1st Quarter 2013

Stocks resumed their climb over the wall of worry in the first quarter. The Standard & Poor's 500 index (S&P 500) rose 10% during the quarter, the strongest first quarter since 1998, to a new all-time closing high. International market performance was mixed. Japan was up nearly 12% as the Bank of Japan telegraphed a plan to add massive amounts of liquidity to their markets. Meanwhile, emerging markets as measured by the MSCI EM Index, declined in price by roughly 2% as Brazil and China, two major EM economies, suffered from renewed policy tightening measures. Europe muddled its way to slightly positive returns as Cyprus became the most recent European nation to get in over its head and require a life-line from European policymakers.

First quarter stock strength was broad during the quarter as all ten Standard & Poor's sectors moved higher with seven of the ten sectors turning in double-digit total returns. "Safe" sectors outperformed as Health Care (+15.8%), Consumer Staples (+14.6%) and Utilities (+13%) led the way higher while cyclical sectors such as Materials and Technology brought up the rear returning 4.8% and 4.6% respectively. Commodities, as measured by the GSCI Commodities Index (+1.3%), underperformed thanks to a nearly 5% decline in gold prices.

As seems like the case for an eternity, the economic picture remains cloudy and the U.S. remains stuck in neutral. GDP growth remains stubbornly low with most economists now penciling in 2% growth or less for 2013. The unemployment rate has improved slightly, however many are pointing to the lowest labor participation rate in a generation as the primary cause. A reduced unemployment rate is welcomed, but a reduced rate because fewer people are looking is clearly not a recipe for economic growth. There are, however, some bright spots in the economy as new car sales and housing starts have hit their highest levels since 2008. Some of this rebound no doubt is being driven by a rebound in household wealth thanks to the continued strength in the stock market.

Once again, higher risk securities outperformed in the bond markets as investors continued to sacrifice credit quality for yield. High yield bonds were the best performers in the fixed income arena returning 2.9% while investment grade corporate bonds inched up .05%. The benchmark 10-year U.S. Treasury yield rose slightly during the first three months of the year and settled at 1.85% as the quarter came to a close.

The U.S. economy continues to recover, albeit at an alarmingly slow pace and we maintain our cautiously optimistic view of the US stock market. At this point, the market as a whole appears to be fairly valued, neither overly cheap nor expensive. Central banks around the globe continue to provide the markets with a tremendous amount of liquidity which has enabled stocks to keep marching higher. At some point however stronger growth will become a necessity.

Based on current valuations, we continue to view equities as relatively more attractive than bonds for a long-term investor but we believe it is prudent for most investors to take a balanced approach given the uncertain climate. Slow but steady corporate earnings growth coupled with ongoing loose monetary policy keeping interest rates low should continue to drive money away from cash and into stocks.

As investors with a long term focus, we continue to invest in companies with sound balance sheets, strong cash flow, attractive business outlooks and relatively inexpensive valuations. Within the fixed income markets we remain selective and take advantage of opportunities when they present themselves by focusing on both the return *of* and the return *on* principal.

We welcome your comments or questions and thank you for your continued confidence.

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