

The S&P 500 and most other global equity markets posted gains during the fourth quarter, either wholly or partially offsetting the third quarter's market declines. The accompanying year end market commentary presents the quarterly and whole year benchmark performance returns for your reference. 2012 was a disappointing year for equities on the whole, with the exception of certain segments of the U.S. market. Most non-U.S. equities ended the year in the red, and it was a particularly poor year for the emerging markets, ending a good ten-year run on a down note. It was a very good year for bonds in contrast to equities, and U.S. Treasuries unexpectedly performed extraordinarily well as investors staged a flight to safer territory in light of problems coming out of Europe and fears of a potential global economic slowdown that could result. It's important to note that an actual slowdown has yet to manifest itself, and the market's positive fourth quarter performance seems to back this up.

All industry sectors within the S&P 500 posted gains during the fourth quarter 2011 led by the energy, materials, and industrial sectors. It was a very mixed bag of results over the whole year however, as the consumer staples, health care, and utilities sectors ended the year with gains of ten percent or higher, while the financial sector continued its long run of poor performance, and was down nearly twenty percent. The financial sector did improve significantly the latter half of the fourth quarter and into the first week of the New Year. It remains to be seen if this rebound can be sustained. We remain skeptical that material improvement in bank balance sheets and earnings potential justifies a complete turnaround.

Our year end commentary highlights two burning issues weighing on the global and U.S. economies. The first is the sovereign debt crisis in Europe that remains far from any meaningful resolution, and the second being the U.S. housing market, where home prices continue to fall. Much of how the equity markets perform in 2012 will be determined by how these two situations play out. There are several interesting parallels between the European debt crisis and U.S. housing, both of which resulted from too much leverage and shady accounting and sales practices. We envision eventual workable solutions both in Europe and here in the U.S., unfortunately they both require a wider share of pain, but ultimately this will be to the benefit of the global markets.

Economic growth in the U.S. is expected to be around two percent the first half of the year, and any signs of better performance should be very good news for stocks. Most indicators in the U.S., for example, retail sales, private sector employment, and industrial production, were stable or improved over the fourth quarter. We believe this momentum can be maintained over the next quarter or two, but this is going to depend on how the major issues of the day are dealt with and not allowed to twist in the wind. Our view is that 2012 is starting out not much different than much of 2011, relatively slow growth, but growth nonetheless, and we should be prepared for continued greater than normal volatility for at least this next quarter.

During the fourth quarter, we generally reduced the most volatile equity holdings when market volatility was at its highest and substituted more stable holdings in the face of greater uncertainty. We've placed even greater emphasis on dividend income, which is tax advantaged through the end of 2012 (another extension of the 2003 tax cuts will soon be on the table), as well as opportunities to add to fixed income holdings when we see attractive spreads over Treasuries for short to intermediate term bonds. These generally are BBB to BB rated corporate credits where we're comfortable with debt to capital ratios and stability of cash flow generation.

We have positive, though guarded, expectations for the coming year, and are positioned accordingly. Some may have noticed slightly greater cash than normal, and we plan on investing any surplus in special opportunities among high quality, attractively priced stocks that may surface during the current earnings season. Thank you for your continued confidence in our abilities to provide you service, and rest assured we will work hard in evaluating and executing on opportunities that best meet your investment needs.