

Fourth Quarter 2011

The stock market posted strong gains in the fourth quarter after the European Central Bank and other central banks around the world forestalled the euro debt crisis by providing massive amounts of liquidity. The crisis has not been solved, but the chance of a disorderly market in the near-term is much less helping the S&P 500 to advance by 11.82% in the quarter and 2.1% for the year. Believe it or not this performance was top of the charts compared to most other stock markets which typically experienced double-digit declines for the year. European stocks were down about 14% while most emerging markets declined by over 20%.

We had one of our best years ever posting returns well above our peers and benchmarks while at the same time experiencing much less volatility. This was accomplished by our willingness to hold cash and avoid underperforming industries. Financials were the clear losers in 2011 which we were fortunate enough to largely avoid. Investors also expressed a clear preference for high-quality, dividend paying stocks which is the foundation of our portfolio. We believe this trend will continue in 2012.

As we begin 2012 our message of caution has basically not changed. While there is a lot of noise on a day-to-day basis in the stock market the most important influence is the massive overhang of global public and private debt that will thwart any robust recovery in the developed economies. This condition means any shock, even a mild one, could put our low-growth economy into a recession.

The market will continue to keep close watch on the events in the eurozone where a recession is widely expected in 2012. Investors are worried that banks will reduce lending in order to reach the new European minimum core tier one capital ratio of 9%. Barclays Capital points out that, if the eurozone's banks improved their capital ratios purely by shrinking their balance-sheets, lending would fall by around €3 trillion, or almost a third of the region's GDP. China too will be monitored to see if contagion from the west spreads to its borders since European banks provide a sizable amount of funding to emerging economies. Chinese officials have successfully engineered a soft-landing to ease inflation pressures but any further weakness in economic data would be worrisome.

Of particular concern are initial signs of earnings weakness. The number of companies in the Standard & Poor's 500 index that have made downward profit

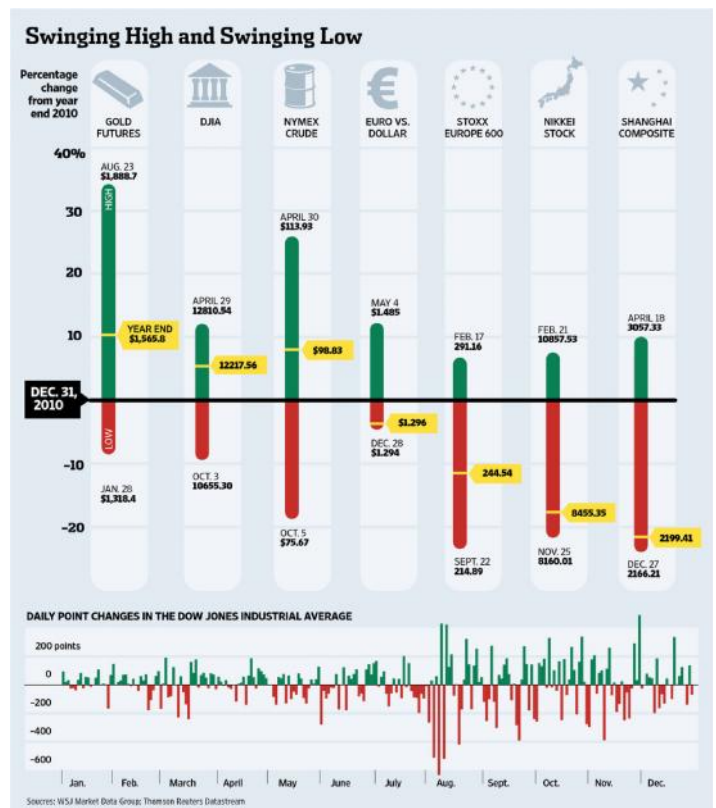
revisions is at a level not seen since the 2001 economic recession, including notable bellwethers such as DuPont, Oracle, and Target. Corporate profit margins continue to elevate at lofty levels which seems unlikely to continue if the macro environment does not improve.

The best news is coming from the U.S. Most recent economic news has surprised on the upside, including improvement on the jobs front. We are not willing to argue yet that this is the start of a long-term trend, but it is nonetheless encouraging.

As mentioned above we see no compelling reason to make significant changes to our strategy. We'll maintain a cash cushion to protect from any downside volatility and continue to emphasize traditional blue chip, high-quality, and deep value stocks. At some point it will be advisable to broaden our portfolio but the time has not yet come.

Despite all the challenges 2011 was a good year, and we hope to navigate successfully what we anticipate will be another tricky year in 2012.

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Let us know if we can answer any questions you may have. Thanks again for working with us.

James Tillar, CFA Steve Wenstrup