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Fourth Quarter 2011

**“THERE IS NOTHING WRONG WITH AMERICA THAT FAITH, LOVE OF FREEDOM, INTELLIGENCE, AND ENERGY OF HER CITIZENS CANNOT CURE.” –DWIGHT D. EISENHOWER**

Whew, what a year! If by some miracle you remained completely out of touch with the news headlines during the past year, you might assume it was an uneventful one with the S&P 500 essentially flat. Unfortunately, 2011 was a rollercoaster ride with ups and downs, and twist and turns, ultimately ending just where it began.

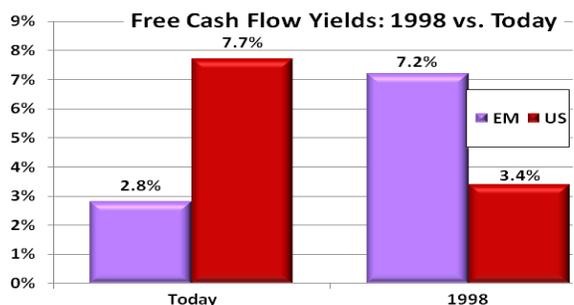
*The Best House in a Bad Neighborhood*

As we reflect on the past year and lackluster performance of the S&P 500, the US stock markets were actually one of the ‘least worst’ for investors, outperforming every other market index in dollar terms.<sup>1</sup> Many investors don’t realize that the S&P 500 has been outperforming the MSCI BRIC (Brazil, Russia, India, China) Index for four years now. To give some perspective, the table below shows the 2011 returns of 10 major International Stock indexes.

Country	Index	2011 Return	Country	Index	2011 Return
France	CAC 40	-17.0%	Germany	DAX	-14.7%
Canada	S&P/TSX Comp	-11.1%	Japan	Nikkei	-17.3%
Australia	S&P/ASX 200	-14.5%	Brazil	Bovespa	-18.1%
China	Shanghai Comp	-21.7%	India	BombaySensex	-24.6%
Int’l Dev	MSCI EAFE	-14.8%	Em.Mkts	MSCI EM	-20.4%

Data Provided by the Wall Street Journal and Thomson Reuters as of 12/31/2011

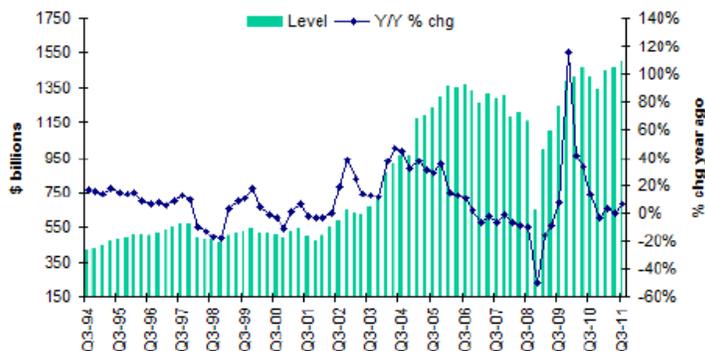
The Chartist believes that the strong relative performance of the S&P 500 ETF versus other country ETFs is an indication the US will lead most of the world indices in the next bull market.<sup>2</sup> Richard Bernstein of Richard Bernstein Advisors notes that when Emerging Market Equities bottomed in 1998 they had free cash flow yields between 7% and 8% while US free cash flow yields were only 3%.<sup>3</sup> Today, it’s the opposite and a good indication for US investments.



Source: Richard Bernstein Advisors LLC, Bloomberg<sup>3</sup>

Mr. Bernstein also believes that US earnings statistics remain the strongest in the world.<sup>3</sup> The graph below shows that US Corporate profits have already recovered and are making new highs. With the S&P 500 flat in 2011 and corporate earnings on the rise, valuations are now more attractive than this time last year.

After Tax Corporate Profits: Level and Yearly Change



updated 12/22/11

ECONOMY

*Market Predictions... an exercise in futility*

If the last few years have shown us anything, it’s that making predictions can be an exercise in futility. We will leave it to the ‘experts’. The table below shows the predictions of 10 Market Strategists from the December 19<sup>th</sup> issue of *Barron’s*. An average of the estimates calls for the S&P 500 to rise 8.5% to 1360 on earnings growth of 5% to 7% and a modest P/E multiple expansion to 13x from 12.5x currently.<sup>1</sup> These strategists acknowledge that there is significant upside and downside to their prognostications depending how the events in Europe continue to unfold. While we hope for the best, hope is not a way to manage risk. We remain focused on conservative managers in each asset class.

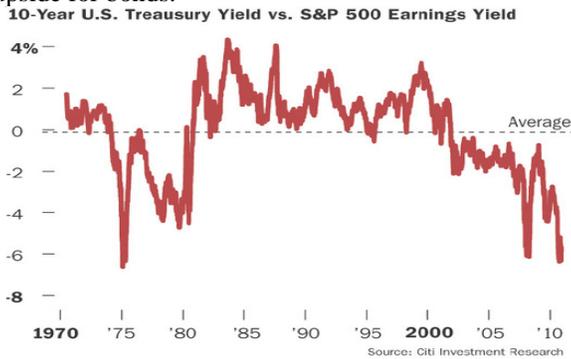
2012 Estimates	S&P 500	% Gain	EPS	US GDP
Steve Auth, Federated Investors	1450	+15%	\$110	2.5-3%
Thomas Lee, JPMorgan	1430	+14%	\$105	1.7%
John Praveen, Prudential	1430	+14%	\$107	2.5%
Jeffrey Knight, Putnam	1420	+13%	\$105	3.0%
Tobias Levkovich, Citibank	1375	+9%	\$101	1.9%
Robert Doll, BlackRock	1350	+7%	\$102-\$103	2.0%
Savita Subramanian, Bank of America	1350	+7%	\$104.50	1.9%
Barry Knapp, Barclays Capital	1330	+6%	\$103	2.5%
David Kostin, Goldman Sachs	1250	0%	\$100	1.5%
Adam Parker, Morgan Stanley	1238*	N/A*	\$103.20	2.2%
<b>Average:</b>	<b>1362</b>	<b>+8.5%</b>	<b>\$104.12</b>	<b>2.2%</b>

\*Year-end 2011 Target

Data Provided by Barron’s as of 12/19/2011<sup>1</sup>

According to Tobias Levkovich at Citibank, the spread between the S&P 500 earnings yield (8.6%) and the 10-year US Treasury yield

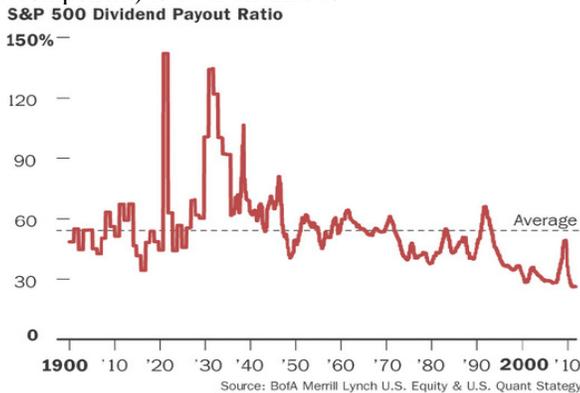
(1.91%) is at a level that preceded big stock market rallies in the past.<sup>1</sup> He is cautiously optimistic on US stocks but does not see much upside for bonds.



Given the ongoing global economic uncertainty, investors should expect continued volatility in the capital markets. Please call us if you would like to discuss your risk tolerance or asset allocation.

*A word on Dividends*

The total return of an investment includes two components: Income and Capital Appreciation. In the graph below, Bank of America Merrill Lynch US Equity and Quantitative Strategist, Savita Subramanian, shows that the S&P 500 dividend-payout ratio (the Income component) is at an all-time low<sup>1</sup>.



This aligns with our commentary last quarter which highlighted the large cash hoards on corporate balance sheets. It's possible we could begin to see companies return this capital to shareholders in the form of increased dividends and share buybacks. For this reason, we've been making Equity Income investments like the Nuveen Santa Barbara Dividend Growth Fund (NSBRX). Manager, Jim Boothe, invests in companies that have a sustainable dividend and the ability to grow their dividend payout over time. Boothe generally avoids the highest yielding stocks, which have actually underperformed historically.

*An update from Private Capital Management, Inc.*

Earlier in the year PCM offered partnership to Justin Apt. He has over nine years of Investment Management experience working for several Registered Investment Advisors around the country. Justin's background is primarily Investment Research and Trading, and his hard work has been instrumental to the firm. We are pleased to have him as part owner and Managing Partner. Justin is an additional resource for you, so please feel free to contact him with any questions or comments about your investments with PCM.

We were sad to see Kim Meade (Whitman) move to Wyoming during the year. And while she is still consulting for PCM as needed, we certainly miss having her in the office each day.

We are excited to announce that Nicki Kadel (Munis) got married this year and delivered a happy and healthy baby girl on December 3<sup>rd</sup>. Her name is Kenley Eliana Kadel and we wish Nicki and her husband a happy and healthy year as a new family.

To help cover the front desk during Nicki's maternity leave, we hired Jennifer Jordan. She has been with us for 3 months and we are very pleased to have her as part of the team.

*Sydney Williams of Monness, Crespi, Hardt & Co., Inc.*

"My best advice for 2012 is to stay healthy and make the most of each day, keeping in mind that every hour that passes is one that is gone forever. Each one of us will have opportunities for success and for failure, and it pays to know the difference. It behooves us to be adaptable and accepting of change, the one constant in our lives. Life is a gift to be savored and enjoyed."<sup>4</sup> ~The PCM Team

**By the numbers...**

Index	Close	4 <sup>th</sup> Quarter	Year to Date
S&P 500	1257	+11.2%	0.0%
MSCI EAFE	1412	+2.9%	-14.8%
MSCI Emerging Markets	916	+4.1%	-20.4%
Barclay's US Aggregate Bond	123	+0.3%	+4.3%
DJ UBS Commodity	140	+0.3%	-13.4%

Data provided by Thomson Reuters as of 12/30/2011

<sup>1</sup> "2012 Outlook: Our pros see stocks rising 12%, after a rough first half. Buckle Up!" Vito J Racanelli, *Barron's* 12/19/2011

<sup>2</sup> "The Chartist: Trendless Volatile Year" Dan Sullivan, Steve Mais 12/22/11

<sup>3</sup> "2012: Politics Versus Fundamentals" Richard Bernstein [www.advisorperspectives.com](http://www.advisorperspectives.com) 12/9/11

<sup>4</sup> "Thought of the Day: "Predictions – An Exercise in Futility" Sydney Williams, Monness, Crespi, Hardt & Co., Inc 12/30/2011

**Disclosures**

**Investment Products:** Not FDIC Insured – No Bank Guarantee – May Lose Value  
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