GROWTH EQUITY REVIEW

Fourth Quarter 2012

PERFORMANCE COMMENTARY

Another very good year, and if one follows history, the present bull market still has time to run. The average bull market lasts 59 months or nearly five years, and some have run much longer. In the 1990's, the bull lasted eight years. The present one has lasted for only 45 months, so there could be a lot of equity room-to-run. Since the beginning of this bull market, March 2009, U.S. equities have returned 129%. That compares to the 1990's market return of 295%, with that bull ending in July 1998.

Interestingly, with the second longest bull market - lasting from 1923 to 1929 – the total return was an outstanding 345%. We won't project that this 21st century bull market will do that well, but that is why we study history. In this case, we hope it repeats.

In 2012, the S&P 500 rose 13.4%, with the total return (including dividends) of 16%. The Russell 3000 Growth was up 15.21%. There was a bias towards value in yearly returns as the Russell 3000 Value was up 17.55%. Our strategy lagged slightly as the "growthiest" holdings of the portfolio did not participate as expected in this year's strong market. For the year, the top performing group of the ten S&P 500 sectors was Financials, up 26%, while only one, Utilities, was down, off nearly 3%. Consumer Discretionary stocks rose 20% while Healthcare gained 14%. Energy and Consumer Staples also rose, but trailed the S&P index overall gain.

So, 2012 equity performance will go down as a good year, despite the ongoing vicissitudes of politics and the middling economic recovery. Last year's 16% return has only been bested in two other years in the last decade: in 2003, following the collapse of the tech bubble, and in 2009, in the wake of the Great Recession. For this year, some market pundits are somewhat more muted, while others predict a repeat of 2012. We are in the camp of the latter unless the divisive Washington political theater continues to retard progress.

	Periods Ending December 31, 2012					
	QTD	1 Yr	3 Yrs	5 Yrs	7 Yrs	10 Yrs
Growth Equity Composite - NET	**-0.4**	**13.5**	**12.3**	**3.8**	**5.5**	**10.5**
Russell 3000 Growth Index	-1.2	15.2	11.5	3.2	5.2	7.7
S&P 500 Index	-0.4	16.0	10.9	1.7	4.1	7.1

Composite performance is reported NET of fees and expenses. Please refer to the disclosures at the end of this report.
Performance figures for periods one year and longer are annualized.

For the year the top five performers in the portfolio were: Computer Sciences (CSC), +69%; Morphosys (MPSYF), +71%; FMC Corporation (FMC), +36%; American Tower (AMT), +29%; and IPG Photonics (IPGP), +97%.

Lagging performers consisted of Universal Display (PANL), –30%; STEC Inc (STEC), –43%; Biolase Technology (BIOL), –27%; Mako Surgical (MAKO), –23% since we purchased it; and Hansen Medical (HNSN), –19%.

PORTFOLIO COMMENTARY

As strategic investors, investing in companies with solid long term growth prospects, the portfolio is comprised of companies ranging from blue chip holdings to smaller emerging enterprises. Small growth companies grow in nonlinear patterns and the speed of market adoption for scientifically driven companies is sometimes difficult to gauge. In this year, and to a degree last year, our exposure to smaller companies has retarded the performance. Three medical device companies, Biolase Technology (BIOL), Hansen Medical (HNSN) and Mako Surgical (MAKO), are hindered by product adoption rates although these all address very different markets. STEC (providing flash drives and memory storage) provides high speed solutions for storing data in the cloud. Their competitive positioning should enable significant growth in the future. Along with stem cell company Cytori (CYTX) and Universal Display (PANL), we see all these holdings as growth engines for the portfolio. And the portfolio still generates a yield of 1.6% while we are waiting for these growth opportunities to unfold.

PORTFOLIO ACTIVITY

We look to buy businesses and let management build value over time. For the year the portfolio turnover was 23%. In the quarter we only made one change to the portfolio, selling Abbott Labs (ABT), which we had only added in the prior quarter. The underlying fundamentals for the company changed. In the third quarter, we believed that Abbott's plans to split in two at year end would unlock inherent but unrecognized value. In October, Abbott's long term prospect dimmed on the failure of a significant drug under development. Accordingly, we sold ABT and purchased a medical device company, Mako Surgical (MAKO).

MARKET COMMENTARY

Where do we go (or grow) from here??

1) **Effects of Fear of the "Fiscal Cliff" Exceed the Reality of its Prospective Impositions**

A fiscal cliff (FC) is of our own creation. There are two ways in which to cope with this incubus FC. One is for the politicians who created it to change it. Therefore, this is not at all comparable to the iceberg that "hit" the Titanic out of the unforeseen. This FC made by man is an obstacle now in the pathway of progress. Thus, it is foreseen, feared, discussed, and made into a much larger obstacle than it otherwise might be. The impact of this 2013 incident has been pulled into 2012, as one consequence from the obsession with this obstacle. Its impact is partially absorbed. Already, this has broadly - but not severely - subdued expectations leading businesses to withhold spending and to pare inventories.

2) **Commerce Slightly Constrained – in the Near Term**

The reporting of revenues and earnings by corporations can scarcely be called disappointing and we expect that to continue. There were evident circumstances constraining revenues and earnings rather broadly, such as the slowdown in Europe, and currency translation of earnings. As mentioned, there was also clear evidence of disciplining inventories, probably provoked by concerns regarding the effects the fiscal cliff might impose. There has been some slowing in India for endemic reasons, and in China, subdued from national policies to slow the pace of activity. All things considered, earnings should be fine, considering we are in the fourteenth quarter reporting sequential gains since June 2009. Moreover, the next will be influenced by many specific one-time effects of hurricane Sandy. When economies are slow, the strong enterprises, if they do not throttle down, gain market share from the weaker. Never have corporations held so much cash, which continues to build. This is representative of very satisfactory product pricing, increased internal efficiencies, and the vigor provided by management.

3) **Sources of Enduring Growth**

America's stability and strength derives in large measure from the variety of people - also of typography, of maritime and continental climates, of four seasons, of abundant natural resources, of many industries, and of the greatest variety of products by far of any nation.

America leads (if by narrowing margins) in technological applications, especially as this applies to growing critical worldwide needs. In agriculture, demonstrable leadership is evident in plant development from seed to genetic manipulation, in growth promotants, and in crop protection, plus the economies of scale. In human and animal biology, America is first in breadths of applications, and first among equals in creativity. In the electronics industry, America remains first among equals, and unmatched in breadth of involvement and product developments. These industries, and these elements of growth, are enduring, and there is no apparent concern about nearby reversals. The oil industry (broadly defined) has never been more dynamic. These are major industries. Prospective price decreases in fossil fuels would only selectively slow development of certain aspects of production, especially those made profitable in recent years by the product price increases. Lower fuel prices would be compensatory to tax increases for consumer spending, and would be a pervasive cost reduction to industry. Overall, the search for new sourcing and more efficient applications of energy goes on with increased, broadening effort.

4) **The Latent Power of Low Interest Rates Will Prevail**

Amid all of the incongruities of the last several years, nothing is so apparent - yet so misperceived and misappraised - as the extreme suppression of interest rates. Rates on treasuries are so low relative to (1) other credit instruments, (2) the dividends available from many first-rate companies, (3) seemingly historical norms, and (4) contemporary earnings by enterprises on physical capital. Yet, interest rate inducement has shown surprisingly little apparent effectiveness thus far. Such latency of effectiveness defies all coined explanations of monetary mechanisms. Do not be fooled. The potential builds to awesome scale. Moreover, this is virtually a worldwide phenomenon. "Rates will remain low so long as the economy's growth is sub-marginal:" Ben Bernanke. This is compliant with cooperative policies of several other leading nations as well. Interest rates on the dollar pull

approximately low rates on Sterling, Yen, Euros, and a few other major currencies. Memories are short. Recall those turn-of-the-century years when the Yen rate encouraged vast borrowing of Yen (risk mitigation by leveraged shorting) of which the application of the "carry" had the effect of stimulating price gains in marketable securities throughout the major capital markets of the world? If such could happen from unduly cheap money on only one major tradable currency, why not expect much more from give-away rates on most major currencies. Furthermore, the former Yen-carry effect took place before cash hoarding built to such very extraordinary sums. These sequestered sums have the potential to overwhelm (at any time) capital markets that now seem partially relieved by (or inured to) the Greek situation (that was largely a scapegoat façade for banking follies).

5) The Daunting Gap: How Can Current Investment Returns Meet Retirement Fund Requirements

One of the most predictable of prospective concerns will be observable in the rising voices of anguish and dismay among pension fund managers and constituent members, particularly for defined benefit plans. The predictability seems to be written deeply into present configurations for rates of return. Vis-à-vis perennially rising liabilities (typically) from payrolls and from actuarial requirements, contemporary low yields on investment-grade bonds will fall well below liability requirements built into plans' configurations. Prospectively, this would give perennial falling behind in meeting plan requirements, following unsatisfactory years for many. This will be especially acute for public funds (state and local), and will likely rise to claim a good deal of national attention. To lesser degrees, life insurance companies will be similarly affected. Expect high profile attention to emanate and so persist in public discourse to become a major market force.

6) **Attractive Valuations of Shares Are Compelling**

Economic growth has withstood denials and recurrent waves of futile "double dip" expectations that recessionary factors would prevail. Public discourse seems to convey ever less substance as the volume increases, the apparent objective being getting attention through dramatizing excessively. Such compelling circumstances as noted herein are sufficient, in and of themselves, to lift equity markets — as has been happening for three years or so, while not needing the hubris of a bullish mind set. Give increased attention to the thriving mighty international enterprises; these will reveal the prevailing leadership beyond that which is possible from governments.

As strategic investors, investing without restriction and primarily in supportive demand trends and investing in (not trading in) businesses with special attributes, we believe even the most doubtful of persons need not be hesitant, given these never-before supportive conditions. In prospective months, corporate and institutional money will flow — because it must flow — where it is best served. Amid present relationships, the relatively high dividend yields on blue chips, and, given more time, the shares of the most rapidly-growing young enterprises, would seem to attract increasing inflowing streams.

DISCLOSURES: The Growth Equity Composite is comprised of discretionary, separately managed taxable and tax-exempt equity accounts managed for growth. Results are calculated internally using Advent portfolio accounting software. Accounts are included in the composite at the beginning of the first full calendar month in which the account is fully reflective of the investment strategy. Composite returns are weighted for the size of each underlying account and are reported net of fees and commissions. Results for individual accounts may vary due to the timing of investments, size of positions, fees, and other reasons. Client returns may be reduced by other expenses incurred in the management of the client's portfolio. Composite and index performance valuations and calculations include dividends, interest and other earnings and are stated in US dollars. All performance figures for periods one year and greater are annualized. The S&P 500 Index is an unmanaged index generally considered to be representative of the U.S. stock market as a whole. The Russell 3000 Growth Index is an unmanaged index constructed to provide a comprehensive, unbiased, and stable barometer of the growth segment of the broad U. S. stock market. Additional information regarding policies for calculations and reporting returns is available upon request. PAST PERFORMANCE SHOULD NOT BE CONSTRUED AS A GUARANTEE OF FUTURE PERFORMANCE. The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients, and the reader should not assume that investments in the securities identified or discussed were or will be profitable. The stocks named as the top or bottom five contributors to performance for the period are based on a representative portfolio (Princeton Capital's oldest Growth Equity wrap account portfolio; also a member of the Growth Equity composite) and have been identified through a report generated by Princeton Capital Management's Advent portfolio accounting system. Further detail on the contribution to performance calculation, which takes into consideration the weighting of every holding in the representative account, as well as a list showing every holding's contribution to performance for the period, is available by contacting Princeton Capital Management at info@pcminvest.com.

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