Quarterly Letter To Investors: *October 2011*

In the age of Twitter, Facebook and text messaging where access to and dissemination of information occurs at an increasingly rapid pace, a number of our clients have expressed a desire for us to summarize our views in a more abbreviated fashion. For them, we offer the following commentary. For those who wish to explore economic and financial market conditions in a bit more detail, please continue reading beyond this cover page.

Executive Summary

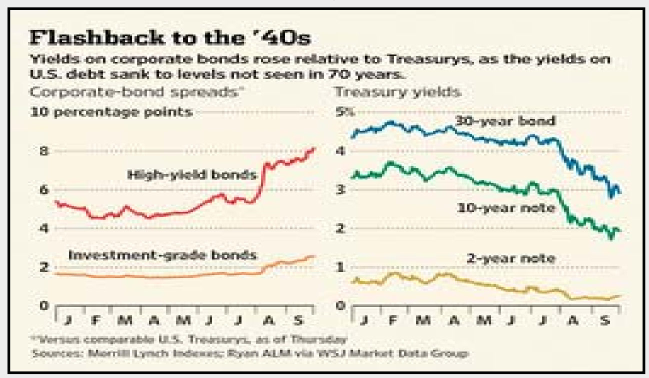
Investors reacted violently to news of economic slowing in the third quarter. Headlines were dire in nearly every corner of the globe as we simultaneously digested the possibility of the U.S. defaulting if the debt ceiling was not raised, a Greek sovereign debt default, large European bank failures and the implications of an economic slowdown in China. All major U.S. stock indexes declined by 12% or more during the quarter, commodities fell by 11% on average, however the U.S dollar and U.S. Treasury securities rallied as investors sought a safe haven, pushing yields to historic lows.

Markets have been battered for months by Europe's debt crisis and continued fears that the world's developed economies are headed for another recession. Since the current correction began in late July, any rally attempts have been short-lived as traders have been quick to take profits and exit positions. Until this pattern changes, it will be difficult to sustain any meaningful move higher.

Economic data do not presently support the widespread concern that the U.S. may be close to entering recession. Employment, manufacturing activity and consumer spending have all continued to grow, albeit at a slow pace. With the financial crisis of 2008-2009 still fresh in investors' minds, the recession concerns appear to be driven by a crisis of confidence surrounding political dysfunction in Europe and Washington D.C. After decades of profligate government spending and rising debt levels, the day of reckoning appears to have arrived. Policy makers in Europe and the U.S. have implemented a series of fiscal and monetary programs intended to stimulate demand and inflate asset prices. Investors are now balking at these efforts as the wrong prescription for the economic ailment. Wall Street is essentially unconvinced that these structural problems can be fixed via traditional cyclical stimulative measures such as lowering interest rates and additional government spending. Nothing short of real fiscal reforms coupled with pro-growth economic policies will satisfy investors for very long.

Sharp drops in interest rates and commodities and stock prices in the last few months have traditionally been leading indicators of slower future economic conditions. Since statistics currently suggest the U.S. economy is growing rather anemically, it is possible that in any of the next several quarters GDP could actually contract. Our view is that since stock prices are already discounting this possibility, if we avoid recession, stocks have the potential for meaningful gains on the order of 20-30% by the end of 2012. Alternatively, if we do slip back into recession, we do not believe the decline in corporate profits will be anywhere near the severity of the last recession. Consequently, we believe the downside for U.S. equity prices from current levels is more in the neighborhood of 10-15% which implies a favorable risk/reward ratio.

On the fixed income front, we admittedly failed to foresee just how much further U.S. Treasury bond yields would drop as the economy weakened.



Ben Bernanke, chairman of the U.S. Federal Reserve Bank has stated that interest rates will likely remain extremely low through at least mid-2013. The Fed's monetary policy stimulus along with the U.S. dollar's safe haven status during turbulent financial periods have pushed Treasury yields near all-time record lows. Nevertheless, we do not believe it makes much sense to invest in U.S. government or government agency securities when 10 year Treasury yields are below 2%. In cases where current yield is required, we suggest investing in higher yield alternatives such as high yield corporate bond funds, REITs, MLPs or even high yielding common stocks.

Naturally, any of our economic or market forecasts need to be properly weighed against individual financial circumstances and risk tolerances.

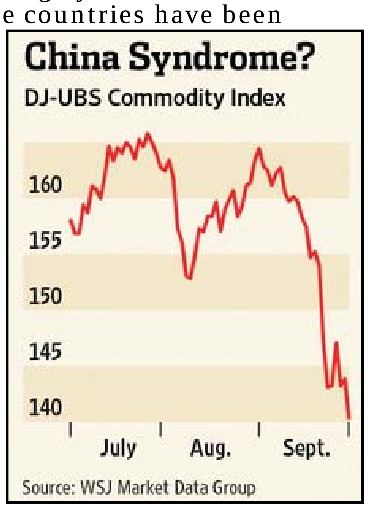
Please continue reading if you are interested in our views on Greece, China, the U.S. credit rating downgrade, U.S. politics and stock market cycles.

Greece

Why is a country that represents less than 2% of the European Union's GDP and a tiny fraction of the world's economy creating chaos in world financial markets? Greece seems to be the lead story every day. Are they meeting their austerity targets? Will the various European authorities approve additional bailout funds? Fears of a Greek sovereign debt default have weighed on markets for the past year and a half. The memory of Lehman Brothers bankruptcy and near monetary system collapse that subsequently ensued has frightened investors who fear a default by Greece would cause European bank failures and systemic global financial crisis. With Italy, Spain, Portugal, Belgium and Ireland also grappling with heavy debt loads and weak economies, there is also the fear of contagion – namely a Greek default would ripple throughout these economies and eventually take down all of Europe. How will all of this play out and what are the implications for financial markets? The European Central Bank, the International Monetary Fund and the European Financial Stability Fund are racing to shore up European banks with emergency funding programs so the banks can absorb higher losses from a likely Greek debt restructuring where creditors will be forced to write down anywhere from 20-40% of the value of their Greek bonds. With the European Union already teetering on the brink of recession, it is hard to believe that a default, coupled with additional austerity measures being implemented across the most heavily indebted countries, won't push the continent over the edge and into recession very soon. Financial markets throughout the world have been declining for months in anticipation of these events, so when it actually happens, it is less likely to cause any significant additional market declines. Unfortunately, providing bank bailouts is another measure which does nothing to resolve the deep rooted structural financial issues that exist within the European Union. Until these issues are addressed, Europe remains vulnerable to future shocks on an even larger scale if one of the larger economies such as Italy or Spain fails to get its act together.

China

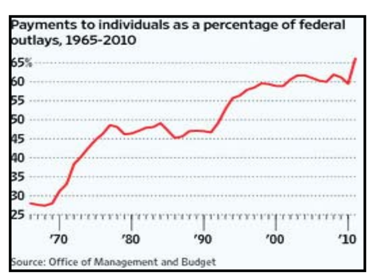
Recent economic reports indicate that China's rapid GDP growth is beginning to slow. China, now the world's second largest economy, has been the engine of growth for Asia and an important contributor to global economic growth. Commodity prices have risen aggressively in the past decade largely because of demand from China and India as those countries have been building physical infrastructure and developing private wealth. Fears of a "hard landing" for China's economy where GDP growth would slow from a 10-11% rate to low single digits have driven commodity prices sharply lower and caused many natural resource intensive sectors to be hard hit. We view a precipitous drop in China's growth rate as unlikely and believe the sudden drop in asset prices most affected by those fears presents a buying opportunity. Energy and basic materials company stocks, emerging market ETFs and commodity ETFs once again offer attractive entry points for investors with an intermediate or longer-term investment horizon.

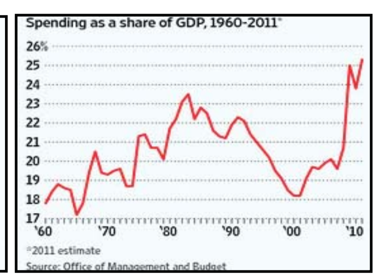


U.S. Credit Rating Downgrade

In August, credit rating agency Standard & Poor's downgraded the United States' credit rating one notch from AAA to AA+. The credit agency said the move was necessary because the deficit reduction plan passed by Congress as part of the debt ceiling negotiations did not go far enough to stabilize the country's debt situation and that policymaking is not as stable or effective as needed to address the current economic challenges. Ironically, yields on U.S. Treasury debt have plummeted since the debt downgrade as global investors still believe the creditworthiness of the U.S. is better than most other alternatives in times of financial distress. In the long run, the downgrade will raise the cost of credit for the federal government, and especially for states and institutions whose debt is pegged to Treasurys.

Our view is that a debt downgrade is a symbol of fiscal mismanagement and a warning of further economic stress if we continue along the same path. The current Administration deserves much of the blame for using the financial crisis as an excuse to spike federal spending to levels not seen since the end of World War II. But the origins behind the debt downgrade go back decades. Federal entitlement programs introduced in the mid-1960s such as Medicare, Medicaid, food stamps, public housing and others have cost dramatically more than estimated at the time of their passage. The biggest problem is that Congress established automatic spending increases on most of these programs as opposed to annual budget reviews. These benefit expansions are considered "mandatory spending" because Congress is required by the laws they passed to make payments to those who meet eligibility standards, regardless of other spending needs or the level of tax revenues. When Medicare was introduced, projections called for outlays of $12 billion by 1990, but the actual cost was $110 billion. The costs of Medicaid have exploded as Congress progressively expanded eligibility and coverage. In inflation-adjusted dollars, Medicaid cost $4 billion in 1966, $41 billion in 1986 and $243 billion in 2010. The accompanying charts make the point in graphical terms. Based upon current spending and revenue projections, $8-$10 trillion more debt will be added to the federal balance sheet in the next ten





years. We are not negating the necessity for safety nets for those in need in our society but merely identifying the basis for the level of deficit spending and federal debt. The bottom line is that automatic spending increases in entitlement programs have meant that Congress has made so many promises to so many citizens that there is no way those promises can be kept, short of raising tax rates to 70 or 80%, which would be economically ruinous.

Serious entitlement reform is therefore necessary in order to stabilize the federal debt and restore U.S. financial health.

U.S. Political Landscape

With the race for the 2012 U.S. Presidency in full swing, what are the implications for financial markets during the next thirteen months and beyond? In 2008, President Obama enjoyed widespread support from Wall Street as well as many members of the business community when he projected a centrist political philosophy. However, the President's push for higher tax rates on wealthy individuals and his administration's support for a more forceful regulatory regime have clearly hurt his standing in the business community. In a recent poll, fully 77% of respondents indicated the belief that the U.S. economy was in recession. These factors along with an unemployment rate above 9% suggest the President faces severe headwinds in his re-election bid. But anyone who underestimates President Obama's enormous political skills does so at their own peril. Given the current state of affairs, the upcoming election will most likely be fought largely on economic issues. The candidate who is able to instill the most confidence in their ability to produce jobs and get the economy growing will likely be the next President. While the President may currently be considered the underdog in the race, it is way too early to be predicting the eventual outcome. For similar reasons, financial markets will probably not be influenced by election year issues until the Republicans settle on a nominee and the economic policies he or she endorses are known. The Congressional deficit reduction super-committee will attempt to find common ground in an effort to reduce the long-term deficit by $1.2 trillion over the next ten years with recommendations due in November. Since automatic across the board cuts to discretionary spending programs and defense have already been agreed to, don't be surprised if this committee is unable to come up with a plan given the partisan makeup of the members. Beyond this we don't expect many legislative initiatives to pass a divided Congress as both political parties are already fashioning their talking points and positioning themselves for next year's general election. We'll continue to monitor the political landscape and provide additional commentary as the race takes on more relevance for financial market performance.

In our first quarter 2009 Investment Outlook we floated the idea that we were mired in a multi-decade long consolidation in U.S. equity prices that began in 2000. The recent stock market correction has increased our conviction that it will take several more years before we return to a consistently upward trending "bull market." We envision the S&P 500 stock index remaining in a trading range of roughly 1,040 on the downside to 1,350 on the upside until economic fundamentals change, as indicated on the chart below. It is interesting to note that in the last eleven years, the S&P has traded within this range approximately 65% of the time. With the S&P currently trading at 1,155, there may be a bit more upside opportunity than downside risk in our view.

With volatility having increased and portfolio values down for the first time since early 2009, we believe it is more important than ever to review financial objectives and affirm asset allocation and risk/reward parameters. If we have not discussed these issues with you recently, we suggest an appointment in the next few months may be beneficial. As always, we welcome your questions, observations, comments and feedback.

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