



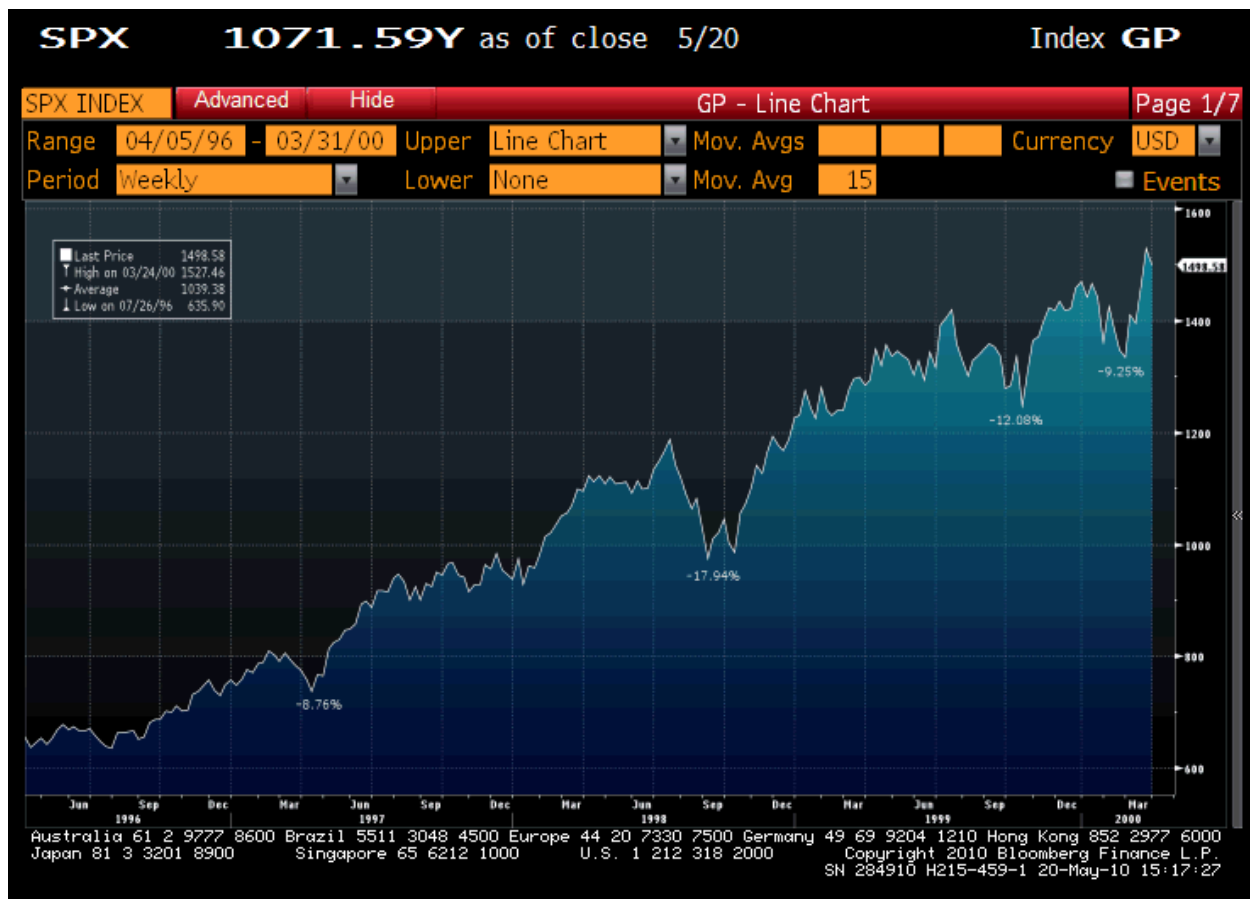
Memo to Advisors: May 20, 2010

Following the “flash crash” that occurred on May 6, when the Dow tumbled 1,000 points in a matter of minutes intraday, markets have continued to experience higher than normal volatility, with the Dow experiencing triple digit closes on 12 out of 17 days. The CBOE Volatility Index has since shot up over 275%, from 16.62 on April 23, when the S&P 500 closed at a new 52 week high, to 45.79 today. The average is around 20. This increase in volatility has been accompanied by a decline in the market. The S&P 500 has fallen 12% since then, and the Dow is back down to close to 10,000.

The large daily fluctuations we are experiencing can be attributed to many factors: the effect of high frequency trading, concerns surrounding Greece’s ability to repay its debt, and the potential impact on the fledgling economic recovery, higher taxes stemming from health care reform, and Goldman Sach’s involvement in the mortgage crisis to name a few. While all these concerns, and others, are certainly legitimate, I would like to add a little perspective on the current situation in general, and the effect on our investment returns in particular.

The media defines “correction” as a pull back of 10%, and a bear market as a drop of 20% or more. Since the Crash of 1929, the ten largest bear markets have averaged 32%. The most recent was the Financial Crisis of 2008-09, which saw the market drop 55% in a little under a year and a half. During the subsequent recovery, from March 9, 2009 to April 23, 2010 the S&P 500 climbed over 80%. Even after today’s 375 drop in the Dow, the market remains up over 60% from its lows. During the entire recovery, we didn’t experience so much as a single 10% correction. The point being; we were most likely overdue. Put simply, the market got ahead of itself and is now adjusting to a manifestation of the “new normal,” which implies lower equity returns and higher volatility going forward.

The following graph depicts one of the largest bull markets in recent memory, the Dot Com rally from 1996 – 2000 to highlight that corrections are a normal part of the market cycle, and do not necessarily portend impending doom.



How has the recent market drop and subsequent spike in volatility impacted our STAR III strategies, *VEGA* in particular? One of the necessary preconditions for any significant increase in market volatility is a drop in prices. There is a reason the press refers to the VIX as the “fear index.” investors pay more for options when there is greater uncertainty about the future. However, high levels of volatility are not very accurate predictors of high volatility in the future. If anything, there is evidence to suggest the opposite: a high VIX is often followed by an increase in the S&P 500 and a subsequent reversion in the VIX back to the norm.

In *VEGA*, we sell options, conservatively in the form of covered calls, but as there is always some level of volatility present, we harvest volatility constantly. During those periods, such as now, when volatility spikes, we suffer some drop in portfolio value initially, but reap an immediate benefit by replacing our existing calls, which are now farther away from current prices and more than likely trading for pennies or nickels, and selling new calls at higher percentage premiums, for a shorter amount of time.

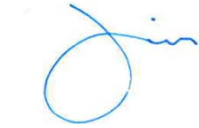
A good illustration of this in action is to compare the premiums on calls based on closing prices on the ETFs in *VEGA* at the end of the 1st quarter, when the VIX was at 17.59, to the premiums we are collecting today. On March 31st, there were 52 days remaining until May expiration. We received 2.9% in premium, or just over 20% annualized. We began covering the May Calls the week of May 11th, two weeks ahead of expiration, and sold a second round of calls for June, just 36 days away. This time, we

received 3.65% or 37% annualized. Averaging the two, we've been able to "lock-in" a 6.00% return net of fees for 80 days. That works out to over 30% annualized from option premiums income alone.

I do not know what the markets will do over the next month, but I do have a high degree of confidence, in the returns in *VEGA* from the options we've sold. In addition, it is important to keep in mind that we always have the ability to participate in price appreciation, whenever it occurs, because the call options we sell are always at a target that is higher than the current price of the underlying ETF. Thus, we are never "locking in losses," but getting paid to participate in appreciation, whether any occurs or not.

Please feel free to call or email with any questions or comments, or if there is a specific question or issue you'd like me to address.

Sincerely,

A handwritten signature in blue ink, appearing to read "James Herrell". The signature is fluid and cursive, with a large loop at the beginning and a smaller loop at the end.

James Herrell, CFA

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