TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

July 2012

Quarterly Insights

EXECUTIVE SUMMARY

Stocks Pull Back In The Second Quarter, Bonds Rise

In the Second Quarter, the domestic S&P 500 Index fell 2.75% yet is still up 9.49% year to date. The index held up remarkably well given heightened European debt worries, fears of an economic slowdown, a stubbornly high unemployment rate, and fiscal cliff uncertainty. Foreign markets fared much worse. Bonds prices rose 2.10%, highlighted by the 10 Year Treasury yield dropping to 1.65%.

The Upcoming Fiscal Cliff

The fiscal cliff is a combination of measures to reduce debt - $7 trillion in tax hikes and spending cuts over the next decade - that will begin in January unless Congress intervenes. Without intervention, the Congressional Budget Office fears a recession.

Given the current political deadlock and the upcoming November election, we don't think we will see progress from Congress in 2012. Rather, we anticipate some tax and spending adjustments will pass in early 2013. Over 93% of Wall Street strategists are assuming we will completely avoid the fiscal cliff. We are not nearly that optimistic. Rather, we are proceeding with caution regarding portfolio strategy.

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Second Quarter 2012

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The Upcoming Fiscal Cliff

What Is The Fiscal Cliff And Why Is It Such A Big Concern?

By now you have likely heard the term "fiscal cliff" frequently mentioned. The alarming connotation of the word "cliff" is that it implies that the country's finances are about to "go over the edge" with no potential recourse. Is the U.S. in huge trouble? Some people think so. Wall Street doesn't. We are cautious.

The fiscal cliff is a combination of measures to reduce debt - $7 trillion in tax hikes and spending cuts over the next decade - that will begin in January unless Congress intervenes. To further complicate matters, Congress is in a political deadlock that will likely persist through the November election. If these measures go through as scheduled, the Congressional Budget Office (CBO) estimates that $500 billion will be taken out of the U.S. economy in 2013 alone. The U.S. GDP would fall 1.3% in the first half of the year and likely cause a recession.

Looking At 2013 Alone - Why The Congressional Budget Office Is So Concerned About The Fiscal Cliff

How Did We Arrive At This Point?

We arrived at this point due to events that transpired in 2011. There was a near stalemate in Congress on passing an increase of the U.S. debt limit because of budget disputes. To avoid a disastrous U.S. debt default, Congress passed a debt limit increase under the proviso of an automatic deficit reduction plan in the absence of a future budget resolution. The thought was that Congress would soon get its act together. It still hasn't.

Europe should serve as a warning. It has enacted austerity measures (significant spending cuts) with disastrous results. Instead of decreasing their deficits, they have caused recessions, high unemployment and political unrest. And yet, Congress continues to avoid dealing with the fiscal cliff. The 2013 start date for automatic spending cuts and tax hikes is around the corner with no solution in sight.

What Tax Hikes And Spending Cuts Are Scheduled?

Failure to negotiate an agreement would result in nearly $1 trillion in automatic spending cuts over the next decade ($100 billion in 2013). The automatic tax increases are much higher than the spending cuts, accounting for nearly 80% of the fiscal cliff impact. Whoever is the next President will highly influence future tax rates.

Current Tax Proposals On The Table

	Current Rate	Scheduled Rate For 2013	Obama Proposal	Romney Proposal
Highest Income Bracket	35%	39.6%	39.6%	28%
Capital Gains Tax	15%	20%	20%	15%
Dividends	15%	39.6%	20%	15%
Estate Tax	35% > $5 million	60%>$1 million	45%>$3.5 million	0%
Payroll Tax	4.2%	6.2%		
Corporate Tax Rate	35%	35%	35%	25%

We Don't Think We Will See Progress From Congress in 2012

Many expect us to avoid European-style austerity by having Congress come to a last-minute agreement. We don't think so. The assumption that Congress and the Administration can negotiate some type of smaller austerity agreement is overstated in our opinion. We cite historic recent political gridlock as evidence.

Party positions are well-staked-out and it will be hard for either side to back down. It certainly will not happen prior to the November election. And barring an emergency Christmas session in Congress, January 2013 is around the corner. According to Fortune Magazine, 93% of Wall Street strategists are assuming we will completely avoid the fiscal cliff. We are not nearly that optimistic.

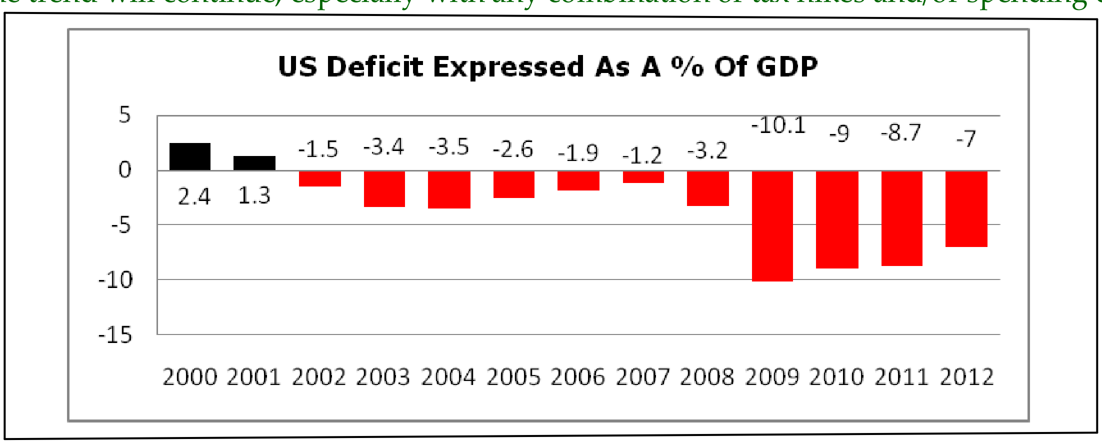
We Anticipate Some Tax And Spending Adjustments Will Pass In Early 2013

No matter the political outcome in November, we anticipate some changes to the scheduled tax hikes and spending cuts will pass in early 2013. These changes will be easier to handicap once we know the election results. For the moment, the election appears very close.

We do not think we will completely avoid the fiscal cliff. Our outlook is not nearly as dire as that of the Congressional Budget Office. Given that we anticipate some adjustments to the 2013 schedule as it stands, we do not envision a $500 billion loss to the economy in 2013. Nor do we anticipate a recession. Slow economic growth is a more likely outcome given a muted recovery in U.S. housing, a European recession, and U.S. companies that are cautious to spend and hire in the absence of policy clarity.

Although Still At An Alarming Level, The U.S. Deficit Continues To Improve

The impetus for the 2011 stalemate in Congress was growing concern regarding high U.S. debt levels. The deficit ballooned to an alarming level in 2009 for reasons including the Bush era tax cuts and extensions, wars in the Middle East, the Great Recession, and significant stimulus measures. While there is still significant need for improvement, the U.S. deficit as a percentage of Gross Domestic Product (GDP) continues to fall. We anticipate the trend will continue, especially with any combination of tax hikes and/or spending cuts.



Our Portfolio Strategy Amidst Fiscal Cliff Uncertainty

We are cautious but not pessimistic regarding the fiscal cliff and our portfolio strategy. We anticipate some compromise regarding tax hikes and spending cuts in early 2013. Right now, we do not have sufficient information to conclude which way these initiatives will unfold. Uncertainty regarding the fiscal cliff will soon subside and when it does, we believe the market will welcome the clarity. For the moment, we remain patient and will continue to emphasize "high quality" stocks and "low duration" bonds in your portfolio.

Stock Market Spotlight

The U.S. Market Slightly Pulled Back In The Second Quarter

In the Second Quarter, the domestic S&P 500 Index fell 2.75% yet is still up 9.49% year to date. The market contended with heightened European debt worries, fears of both a domestic and global economic slowdown, an unemployment rate that would not budge, and fiscal cliff uncertainty. Although the U.S. market pulled back from a torrid First Quarter (+12.59%) and Fourth Quarter (+11.82%), we felt it held up remarkably well under the circumstances.

The U.S. Market Is Still The Place To Be

Foreign markets did not fare nearly as well in the Second Quarter. Europe, Japan, China, India and Brazil lagged the U.S. by a considerable margin. Over the last 12 months, the U.S. out-performance is staggering.

Equity Index Performance

Index	Second Quarter 2012	Year To Date 2012	Last 12 Months	Relative U.S. Outperformance Last 12 Months
S&P 500 (Domestic)	(2.75%)	9.49%	5.45%	-
MSCI EAFE (Foreign)*	(6.85%)	3.38%	(13.38%)	+18.83%
MSCI EMU (European Monetary Union)	(9.96%)	1.45%	(25.58%)	+31.03%
MSCI Japan	(7.29%)	3.23%	(7.07%)	+12.52%
MSCI China	(5.26%)	4.14%	(15.78%)	+21.23%
MSCI India	(9.54%)	8.60%	(25.44%)	+30.89%
MSCI Brazil	(18.76%)	(7.54%)	(26.40%)	+31.85%

* Europe, Australia and the Far East

We Went Against The Consensus One Year Ago And Shifted To U.S. Blue Chip Stocks

Here is an excerpt from our Quarterly Insights July 2011 *("U.S. Blue Chip Stocks: Unloved And Attractive"):*

> More often than not, the consensus is wrong when it comes to investing. Investors are usually late to the party. Skyrocketing oil prices, higher emerging markets demand for oil, and a weak U.S. Dollar stemming from the Fed's quantitative easing, has resulted in oil companies making more money than any industry in history. Gold has broken through the $1500 an ounce range. Emerging markets regions such as China and India boast higher GDP growth and are up 200% in market value over the past decade. In a delayed response, investors are hitching up to oil, materials, and emerging markets. Will they be late to the party again? We think so. Investors should look elsewhere. We think the time is right for U.S. blue chip stocks.

We Were Right!

By far, our most important portfolio decision over the last year has been to heavily emphasize U.S. stocks. In terms of domestic versus foreign stock weighting, statistically the greatest portfolio risk control is reached around an 80% domestic weight. However, there are additional considerations when we assess desired domestic versus foreign weighting at a given time in the market. We effectively operate within a range of 70% to 90% domestic exposure. For the last few years, we have been on the 90% side of the range, and it has worked out very well (foreign stocks have lagged considerably). Because we advocate style rotation, there will be a time where we significantly increase our foreign weighting. But we see no reason to do it right now.

We Are Holding High Quality Companies Versus Low Quality Companies

We define a "high quality" company as one that has financial strength (a strong balance sheet), a well-established market niche, and solid projected growth rates. An example of a high quality company is Apple. The stock has tripled over the last five years. The company has more cash than the U.S. Treasury, a projected annual revenue growth of 42%, and a Price/Earnings ratio (14.6) that is close to the technology industry average. Apple is not a cheap stock, but many find it attractive (ourselves included).

We define a "low quality" company as one that is trading below what is considered its intrinsic value (it is "undervalued" by various financial measures). The approach to investing in these types of companies is often referred to as "value investing". An example of a "low quality" company is Citigroup. The stock has been decimated over the last five years (beaten down 95%). Its current Price/Earnings ratio is 6.9 as compared to its financial industry average of 10.1. There is a reason for this discount - the company is considered risky as compared to its peers. A value investor might consider Citigroup as a cheap attractive stock.

Right Now, High Quality Companies Have Better Financial Strength And Agility

There are numerous challenges and uncertainties in the market right now. Europe is in a recession and its issues are far from solved. U.S. and Chinese growth rates are slowing. Housing is in a muted recovery. The November election is too close to call. And the fiscal cliff issue will likely go untouched until early next year.

We believe this is a time to favor high quality companies versus low quality companies for two reasons:

1. Financial Strength

The high quality companies have done an amazing job of reducing costs during recent challenging economic times. S&P 500 operating margins, a major factor in profits, were up 9.17% last quarter (the third highest jump ever). Of course, the 9.17% figure was the average. The higher quality companies exceeded this average.

Higher company profits have further buffered their strong balance sheets. The high quality companies have tremendous cash on hand for potential acquisitions, business expansion and hiring. They are in the strongest position to react once we have election and fiscal cliff clarity. They are in the strongest position to react in the event Europe improves, global GDP growth accelerates and/or the U.S. housing market strengthens.

2. Agility

The high quality companies are in a relatively better position to wait out the uncertainty and continue to progress. They also have the greater ability to deploy funds quickly (they have the bigger war chests) should the economy re-accelerate. In that sense, they are presently much more agile than the low quality companies.

Right Now, High Quality Companies Offer A Better Risk/Return Tradeoff

We believe this is a highly unusual time where the less-risky companies (the high quality companies) offer the higher potential returns. It is normally the situation that the higher the company risk, the higher its potential return. This is the cornerstone theory of the risk/return tradeoff. But the tradeoff has inverted.

There will be a time where we rotate towards "lower quality" companies, likely a time when the market has more certainty and the business cycle is in an expansion phase. Historically, tactical adjustments between high quality and low quality companies can provide opportunities to out-perform the market.

Bond Market Spotlight

Bond Prices Rise In The Second Quarter

The Barclay's Capital Aggregate Bond Composite Index, a broad-based representation of bond performance, was up 2.10% in the Second Quarter as government bond rates fell. The 10 Year Treasury fell from 2.21% to 1.65% yield to maturity (bond prices rise as yields fall). For the year, the index is up 2.4%. U.S. bonds continue to do well as investors reallocate funds traditionally earmarked for European bonds to the perceived safety of U.S. markets.

Bond Yields For Barclay's Bond Indices

Barclay's Bond Indices	2012 Second Quarter	2012 Year To Date	Last 12 Months	Last 36 Months	Last 60 Months
Capital Aggregate Bond	2.1%	2.4%	7.5%	6.9%	6.8%
Global Bond	1.0%	0.5%	2.7%	5.7%	7.1%
Capital Municipal Bond	1.9%	3.7%	9.9%	7.6%	6.0%

The risk of the European bond markets is well documented and frequently in the news. Clearly the foreign bond markets have done poorly as evidenced by the Global Bond return (bear in mind that the Global Bond return also incorporates U.S. exposure, so the non-U.S. bonds have done very poorly).

Muni Bond Markets Show Signs Of Trouble

Right after the 2008-2009 recession, the federal government helped many states and municipalities with their budget shortfalls with assistance through the $831 billion American Reinvestment and Recovery Act. The Act helped the states and municipalities weather the economic storm for almost three years. They met their budget shortfalls on the back of a significantly increased federal deficit. Now the federal government has turned off the money tap. States are standing on their feet. Many municipalities are in deep trouble.

All states (except Vermont) are required to balance their budgets each year. To meet this mandate, most states simply cut spending and increased taxes. According to the Rockefeller Institute, state tax collections are now at pre-recession levels.

Municipalities are a different story. Most cities receive the bulk of their revenues through property taxes. The real estate boom caused expectations to soar in regards to future municipal revenues. Counting on those higher future revenues, cities took on aggressive projects and committed considerable retirement benefits to their employees. As the real estate bubble burst, property tax revenues fell. Many cities are now struggling to meet their budgets. Be wary of muni bond exposure in areas of fallen real estate prices.

Stockton (California) just filed for Chapter 9 bankruptcy. Its tax revenues went from $139 million (2001) to $186 million (2006) as real estate peaked. Revenues are now down to $155 million because median home prices fell from $400,000 to $110,000. San Bernardino also just filed for Chapter 9. More cities may follow.

We Remain Skeptical Of Bonds But Maintain A Disciplined Asset Allocation Strategy

The bond market remains "yield challenged". Although we currently view stocks as more attractive than bonds, we hold bonds where warranted as part of a disciplined asset allocation strategy We advocate corporate bonds and shorter-term (low duration) Treasury Inflation Protected Securities (TIPS).

Your Portfolio

The stock market pulled back in the Second Quarter. We did not change our outlook or our strategic emphasis. We made further portfolio adjustments during the quarter. There was a continued theme to these adjustments. We added more high quality companies that are better positioned to out-perform whenever market uncertainty subsides and the economy improves.

We sold Watson Pharmaceuticals (symbol: WPI), a leading generic drugs manufacturer. It doubled in price and it was time to take profits. Due to its considerable future challenges, we sold Iron Mountain (symbol: IRM), a global leader in data storage. Finally, we sold Analog Devices (symbol: ADI), a leading chipmaker. We did so because of its correlation with Apple (we own Apple) and to diversify our technology exposure.

We purchased Celgene Corporation (symbol: CELG), a leading cancer drug producer, to broaden our health care exposure. Johnson Controls (symbol: JCI) positions us for a rising economy in the areas of auto supplies, HVAC systems and batteries. Finally, we purchased F5 Networks (symbol: FFIV) to replace Analog Devices.

Our bond portfolio was hardly adjusted in the Second Quarter and we do not anticipate changes in the near term. The portfolio has a short duration to ensure that it is less susceptible to rising interest rates.

Over the next several months, we anticipate further adjustments to the stock component of your portfolio as we believe the market has upside potential through the rest of the year. Stay tuned for updates.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

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