ATLANTIC CAPITAL MANAGEMENT, INC.

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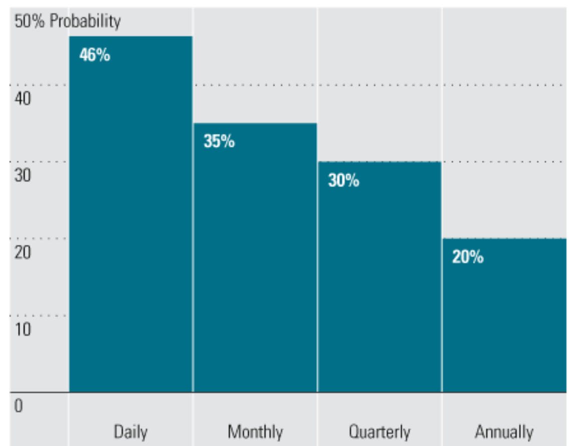
Short-Term Focus: Coping with Near-Term Fluctuations

Instant access to real-time quotes and media reports can make it difficult for investors with a long-term investment horizon to stay focused on their goals. In reality, these daily market movements may not be as extreme as they seem. As investors look longer term, their perception often changes. Short-term market fluctuations can be quite volatile, and the probability of realizing a loss within any given day is high. However, the likelihood of realizing a loss has historically decreased over longer holding periods. The image illustrates that while the probability of losing money on a daily basis over the past 20 years was 46%, the probability dropped dramatically when analyzing an annual time period—20%. Periodic review of an investment portfolio is necessary, but investors shouldn't let short-term swings affect their view of the future.

Probability of losing money in the market 1991–2010



Source: Stocks are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. An investment cannot be made directly in an index. Returns and principal invested in stocks are not guaranteed. Probability of loss is calculated as the number of negative periods divided by the number of total periods using the specified frequency of data.

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Atlantic Capital Management has been providing their clients with strategic financial planning and investment management services for over 25 years.

Our active and sophisticated investment approach is designed to minimize risk and maximize returns.

Monthly Market Commentary

Much of July consisted of market participants eagerly awaiting announcements from the U.S. Federal Reserve and the European Central Bank (ECB). The main expectation was for some form of concrete action to revitalize lackluster economies in the wake of the global slowdown. Markets soared after ECB chief Mario Draghi made strong statements, including how the ECB was "ready to do whatever it takes to preserve the euro," but unfortunately fell sharply again when the ECB failed to actually provide any strong policy support to troubled Eurozone economies. Earnings season showed corporate earnings mostly came in better than expected, though revenue was mostly light as the European crisis continued to affect many companies.

GDP: Second quarter real GDP growth came in at an anemic, but not surprising 1.5%, down from a revised 2.0% in the first quarter. A slowdown in consumer spending and a rise in imports were the main causes of this deceleration. While many have questioned whether the U.S. might already be in a recession, the latest GDP results do not currently reveal that. At the same time, it is difficult to argue that the U.S. economy is booming.

Employment: Investors breathed a huge sigh of relief as 172,000 jobs were added in July, up from a revised 73,000 jobs in June. Most of the job growth came from business services, restaurants, health care, and manufacturing while government hiring shrank by 9,000. Unfortunately, the construction industry continued to contract from poor construction hiring in the commercial sector. The unemployment rate inched upwards slightly to 8.3%.

Housing: Housing data continued to show improvements, as July builder sentiment made its largest single-month increase in a decade. June housing starts set a new recovery high after rising 29% year-over-year, and June existing home inventories remained about 20% below year-ago levels. While low inventories have started to weigh on existing home sales, which fell 5.4% from May to June, lower inventory levels also caused a dramatic rise in median prices. Morningstar economists believe that while it is unfortunate housing is improving at such a slow pace, it still has a lot of room to expand and may drive the economy even higher as exports and manufacturing begin to slow.

Manufacturing: The purchasing manager reports in July indicated paltry gains for both U.S. and China manufacturing, while the Eurozone continued to show broad-based weakness with a 37-month low reading as European companies continued to cut employment and inventories in the face of further expected declines. More importantly, slowdowns in France and Germany suggest that further weakness lies ahead.

Auto: Auto sales were a big help for the economy in both the December 2011 quarter and the March 2012 quarter, but were essentially flat from March to June. With July's vehicle sales of 14 million units, the auto industry continued to hold steady and will most likely not be a big help in the second half of 2012. Although sales did not accelerate, more sales were made to consumers instead of corporate fleets or rental car companies. It is worthwhile to note that consumer sales tend to occur at higher prices and are considered more indicative of economic strength.

Inflation: June's CPI report showed that medical services and apparel prices increased, while overall energy and airline prices fell. Droughts in the Midwest continued, which could mean even higher corn and soybean prices that may further drive up the prices of items (such as pork and chicken) higher up the food chain. Unfortunately, this may hurt consumers, who were just beginning to get ahead of inflation.

Keeping It Real

Inflation has averaged 3.1% over the last 30 years. This might not seem like much, but this reported figure only tracks total goods and services purchased by the typical consumer. This is a good measure for the economy at large, but it may not be representative for individuals whose lifestyles and buying habits differ from the typical consumer.

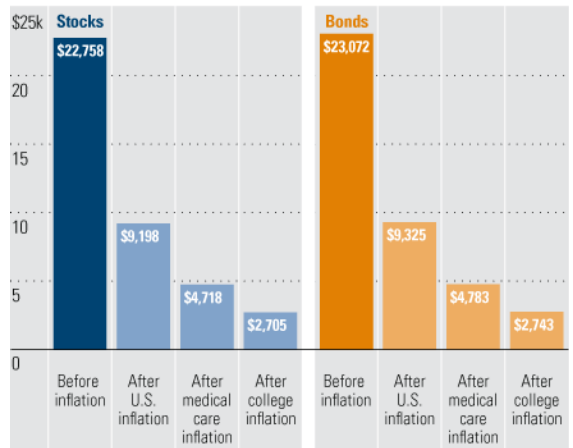
Goal-based investors may experience higher inflation. People who need to focus on savings for college or medical care may be left short, as the cost for such items often tends to rise at a faster rate than the average cost of living. Those investors might not be able to keep pace with rising costs if they do not take their real inflation rate into account when planning their investment goals.

The image illustrates the effect of three types of inflation on an investment of $1,000 in stocks and bonds: overall U.S. inflation, medical-care inflation, and college inflation. After 30 years, inflation has considerably reduced the wealth of the original investment. For example, the $1,000 invested in stocks and bonds only grew to $9,198 and $9,325, respectively, after adjusting for U.S. inflation. Alas, even more bad news for a family with children or a baby boomer nearing retirement.

Further, of the two asset classes considered, bonds provided more growth after inflation, which is unusual. Investors wishing to keep pace with inflation would typically consider a larger allocation to stocks or explore other investments that protect against inflation. However, due to the two major crises and associated stock market declines experienced during the "lost decade," stocks performed more weakly than bonds.

Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss. The rates used in the analysis and their corresponding compound annual growth rates are the consumer price index for: all urban consumers (CPI-U) (3.1%), medical care (5.4%), and college tuition and fees (7.4%).

Investment of $1,000 in Stocks and Bonds Before and After Inflation Rates, 1982–2011



Source: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and is considered to be representative of the U.S. stock market in general; Bonds—20-year U.S. government bond; Historical inflation—Consumer Price Index; Growth rates of CPI categories—non-seasonally adjusted U.S. city averages from the Bureau of Labor Statistics.

Annuities: Beware of Excess Withdrawals

It's extremely important to understand the impact of withdrawals on a living benefit attached to an annuity contract. The most widely used living benefit today is the lifetime guaranteed minimum withdrawal benefit (Lifetime GMWB). These usually allow you to make withdrawals from your account up to an annual limit (usually 4–6% of your investment). If you withdraw more than that percentage, future payments may be reduced. Sometimes, an excess withdrawal triggers a reset of the base on which your guaranteed amount is calculated. These withdrawals can also negatively impact the account value and death benefit. Example: You purchase an annuity for $100,000 that allows you a guaranteed 5% annual withdrawal until you start receiving your monthly payments for life. You may withdraw $5,000 every year. If you take out more than $5,000, your annual guaranteed withdrawal amount may decrease, and you won't be able to take out as much the following year. An excess withdrawal of, say, $5,500 will trigger a reset of your benefit base to equal your current account value. If the current value of your investment sub-accounts is, say, $80,000, you now get 5% of $80,000: only $4,000. The examples presented herein are for informational purposes only. They are not representative of any specific annuity and do not constitute investment advice. Annuities are suitable for long-term investing, particularly retirement savings. Withdrawal of earnings will be subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal tax penalty. Additional fees apply for living-benefit options. Investment restrictions may also apply for all living-benefit options. Violating the terms and conditions of the annuity contract may void guarantees. Read your prospectus carefully for all the fees and expenses that may apply to your variable annuity contract. It is also recommended that you consult with a financial advisor and tax advisor before purchasing an annuity.

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