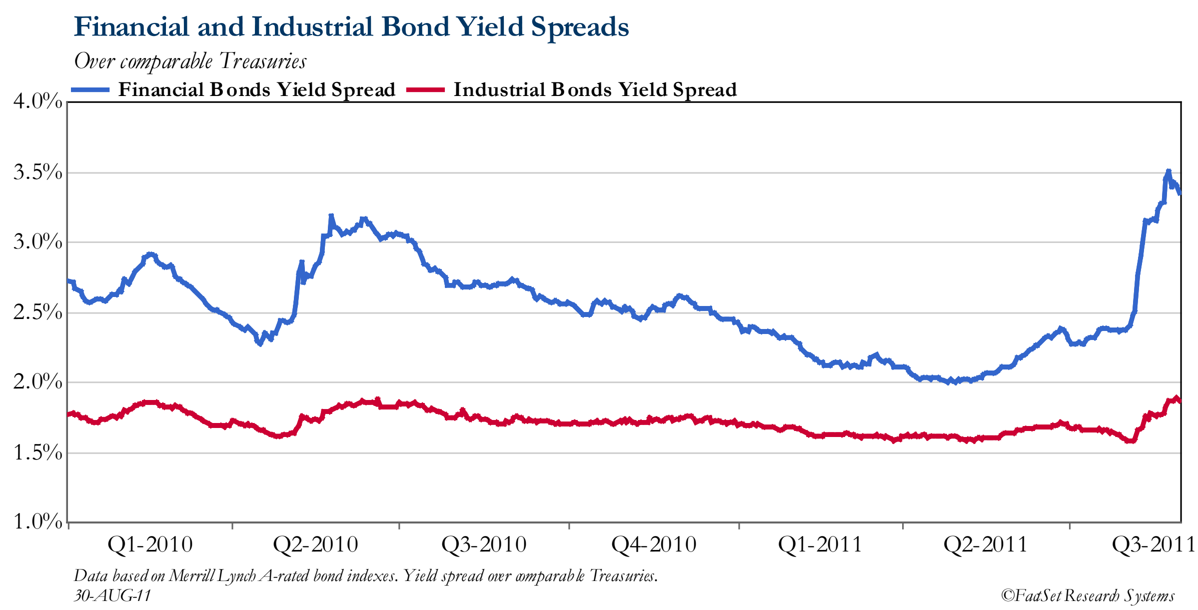
In their rationale for the downgrade, S&P cited not just the growing U.S. debt burden, but also S&P's "view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges to a degree more than [previously] envisioned." Thus, we believe the downgrade is more a result of the acrimonious political process unfolding in Washington and not indicative of the relative safety and soundness of the United States relative to other triple-A rated sovereigns.

Standard & Poor's was correct in stating that the growing debt burden is a major concern that must be addressed. The most visible example is the monthly supply of new money debt. August 2011 saw $99 billion in new-issue Treasuries, which excludes the debt issued to roll over maturing bonds, and September 2011 is expected to see a further $118 billion in new supply. The U.S. Treasury is expected to issue, on average, $100 billion of new debt each month for as long as deficits continue at current levels. Current interest rates are being unduly influenced by investors' flight to safety and fears over the economy. With the ten-year yield near 2% and the five-year below 1%, we do not believe rates adequately compensate investors for the risks involved in owning longer dated securities. We would become more favorably inclined to Treasuries when rates rebound to reflect improved psychology regarding the economy.



U.S. Agency issues benefited from a favorable supply picture during 2011. Year-to-date issuance of $552 billion is down substantially versus the $955 billion of new debt issued during the first three quarters of 2010. As a result, Agency yield spreads versus benchmark Treasury yields have remained relatively stable despite all Agency issues being downgraded by S&P in concert with their downgrade of the U.S. Treasury.

Investment grade corporate bonds currently present the best value among taxable fixed income asset classes. Yield spreads – the extra interest required above a Treasury bond of similar maturity – have varied by market sector. Industrial spreads have remained relatively stable while the spread on financial issues has widened due to European concerns and ongoing weakness in the U.S. real estate sector. Financial issues warrant a risk premium in the form of extra yield compared to non-financial issues. As with our equity strategy, we are comfortable investing in the debt instruments of financial companies that we deem to be well capitalized.



Overhanging credit concerns and financial strains put the municipal bond market under extreme stress at the beginning of the year. As we stated at the time, municipal finances were under more pressure than in any cycle since the mid-1970's, but were not subject to the possibility of widespread defaults that some predicted. Municipal government revenues, particularly at the state level, improved significantly in recent quarters. Stronger tax revenues, coupled with sharply reduced new-issue supply, have significantly aided psychology. Bond issuance in the municipal market has only been $145 billion so far in 2011, 42% less than the $252 billion issued during the similar period in 2010. As a result, yields on high-quality municipal bonds have dropped in tandem with U.S. Treasury securities. Data from Bloomberg Finance LP illustrates the yield on AAA municipal bonds has fallen 111 basis points since year-end 2010, as compared to the 98-basis-point decline in U.S. Treasury yields detailed above.

Fixed income investors face a challenge as each maturing bond is replaced at today's lower yields. The comments made by Federal Reserve Chairman Bernanke about keeping rates low may seem to exacerbate this problem, but in fact it actually adds clarity to the analysis for investors with a shorter time horizon. Those investors can now more accurately quantify the expected volatility of their bond investments. For example, with interest rates anchored for the next two years, a three-year bond will exhibit relatively little volatility. A ten-year issue, however, will still have eight years to maturity in 2013 and exhibit substantially the same volatility profile. Our conclusion is that investors can use that two year time frame to recalculate how much potential volatility they can absorb in exchange for some increase in yield. In a slow-growth, low-yield environment such as this, a willingness to extend the maturity of high-quality bonds in order to earn incremental yield is preferable to moving down the quality spectrum to achieve the same objective. We particularly favor these opportunities in the corporate and municipal sectors.

Maintaining Perspective

We know how difficult it is to stomach the day-to-day volatility of the financial markets. Bad news has always been good for newspaper sales, and the evolution of the investment industry has resulted in far more market players focusing on the short term, trading around each successive data point. Haverford will retain perspective and remain focused on the long-term drivers of asset prices – earnings, dividends, and balance sheets – but we will also seek to take advantage of short-term dislocations in the market in order to improve our portfolios for long-term performance.

HAVERFORD

QUALITY INVESTING

THE HAVERFORD TRUST COMPANY
Three Radnor Corporate Center, Suite 450
Radnor, Pennsylvania 19087-4546
T 610-995-8700 / 888-995-5995 / F 610-995-8796
www.haverfordquality.com