



Title: Volatility May Create Opportunity

November 30, 2011

Dear Valued Investor,

The 84th Academy Awards nominations are to be announced in late January and many movie studios are now releasing their candidates for consideration. While there are many worthy contenders to win the Oscar for best picture of 2011, it is hard for any of them to match the action, intrigue, fireworks and scope of this year's drama in Europe that has played out on small screens across the world. The swings in the plot have been matched by swings in the markets making for a challenging environment for investors.

European policymakers agreed on a script in late October that avoided a financial crisis, but Italian and Spanish bond yields continued to rise in November threatening to undermine the efforts to close budget gaps. The European Central Bank has been buying Italian and Spanish government bonds in an effort to stem the rise in yields. However, the recently elected governments in Italy and Spain must now follow through on mandates to adopt more stringent austerity measures to reduce their nations' budget deficits in order to reverse the rise in yields and return to fiscal sustainability.

Investors were already fragile from the European debt concerns when their attention changed scenes to Washington in November and sentiment slumped further following the Super Committee's failure to agree on budget deficit reduction measures which would avoid automatic cuts starting in 2013. The market's skepticism over the ability of lawmakers to address U.S. fiscal imbalances means that inaction is likely already priced into valuations and any progress could provide a catalyst for a stock market rally. However, Congress must act soon to extend the payroll tax cut and unemployment benefits scheduled to expire at the end of 2011. The incentive to keep these stimulus measures intact ought to be strong, as they put money directly into consumers' pockets which helps boost the U.S. economy.

Though the main stage is taken by European and U.S. government actions, behind the scenes, the U.S. economy has posted solid results most recently reflected in a blockbuster Thanksgiving weekend for retailers. Also, companies continue to generate positive earnings results. Nearly every S&P 500 company has reported third-quarter earnings results with 70% beating estimates—reflecting strong 18% earnings growth from a year ago. Importantly, the impressive results are not just a function of cost-cutting, as 60% of companies have also outpaced sales projections. This strong earnings growth coupled with declining stock market levels has resulted in valuations well below their historical average.

As life continues to imitate art, the drama and market volatility may continue. The European debt problems are likely to remain front and center and additional steps need to be taken. U.S. lawmakers must prove they can work together and act decisively by extending the payroll tax cut and expanding unemployment benefits. And, as business leaders feel greater assurance



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that the economic recovery is on firm footing, they must invest their record profits and stockpiles of cash in capital expenditures to grow their business and hire workers.

A positive fundamental backdrop and compelling valuations set the stage for investment opportunities. However, policymakers need to restore investor confidence. While it will take years to resolve the debt problems in Europe, as with the lingering subprime mortgage debt and housing problems in the United States, merely stabilizing the problem can allow markets and the economy to heal from the damage. The tagline for investors is: volatility may create opportunity. As always, if you have questions, I encourage you to contact me.

Sincerely,

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