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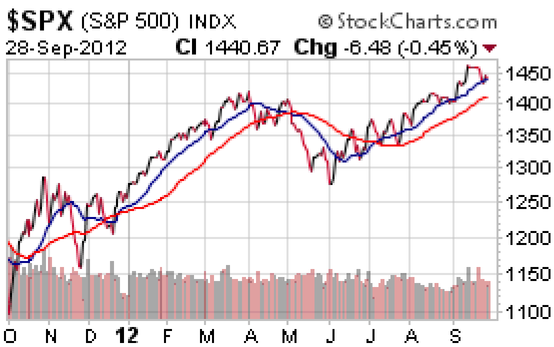
Third Quarter 2012



US stocks resumed their advance in the third quarter, following the second quarter's pullback. The S&P 500 and Russell 2000 Small Cap indices rose 5.8%, and 4.9%, respectively. Most international markets also posted gains. The MSCI Europe, Australia and Far East Index rose 6.9%, and MSCI's Emerging Markets Index gained 6.7%. For the year, the S&P 500 and Russell 2000 have gained 14.6% and 11.3%, respectively.

The quarter began with European Central Bank ("ECB") president Mario Draghi announcing that he will do whatever necessary to hold the Eurozone together. Second quarter earnings then boosted stocks, as investors took a "glass half full" view of company results and outlooks. Approximately 70% of the S&P 500 reported earnings per share that exceeded analyst expectations.

In a relatively quiet quarter, headlines provided fodder for both bears and bulls. The positives came primarily from policy announcements. The ECB provided details of a new bond buying program that they will use to boost sovereign bond prices and lower yields and borrowing costs. In addition, Germany's courts affirmed the legality of the ECB bond buying facility, thus assuring German support for the program. At the end of the quarter, Spain, one of Europe's weaker economies, approved an austere budget that will help rein in borrowing.

In the U.S., Federal Reserve Chairman Ben Bernanke announced a third round of monetary stimulus, dubbed QE3 (Quantitative Easing) in the press. The Fed will buy $40 billion of mortgage-backed debt each month, until employment reaches acceptable levels. While this does not guarantee more robust economic growth, it does mean that interest rates will remain low, keeping borrowing costs low for both businessses and individuals.

Other headlines provided a steady drumbeat of worry. Economic news from Europe remained weak, with much of the continent in or close to recession. In addition, growth in emerging market countries has slowed significantly. China in particular appears to be suffering from a long cycle of overbuilding. Concerns are being raised about the quality of its bank debt, while at the same time Chinese exports are suffering from lower European demand.

With the U.S. approaching the end of the last budget deal, lawmakers must act to avoid mandatory and sudden spending cuts and tax increases that could seriously crimp our economic recovery. Finally, the upcoming election is a source of uncertainty. And regardless of which party emerges victorious, the U.S. economy will still have record national debt and budget deficits, acting as potential drags on future growth.

Dow Jones U.S. Consumer Goods

Dow Jones U.S. Financials

However, even with these many known negatives, most indices have posted solid gains this year. This may be due, in part, to the rise of the U.S. consumer. As noted in last quarter's letter, U.S. consumer balance sheets have strengthened, and debt service costs have fallen to their lowest levels since 1994. And while unemployment is still uncomfortably high, it appears that those with jobs are feeling more secure about their situation. Because the U.S. consumer represents 70% of the world's largest economy, it is a powerful force for both domestic and global growth. Consumer confidence has risen this year, with surveys reaching their highest levels of the recovery. Confidence has boosted spending, leading to solid returns in consumer discretionary stocks.

The housing sector has also steadied this year. Inventories of new and existing homes have fallen, and prices have firmed and begun to post gains over last year. Financial stocks have been among the leaders this year, as mortgage volumes and loan quality have helped bank profitability. This trend may well continue, as the housing market strengthens and consumer confidence rises. A rising financial sector is a significant positive for equities, providing evidence of functioning credit markets, an key factor in economic expansions.

In closing, we note that, while there are still many reasons for concern, stocks must generally climb a wall of worry. Europe, China, and our own fiscal cliff bear watching, but for the time being, headline-induced pullbacks may provide buying opportunities for attentive investors.

We are grateful for the opportunity to serve as your investment advisor. As always, we encourage you to call with any questions.

Sincerely,

Kenneth M. Bernard, CFA