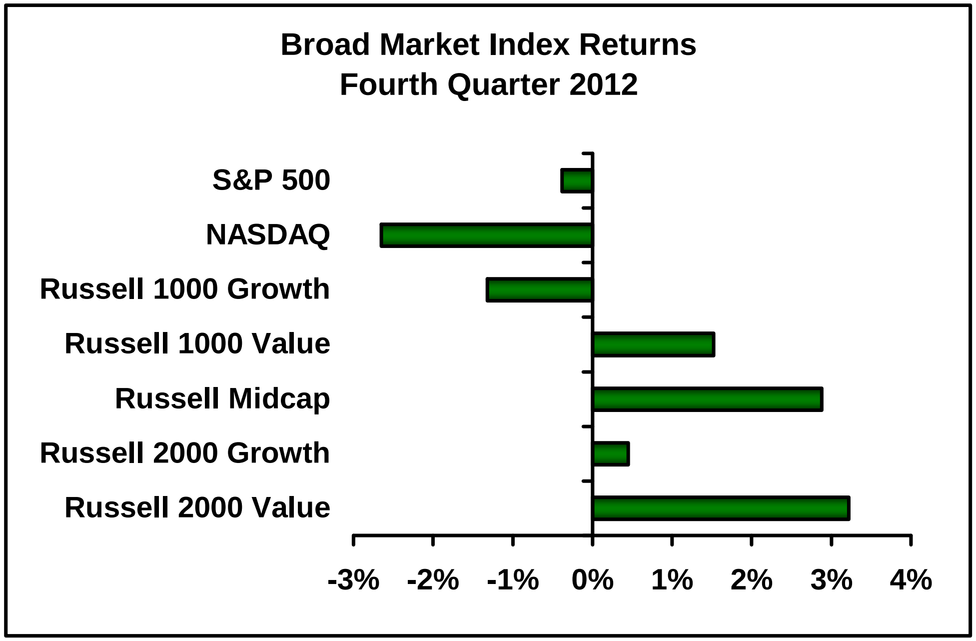
Fourth Quarter 2012 Market Summary

Fourth quarter performance was hampered as U.S. markets weakened after the election. The focus shifted to the "fiscal cliff" debate and the fear that the expiration of the Bush era tax rates combined with the automatic spending cuts would drive the U.S. into recession in 2013. Better economic news in early December caused a rebound in the markets, which ultimately fizzled out later in December due to lack of an agreement. As a result, U.S. large cap equity returns were slightly negative during the quarter, while U.S. fixed income returns were slightly positive. Both international equity and international fixed income returns had a nice rebound in the fourth quarter, causing full year returns to be slightly better than U.S. returns.



Although market returns were mixed during the fourth quarter, most investment returns were quite strong for the full year. The resiliency of the markets during 2012 might be surprising to most considering the focus on economic and political uncertainty. Despite the many risks, including the fear that slowing growth in China would drive the world economy into a mild recession, the fear that the ongoing European debt crisis could explode and the uncertainty caused by the potential "fiscal cliff" in the U.S., the equity markets were up more than 16% in 2012.

From an economic perspective, labor markets continued their slow recovery during 2012 while the U.S. housing market improved, leading many experts to believe that the housing recovery is finally underway. While not predicted to be a particularly fast or strong rebound, any improvement in housing will likely lead to job growth as new housing starts finally begin to resume. In addition, a modest housing recovery could also further contribute to improvements in consumer sentiment, a trend that was seen through much of the year.

Highlights

GDP

- The Bureau of Economic Analysis released the third estimate of third quarter 2012 GDP, an increase of 3.1% versus second quarter 2012, revised up from the second estimate of 2.7%.
- Real GDP rose 2.6% from the third quarter of 2011 to the third quarter of 2012.
- The University of Michigan Consumer Sentiment Index in December was revised down from 74.5 to 72.9, which was a decrease from November. November was 82.7 up from 82.6 in October.
- ISM Manufacturing Index increased to 50.7 in December from 49.5 in November. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- In November, Conference Board Leading Economic Index increased 1.81% year-over-year to 95.8
- The price of WTI Crude Oil was $91.83 at the end of December, which is 0.4% lower than $92.18 at the end of September. The price of Brent Crude Oil declined 0.5% in the quarter to $110.80.
- Headline CPI was has increased slightly over the past few months; however, November came in at 1.8% year-over-year, down from 2.2% in October. Core CPI, which does not include food and energy, came in at 1.9%. Inflation levels have increased in the past two years but remain at acceptable levels as they are under historical averages.

HOUSING

- Preliminary existing home sales rose in November with an annualized rate of 5.04 million units from 4.76 million units in October. The November annualized rate is 14.5% above the 4.4 million units in November 2011 as existing home sales have been rising slowly since last summer.
- Median existing home sale prices rose during the quarter. Prices have risen since the beginning of the year and in November; prices were 10.1% higher from the levels of one year ago.
- New home sales increased slightly in November with a seasonally adjusted annual rate of 377k homes sold versus 361k in October and 374k in September. Home sales have been trending up since August 2011, when 292K new homes were sold. However, new home sales are still at depressed levels compared to long-term averages of above 600k units.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose 5.7% year-over-year in October. This is the ninth month in a row that prices have risen after twenty months of falling prices.

EMPLOYMENT

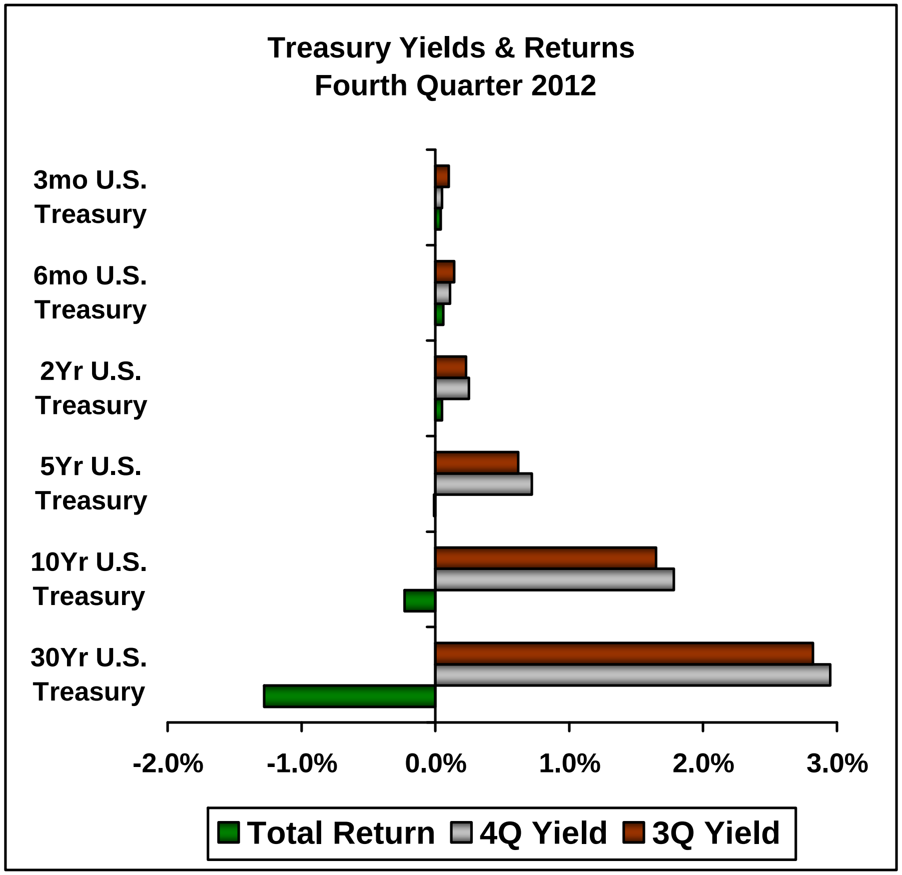
- The labor market was stable in the third quarter as the October and November Nonfarm Payrolls increased by 137,000 and 161,000 respectively. In December, preliminary Nonfarm Payrolls increased by 155,000, which was higher than consensus expectation of 150,000 new jobs. Stable growth in the fourth quarter was encouraging but unspectacular.
- The unemployment rate did not change from 7.8% in September to 7.8% in December.
- Initial Jobless Claims continue to decrease but at a lower rate in the past year.

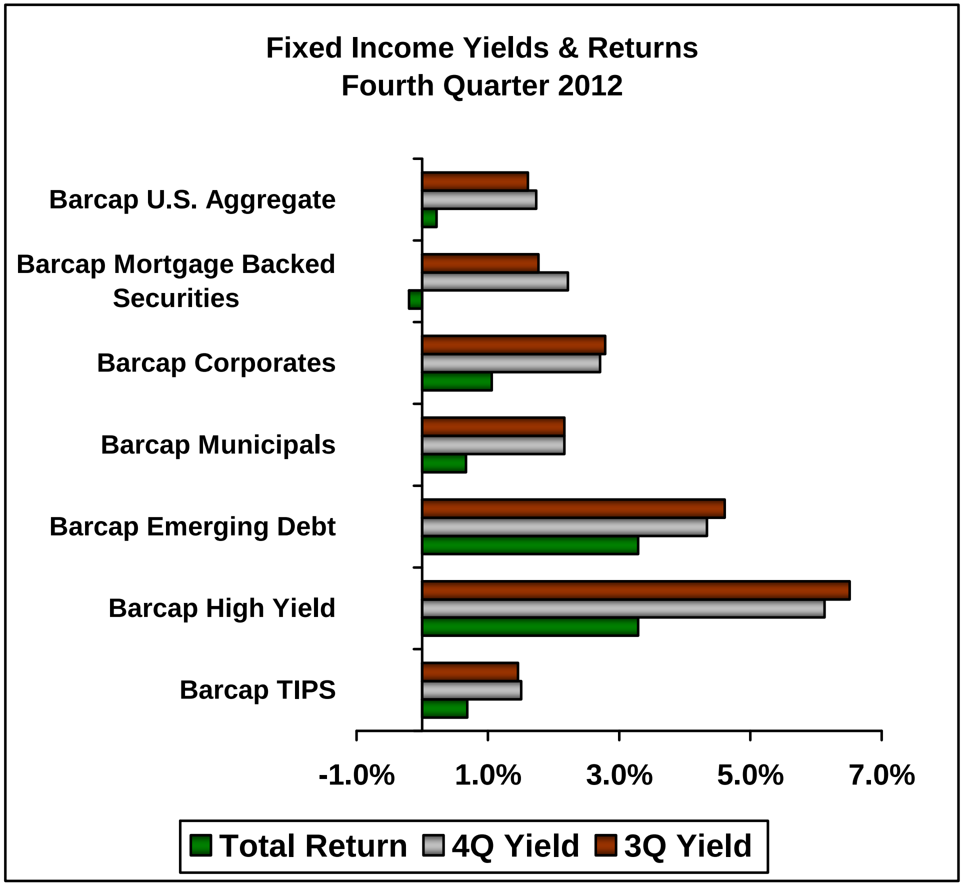
FIXED INCOME

- The yields on Treasury securities increased on a quarter-over-quarter basis with the exception of 3mo and 6mo Treasuries. The rising of longer-term Treasury yields caused the yield curve to steepen.
- The credit segment of the market witnessed a decrease in rates. Yields for High Yield and Emerging Market Debt had the largest decrease in yields; these segments were the best performing in the third quarter. Investors search for income has decreased yields in the credit markets dramatically over the year, as much as 175-225bps in the High Yield and EMD.
- The TED Spread, which is the difference between the three-month LIBOR and three-month T-bill rates, has decreased from 0.35% in September to 0.22% currently. A low TED Spread indicates the perceived risk of bank defaults is low.

FED POLICY

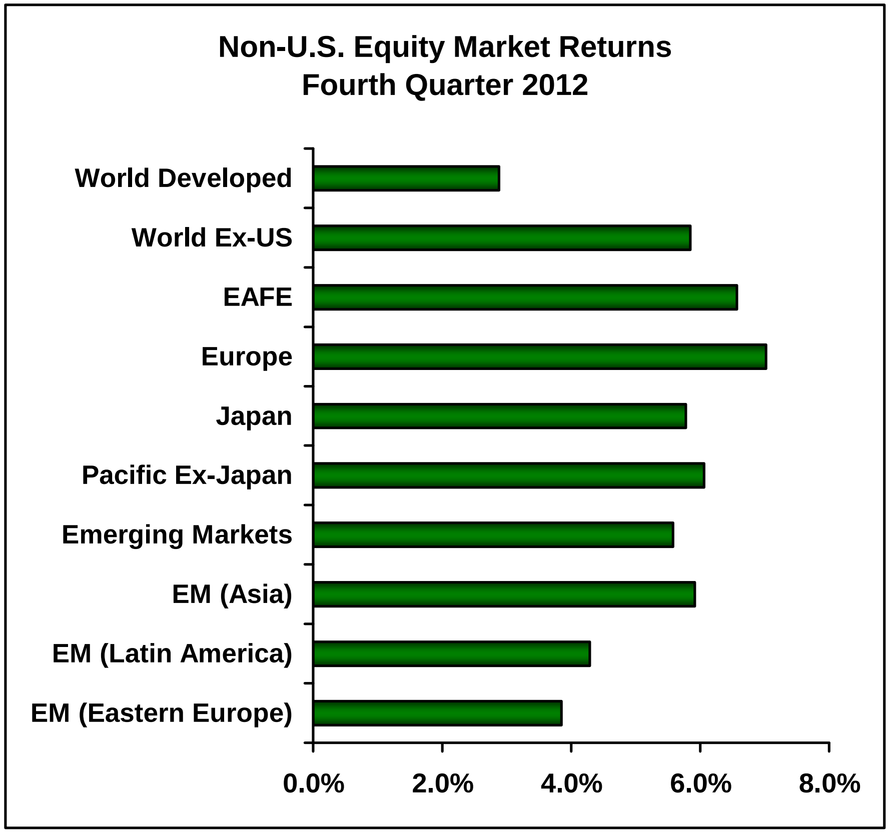
- In December, the Federal Open Market Committee (FOMC) announced they will leave the federal funds rate at 0% to 0.25% percent. They maintained the fed funds rate will remain at exceptionally low levels if the unemployment rate stays above 6.5% and inflation remains low.

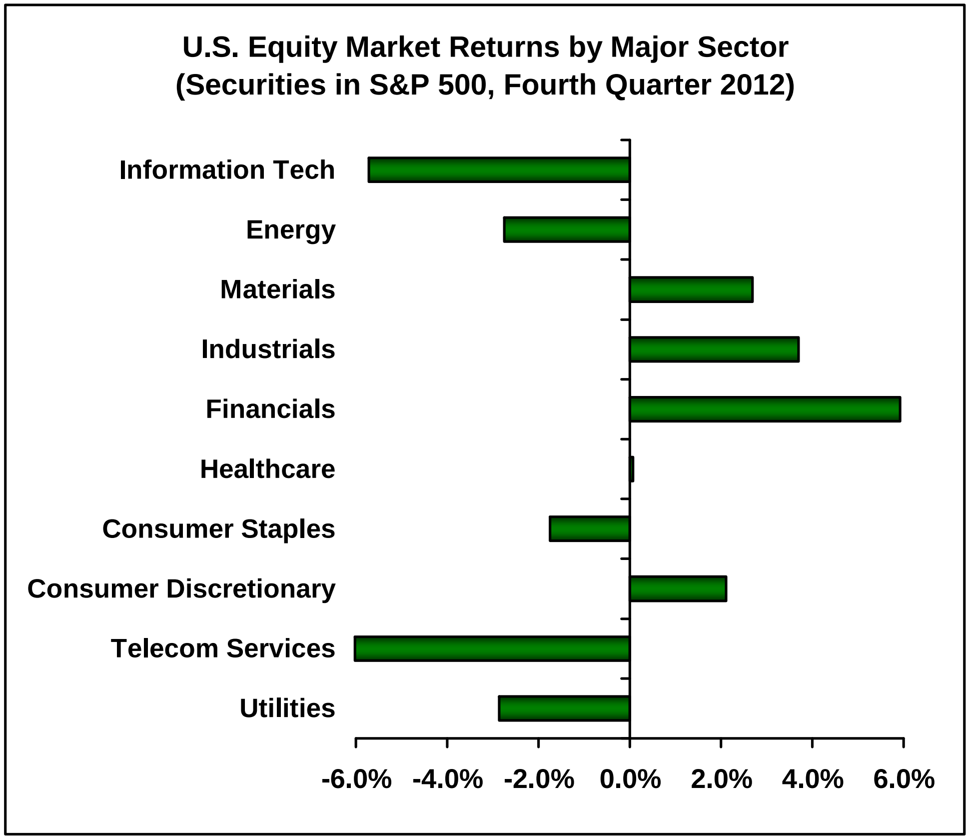




EQUITIES

- For the quarter, stock prices ended higher. Performance was better for small/mid capitalization stocks versus large capitalization stocks. Growth stocks performed worse on a relative basis than value stocks.
- The Russell 1000 Index of large capitalization stocks posted a total return of 0.12% during the quarter. On a year-over-year basis, the Russell 1000 Index has advanced 16.42%.
- Small capitalization stocks, as represented by the Russell 2000 Index, posted a gain of 1.85% during the quarter. On a year-over-year basis, the index has increased 16.35%.
- International stocks performed better than U.S. domestic equities. The MSCI EAFE index of international markets stocks increased 6.57% during the quarter. On a year-over-year, the EAFE is up 17.32%.
- During the quarter, emerging market stocks performed inline relative the developed markets. The MSCI Emerging Markets Index increased 5.58% in the quarter, and it is up 18.22% on a year-over-year basis.
- CBOE Volatility Index (VIX) rose slightly in the quarter from 15.73 at the end of September to 18.02 at the end of December. The VIX spiked in late December to 23, due to fiscal cliff concerns, before retreating. Low levels on the VIX are generally positive for the equity markets.





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