QUARTERLY COMMENTARY Q4

Newsletter 01-10-13

Don't Jump!

Despite a year of events that have caused investors, companies, and consumers alike to proceed with caution, in the end, the broader financial markets did well. The markets endured a presidential election, continuing fears about the weak economic condition of Europe and the possibility of a double dip recession in the US (or *fiscal cliff*), slowing growth in emerging markets, and ongoing Middle East tensions. In an attempt to bolster confidence, the Fed continued its expansionary policy in 2012 driving investors into riskier assets. A summary of the performance of key indices we follow is listed below.

2012 Index Performance

	Total Returns	
	Q4 2012	YOY 2012
Standard & Poor's 500	-0.4%	16.0%
Dow Jones Industrial Avg.	-1.7%	10.2%
Alerian MLP	-3.8%	4.4%
High Yield Bonds	-	18.7%
Investment Grade Bonds	-	10.9%
US 10-Year Treasuries	-	2.3%

We believe the global economy is going to experience a slowing trend line growth rate due to the repayment of debt and underfunded liabilities such as social security, welfare, and healthcare. Policymakers continue to propose short term fixes (during their elected terms) rather than making the hard decisions required for long term solutions.

In the short term, the first half of 2013 is likely to face some economic and financial market challenges. Economic growth is expected to be muted, though not recessionary as previously feared. In response to the fiscal cliff, Washington took a small step in resolving the budgetary issues of the US. The Bush income tax cuts were permanently extended for individuals with income below $400,000 ($450,000 per family), but payroll tax increases (from 4.2% social security tax to 6.2%) lowering the take home pay, thus spending power, of many US consumers. Relieving some uncertainty, the maximum capital gains and dividend tax rates for high-income earners went from 15% to 20% (23.8% after the surcharge to help pay for the Affordable Care Act otherwise known as ObamaCare), which is a positive for dividend-paying stock holders as the maximum could have been 43.4%.

Market volatility is likely to continue as budget discussions persist and the country faces its debt ceiling on February 28. The debt ceiling deadline was December 31, 2012, but the Fed's expansionary policy is enabling Washington to have the additional months before it hits the ceiling. The Fed's purchases provide additional funds the government doesn't have to borrow. It recently announced it will purchase an additional $85 billion per month.

Expect the congressional boxing match to continue and possibly become bloodier! The bulk of the agreed upon spending cuts of about $109 billion, half from defense and half from domestic programs, still have to be made. The risk of a downgrade of the US credit rating looms if the Fed slows its buying as it recently alluded to. Congress has not shown the inclination to push forward with the hard decisions that will have to be made to trim the budget, including the much needed entitlement reform. Republicans are likely to leverage the debt ceiling to force President Obama to accept entitlement spending cuts over which Obama has dug in his heels.

In the second half of 2013, with the fiscal cliff issues being addressed, albeit in painful baby steps, we believe we can look forward to reasonable US economic and market growth. Potential growth drivers of the US economy include improvement in employment and housing, pent up global consumer demand, surging US production of oil and gas (resulting in lower energy prices and job creation), and renewed business investment including a technology upgrade cycle.

Forecasts for US GDP and Global Ex US GDP suggest that countries outside the US will be greater drivers of global growth in 2013. Risks in Europe, while not eliminated, have been reduced by the European Central Bank. Recession is now less likely. Global growth is expected to be about 3.3% in 2013 led by China at 7.5%, 5.5% in emerging markets, 2.5% in the US and gradual strengthening of Europe. On a P/E basis, European and Asian stocks are more attractively valued currently relative to US stocks which have been strong performers in 2012.

Inflation should remain muted due to the slow global growth in 2012, spare global capacity, continued low interest rates, and global monetary easing. The cautious stance of most investors has resulted in significant cash on the sidelines that should bolster stocks if confidence returns. While we do not expect interest rates to increase dramatically, the Fed's hinting at slowing its purchase of debt is the first sign of tightening we have seen in several years. This will push yields up but not in a hyper-inflationary way. Fixed income investors reaching for yield should focus on 'good junk', ratings of BAA or better, as bonds with riskier ratings are likely to get crushed in a rising interest rate environment. We do not expect a sell-off in US high yield but after a strong rally in 2012, we believe dividend growth stocks offer a better value. Stocks remain cheap relative to bonds.

Conclusion

Much of this newsletter has been spent reviewing 2012 and looking ahead to 2013. It is important to do this in the short term to establish tactical strategy, but as has been proven time and again historically, a long term investment focus has been the key to growing and maintaining portfolios**.**

The themes we are focused on for long term investment outperformance include energy independence and eventual export for the US, feeding the world, water supply, healthcare, productivity improvement through communication and technology, and infrastructure build out. A chase for yield was a key theme in 2012 and is likely to continue due to the low interest rate environment and growing demand of retiring baby boomers as they swap growth for income. We focus on stocks with sustainable and growing dividends vs. high yields. Given the slowing trend line economic growth and expected volatility of the financial markets as the world works through its debt issues, we are looking at higher quality companies with strong balance sheets (low debt), franchise value, global reach, and, of course, a growing dividend. In addition to quality dividend paying stocks the second key strategy we recommend in this slowing growth environment is investment in Master Limited Partnerships (MLPs). Why?

- Income (cash distributions) is valuable in volatile stock markets.
- Investors pay less tax on the cash distributions because MLPs are partnerships, particularly valuable in a rising tax rate environment.
- US demand for energy is expected to grow over time. Energy adequate to power a modern economy is not optional, it is essential.
- Energy MLPs play a critical role in providing energy to the US because they own the networks of storage facilities and pipelines used to transport that energy from the refineries to the end-users.

We value your continued trust as we move into the New Year and welcome your comments. As our company grows, we are adding staff to ensure the best possible customer service. To that end, we welcome aboard Lynn Thompson (Senior Research Analyst), Peter Gerry (Customer Service and Research Analyst), and Joyce Conti (Receptionist and Office Administrator).

Sources: Bloomberg, AMP Capital, US Federal Reserve

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Important Disclosures

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There are no guarantees that dividend paying stocks will continue to pay dividends. In addition, dividend paying stocks may not experience the same capital appreciation potential as non-dividend paying stocks. The past performance of the strategy is not an indicator of future performance; and investment results may vary.

An investment in a Master Limited Partnership (MLP) unit involves risks that differ from a similar investment in equity securities including ownership controls associated with the limited partnership structure, high debt to equity ratios, and certain tax risks.

Investments in international markets present special risks including currency fluctuation, the potential for diplomatic and political instability, regulatory and liquidity risk, foreign taxation and differences in auditing and other financial standards. Risks of foreign investing are generally intensified for investments in emerging markets.

The S&P500 Index is a widely recognized unmanaged index of equity prices and is representative of a broader market and range of securities than is found in individual client portfolios. The Alerian MLP Index (NYSE: AMZ) is a widely recognized, unmanaged index that includes a composite of the 50 most prominent energy (MLPs). The Index returns do not reflect the deduction of expenses, fees, and taxes and assumes reinvestment of all distributions. Individuals cannot invest directly in the Index; however, an individual can invest in exchange traded funds or other investment vehicles that attempt to track the performance of a benchmark index. Dow Jones U.S. Index is a broad-based but investable measure of the U.S. stock market, intended for use as the basis of investment products. The index aims to consistently represent the top 95% of U.S. companies based on float-adjusted market capitalization, excluding the very smallest and least-liquid stocks. This index assumes the reinvestment of dividends and the percentage changes in the benchmark represent the annual percentage change of the index for the period reported. NASDAQ Composite Index is a stock market index of all of the common stocks and similar securities (e.g. ADRs, tracking stocks, limited partnership interests) listed on the NASDAQ stock market, meaning that it has over 3,000 components. Since both U.S. and non-U.S. companies are listed on the NASDAQ stock market, the index is not an exclusively U.S. index.