OCTOBER 2012 INVESTMENT COMMENTARY

ON THE EVE OF THE ELECTION AND THE EDGE OF THE CLIFF - LOOKING AHEAD TO BETTER TIMES

When we sit down to write each month's investment commentary we set out to convey what we are thinking based upon the most current and pertinent information and the knowledge that we acquired over the past month. Additionally, we attempt to reinforce our core philosophies as they relate to what is happening in the economy and capital markets.

September gave us another solid month of gains in the equity markets thanks in part to the Federal Reserve announcing an open ended QE bond buying program focused on mortgage backed securities – dubbed by the media as QE Infinity. Additionally, the Federal Reserve again reinforced and extended its commitment to keep interest rates low until early 2015. The reinforcement of this commitment came in the form of a statement that they will not immediately begin to reverse the 0% to .25% target range for short-term interest rates even once the economy begins to initially strengthen.

Many pundits have suggested that the Fed's aggressive action in September was politically motivated given that candidate Romney has vowed to replace Chairman Bernanke, should he be elected President. We always pay attention to what the Fed Chairman is saying and doing; we believe that this newly announced QE program was the next logical extension of the previous two QE programs, justified by persistently weak economic data and subdued inflation pressures. Had the Fed delayed its actions in implementing this new policy action until after the November election simply because of the election calendar, this would have been politically motivated and would have jeopardized the perceived independence of the Fed.

Right now, with paralysis in Washington, the Fed remains the only policy body that can act to effect economic activity, which is central to businesses deciding to invest in new workers. Post-election, should we see the gridlock in Washington loosen and pro-economic growth policies begin to be seriously debated in a bi-partisan manner, maybe then, and only then, can the Federal Reserve stand-down.

We are fairly convinced that no matter who wins the White House, Congress will attempt to rehabilitate its badly tarnished reputation and take on the challenges of tax reform and deficit reduction that are so badly in need of attention. If we retain a split Congress, as we anticipate, the legislature that emerges will have to act in a bi-partisan, and the President will be compelled to sign bi-partisan legislation into law. Should this happen as we anticipate, we believe that the negative sentiment that currently pervades the country will turn noticeably more positive as 2013 progresses. However, should either party run the tables in November, all bets are off as 2013 could look decidedly different and more challenging. Our base case is the continuation of a divided government in Washington, a rediscovery of compromise resulting less fear and uncertainty as 2013 progresses. As far as the "Fiscal Cliff", we foresee heightened drama in the "lame duck" session of Congress following the election, but when all is said and done, an anti-climactic postponement of the most dreaded aspects this

culmination of the dysfunction that has defined Congress over the last two years. In the meantime, economies around the world are sluggish at best, weighed down by the recessionary environment in Europe and inevitable slow-down in the once red-hot emerging markets, which is well underway.

SLOWING GROWTH / RISING STOCK MARKET – WHAT IS THAT TELLING US?

The IMF's most recent assessment of the global economy reduced expected growth rates around the world, with global growth for 2012 now expected to be 3.3%, down from an earlier forecast of 3.5%. The U.S. is projected to post economic growth of 2.2% this year, among the fastest growing of all developed economies around the world. For 2013, global growth is expected to be 3.6%, down from a previous estimate of 3.9%. These current forecasts assume that the U.S. does not allow the potential disruptive effects from the "fiscal cliff" to materially impact the economy. In many ways, as with the "fiscal cliff", the U.S. controls its own economic destiny. With respect to boosting economic growth from current levels, policy makers in the U.S. can impact whether we participate fully in a growing global economy or whether we become an anchor on global growth. Listening to election rhetoric, one would think that U.S. economic growth is exclusively hampered by our own bad decisions, when clearly we have been one of the most successful developed nations in the world in re-igniting economic growth following the financial crisis and deep recession. A global economy ties all economic participants together much more than most Americans are willing to concede. Our outlook is formed through by looking at investment opportunities through a global prism, not a fixed U.S. centric telescope.

Knowing that the world economy has been slowing down, we are currently much more focused on the upcoming corporate earnings season, which is not expected to be filled with positive catalysts. That's actually somewhat comforting since the expectations bar has been lowered significantly over the last several months, while the stock market has continued its ascent. It is very possible that the third quarter earnings announcements will, on average, not turn out to be quite as gloomy as currently expected. That being said, since the stock market has not fallen ahead of these earnings reports, the market is unlikely to continue its advance even if earnings are slightly better than expected. Being active managers, we attempt to single out those companies who are truly operating in such a manner that they can outperform market expectations going forward.

We are very comfortable with our stock selection process, which is flexible, but driven by an unwavering commitment to fundamental value assessments, as well as avoiding value traps, over-hyped areas, and companies that are virtually impossible to value due to incomprehensible complexity. In terms of bonds, we add value because we select bonds based upon our uncommon approach of digging into what matters most, how our clients get paid back on the loan that they are making when they own a bond. We have learned over the last decade that the most dangerous bonds to own are the ones that seemingly have very little risk because of the rating placed on them by S&P or Moody's. These ratings create complacency that can lead to unexpected surprises. When this happens you can get blindsided by the unforeseen and this can cause a bond that is rated AA on Tuesday to become a Junk rated bond by Wednesday morning, without warning. In spite of the credit work that we do, rising interest rates will always remain a risk to the market value of our clients' bond portfolios. Should our aforementioned 2013 scenario unfold, higher interest rates on longer dated bonds would likely ensue, and the gains that currently appear on the statements of many of our clients' bond portfolios will begin to disappear.

REJECTING THE BINARY CHOICE OF STOCKS OR BONDS

As we assess our outlook for the next 12-18 months, we must be prepared to replace a portion of our clients' respective bond portfolios in order to preserve the gains that have been generated by well-timed bond purchases. The obvious answer would simply be to shift a portion of the assets that are currently invested in fixed income toward equities. However, given that the risk of geopolitical shocks is not likely to recede anytime soon, moving to a significant overweight in traditional stocks would not necessarily be prudent. Therefore, we have challenged ourselves to find investments capable

of producing equity like returns, and current income, while insulating our clients from traditional market volatility. On the surface this challenge seems daunting; however we believe that our search has turned up several opportunities that accomplish all of those objectives. Our partner, Coastal Investment Advisors, held their annual investment conference last month. We attended this conference for the first time and were honored that Mike Donnelly chose to have us join a panel of select asset managers from across the country to discuss our asset management approach and views on investing in today's market. This conference was truly an educational experience for everyone who attended. We especially benefited by establishing relationships with other presenters who attended the conference. We became aware of very impressive provider of proven investment strategies that were characterized by the rare qualities of being both non-traditional and easy to understand.

Many of these presenters represented specialized investment companies, whose strategies fit amazingly well into the previously mentioned category of investments that we had challenged ourselves to find for our clients. Over the last several weeks we have continued our discussion with several of these companies. We are looking forward to discussing these strategies with clients who we believe can benefit from them.

These strategies cover investment categories ranging from private energy investment, pre-development land acquisition, and specialized pools of private equity loans. Access to these investments, which are typically offered with very high minimum investment thresholds and substantial front loads, are made possible through our affiliation with Coastal Investment Advisors without any front loads, and at significantly lower minimum investment amounts.

As StaufferWilliams winds down its first year, our ability to deliver truly differentiated investment management capabilities continues to expand, as does our optimism that we have built a truly unique organization that can and will continually to improve. We will have more announcements to make in the near future that will illustrate this desire to continuously stretch our capabilities.

We have already began introducing the idea of incorporating one or more the of the aforementioned non-traditional investment strategies for some clients. Please do not hesitate to reach out to either of us if you want to learn more about these unique investment opportunities.

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