TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

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Quarterly Insights

EXECUTIVE SUMMARY

Stocks Enjoy Robust 2012, Bonds Have Mediocre 2012

In the Fourth Quarter, the domestic S&P 500 Index was flat but finished the year up 16.0%. Other markets fared similarly well. Encouraging trends included favorable company earnings, a rising GDP, a falling unemployment rate, a strengthened auto industry, and a housing recovery. The Barclay's bond index returned 0.2% in the Fourth Quarter and finished the year up a mediocre 4.03%. U.S. Treasury yields hardly moved. The Fed Target rate did not move at all. Stocks were much more exciting than bonds in 2012.

We Believe The S&P 500 Index Will Rise 6%-9% In 2013

We are mildly bullish for 2013 and believe the S&P 500 Index will rise 6% to 9%. Three factors should drive up the stock market: the continued U.S. economic recovery, still-attractive stock valuations, and the paradox of negative sentiment.

We do not share the same enthusiasm for bonds. Yields are unattractive. Interest rates are so low that the 10-Year Treasury has a negative real rate of return. Although not likely an immediate threat, a rise in interest rates will cause bond prices to fall.

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Fourth Quarter 2012

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2012 - The Year In Review

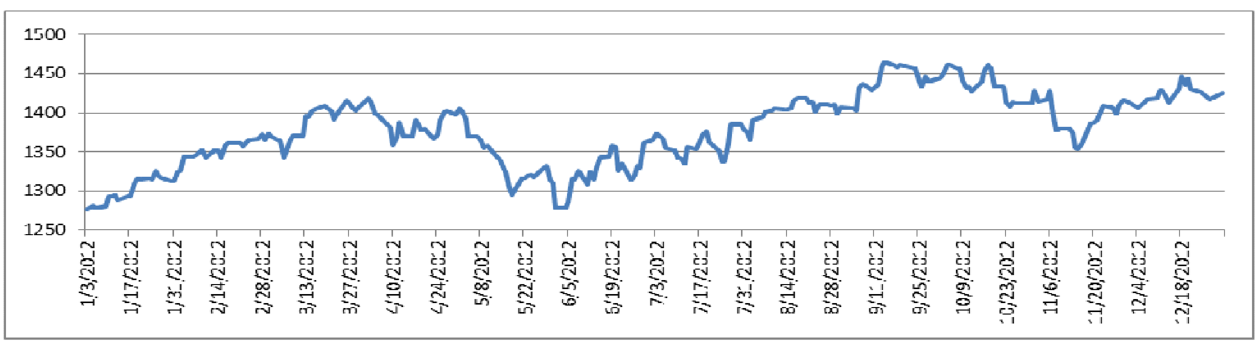
2012 Performance Was Surprising To Many, But Not To Us

We reflect on 2012 as a year where many investors were shocked that the S&P 500 Index rose 16.0%. They expected a lot worse. The market ascent did not surprise us as we predicted a 12% to 15% rise (see Quarterly Insights January 2012). Despite high stock returns, favorable company earnings, a rising GDP, a falling unemployment rate, a strengthened auto industry, and a housing recovery, investor confidence fell. Money flowed from stocks to bonds in every month despite a considerable stock out-performance. What drove investors from stocks? It was three factors: European fears, election anxiety and an unresolved fiscal cliff. The media gave sensational 24/7 coverage in these areas and scared many people. From a portfolio standpoint, the key to managing well in 2012 was to "avoid the noise" and maintain a disciplined investment strategy. Decisions involving regional emphasis and sector weights were less critical.

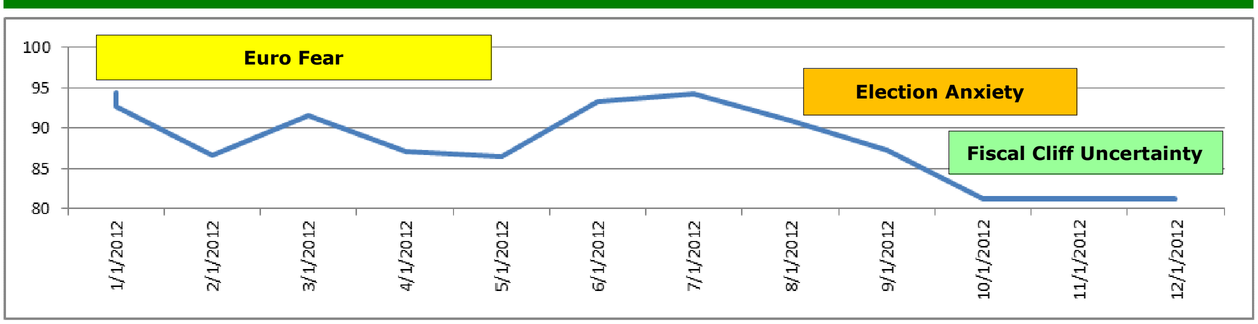
1. Investor Confidence Waned In A Rising Market

In the first half of 2012, the main investor fear was the potential demise of the Euro. Greece and Spain were in serious trouble and threatening the European Union. Euro fear dissipated in the Third Quarter once the ECB initiated its significant bond buying program to keep European interest rates low and effectively guarantee successful sovereign debt auctions. In the second half of 2012, investor fear was first dominated by U.S. election anxiety (now gone) and followed by fiscal cliff uncertainty. Most of the year, market returns and investor confidence moved in opposite directions. Keeping a cool head in 2012 was a virtue.

S&P 500 Index Performance - 2012 (source: Standard & Poor's)



Investor Confidence Index (source: State Street Global Markets)



The fear mongering media steered investors in the wrong direction. Mutual fund money flows reflected lower confidence. Over $140 billion was taken out of stocks and over $300 billion was added to bonds (source: Investment Company Institute). Even more interesting was the monthly consistency of the outflows/inflows as measured in dollars. There was not one month that had a net stock inflow or a net bond outflow.

2. Limited Regional Disparity

The U.S. led regional performance for the first half of 2012. Europe made up ground in the second half of 2012 as fears eased regarding its fiscal challenges (the Euro appreciated) and the U.S. market began to deal with its election anxiety and fiscal cliff uncertainty. By year-end, there was limited performance disparity between regions. The relatively small (10%) foreign weight of your portfolio did not greatly impact performance.

Equity Index Performance

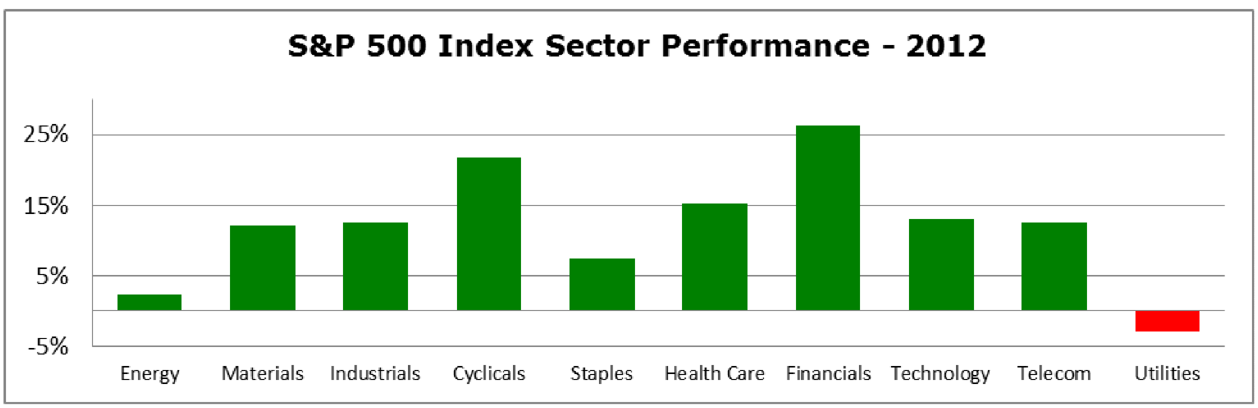
Index	2012
S&P 500 (Domestic)	16.00%
Russell 2000 (Small Cap)*	16.35%
MSCI EAFE (Foreign)**	17.91%
MSCI Emerging Markets	18.69%
MSCI EMU (European Monetary Union)	22.49%
MSCI Japan	8.36%

* Performance data does not include dividends

** Europe, Australia and the Far East

3. Limited Sector Out-Performance

Only two out of 10 sectors out-performed the S&P 500 Index: Financials (+26%) and Consumer Discretionary (+22%). Since these sectors comprise less than 28% of the overall index, it was tough to beat our S&P 500 benchmark through sector weight decisions alone.



Assessment Of Our 2012 Portfolio Strategy And Performance

The best thing we did in 2012 was to avoid getting faked out of the market. We maintained a disciplined asset allocation strategy for each of our clients throughout the European, U.S. election and fiscal cliff fears. Sticking with a 10% foreign allocation neither helped nor hindered overall portfolio performance. Maintaining a large-cap stock focus provided a better risk/return tradeoff. In terms of sector weightings, we over-weighted Consumer Discretionary (a good move), over-weighted Technology (it fell in the Fourth Quarter to become a market laggard), and neutral-weighted Financials (the 2012 sector leader after a strong Fourth Quarter). All in all, our 2012 sector selections were neither bad nor great. We did not increase Financials in October because we anticipated an upcoming Obama victory and a continued push towards tougher financial regulations (see Quarterly Insights, October 2012, page 3: Election Outcomes And Market Returns, Sector Effects).

2013 - Looking Ahead

We Believe The S&P 500 Index Will Rise 6% to 9% In 2013

We are mildly bullish for 2013 and believe the S&P 500 Index will rise 6% to 9%. This may appear to be a bold prediction in the face of a partially resolved fiscal cliff and an unresolved debt ceiling. Our optimism is fueled by the good things happening in our backyard. Five factors should moderately drive up the stock market: a resolution to the fiscal cliff, a resolution to the debt ceiling, a continued U.S. economic recovery, still-attractive stock valuations, and the paradox of negative sentiment.

1. Fiscal Cliff Resolution

In our July 2012 Quarterly Insights report, we stated the following:

"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."

We were right and are sticking to our prediction of an early 2013 fiscal cliff resolution. The tax adjustments have already been passed by Congress but the spending adjustments got "kicked down the road for 60 days". We anticipate a tremendously heated argument in Congress regarding spending cuts, but an argument that will be resolved. This will remove some of the market uncertainty which has inhibited the market as of late.

2. Debt Ceiling Resolution

The debt limit is the maximum amount that the U.S. government can borrow at any given time. It is important to note that the debt limit doesn't authorize new spending; instead it provides the funding to pay for spending commitments already made by Congress. Currently the limit is set at $16.4 trillion. It needs to be raised in February. You may recall the Congressional fight in August 2011 to increase the debt limit by $2.4 trillion. The possibility that the U.S. could/would default on its debt resulted in a U.S. bond downgrade (one notch below AAA) by Standard & Poor's. We anticipate a spirited fight.

3. Continued U.S. Economic Recovery

There were encouraging U.S. economic trends in 2012. GDP growth is now at 2.5% (source: The Economist). Housing prices rallied 3.9% and home construction is on the rise, which bodes well for future consumer confidence and spending. U.S. automobile sales rose above 15 million. The unemployment rate fell to 7.7%. With a resolution to the fiscal cliff, we anticipate a continued U.S. economic recovery, albeit at a modest pace.

Despite a second-half spike in European stock market performance, we do not share the same optimism for the European economy in 2013. Much-needed stability came from the ECB plan to buy the bonds of ailing Eurozone nations and the German-led establishment of a permanent rescue fund (the European Stability Mechanism). In return, highly indebted Eurozone states have committed themselves to spending cuts and tax increases. However, the austerity drive has already tipped the Eurozone back into recession. German GDP growth (now a paltry 0.9% according to The Economist) has all but disappeared. Tough times are ahead.

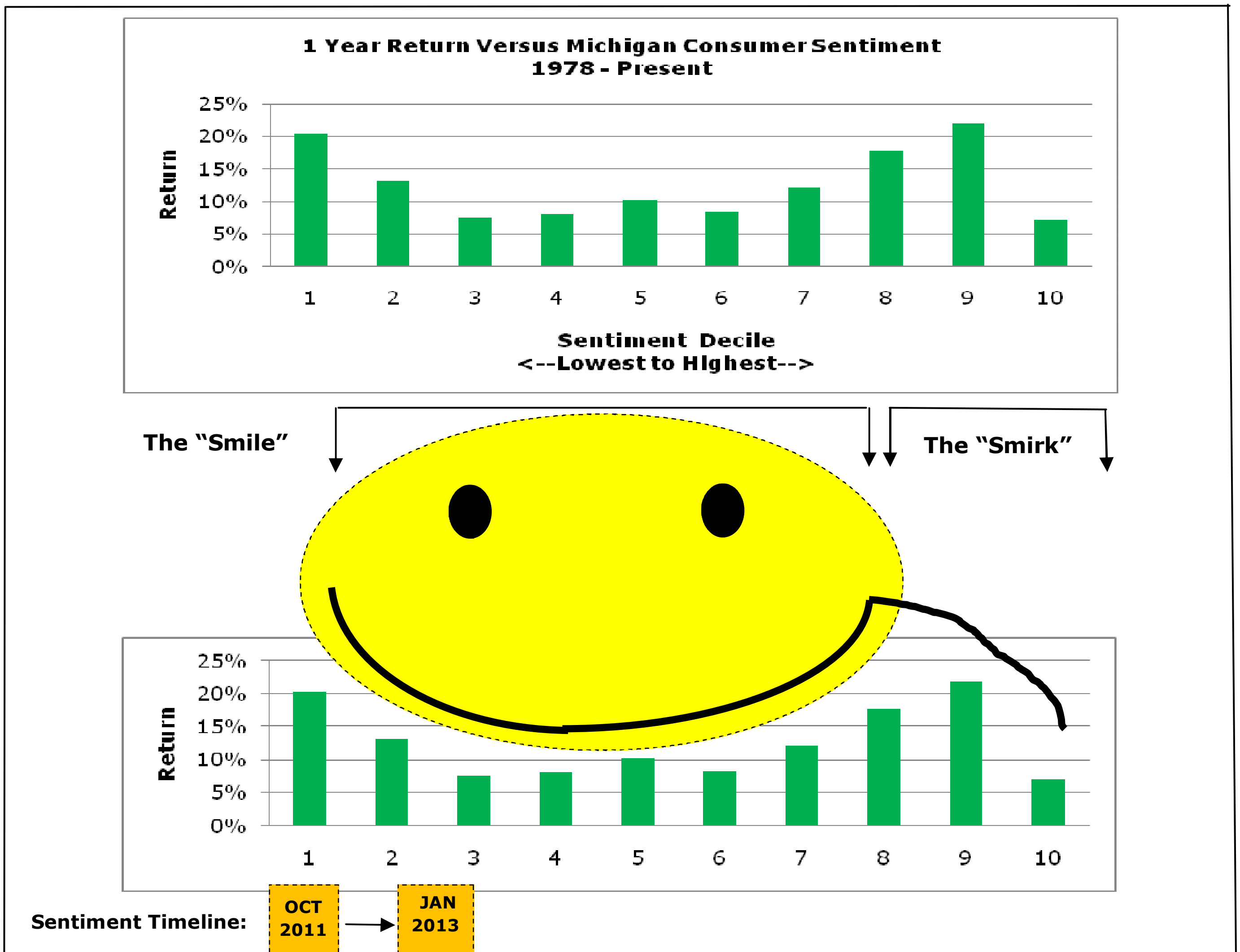
4. Still-Attractive Stock Valuations

The earnings multiple of a stock, also called the price/earnings (P/E) ratio, is the share price divided by the earnings per share. The higher the earnings multiple, the more investors are willing to pay for future growth. The P/E ratio rose from 14 to 16 in 2012. Market multiples are within historical range. Strong company balance sheets provide downside protection. We think there is room to move up.

5. The Paradox Of Negative Sentiment

We first discussed the paradox of negative sentiment 15 months ago (Quarterly Insights October 2011, The Sentiment "Smile & Smirk", pages 2 to 3). Within this special section, we pointed out that future one-year market returns are near their highest when the Michigan Consumer Sentiment is extremely low or very high.

The graph below splits the monthly Michigan Consumer Sentiment into ten deciles of sentiment, from lowest to highest. The S&P 500 Index stock returns are then calculated from that sentiment level for the following 12 months. Notice how the graph forms a smile and a smirk. The smile forms because market returns are highest when sentiment is extremely low or very high. However, at bubble levels of positive sentiment, returns fall to their lowest levels. This forms the smirk.



The historical average level of Michigan Consumer Sentiment is 85. In October 2011, sentiment was 60.8 (the lowest decile). This implied a subsequent 12-month return of 20% - which was exactly what happened! The sentiment indicator was consistent with our 2012 prediction of a 12% to 15% return, which proved dead on. Current sentiment (December 2012) is 72.9, which for now places sentiment in the 21st decile. This implies a subsequent 12-month return in the range of 6% to 9%, which is consistent with our 2013 market prediction.

Portfolio Strategy - Stay The Course Pending Fiscal Cliff And Debt Ceiling Resolution

Pending further resolution of the fiscal cliff and debt ceiling, we see no reason to deviate from our strategy. We still view the U.S. market as the one with the most upside potential, and see no reason to increase Europe or Emerging Markets. In our opinion, it is best to keep a large cap focus. We will adjust as conditions change.

Bond Market Spotlight

Bond Returns Were Uneventful In An Eventful Year

The Barclay's Capital U.S. Aggregate Bond Index, a broad-based representation of bond performance, returned 0.2% in the Fourth Quarter and finished the year up a mediocre 4.03%. This was in stark contrast to an 8.72% return in 2011. The Fed Target rate did not move at all, nor does it appear that it will move in the near future. Treasury yields barely moved. Simply said, there was a lot more excitement in stocks than bonds in 2012.

Key U.S. Interest Rates	Jan. 1, 2012	Dec. 31, 2012	Change
Federal Reserve Board Funds Target Rate	0-0.25%	0-0.25%	No change
5-Year Treasury (Constant Maturity)	0.83%	0.73%	-10 basis points
10-Year Treasury (Constant Maturity)	1.87%	1.76%	-11 basis points
30-Year Treasury (Constant Maturity)	2.89%	2.95%	+ 6 basis points

Note: 100 basis points (bp) = 1.00% Source: Telemet

Lackluster Bond Returns Did Not Discourage Investors

Investors continue to seek the safety of government bonds even after the 2011 credit downgrade. Election anxiety and fiscal cliff uncertainty failed to impact yields in 2012. Money consistently flowed out of stocks and into bonds in a seemingly irrational manner given the relative returns of the two asset classes.

According to a December Wells Fargo investor survey, 68% of the respondents said they have "little to no" confidence in the stock market as a place to invest for retirement. Of those who have pulled out of the market, 67% of those investors said they have no regrets about doing so over the past four years, even after the bull market since early 2009. This illustrates the delirious extent of negative investor sentiment.

The 10-Year U.S. Treasury Bond has an historical average yield of 6.8% (source: Federal Reserve). Right now, the 10-Year is unattractive because it has a negative real rate of return - it yields 1.76% and inflation is at 1.8% (source: Bureau of Labor Statistics). And yet, investors enthusiastically continue to buy them.

There Is Considerable Risk In Bonds - The Question Is When Will Interest Rates Rise

The biggest risk to bonds is interest rates. When interest rates rise, bond prices fall (yields increase). For the moment, record-low interest rates should remain. The Fed announced it plans to keep its key short-term rate near zero until the unemployment rate reaches 6.5% or less. This will take some time. Our concern is that an inevitable rise in interest rates will send bond prices down and bond investors running for the hills. We know it will happen, just not when.

The Bond Risk Dilemma: Interest Rates ↑ ➡ Bond Prices ↓ / Bond Yields ↑ ➡ Bond Investor Panic

Long-Term Investment Strategies Require Disciplined Asset Allocation

We hold bonds where warranted as part of a disciplined asset allocation. At this time, we have short-term corporate bonds, high yield corporate bonds, and Treasury Inflation Protected Securities (TIPs).

Your Portfolio

The S&P 500 Index was flat (-0.38%) in the Fourth Quarter, but 2012 as a whole was excellent (+16.0%). Our 2012 market prediction of 12% to 15% made at the beginning of the year proved dead accurate. We would like to say that the accuracy was entirely attributable to our intelligence and research skills, but there is a lot of randomness and luck involved with predictions! The important thing is that we correctly gauged the steep ascent of the market and stuck to our guns regarding clients' specific target asset allocations.

Our Fourth Quarter trading was limited. We sold St. Jude Medical (symbol: STJ) when the company came under fire from the FDA for manufacturing problems and a possible cover-up. In its place, we bought Intuit (symbol: INTU), a software company best known for TurboTax and QuickBooks. In some taxable accounts, we did tax-loss selling (to lower taxes) as well as tax-gain selling (in anticipation of higher capital gains rates).

We are moderately bullish for 2013. The immediate challenge is a resolution of the fiscal cliff (the spending aspects) and the debt ceiling. If there is some market turbulence in the next two months amidst the inevitable fighting in Congress, we will remain patient. We believe these issues will be put behind us and the market focus will shift to economic growth and attractive stock valuations. There is an outside chance of an upside market surprise if Congress acts quickly without fanfare, but we are not counting on it.

Over the next few months, we anticipate further adjustments to both the stock and bond components of your portfolio. Market conditions will change and we believe in style rotation. 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,

TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

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Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.