Portfolio Shift Commentary: December 11, 2012

While the uncertainty over the election result has been removed, policymakers face the same set of economic and fiscal challenges as pre-election. The most immediate challenge is the Fiscal Cliff. If Congress does not act, the burden of expiring tax cuts, new taxes and automatic spending cuts which is set to take effect at the end of 2012, could bring about an estimated nominal GDP drag of 4%.

We feel that the Administration and Congress will hammer out a last minute marginal compromise, which will prevent a short-term financial crisis, but will not likely lay out a long-term plan. However, a longer term or "Grand Bargain" solution will not likely immerge until the Administration has re-organized its Cabinet. Following this process, we feel a tax compromise will take shape and focus upon upward adjustments in the top marginal tax rates and a hike in the Capital Gains and Dividend tax rates. In addition, certain levels of means testing on mortgage and other current income tax deductions will be ushered into the negotiations. The marginal compromise we outlined above does little to provide clarity for the markets. We generally expect a more negative or defensive market tone until a definitive national fiscal agreement is set forth.

Our overall asset allocation view continues to be cautious and reflects a highly conflicted macro environment. The weak global economic picture and the high potential for a negative shock from the US fiscal cliff argue against taking on risk. However, the positive tone of recent US and emerging market economic data and unlimited Fed liquidity, suggest further downside may be limited. Intrinsically, we remain neutral to any major risk decisions.

Within fixed income, we continue to carry a mostly core bias with diversification in investment grade credits and treasuries. On the equity side, we continue to carry a value tilt on our domestic positions and remain diversified in commodities and gold. Within international equity, we removed our core Europe Pacific EAFE, Emerging Market and All-World ex-US positions and moved the proceeds to minimum volatility positions in the same international regions. We feel this move will gain access to potentially better risk adjusted returns, by adding downside protection while maintaining exposure to potential upside participation.

As always we turn our thoughts this time of year to family and friends that are near and dear to us. We thank you all for your continued support and send our good wishes to you and your family for health and happiness throughout the coming year.

Sincerely,

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