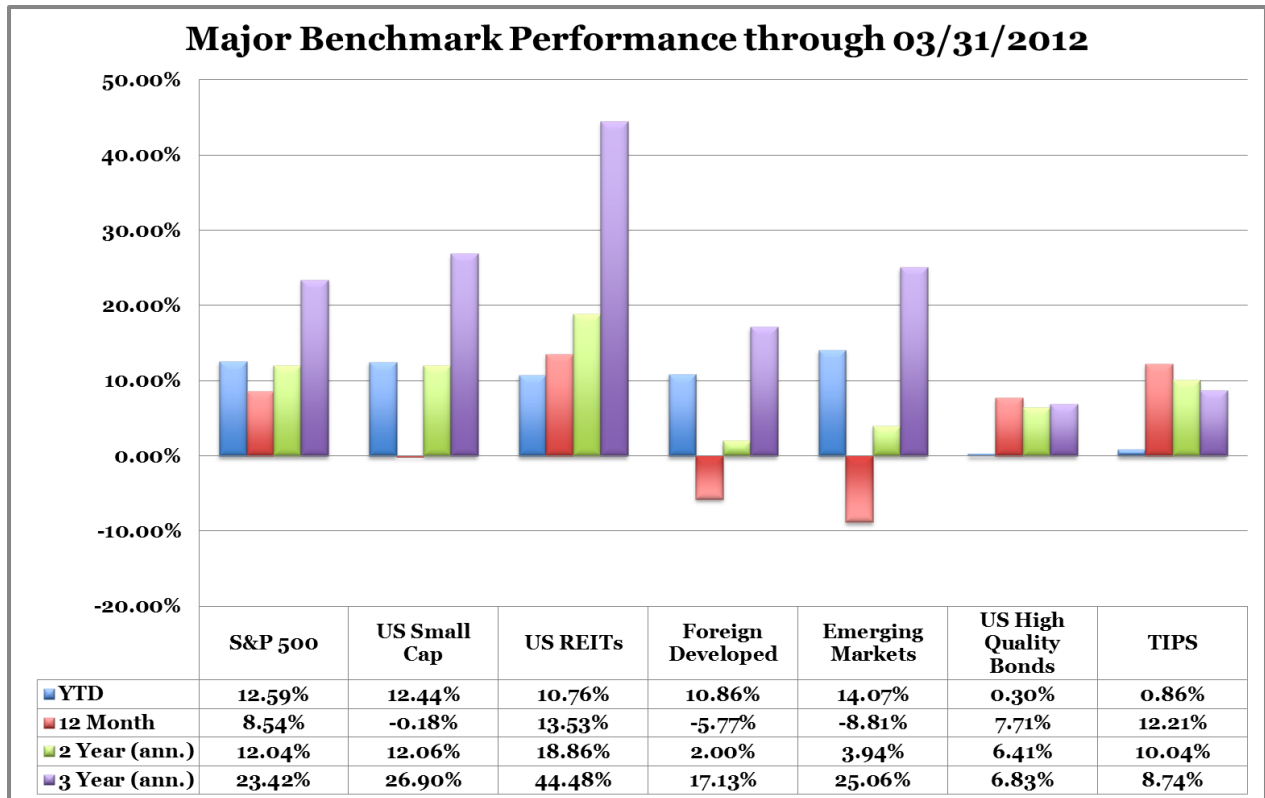


Market

After a tumultuous 2011, the first quarter of 2012 provided a nice reprieve from market volatility. All investment returns for the quarter were positive (see chart below). Also note the three year annualized returns. While there has been a fair amount of volatility in the past three years, the S&P 500 is now up over 100% since its low on March 9, 2009.



Source: DFA

Despite this quarter's positive numbers, the investor mood was very different at the end of 2011. Investors were shell-shocked - the S&P 500 had declined over 20% between late July and early October and the predictions for 2012 were for a slow recovery, a recession in Europe, a possible default of Greece and a slowdown of China (in addition to a potentially contentious US presidential election). Investors who acted on these concerns and got out of the markets in 2011 and/or stayed out of the market in the first quarter were likely frustrated with themselves on March 31.

As we progress into 2012, we are optimistic the US economy will continue to improve slowly, but do expect volatility.

Our consistent recommendation, especially for this quarter, is for our clients to remain invested in a diversified portfolio. With that said, we do not believe the pace of growth we just experienced is sustainable and would not be surprised if the markets corrected somewhat in this quarter.

Below are a few noteworthy developments we identified from news stories, economists, and commentaries:

US

- The US **unemployment** rate continued to drop at a painfully slow rate, ending the quarter at 8.3% (down from a high of 10% at the end of 2009). To put this number into perspective, when the economy was at full employment in 2007 the unemployment rate was under 4.5%. The generally accepted full rate of employment is 5%.
- **Housing**: the Case Shiller index for housing prices dropped again in January although the pace of the decline slowed, possibly indicating a stabilization of market drops. However, we do not believe the trouble is completely behind us as the number of potential foreclosures remains high.
- **GDP** – the third and final estimate for 4Q11 was an annualized 3%, not spectacular but moving in the right direction. Unused pent-up demand in areas such as housing, autos, and inventories should continue to drive growth.
- **US corporate profits**: after three years of rapidly increasing profits, the prediction for 2012 is for a slowdown in that trend. Some believe corporations are reinvesting some of their profits into hiring, which of course contributes to lower unemployment.
- The **Federal Reserve** indicated in its most recent minutes that it is less likely to provide another round of stimulus. The markets reacted negatively to this news. For the long term good of this country, we do not see weaning ourselves off easy money as a bad thing.
- **Market valuation** - One measure of fair value of the market is the price to earnings (P/E) ratio which is a measure of the price paid for a share relative to its annual net income per share. JP Morgan indicates the forward P/E ratio for the S&P 500 is 13, below the long term trend of 16. Because there are so many

ways of measuring P/E trends and averages, we take this number somewhat with a grain of salt, but we do not believe the market is overvalued.

International

- **Greece** successfully pulled off an out of bankruptcy restructuring. Although some holders of existing Greek debt tried to threaten the deal, they were unable to prevent the exchange of existing Greek debt for new bonds with a lower principal amount and longer maturities. While this development is a huge relief, investors are still wearily watching other European sovereign debt offerings (e.g. Spain, Italy, and Portugal) and whether demand will be high enough to keep yields down.
- **China** – after growing at 10% per year for much of the past decade, China recently revised downward its 2012 GDP to 7.5%, which could have worldwide reverberations. Many pundits think the recent market reaction to the news is overblown.

Summary

Strong performance in the first quarter left investors feeling good about the markets. While we are pleased at the turnaround after a rough 2011, we remain cautious and recommend our clients remain diversified as we maintain no one can accurately and consistently predict the markets.

We thank you for your continued confidence in us and encourage you to call or email anytime.

Sincerely,
Barry & Janet