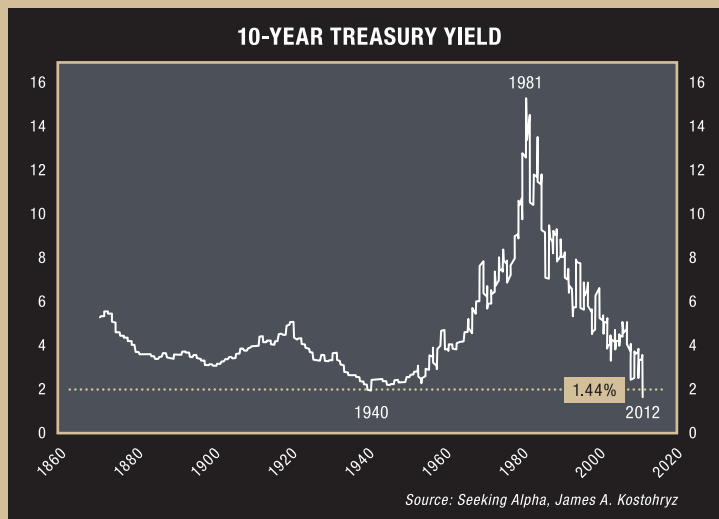


MARKET COMMENTARY

Macroeconomic concerns dominated news headlines during the second quarter of 2012. Equity markets responded negatively to investor sentiment, giving up significant portions of their first quarter gains. Following a fast start in the first quarter, equity markets trended downward in April and May. Positive reaction to the recent European Union summit led to a strong rally at the end of the quarter, producing the best June performance for the Dow Jones Industrial Average (DJIA) since 1999. For the half year, the DJIA gained 6.8%, and the S&P 500 was up 9.5% (both total return). Second quarter volatility reflected global economic concerns: Europe entering a recession, growth slowing in China, and US debt escalating (now nearing \$16 trillion). As a result of the uncertainty, economic forecasters pared global growth on average from 4.0% to 3.5% for all of 2012.

The performance of the financial markets is déjà vu of the summer months of the past two years. Europe's ongoing woes plague the progress of the global economy. We believe the uncertainty will continue throughout the year even though encouraging news from June's European summit in Brussels demonstrated rays of hope. Germany, which has the strongest financial posture in Europe, surprisingly agreed to implement rescue plans directly with ailing European banks and not add to various sovereign debt. The news also hints at the formation of a European banking union providing better control and stability of European banks, similar to the system in the United States which is centrally monitored by the Federal Reserve Bank. Global equity markets reacted positively to the conclusion of the summit as the participants indicated progress but will need time to devise a specific strategy. This approach may be kicking the can down the road, but for now, it precludes a financial meltdown and is an indication of a lasting solution.

The view of China, which has been a growth engine for much of the world, is also experiencing a slowdown. China's GDP growth rate of low double digits for most of the past decade has slowed to an estimated 8.0%-8.5% for 2012-2013. Slower growth reflects diminished world demand for China's exports, particularly consumer goods. Imports into China, especially industrial materials, have also softened and negatively affected commodity related stocks. As a reference, the total value of China's exports and imports quadrupled in the past decade to nearly \$4 trillion. China is now the third largest world economy after the European Union and the United States. In the past month, the People's Bank of China lowered its lending rate twice and over the past year instituted several cuts in its bank reserve requirements. The hope is this monetary easing will stimulate loan demand for housing and infrastructure projects.



A reflection of the world's concern is the flight to safety in US debt. In our October 2011 Market Commentary, we mentioned the drop in the yield of the 10-year Treasury note to a then record low of 1.695%. On June 1, the yield reached yet another record low of 1.44% as illustrated above.

Despite a sluggish economy, the outlook for US equity markets is arguably the best port in the storm. While the US employment growth is stagnant, several macro events may be setting up a recovery later this year. The central focus is a housing recovery as housing starts are up 30% year-over-year and household formation exceeds 1 million annualized, which last occurred in 2006. Household formation is a strong harbinger of employment growth, considering all the ancillary markets affected. As we have written previously, normalized annual housing starts are about 1.5 million units. Consumers also benefit from lower gasoline prices with estimates of \$50-60 billion in annual savings as the price per gallon of gasoline drops from \$4.00 to \$3.50. Auto sales have also been tracking at about 14 million units, up from 13 million a year ago and 11 million in 2010. Corporate balance sheets are still brimming with \$1.2 trillion of cash, or 12% of assets (S&P 500 ex-financials), the highest level since 1950.

Valuation is also a metric for review. The S&P 500 trades at 12.5x estimated earnings. This compares to a price earnings ratio (P/E) of 62x for the 10 year US treasury bond, 25x for corporate investment grade bonds and 14x for high yield corporate bonds. For decades, high yield bonds have always traded at a discount to equities. Valuations reflect investors' willingness to pay more for ostensibly safer principal such as US Treasuries and investment grade bonds, and less for more risk such as common stocks.

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Until the outcome of these scenarios becomes evident, the markets will likely trade in a range near its recent levels. The US, and Europe to a lesser extent, have a good chance of muddling through without a severe recession. A clear insight of a return to growth associated with an expanding world economy would put a firmer footing to the equity markets.

2012 TAX REFERENCE GUIDE

Later this year, Congress may enact sweeping tax reform that could have a major impact in 2012 and beyond. Even if there's no major tax legislation in the immediate future, next year Congress will have to address significant fiscal policy issues, such as whether to once again "patch" the alternative minimum tax, eliminate the post-2012 expiration of the Bush-era income tax cuts (including the current rate schedules, and low tax rates for long-term capital gains and qualified dividends), and the expiration of favorable estate and gift rules for estates of decedents dying, gifts made, or generation-skipping transfers made after Dec. 31, 2012. A few common provisions of the current tax code are listed below:

Standard Deduction

Married, joint	\$11,900
Single	\$5,950
Married, separate	\$5,950

IRA & Pension Plan Limits

IRA contribution	
Under age 50	\$5,000
Age 50 and over	\$6,000

Income phaseout for deducting IRA contribution	
Married, joint	\$92,000 - \$112,000
Single, Head of Household	\$58,000 - \$68,000
Married, separate	\$0 - \$10,000

Income phaseout of Roth contribution eligibility	
Married, joint	\$173,000 - \$183,000
Single, Head of Household	\$110,000 - \$125,000
Married, separate	\$0 - \$10,000

SEP IRA contribution	
Up to 25% of compensation	limit \$50,000

SIMPLE IRA elective deferral	
Under age 50	\$11,500
Age 50 and over	\$14,000

401(k), 403(b) elective	
deferral under age 50	\$17,000
deferral age 50 and over	\$22,500

Gift and Estate Tax

Gift tax annual exclusion	\$13,000
Highest estate and gift tax rate	35%
Estate tax exemption	\$5,120,000
Lifetime gift exemption	\$5,120,000
GST exemption	\$5,120,000

MARKET PERFORMANCE

	2Q 2012	2012 YTD
Dow Jones	-1.87%	6.87%
S&P 500	-2.84%	9.46%
Nasdaq	-5.06%	12.66%
Russell 2000	-3.83%	7.77%
MSCI EAFE	-8.37%	0.77%
Barclays Agg	2.06%	2.37%

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- Manage accumulated wealth, inheritances and settlements to meet investment objectives

ENDOWMENTS AND FOUNDATIONS

- Manage assets with a long-term growth strategy while meeting investment policy requirements

BUSINESS OWNERS

- Customize investment portfolios to meet investment objectives and lessen risk of concentrated assets
- Defer taxable earnings in profit sharing plans
- Manage and advise 401(k) plans

BUSINESS PROFESSIONALS

- Customize investment portfolios, manage stock options and consolidate 401(k)/IRA plans to meet investment objectives and lessen risk of concentrated assets

RETIREES

- Customize investment portfolios to meet investment objectives with the option of drawing income
- Management of IRAs, trusts and taxable accounts

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