



Investment Commentary March 31, 2012

Wilting Narcissus

The landscape beds around our office include the perennially blooming Narcissus. Commonly known as Daffodils, the flowers on these plants, native to Spain and Portugal, herald the arrival of Spring. The variety at our office seems to start earlier than most, pushing through the soil during the cold days in mid-winter. I sometimes wonder how they manage to survive when the shoots push through the ice and snow, but this year there wasn't much doubt. The warmer winter and ample rainfall contributed to a flowering more robust than usual and we enjoyed them, especially during the warm week that was more like summer than early March. That all changed quickly, however, when then cold returned with a vengeance, leaving just overgrown fronds tipped with the brown remnants of the yellow flowers.

The stock market also enjoyed an early growth spurt this year. The S&P 500 rose more than 12%, a return that was the best 1st quarter since 1998, and rose more than 3% each month of the quarter, a feat that has never been accomplished since the index started back in 1950. Since September 2011 the market rallied 28% and now stands just 10% below the peak in 2007.

For the most part, the rally was fueled by three factors: improved headline economic numbers in the US, reduced concerns about the possibility of a financial collapse in Europe, and accommodative policies from the Fed and the European Central Bank.

In the US, the employment picture improved with stronger monthly jobs numbers, a lower unemployment rate, and lower unemployment claims. Consumer spending rose sharply, along with industrial production, and corporate earnings extended their string of double digit growth. In Europe, the ECB cobbled together a last minute deal to forestall a default by Greece, which seemed to reduce the risk of any financial problem in the minds of investors. All the while, the ECB continued to finance the purchase of shaky sovereign debt by lending even more money to the regions' banks. At home the Fed continued to fund our own borrowing in the hope of supporting financial assets, using short term lending to finance the purchase of longer maturity securities under its "Operation Twist" program. When results from the stress test of our domestic banks seemed more positive than expected, many banks announced dividend increases and stock buybacks that overshadowed the actual results. The rebound of many of these downtrodden stocks added another leg to the market move.

But beneath the surface there are troubling signs that could cause problems later in the year. The headline employment numbers are not supported by growth in actual withholding

receipts by the Treasury, raising concerns about the quality of the data and the jobs created. In Europe, there are signs of a growing recession, renewed financial stress in Spain and Portugal, and the possibility of further problems for Greece. While some have argued that the US economy has "decoupled" from the problems in Europe, US corporations generate a major portion of their revenue and earnings there and are likely to be affected by any slowdown. Since the Fed will be reluctant to extend additional financial stimulus in an election year, any stumble could accelerate the decline in corporate earnings growth which is already projected to fall into the mid single digits by year-end.

The exuberance accompanying the market rally may have prompted investors to overlook some hard realities. Austerity measured in Europe could suppress economic growth for years to come, adding additional stress not just to the individual economies within the Eurozone, but to the overall structure and stability of the European monetary union. With European unemployment already at high levels, and social support systems stretched to the limit, a prolonged period of meager economic growth could put the future of the Euro at risk. Here at home the combination of slowing earnings growth estimates, an economic rebound that is fragile at best, and a Fed reluctant to take any additional bold steps in the midst of an election year cycle, could raise uncertainties for the markets. In addition, we face unprecedented economic and governmental policy challenges that will be difficult to confront in our contentious political climate. Without credible action to reduce our growing deficit we face a policy deadline at year-end that would trigger tax increases and across-the-board budget cutbacks that could spark another market disruption.

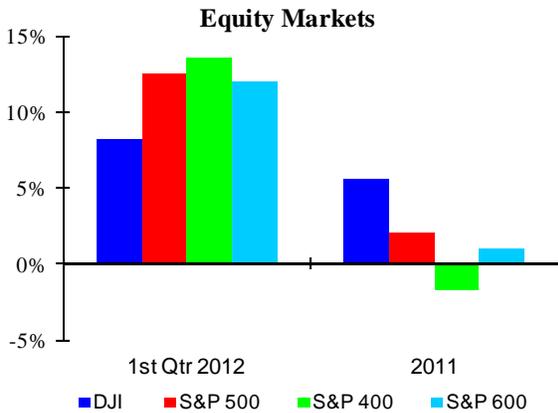
The result of all this uncertainty is a market that continues to trade at attractive valuations, despite the recent run-up. The S&P 500 index currently trades at 13 times forward earnings, well below historical averages. This level is inexpensive, especially considering the unprecedented monetary and fiscal stimulus over the past several years, the historic low interest rate environment, and continuing earnings growth. These valuation levels reinforce our belief that we can still find attractive investment opportunities in companies that are managed for growth and profitability despite the uncertain market conditions. Just as those early flowers are sometimes short-lived, April showers, and the warmth of late Spring, often yield a rebirth among the flowering species.

Sincerely,
Daniel A. Morris

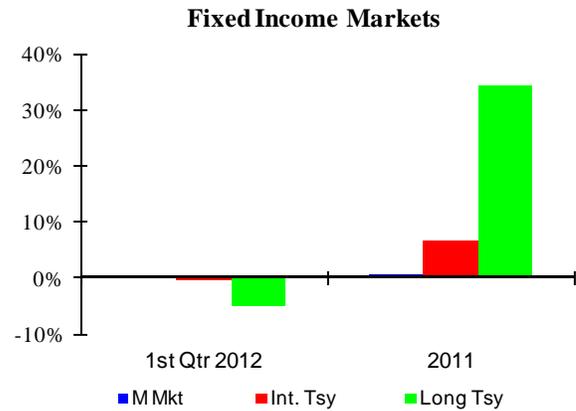
Market summaries on reverse page



Market Summary March 31, 2012



The market continued its impressive upward march in 2012's first quarter, with the S&P 500 rising more than 12%. The rally was fueled by three factors: improved headline economic numbers in the US, reduced concerns about the possibility of a financial collapse in Europe, and accommodative policies from the Fed and the European Central Bank.



Prices of Treasury securities traded in a narrow range for the second quarter in a row, but yields ended the quarter slightly higher than year-end. Steady Fed buying of longer dated maturities, couldn't quite offset expectations that Fed stimulus was likely to be scaled back as the economy continues to improve. Longer-dated Treasuries posted a modestly negative total return for the quarter, in sharp contrast to the very strong returns offered by the stock market.