KWAG April Update

The first quarter of 2012 was one for the record books. U.S. stocks rose significantly, boosted by encouraging data on consumer spending, manufacturing activity, employment, corporate growth and credit conditions. For the quarter, the S&P 500 recorded its biggest point gain EVER, rising 150.87 points, or 12.0%, during the first three months of the year. Small cap companies, as measured by the Russell 2000 even performed a little better, increasing 12.1% over the same period. At this point, the recovery in the U.S. appears to be on solid footing and the economy continues to strengthen, albeit slowly.

We believe the market rally over the past two quarters is the result of broader macro-economic factors we have been discussing for the past few years and that have continued to drive significant increases in corporate cash flows and profitability. Specifically, the macro-economic factors - which still remain in place today - are low interest rates (or cost of capital), relatively cheap and stable labor costs (globally), technological advances (allowing companies to leverage low input costs and grow productivity) and a growing global middle class. As long as these factors remain in place, we believe long-term prospects for stocks will remain bright.

Issues Still Remain

Even though we remain optimistic long term, a number of shorter-term risks still remain. For example, the U.S. currently holds the distinction of being the only major economy whose growth rate is poised to outpace that of last year. Europe is currently experiencing a recession and will probably be economically stagnant for some time. Of course, this has driven down prices of European stocks dramatically, meaning now may be a great time to do some bargain hunting. China is slowing down over the short term, given their goal to be driven <u>less</u> by exports and <u>more</u> by their own consumers. We believe this is a

necessary strategy long term if China is to continue its move toward becoming a mature, developed economy.

Other near-term term issues include Iran, Syria, the U.S. deficit and the political gridlock that is typical of an election year. A significant amount of uncertainty seems likely to surround health care legislation, taxes, and government spending through the end of the year, because a number of things are slated to change even if Congress does nothing. It seems likely we'll see some compromises on tax hikes, spending cuts, and health care reform, as there is broad incentive for both parties to keep the electorate happy. However, it's impossible at this point to predict the form and/or significance of the compromises. What is predictable, however, is that heated debate over these issues will be a catalyst for market volatility—because markets hate uncertainty.

Keep in mind that the equity market averages a 10% to 15% dip every year and no one knows with any degree of reliability when—or even if—these dips will occur. This is why we construct client portfolios in such a way that we can use market volatility to our advantage, increasing equity exposure during dips and decreasing it after rallies…which leads to a brief discussion of our bond portfolios.

Our Bond Portfolios

In past newsletters, we have discussed the bond "conundrum" and the issue of rising interest rates. We have also discussed the fact that the bond market is twice as large as the stock market, which means there are excellent opportunities for those who think "outside the box". Over the first quarter of 2012 our bond returns have also been excellent - relative to their benchmarks - because our managers have looked beyond traditional bond strategies. We will spend a portion of the upcoming newsletter discussing our bond fund

managers and their unique strategies in the upcoming quarterly newsletter, so please stay tuned.

First Quarter 2012 Newsletter

On Thursday, April 19th, 2012 we plan to mail out your quarterly portfolio reports and the newsletter. The newsletter will cover our thoughts on the stock and bond markets, the economy and our economic outlook going forward. We will place special emphasis on our process of monitoring our managers, and our client portfolios. We spend a great deal of time monitoring both our managers and our client portfolios and the newsletter will provide a little behind the scenes insight into how each of these activities is accomplished.

In Closing

As usual, if you have any questions or concerns regarding our updates, your portfolio or any of our investment strategies, please feel free to contact us immediately. We always look forward to hearing from you and thank you for your continued confidence in our firm. The recent referrals are much appreciated. As you know, we remain 100% committed towards your financial well-being at all times. If you need anything or your goals or time horizons have changed, please do not hesitate to call or drop an e-mail to set up an appointment. We are here to serve your financial needs, whatever they may be.

- ***Joe and The Gang at KWAG***