

O'BRIEN MANAGEMENT QUARTERLY REVIEW

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Economic Overview

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Although real U.S. Gross Domestic Product likely grew by only a moderate 2% in 2011, the economy has avoided falling into a double dip recession. This is a significant achievement in light of the many stresses that the economy faced in 2011 – the Japanese tsunami disaster, higher gas prices, the debt ceiling debate and European sovereign debt concerns. Corporate America is in good health and U.S. consumers are reducing their debts. The U.S. economy is likely to remain resilient despite the near term likelihood that the European sovereign debt crisis will continue to negatively impact global economic and financial market conditions.

U.S. ECONOMIC DATA IMPROVING

An increasing number of U.S. economic data points improved during 2011 as retail sales, manufacturing and employment all contributed to a growing sense of confidence in the economic recovery. Notably within retail sales, auto sales have continued to improve. Sales of autos are a good indication of the public's confidence. These sales have rebounded from the crisis lows, as December's monthly light vehicle sales approached their highest point in two years. The full year sales of light vehicles rose 10.4% after 2010's 11.6% increase. Manufacturing indices have also continued to show expansion. This segment of the economy has been adding jobs and contributing to economic growth. One developing thesis to explain part of the rebound in manufacturing is that we are beginning to see manufacturing that had been outsourced overseas returning to U.S. soil.

U.S. HOUSEHOLD DELEVERAGING AND EMPLOYMENT

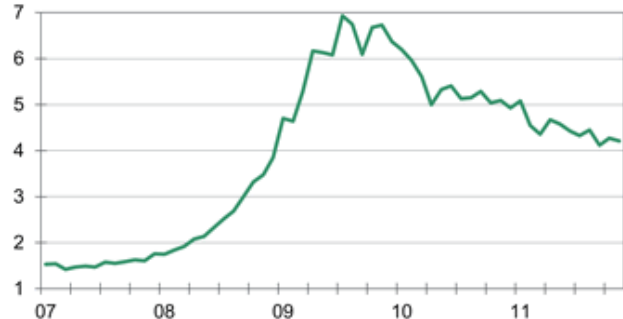
American households are still highly indebted, but are carrying less debt than they were and thus improving their personal balance sheets. Households have shed \$1.3 trillion in debt since the Great Recession in 2008. Unfortunately, the majority of this debt reduction has been in the form of defaults rather than deliberate repayments but this still purges the system of excess debt. According to Moody's Analytics, "in early 2009, nearly 35 million household loans were delinquent, including credit card accounts, residential mortgages, and student loans. At the end of 2011, only 24 million loans were delinquent, fewer than before the recession." There are still more than 3 million homes in foreclosure or more than 90 days delinquent on mortgage payments, but the number of 30- and 60-day delinquent loans has been declining rapidly.

As indicated by the recent positive monthly jobs numbers and the graph on the following page, the overall employment picture is slowly improving. Over the past year, the unemployment rate has declined from 9.4% to 8.5%. However, this improvement masks some significant concerns with respect to the U.S. workforce. First, the improvement in the unemployment rate in part reflects unusually weak labor participation. If the labor force were truly healthy, then the size of the labor force should show growth to reflect population growth. According to Moody's Analytics, there are some 6.4 million individuals not in the labor force but who say they want a job. This is almost 2 million more such people than at the start of the

recession. Moody's notes that almost 1 million individuals in their teens or early 20s left the labor force during the recession. Many of them went back to school and will shortly try to rejoin the labor force. The economy needs corporate America to feel sufficient confidence in our economic future to create even more jobs.

Job Availability Headed in the Right Direction

Unemployed workers per job opening



Sources: Moody's Analytics, BLS

CORPORATE AMERICA

Corporate America is extraordinarily healthy. Throughout the recession, U.S. companies have slashed costs and improved profit margins to the best levels in 50 years. Operating margins for the members of the S&P 500 were approximately 9 percent last year, which compares to below 7 percent on average from 1997 through 2009. Businesses have amassed nearly \$2 trillion of cash in their coffers. Corporate debt burdens are light. Non-financial firms' interest coverage ratios, or the percent of cash flow dedicated to interest payments, have fallen dramatically. In order for Corporate America to maintain these lofty profit margins, it needs to invest the cash in projects or strategies that will enhance revenues. There is a significant gap between available free cash flow and capital investments. This means that companies either cannot find economically-viable, revenue-enhancing projects or they lack the confidence to invest given the perceived economic risks. One of the risks that Corporate America is worried about is the European debt crisis. Approximately 25% of U.S. exports are sold to Europe, and Europe is likely already in recession. However, in fact, even a deep European

recession shouldn't crush overall U.S. growth as such exports contribute only about 0.2% to U.S. GDP.

EUROPEAN SOVEREIGN DEBT CRISIS

The single most significant risk to global growth is the ongoing European debt crisis. Summit after summit has attempted to buy time for peripheral countries to improve their fiscal standing and reduce their debt. However, this delay has also provided time for the crisis to spread from Greece to the Eurozone as a whole. A crisis that began with a lack of borrowing capacity has now become a prospect that includes widespread bankruptcy. There has been no clear solution proposed to the situation. It seems that market forces, as evidenced by the high interest rates being assigned to European sovereign debt, could now be forcing policy makers to stop delaying and to make some very difficult decisions.

A few steps were agreed upon in December to address the crisis and boost confidence, including an agreement to more strictly oversee Eurozone member's fiscal discipline and a financial arrangement by the European Central Bank (ECB) to relieve the pressure of maturing sovereign debt. But the funds that have been made available are not going to be enough to support the significant amount of sovereign debt maturities that need to be funded, particularly those of Italy, in 2012. Something has to give soon. It is possible the ECB will begin to print money and support sovereign debt directly, something it is reluctant to do. Or, the Eurozone could begin to split apart, with weaker peripheral nations leaving the Eurozone structure.

A prime example of the stress affecting one of the weak peripheral members is the very tense negotiation now ongoing between Greece and its creditors. The European Union has agreed to write off approximately \$125 billion of Greece's debt if the Greeks can convince private bondholders to take at least a 50% loss on their holdings. A deal is needed soon because Greece has a government bond issue maturing at the end of March. If the creditors are pushed to take a haircut larger than 50%, they may not agree on the "voluntary" nature of this haircut. This is important, because an "involuntary"

debt reduction agreement would be considered a “default.” If a default occurs, then this would trigger the credit default swaps on Greek debt. Credit default swaps are a type of insurance that contributed to massive market disruptions during the U.S. financial crisis. It is not now known what institutions have insured the Greek bonds and therefore might also be forced into bankruptcy.

SUMMARY

The U.S. economy appears to have avoided a double dip recession despite numerous disruptive blows to

the economy and the financial markets during 2011. Corporate America is extremely strong and healthy, and is slowly beginning to hire again. Continued improvements from this point will depend in part on improved business confidence and this in turn will depend in part on some resolution of the European debt crisis. At O’Brien Management your portfolios are conservatively positioned in the event of unforeseen volatility. However, times of market stress and volatility can create opportunities. We continue to monitor economic and market events with an eye for good investments at reasonable or even cheap prices.

Market Update

By: William J. O’Neill

Investment Research Associate

Domestic equity markets rallied in the final quarter of 2011. After a tumultuous third quarter, investors differentiated between “riskier” European and “safer” United States opportunities, based upon strengthening U.S. economic data in the fourth quarter. The vote of confidence was tangible as the S&P 500 Stock Index posted 11.8% quarterly returns with a 10.8% run in the month of October alone. Bailed out by its strong finish, the S&P’s total return for 2011 was 2.1%. The U.S. bond market, as measured by the Barclay’s Aggregate Bond Index returned 1.1% in the fourth quarter to earn an above average total return of 7.8% for the year.

The fourth quarter displayed the same flight to quality theme that characterized the volatile third quarter. In December, the Euro dropped below \$1.30 for the first time since January as investors sought refuge in an appreciating dollar amidst ominous Euro zone economic forecasts. The European Sovereign Debt crisis continued to infect international equity markets. After posting a 4.9% total return in 2010, the MSCI EAFE plunged 12.2% for the year in 2011. A 3.2% return in the fourth quarter was likely the response to a litany of European Union (EU) summit meetings. Unfortunately while hopeful, the meetings failed to provide conclusive measures to decrease sovereign debt among the countries that constitute the EU

periphery. Emerging markets, measured by the MSCI EM index, returned 5% for the fourth quarter which did little to offset the previous 26% fall in the third quarter. For the year, Emerging Markets were down more than 18%.

In the third quarter O’Brien Management executed a tactical trade that lowered our large company equity exposure, re-establishing our “baseline” level of small company holdings. During the fourth quarter, small caps proceeded to outperform large caps in both the growth and the value categories.

For the third year in a row, growth stocks outperformed value stocks across the large, mid and small capitalization categories. Since May 2010, O’Brien Management has continued to structure equity exposure that satisfies our goal of adding value while preserving wealth with quality selections. For example, the SPDR Dividend ETF (ticker “SDY”), is designed to track the S&P High Yield Dividend Aristocrats Index. As described by State Street Global Advisors, this index “is comprised of the 60 highest dividend-yielding stock constituents of the S&P Composite 1500 Index that have increased dividends for at least 25 consecutive years. These stocks have both capital growth and dividend income characteristics, as opposed to stocks that are mostly dividend, or mostly capital growth oriented.” SDY outperformed the S&P 500 from August 2011 through the fourth quarter by 5%.

Investors with an appetite for risk experienced generous returns in 2011 in the long term bond market. Credit risk and duration risk provided strong returns. Where 2011 U.S. equities provided very modest annual returns, the bond markets topped impressive 2010 figures, driven largely by high yield bonds and long term bonds. High yield returns, measured by the HYG exchange traded fund, rendered nearly 7% gains for 2011, while bonds exceeding 20 years duration earned an astounding 28%. The interest rate on U.S. 10-year treasuries declined below 2%, driving prices for U.S. government paper higher. Overall Barclay's Aggregate Bond Index, a broad measure of bond performance, returned 7.84% in 2011 after a return of 6.54% in 2010.

The bond markets above average returns in 2011 were largely due to the performance of very risky long duration bonds. With our conservative overall

stance we did not participate in this long duration rally. Interest rates are at historical lows. If interest rates return to normal, long duration bonds will lose a great deal of money. Thus we are currently holding a portion of our core bond position in short term bonds and cash.

Throughout these increasingly volatile times, O'Brien Management is constantly evaluating new ways and ideas to add value to your portfolios through asset allocation and careful mutual fund selection. Our investment objectives remain to protect and grow your savings. In the third quarter we decreased the position in large cap stocks while placing more emphasis in small cap stocks. As volatile markets provide us further opportunities to identify mispriced assets, we will take advantage of those opportunities. Our best wishes to all our clients for a happy and successful 2012.

The O'Brien Management Investment Committee

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