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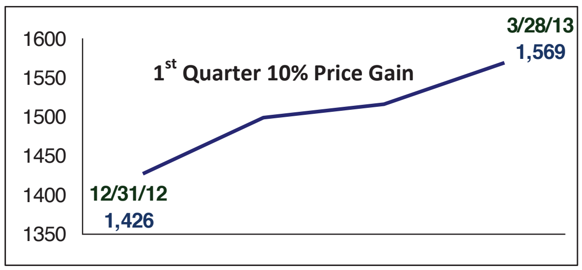
QUARTERLY INVESTMENT REPORT
March 31, 2013

Dear Investor:

Happy 4th year anniversary Bull Market! As a reminder, the classic definition of a bull market is a market gain of at least 20% from its lowest point for at least six months. To celebrate its anniversary the market broke its previous record close of 1,565 on October 9th 2007 with a new record of 1,569 on March 28, 2013. We got here with a 10% price gain for the S&P 500 in the first quarter of the year.

S&P 500 2013



Heading into both 2012 and 2013 we held a positive view that stocks were reasonably valued. We think stock values are still at or below average, but less so now than they have been over the last few years. The market seems ready for a temporary pull back but generally we don't think this bull market is too long in the horn. Two over arching themes continue to dominate the investment landscape: an improving economy and the relative attractiveness of stocks versus bonds.

Many investors are beginning to worry that the market is too extended since it has risen for four years now. The average length of post World War II bull market cycles is a little more than four and a half years, so it is normal for investors to feel some jitters. After all, the almost 50% declines of 2000-2002 and 2008-2009 are still painfully fresh in our minds. We thought it would be interesting (and perhaps comforting) to highlight a few stats about the eleven bull markets we have had since the end of World War II:

Post World War II Bull Markets
(including the one we are in that began March 9, 2009)

Average duration	4.8 years	
Shortest duration	1.1 years	May 1947 - June 1948
Longest duration	12.3 years	December 1987 - March 2000
Median duration	4.1 years	
# of bull markets lasting more than 4 years	7	average length was 6.3 years
# of bull markets lasting fewer than 4 years	4	average length was 2.4 years

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Will the bull keep on charging or settle in for a nap? Of course we can't predict the future. As we saw from the chart on page two, there are no set rules as to how long a bull market should last. It depends on the economy.

While it may not be a stampede into higher prices from here, we think the bull is not too tuckered out yet as he likely sees an improving economy ahead. We view these improvements in terms of three general topics:

- Federal Reserve monetary policy
- Consumer wealth effect
- Nascent manufacturing renaissance

The Federal Reserve uses two strategies to manipulate market interest rates. It buys or sells treasury or mortgage backed securities and controls the interest rate level of short term inter-bank interest rates. Both policies have served as considerable economic lubricant since the recent financial crises. Over the course of three rounds of securities buying (Quantitative Easing) the Fed has put about $2 trillion into the economy and kept mortgage rates and other lending rates low. The Fed has had no near-term plans to raise short-term interest rates. We are closer to the end rather than the beginning of these policies, though another year of accommodation is likely.

As Fed asset buying begins to taper off we expect to see interest rates rise, but not sharply. A couple of factors may keep rates subdued, such as the fact that although it will stop buying securities, the Fed will probably not rush to sell its securities. We don't see any near term changes in short-term inter-bank interest rates. And finally, Cyprus is a perfect example for why treasury securities can maintain its global safe-haven status and keep a lid on interest rates. We think interest rates will eventually rise sharply, but just not in the next few quarters.

The Consumer Wealth Effect means that consumers are financially healthier and more relaxed about spending. They have spent the last four years reducing debt and repairing their household balance sheets. In the 2000s Americans took on huge amounts of debt - mortgages to finance new homes and vacation homes; home-equity loans to buy appliances, pay for college, and take vacations; credit card debt to cover everyday needs. Debt, not rising wages, is what kept the economy running through much of the 2003-2008 period.

Household debt service – the amount required in a given period to pay both interest and debt principal – reached more than 14% of after-tax income in 2007, just before the Great Recession was getting under way. In the past couple of years, consumers have been paying off these debts. Some types of borrowing, such as college loans are still

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high, but overall debt service is down to about 10.5% of income, the lowest it's been since 1981.

A rebound in housing is helping consumers feel more at ease with their budgets and personal spending. Building permits are up strongly, while the inventory of unsold homes is down. Purchases of furniture and appliances are also up. Construction companies are hiring workers, and most important, housing prices are up 6% since bottoming out last winter. Pent-up demand from those who had postponed home buying should continue to drive sales.

Low interest rates and a healthy consumer are to the economy like a red cape is to a bull – magnetically attractive! But we also like to see some type of catalyst that will add longer term sustainability to the recovery to help bring the unemployment rate down.

We think we see this catalyst from a nascent manufacturing renaissance in this country. Manufacturing is benefitting from several long-term competitive advantages – restrained labor costs, advanced automation and technology, big Emerging Market wage increases, abundant energy and low natural gas prices, low dollar, labor market stability, rule of law, economic and accounting transparency, demographics, sophisticated and liquid capital markets, well-developed infrastructure, better inventory control, and Eurozone uncertainty.

The evidence of this renaissance can be seen in the expanded production from a wide range of industries in 2012 and 2013. Just to name a few examples: (1) more than a dozen chemical companies are expanding in the US to take advantage of very low natural gas prices, (2) Airbus is building a new factory in Alabama, (3) Rolls-Royce is building a new factory in Indiana, (4) Starbucks decided to tap a factory in the US instead of China for its coffee mugs, (5) GM will move production of its Camaro from Canada to Michigan, (6) Whirlpool brought back production of KitchenAid mixers to the US from China.

As a result of the energy boom from shale gas, many states are prospering similar to the build-out of many Emerging Market economies. These states have to build out infrastructure - from roads to the electrical grid to schools, houses, and airports, etc.

We are not saying that stock investing has gotten any easier, in fact it's become much more difficult since prices are no longer as cheap as they were. But we are hopeful that the economy can remain on a stronger footing for a while longer. Even though there is a growing feeling that the sequester will remain in place for months, we expect private job gains to help balance out government job losses. As the economy grows, larger tax revenues and exports may help reduce some of our national debt. The real win we look for is wage growth and higher employment.

We hope everyone had a Happy Easter and Passover!

Sincerely,

Ellen P. Le, CFA
President

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100 Years of the Income Tax

On February 3, 1913, the 16th Amendment to the Constitution authorizing a federal income tax was ratified and the now ubiquitous 1040 form was introduced. As we all face the dreaded tax filing deadline we share some fun and not so fun facts about the U.S. income tax.

- While the 16th Amendment was the genesis of today's income tax it was not our country's first income tax. The first U.S. income tax was implemented in 1861 to raise money during the Civil War, and imposed a 3% tax on annual incomes over $800. The Internal Revenue Act of 1862 instituted a graduated tax rate making the first $600 of income exempt and taxing incomes between $600 and $10,000 at 3% and anything over $10,000 was taxed at 5%. The income tax was repealed in 1872 because the revenues were no longer needed.

- The original 1913 income tax was proposed as a flat 4% tax but it was turned into a graduated tax of 1% to 7% with an annual exemption of $3,000 (equivalent to $70,000 today). This exempted most Americans from the income tax.

- In 1913 the tax code was 15 pages long, today the code is over 70,000 pages.

- In 1920 75% of the U.S. population fell into the lowest tax bracket. Today less then 25% of the U.S. population falls into the lowest tax bracket.

- The U.S. income tax on the top earnings tier was the highest in 1945 when it stood at 94%.

- The top income tax bracket in 1913 was 7%: The top income tax bracket in 2013 is 39.6%.

So to the IRS on the 100th anniversary of the 16th Amendment: Many Unhappy Returns – Millions of Them.

Don't forget to file your taxes!!!

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