

QUARTERLY NEWSLETTER

Winter 2012



VESTOR | CAPITAL

INVESTMENT & WEALTH MANAGEMENT

INVESTMENT COMMENTARY

The following table presents the total return performance of the major U.S. and International Equity Indices for year-to-date through December. U.S. total returns in 2011 were essentially flat, with the exception of the Dow Jones Industrial Average, which was up 8%. Year-to-date developed international indices were negative, ranging from -11.7% for the MSCI EAFE Large Cap Index to -18.4% for the MSCI Emerging Markets Index. Developed international indices are down due to concern over the still unresolved debt crisis in Europe and the effect this will have on economic growth going forward. As many emerging market countries

Total Return Performance for the Major U.S. and International Stock Market Indices					
	1 Q 2011	2Q 2011	3Q 2011	4Q 2011	2011
U.S.					
<i>Dow Jones Industrial Average</i>	7.07%	1.42%	-11.49%	12.77%	8.38%
<i>S&P 500 Composite Index</i>	5.92%	0.10%	-13.87%	11.82%	2.11%
<i>NASDAQ Composite Index</i>	5.05%	-0.03%	-12.70%	8.21%	-0.79%
<i>S&P 600 Small Cap Index</i>	7.71%	-0.17%	-19.83%	17.17%	1.01%
International					
<i>MSCI EAFE Large Cap Index</i>	3.50%	1.80%	-18.92%	3.40%	-11.67%
<i>MSCI EAFE Small Cap Index</i>	3.05%	1.03%	-18.50%	-0.49%	-15.57%
<i>MSCI EM Emerging Markets Index</i>	1.95%	-1.10%	-22.49%	4.44%	-18.37%
Source: Bloomberg, L.P.					

have significant exports to Europe, the European crisis has landed on their shores also. The U.S. is relatively less dependent on Europe for growth than emerging market countries, which has helped the U.S. market remain more resilient.

Equity markets were extremely volatile in 2011, due largely to the never ending news flow that caused investors to continually reassess their investment theses and how current or projected events would impact their investments going forward. Not only were equity markets volatile in 2011, commodities and currencies swung wildly in value. Ironically, 2011 began on a relatively calm and upbeat note. The global economy was picking up, and equity valuations and inter-

est rates were low, which is generally a solid backdrop for a healthy equity market. Then several shocks hit which caused markets to react. In the March/April time period we had the tsunami in Japan, and an Arab spring in the Middle East with multiple uprisings. In the late summer we had the first ever downgrade of U.S. debt by Standard & Poor's, and the growing realization that the sovereign debt issues in Europe were not going to be solved in an expedient manner. These events taxed investors who now had to handicap a host of different yet interconnected issues. In the end, investors fled to the safety of U.S. Treasuries, sold off European and Emerging Market equities and, after much jostling in U.S. equity markets, U.S. markets were essentially unchanged in 2011. Certainly this would have been a difficult scenario to foretell at the beginning of 2011.

PORTFOLIO EQUITY VIEW

For 2011, the **Vestor Capital U.S. Core Equity** strategy produced a total return performance that was behind that of the benchmark S&P 500 Composite Index. While we are disappointed to have trailed our benchmark in 2011, our long-term track record is very strong and we did match or beat the S&P 500 in 2008, 2009 and 2010. A large number of investment managers lagged their respective benchmarks in 2011. There are a number of different theories as to why this was the case, although most market commentators point to the extreme volatility and the small number of companies that contributed an unusually large portion of the total market gain in 2011.

Our **Vestor Capital Equity Income** portfolio produced a total return performance that was well ahead of the benchmark S&P 500 Composite Index in 2011. Strong absolute and relative performance in the utility, energy and information technology sectors were the primary reasons for the outperformance. Our holdings in the energy sector are comprised primarily of master limited partnerships (MLPs) which generate their earnings from the transportation and storage of energy products, and tend to be less affected by economic cycles. In addition, these MLPs pay a generous quarterly distribution which is attractive in the current low interest rate environment. We are also overweight in businesses operating in the utilities sector, which was the best performing sector in 2011.



The **Global Strategy** consists of both a U.S. and an International component. In 2011, our Global Strategy portfolio produced a total return performance that was slightly behind that of its benchmark. The price-to-earnings ratios in International and Emerging markets are currently near multi-year lows as investors are nervous due to sovereign debt issues in Europe and concern over slowing growth in emerging markets.

We added DuPont (DD), one of the world's leading science and technology companies to the U.S. Core Equity and Equity Income strategies in December. DuPont develops and manufactures a wide range of innovative products and services for markets including agriculture and nutrition, performance coatings, chemicals and materials, electronics and communications, and safety and protection. DuPont's growth will come from increasing exposure to megatrends in food, energy and safety. DuPont is much less cyclical than perceived, as 70% of earnings are tied to performance chemicals, food and seeds which perform well in an economic environment of slow growth. In addition, DuPont pays a generous dividend. DuPont is also a member of the Dow Jones Industrial Average.

FIXED INCOME

Yields on longer-dated Treasury bonds fell during December, moving closer to the historic lows reached in the fall as investors continue to flock to the relative safety of U.S. Government securities during these periods of increased global uncertainty and market volatility. We continue to emphasize caution in our outlook for the fixed income markets due to the current level of low interest rates. While world economies continue to recover, growth rates have slowed. Slowing economic growth is typically bullish for bonds, but with rates at historical low levels, we are cautious on longer-term bonds going forward. Since bond yields are still well below their historical averages, we continue to recommend that fixed-income investors' new money be invested in fixed-income portfolios with maturities of 3 to 5 years.

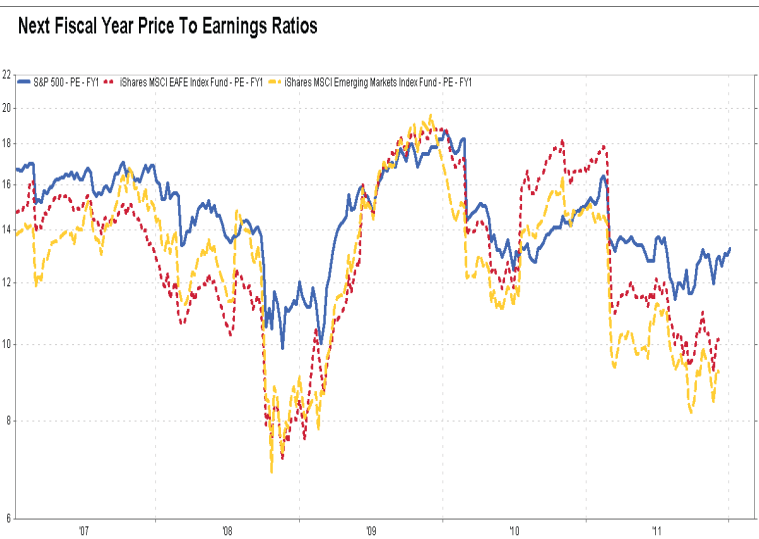
SUMMARY

After what we have seen in 2011, it is very easy to predict continued market volatility in 2012. The consensus expectation is that Europe will enter into a recession in 2012, if they haven't entered one already. The U.S. is expected to produce low GDP growth in the 2% range, and emerging market economies are projected to slow, but still produce mid-to-upper single digit GDP growth, which is spectacular compared to developed economies. We believe that world eq-

uity markets have largely priced this scenario into valuations, although we feel that markets may have over discounted the slowdown in Emerging Markets, as valuation levels are at multi-year lows, while growth will still be strong.

The question is "What could happen to change the consensus opinion?". Certainly the situation in Europe is very fluid and could turn worse, as European officials do not seem in a hurry to address the sovereign debt situation due to competing interests. However, it is in their collective best interest to address their debt problems and we are cautiously optimistic that additional progress will be made. We are already seeing signs that governments are making efforts to stimulate domestic demand. The debt situation in the U.S. is growing at an unsustainable pace, and budget battles may increase as 2012 unfolds. The U.S. elections in the fall will have an impact on equity markets as many believe that a Republican victory would signal a more pro-business climate going forward, which would likely be beneficial for equities.

We believe that the risks we have discussed are already largely priced into the market. As the graph below illustrates, valuations are near multi-year lows for the S&P 500, International and Emerging Markets. This provides excellent support for equities, if corporate earnings come in as projected in 2012. We remain confident in our portfolio companies, as they possess seasoned, shareholder-oriented management teams, strong balance sheets, excellent profit margin profiles and are well positioned for long-term growth. We will continue to monitor their business performance carefully going forward,



and take advantage of market dislocations to selectively upgrade our holdings where appropriate.

