Investment Management
ADVISOR SERIES

"It's never paid to bet against America.
We come through things, but it's not always a smooth ride.
-Warren Buffett-

July 1, 2012

Dear Fellow Investor,

Volatility continues and so does our belief that long-term investors should embrace Dollar Cost Averaging and Compounding to take advantage of it. The market movements of the first half of this year are a continuation of the investing landscape that investors have grown accustomed to since 1999. The S&P 500 was up just over 12% in the first quarter, down by 7% from April to May, and then recovered roughly 4% in June. The end result is that we are up nearly 8% through the end of June. Those who have stayed invested, or continued to invest at regular intervals, and received the compounding effect of dividend reinvestment have actually benefited from the volatility. They are acquiring more shares of income producing assets and seeing their sustainable portfolio income increase. While we truly believe the markets are due for a significant move higher in the next five to ten years, we do not know when the volatility will give way to a sustained advance. We do believe that the advance will happen when very few see the reasons why. The market looks forward beyond the current news to future earnings and economics. Investors making investment decisions based on the nightly news will most likely miss out on the forward looking opportunities of capitalism by not being invested when the equity markets do move higher.

Since 1999 we've been working through many financial issues the world has thrown our way such as the "Internet Crash of 2000" and "Financial Collapse of 2008". There are, and always will be, issues to work through. But while we may think two major market collapses was unprecedented, it was not. About every 40 years each investing generation has its own financial meltdown. My grandfather told me of his generation's great depression with soup lines, work projects, boarded up houses and 25% plus unemployment. My father told me of the middle of the 1970's with oil embargos, sky-high interest rates, the crash of '74, "Whip Inflation Now" buttons, and Volker taking rates to unprecedented heights. It is never exactly the same, but each generation has to learn for itself that excess can not be sustained. What history has shown us is that after the meltdowns comes a period of adjustments and a return to basic economic principles. These periods are initially aided in great measure by unpopular but appropriate fiscal policy on the part of the federal government. Then when the panic subsides, the economy should give way to a new age of growth, innovation and prosperity driven by free-market forces. We believe we are well along in the period of adjustments and past the time where massive government intervention is needed. We remain optimistic about our current recovery and see corporations driving the next leg of recovery as their fear of the unknown is calmed by political & fiscal answers and time. Not everyone will like the answers but corporations will no longer be held hostage to these fears.

We feel adjustments have largely been made in the equity markets with the stock market currently trading at historically attractive levels based on earnings, dividend yield and book value. It has taken over 12 years for the stock valuations to reset to

our current reasonable economic levels. We have similar feeling in regards to Real Estate as values have readjusted from the over-leverage induced prices of 2006/7 and are now selling at far more economically justifiable levels based on replacement costs and positive cash flows. The last market to feel the needed readjustments, and therefore have the greatest risk of price adjustments, appears to be the fixed income market.

We believe that many investors have lost sight of the reality that when you lend your money you are taking on three major risks:

- ***Interest Rate Risk*** - when interest rates rise the principal value of existing bonds decline
- ***Inflation Risk*** - principal returned at maturity will buy less goods and services if those goods and services have increased in price due to inflation. (The Consumer Price Index (CPI) is trending up and it doesn't even reflect the true cost of inflation when you look at your grocery bill!)
- ***Credit Risk*** - when you lend your money you are a partner in the enterprise that you have leant money on or to. If the enterprise goes into bankruptcy the court will decide if, when, and how much you will recover. If you lent on an asset such as a home mortgage, and the asset declines substantially in value, you can lose principal (just ask Countrywide, Fannie Mae and Freddie Mac!). Lending to governments is not risk free either – just ask those who had their Greek bonds restructured down 70% in value.

We want to stress to our fellow investors that lending money is not risk free, not even to cities, states, governments, banks, or corporations. Unfortunately, when interest rates drop investors tend to make poor choices in search of yield. They will compromise good economic sense by discounting the value of an entity's financial strength and take on more credit risk than they should. Or, they will lock in the higher interest rates of long-term maturities in an effort to chase higher yield and take on greater interest and inflation risk. In our opinion, one of the biggest risks in today's financial markets is the perceived safety of fixed income. When this perceived safety bubble bursts and economic reality sinks in we envision a swift readjustment that will paralyze many investors. The result will be many investors left holding long-term, low yielding, higher risk investments until they mature because no one will want to sell them for the hugely discounted prices.

The great corporations of the world have survived and prospered while governments and currencies have failed (we recently have been buying securities of a company founded in 1818). We feel strongly that scouring the markets for these great corporations, investing in these corporations at attractive prices, focusing on cash flow and income to the investor, and staying true to our common sense fundamental disciplines allows us to build diversified portfolios for our clients that help build wealth over the long-term and sustainable cash flows to live on now.

As always we welcome your comments and questions and thank you for the opportunity to help you achieve your Financial Independence.

Blake Todd – AIF®
Portfolio Manager

Jarrett Perez – CFA
Associate Portfolio Manager

This letter expresses the personal views of the authors on the current and future economic and investment landscape, at this date. It is subject to change without notice. The information contained in this presentation has been taken from trade and statistical services and other source, which we believe to be reliable. We do not guarantee that this information is accurate or complete and it should not be relied upon as such.