CORE EQUITY PORTFOLIO REVIEW

Fourth Quarter 2011

PERFORMANCE COMMENTARY

What's not to like about a Quarter that returns 11.8% for the S&P 500? Core Equity participated fully in the rally with an 11.52 % return. What's not to like about the domestic US equity markets that outperformed virtually all other world equity markets? For such outstanding returns it sure didn't feel like a great Quarter, based on both commentator and investor attitudinal responses.

This sour mood is due in part to the parade of headlines about a looming European recession and slowing global economy, the continuation of wrangling and political posturing in Washington, the lack of visible leadership of the President, and the evidential likelihood of little plausible potential leadership as depicted by the Republican primary debates. The returns of the Quarter came only from a sharp short bounce off the early October bottom. November ended on a sell-off and the Santa Claus rally of December never came to fruition. December made up just enough to recover from November (taken together the two months were essentially flat).

To those old enough to remember the old Alka Seltzer jingle, it was simply a "plop plop fizz fizz, oh what a relief it is" Quarter. However, the hangover remains. A caustic attitude still prevails in both the hearts and minds of most investors. Ghosts from 2008 are still haunting investors' psyches, as deep scars remain, and the hurdles ahead appear to be intractable as we seem to be lacking in corporate and political leadership both here at home and in Europe.

	Periods Ending December 31, 2011					
	Quarter	Year-to-date	1 Year	3 Years	5 Years	10 Years
Core Equity Composite – GROSS	**11.5%**	**2.6%**	**2.6%**	**15.2%**	**5.3%**	**8.1%**
Russell 1000 Growth Index	10.6%	2.6%	2.6%	18.0%	2.5%	2.6%
S&P 500	11.8	2.1	2.1	14.1	-0.25	2.9

Composite performance is reported **GROSS** 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.

Core Equity, up 11.5%, had a solid quarter, especially considering that it is structured to be defensive, and thus historically lags in rapidly rising markets. That the portfolio matched the broad market in such a strong recovery was due to investor demand for large blue chip dividend-paying companies. This was not a more common market move towards growth but a migration towards safety and yield. However, similar to the third Quarter, clients received essentially a market return, which in turn translated into generating only a slightly better return than the market for the year. The portfolio was up 2.6 % against the S&P 500 return of 2.1%, or flat against the Russell 1000 Growth index up 2.6%.

The top five contributors to performance, **Google (GOOG)**, **Canadian Pacific (CP)**, **FMC Corp (FMC), General Electric (GE)**, and **Union Pacific (UNP)**, all came roaring back. The two rails were both up over 30% and GE, FMC, and GOOG were up 19 to 25% respectively. That only three of the five holdings detracting from performance (**Computer Sciences (CSC), Cree (CREE)** and **Bunge Limited (BG)**) were down in the Quarter is indicative of what a one-way market it was for large blue chip companies. **Novozymes (NVZMY)** up 3% and **John Wiley (JW-A)** up 1% simply lagged their portfolio peers in performance.

PORTFOLIO COMMENTARY

We made few changes this quarter after a significant realignment of the portfolio in 3Q. Last quarter we substantially increased the yield and took advantage of what we believed to be extraordinarily discounted large blue chip companies.

We did sell **Life Technologies** in the first week of October and replaced it with a second cell tower company, **Crown Castle (CCI)**, in keeping with our belief that the demand for mobile media and data and transition from 3G to 4G will increase transmission traffic significantly and drive revenues and earnings. In late November, we also sold one of our long time holdings, **Novozymes,** to add **GlaxoSmithKline (GSK)**. Again we continue to take a slightly more defensive or conservative tack to increase the yield in the portfolio. GSK, a first rate quality global pharmaceutical company, adds a 5% yield to the portfolio. Their Board replaced management three years ago and we believe their subsequent change in strategic direction has finally succeeded in turning the ship in the right direction. Glaxo faces minimal patent expiration issues unlike some of their competition, has solidified their respiratory care business, and has a greater degree of US exposure than many alternative multinational drug companies. The swap was driven more by portfolio construction considerations than by company fundamentals. Novozymes has served us well over the course of our investment, and recently has held its value and was fairly priced against other alternatives.

As a review of the portfolio activity in 2011 and regarding our expectations for the portfolio in 2012, we would begin with the statement, “All Hail Dividends". At least that is what the market seemed to say in the second half of 2011. That same theme seems likely to continue in 2012. While 2011 was a frustrating year for investors; we see 2012 to be a bit more promising. That being said, we continue to have a significant portion of growth stocks paying dividends in our portfolios. We consider this to be an insurance policy. With interest rates near zero, it makes sense to own stocks in companies that are growing their dividends. That is; we want to get paid to wait as the market deals with both the tumult and uncertainty of the presidential and congressional election cycle, and the stumbling European responses to resolving their debt crisis.

Last summer we re-positioned the portfolio by increasing both the number of stocks paying dividends and the percentage yield of stocks paying dividends. The reasoning? We believe, and so it seems does the stock market, that dividend-paying growth stocks somewhat lessen the risk in an increasingly volatile investment climate. However, when we look at such stocks, remember that we buy the business first and foremost — the dividend is just the "sweetener”. Better to get paid something — a yield of 1-5% or more — than to have little to show for owning assets expecting only market appreciation in the current market environment. Dividends are to many investors similar to a "hearty soup", keeping them warm during a cold investment winter. Money markets with negligible yields for years have been lousy havens for parking money. As for low yielding bonds, we would rather hold telecoms such as Verizon and AT&T, with yields of 5% and 5.8% respectively, and with the potential for price appreciation from exposure to the rapidly growing wireless demand phenomena.

Currently, 82% of the 28 stocks in the Core Equity portfolio pay dividends, with yields ranging from 1.3% (Cisco) to nearly 6% (AT&T). The total portfolio's yield at year end was 2.5%.

By portfolio design, we added **American Tower (AMT),** a leading global tower company, to portfolios last year to take advantage of the explosive growth in wireless traffic. With its huge cash flows, it just reorganized into a REIT company for the benefit of shareholders and began paying its first dividend in December at $.35 a share. For 2012, the Company has stated it plans a yearly dividend of $0.80 to $0.90, which would be an annual dividend of 1.3 to 1.5% based on its 2011 closing price of $60. If you add the recent $.35 dividend, then the next twelve month effective yield would be 1.9% to 2.1%. That's not too bad when one considers that AMT has increased by 22% in price since we bought it last year. Obviously, the market liked AMT's decision to return cash flow to investors through a REIT platform.

Various industry studies support the importance of dividend growth stocks in portfolios. RBC Capital Markets' recent report stated that from 1986 to February 2010, dividend growth stocks were up 12% annually versus the S&P composite annual return of 6.1% during the same period. Companies that did not pay a dividend were up only 0.1% annually in the corresponding period.

We believe dividends impose a capital discipline on managements, and help reduce risk for many companies. Dividend paying growth stocks by nature are more stable and less cyclical than growth stocks not paying dividends. For retirees, dividend growth stocks currently offer more purchasing power than bonds and help keep pace with inflation, which many strategists think our economy will face in the years ahead.

While U.S. corporate profits hit record highs in 2011, dividend yields have not returned to the peak reached before the 2008-09 financial crisis. So with companies holding record cash surpluses, dividend payout ratios should improve. The S&P calculates that companies are paying out less than 30% of their earnings as dividends compared to an historic average of around 50% for the S&P 500 companies.

The bottom line is that in times of uncertainty (and if our surmises for a recovering economy are stretched out or do not pan out) we like to get paid to wait.

MARKET COMMENTARY

The issues before us do not need further delineation or discussion from us. These are dissected, debated, and headlined almost ad nauseam by both market seers and headline seekers. As we look to invest in a world finding its way ahead, we pose several residual questions and considerations for equity investing.

1) Would you prefer (as is happening) a slowing of economies (especially in America and Europe) that induces very low interest rates to a more rapid growth rate and much higher interest rates? Do not the extremely low rates, now enforced by central banks, set a proclivity of preference among investors to move from bonds or from cash toward shares of robust enterprises?

2) Can investors recall times (other than those few brief moments of extreme market stress) since 1948-49 when so many shares were so attractively priced relative to alternative securities?

3) Was there ever a time when major American corporations held so much cash, enabling many options for deployment — increasing dividend payouts, purchasing their own shares, strategic acquisitions, or capital expenditures for expansion?

4) As mergers and acquisitions were a major driving force to the stock market uptrend in the latter 1990's, will the huge acquisitions and mergers of this year, previously and prospectively, have a similar effect, in combination with other supportive factors (cheap money noteworthily among such)?

5) Was the October rally merely a correction to the over-sold September low points, or another spurt of strength along an enduring uptrend? This is the larger and most primary of questions, to which a positive answer comes in from worldwide circumstances.

Our answers to all five questions are supportive to expectations for shares of most strong enterprises; especially those fortified with cash and supported by assured high dividend yields. Contemporary circumstances seem to provide a never-before-experienced precept: No matter the fears and expectations — positive or negative — this is the first time in the long career of the writer that bulls and bears would enjoy the same diet. Think about this. It is true. Both the conservative and the fearful are better served owning the shares of many providers of communication services and of electric energy. Their dividend yields obviate rational choice of cash at such low interest yields, or of high quality bonds whose yields (also unduly low) will probably be surpassed by declining prices of principal beginning probably before 2012 moves into history. Also for the optimist, the solid attractiveness of secure dividend yields from enterprises that also provide growth (albeit at pedestrian pace) qualifies such shares for a large platform portion of a diversified investment position. So the bull and the bear may well inhabit the same quarters, as never before — and much before "the lion and the lamb might lie down and eat straw together." We are not waiting for eternity. We see value in the market in select sectors and enterprises now.

❖ ❖ ❖