

# Quarterly Review



Knowledge • Experience • Integrity

## April 2012: First Quarter

### U.S. Stocks Continue to Lead

The S&P 500 Index provided a 12.2% return for the first quarter of 2012. But unlike last year, most other stock indices managed to follow suit. The Russell 2000 U.S. Small-Cap Index provided a 12.7% return. Both U.S. indices were trailed by a 10.2% return for the MSCI Emerging Market Index and 9.9% return for EAFE Index (Europe, Asia, Far East).

Encouraging news about the U.S. economy fueled double-digit gains in the financial services, technology, consumer discretionary and industrial sectors of the S&P 500 Index. Investor optimism was validated by the above-consensus estimate of a 3.0% rate of growth in real GDP for the final quarter of 2011.

### Traders Swapped Their Safe-Haven U.S. Treasuries for Equities

Intermediate-term U.S. Treasuries were a favorite parking place for investors seeking shelter from last summer's three-part tragedy led by the near-default in Greek government debt. The concerns over a possible European banking crisis, a slowing U.S. economy and a hard landing for China's economy caused traders to seek safety in U.S. Treasury bonds. As these concerns faded, investors restocked their higher-risk equity investments by trading in some of their holdings in U.S. Treasuries. While the Barclays Capital 3-7 Year U.S. Treasuries Index provided an 8.1% return in 2011, it declined 0.5% during in the first quarter of 2012.

### As Some Concerns Fade, New Ones Are Beginning to Appear

Although the recent news on the economy has been encouraging, expectations for future gains must incorporate the contractionary implications of the increases in tax rates slated to take effect in 2013. The combination of the expiration of the Bush tax cuts and the surcharges embedded in the Obama Affordable Care Act raises the top marginal tax rate on ordinary income to 43.8%, up from today's rate of 35%. Under the currently legislated tax schedule for 2013, tax revenues are estimated to increase by 30% on an annual basis over the next two years. That projection assumes transferring tax dollars from the private sector to the public sector has no impact on future rates of growth in our economy. Common sense tells us that it will.

Also slated to begin in 2013 are the automatic spending cuts called for in the 2010 congressional compromise to raise the debt ceiling. The cuts are legislated to reduce government spending by an accumulated total of \$1 trillion over the next several years. We believe there has been minimal dialogue on these issues because of the presidential election that stands between now and their enactment.

### Portfolio Allocations Incorporate Global Perspective

Although we remain constructive on the equity markets due to improving fundamentals and reasonable valuation levels, we recognize that a number of obstacles still stand in the way of sustainable growth in the

PRICE CHANGES FOR LAST 3 MONTHS AND YTD

VALUE	BLEND	GROWTH	
10.4%	12.3%	14.3%	LARGE
<b>10.4%</b>	<b>12.3%</b>	<b>14.3%</b>	
10.8%	12.5%	14.2%	MEDIUM
<b>10.8%</b>	<b>12.5%</b>	<b>14.2%</b>	
11.1%	12.1%	13.1%	SMALL
<b>11.1%</b>	<b>12.1%</b>	<b>13.1%</b>	

global economy. Our equity portfolios reflect our commitment to a global growth investment theme, led by the economies in the emerging markets. However, our allocation to international stock markets is on the conservative side. Europe's sovereign debt problems are not solved. They still have the potential to disrupt the economic landscape. We are comfortable accessing the emerging market growth opportunities in part through a heavy allocation to our U.S. multi-national corporations, who have had much success in capitalizing on that growth.

The multi-generational lows in U.S. Treasury yields also cause us to maintain our cautious positions in our bond exposures. Our bond portfolios tilt toward the shorter end of the maturity spectrum, including some exposure to some higher-yielding international bond markets.